

Cathryn Ross
Ofwat,
Centre City Tower,
Hill Street,
Birmingham,
B5 4UA

By email to: water2020@ofwat.gsi.gov.uk



South Staffs Water

Green Lane, Walsall WS2 7PD
www.south-staffs-water.co.uk

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Dear Cathryn,

Outcomes Framework for PR19 – South Staffs Water Response

Thank you for the opportunity to comment on this consultation. We believe that the introduction of outcomes at PR14 represented a significant shift in how companies deliver what really matters to customers and we recognise the benefits this is already generating.

The performance regime set out in this consultation is in line with our expectations of how the industry should be regulated in the future, and we are fully supportive of the themes set out. We can see how this approach will bring both incentives to companies and improved service to customers. In particular we support the introduction of common performance commitments, uniform performance targets and challenging setting of those targets at the upper quartile. We also support the use of dynamic targets where the measure is proven and the basis for calculation is common. We believe that a well constructed basket of outcomes and targets will ensure that it is only the best performing companies that overall are rewarded and that this will stretch us to deliver better levels of service for our customers.

We are also supportive of the idea to link performance against these targets to the level of return on equity, in line with the concept of an “equity menu”, rewarding us for great performance will drive us towards that performance.

Inevitably, we have some more technical comments to make around the specifics for each proposal; we set these out in our detailed response which follows. We recognise that to be truly successful such regulatory developments inevitably require a strong technical implementation and provide our responses with this in mind. However, we would like to stress that these do not undermine in any way our overall support for the proposal, we are of course keen to contribute to getting the detailed design right in order that rewards are genuinely generated by great performance.

Our Board has been fully engaged with me on the consultation and we would welcome the opportunity to discuss our further involvement in this process with you.

Yours sincerely,

Phil Newland,
Managing Director
South Staffordshire Water PLC

Q1: What is your view on the use of improved information, including comparative performance information, to make performance commitments more stretching?

We support the use of improved information and recognise that better comparative information can give stakeholders, including customers and customer groups, the information they need to effectively challenge companies to deliver service improvement. The Discover Water dashboard has been a positive project, making available a core set of service metrics, and other published reports are also able to provide comparative data publically.

Q2: What is your view on the common performance commitments we are suggesting for PR19?

Overall the package of measures appears well balanced and we are supportive of the proposals. We believe that PCs should be specific to a price control (as Ofwat suggests in the consultation) and that overlaps between price controls should be minimised. Comments by measure are as follows in order to support a successful implementation (we have not commented on the wastewater measures):

1. New customer experience measure

We are supportive of SIM as a strong mechanism of customer service improvement. Our views on replacement measures are set out in our response to Q6.

2. Water quality compliance

We agree that water quality is a top customer priority and therefore support a common ODI.

We are contributing via Water UK into DWI's development of a new water quality measure (Compliance Risk Index). We believe that the new measure should have clear scoring guidelines (minimal subjective assessments), and reduce the weighting for parameters/issues that are largely outside of company control (e.g. influenced by customer plumbing).

3. Customer water supply interruptions

We support the inclusion of a supply reliability measure. In terms of its measurement, our current supply interruptions ODI includes both planned and unplanned interruptions of three hours or more. We believe that the supply interruptions ODI at PR19 should only reflect unplanned interruptions in its current 'average minutes' form, to avoid dis-incentivising the right asset health behaviours. It would be entirely fair to customers to continue to incentivise planned interruptions but it would be more appropriate to do this using dedicated metrics relevant to that work, such as whether jobs over-run, insufficient notice periods, or inadequate vulnerable group protection. At PR14, we note that Bristol Water only included unplanned interruptions in their supply interruption ODIs.

4. Water distribution input (or leakage and per capita consumption)

We agree that a measure around leakage should be included – however please refer to our response to Q4 below for our further detailed views on leakage measures.

5. Abstraction incentive mechanism

We have previously expressed views on AIM in our response to Ofwat's consultation in January 2016. Incentives in this area are important, however we have doubts as to the suitability of AIM as a comparative measure and a sector wide incentive due to the small number of sites proposed. There was a significant bias with one company having 23 out of the total of 47 sites under AIM, and with seven companies having zero sites. We also believe that the lack of EA monitoring stations means that it is difficult to evidence a correlation between abstraction and river flows. The EA are currently enforcing the 'no-deterioration' principle of the Water Framework Directive which could result in licence claw-back, significantly reducing the ability to drive additional reductions under AIM.

8. Asset health water – pipe bursts

In the past mains bursts was the main asset health indicator for infrastructure assets, supported by a suite of other measures. It is also still reflected in our ODI package but as a sub-measure of our serviceability ODI. We consider that pipe bursts is the best available indicator and has the benefit of good data history and good level of historical focus in companies.

10. Possible new measure of resilience

We support the introduction of a specific resilience measure.

We believe that the measure should pick up the following principles:

- Overlap with the other ODIs should be minimal
- Long term focused – a single end of period target set in the context of a longer term target.
- Specific to each company's starting position and operating environment.
- Able to react to specific interventions that companies undertake in trying to improve resilience.

Potentially hosepipe bans should be used as a specific measure in this area as history has shown that these really matter to customers when they happen. We would also welcome the flexibility to develop and propose our own method of measuring resilience as by doing this we can demonstrate a wide scope of coverage and focus on issues of resilience that are tailored for South Staffs Water. This is one of the areas where companies could demonstrate innovation at PR19 as it is particularly difficult to make direct company to company comparisons.

Q3: What is your view on how we might apply comparative assessments at PR19?

We have formatted our response to this question around the consultation headings in appendix 1, addressing sections 3.4.1 through to 3.4.7.

3.4.1: An upper quartile challenge or tougher

We recognise that service improvement is a desirable outcome. If we get this right it will support Ofwat's resilience duty, improve customer trust and legitimacy, and improve company efficiency on performance and costs. However, we do need to design this correctly and ensure the measure is consistent in order to avoid driving company behaviour

that does not benefit customers where a challenging target is perceived as unachievable and effort falls away.

Industry wide common targets may not take into account company specific differences in customer preferences. We believe that where customer support can be demonstrated, a mechanism for adjustment to targets should be considered; this could be linked to bespoke targets where performance and importance can be demonstrated.

3.4.2: The data on which to base the assessment

Static versus Dynamic:

We are supportive of the use of dynamic targets where the measure is well proven and the basis and methodology for calculation is common.

A static approach (setting target levels at the start of AMP7) may provide more transparency to stakeholders including customers, and link better with the regulatory frameworks where funding is set for the five years with certainty on the level of targets to achieve. However a dynamic approach will benefit customers as it requires Companies to continually improve performance, and requires innovation to ensure that this is achieved within existing funding and the rewards that can be achieved.

There is a risk that targets are influenced by atypical events (for example weather) outside of the industry's control, a method of factoring such events into dynamic targets may be required.

Historic versus Forecast:

We think that performance commitment targets should be derived from companies' historic data in order to avoid any subjectivity or uncertainty that may arise from using forecast data. However, the use of dynamic targets based on performance will quickly move boundaries forwards.

3.4.3: Average or annual data

Within our current ODIs we only have an averaging mechanism for our asset health measures, which was done to ensure it has a focus on longer term trends rather than in-year variability. We believe that this should be extended to other longer term measures such as asset health, resilience and leakage where it can be justified to customers. However, we think that the annual performance should still be published alongside the average in order to be transparent to customers.

3.4.4: Applying the commitment levels to individual measures or a number of sub-measures

We believe it is right to be transparent on the measures that customers care about and to incentivise these individually and dynamically. Single measures are likely to make it easier to communicate performance and delivery plans to customers in a way they can understand and engage with.

This does not remove the opportunity for innovation in this area, maybe allowing companies the flexibility to put forward their own proposals for grouping measures of performance, supported by the appropriate business and customer benefit cases or maybe trialling with a limited group of incentives. Whilst our view is that we do not prefer the use of sub-measures

approach at the moment, we are open to discussion, and are particularly interested in how this could operate with dynamic targets.

3.4.6: The use of glidepaths

We recognise that service improvement is important to customers and that Ofwat needs to provide a strong challenge. However, performance improvement targets need to be deliverable and sustainable, and complementary to Ofwat's parallel objectives of asset health and resilience.

We therefore believe that Ofwat should consider allowing companies a glidepath provided it is accompanied by a strong set of proposals, has the appropriate balance of incentives and is supported by customers. We acknowledge that the case for this must be strong but nevertheless the opportunity to present this case should feature in Ofwat's framework. Choosing a glidepath in this case would prevent achievement of reward.

3.4.7: Making adjustments for company-specific factors

We believe that it is important for the regulatory framework to provide for company-specific factors, and we believe this is made further important by the introduction of more common performance commitments and stretching targets. We believe adjustment requests would probably fall into two categories: those outside of a Company's control (for example engineering/legacy issues), and customer preferences.

We propose that as a way to incorporate company specific factors, Ofwat could keep the same stretching performance common commitment levels, however, potentially ease the level where a penalty would be incurred for those companies that provided well evidenced adjustments.

Q4: To what extent do you agree with our proposed approach to leakage performance commitments for PR19?

We note that Water UK and UKWIR are currently leading industry projects looking at how leakage is measured across companies and we await the conclusion of this work in the hope that it identifies a useable measure. We believe that is particularly important that there is a prescribed methodology for calculating leakage across companies in order to drive consistency in this area. Once an approach has been agreed this consistent methodology should then be used to set the appropriate leakage targets, recognising that these may be higher or lower than the previous targets set on an inconsistent basis.

We can see benefits and challenges with each measure (distribution input, leakage, PCC). PCC suffers from the difficulty in predicting occupancy which raises issues of consistency between companies; we suggest that using Per Household Consumption (PHC) instead would measure almost the same thing from the point of view of demand management, yet removes the dependency on occupancy data.

Q5: What factors should we take into account in our guidance on setting performance levels for bespoke performance commitments at PR19?

We recognise that it is up to companies to engage with customers to gain support for bespoke PCs. We think that there should be flexibility for commitments to be segmented, where appropriate, to different customer groups where there may be particular local issues

of concern to them.. We think this is particularly important in maintaining customer trust and confidence.

We note that Ofwat is considering whether it would be possible to share comparative information on marginal costs so that customers and CCGs can challenge company estimates. We are unsure how this would work in practice as the commitments are bespoke and so the data would probably not exist industry wide. Even if similar commitments were proposed by a number of companies it is likely that the data provided would not be on a consistent basis. We therefore think that it would need to be for companies to demonstrate that the cost data used to engage with customers was evidenced, transparent and robust.

Q6: What is your view on our development of a new customer experience measure for PR19?

We have been supportive of the SIM mechanism and believe it has been a valuable incentive to drive customer service performance forward in the industry. We agree that with both a changing industry and changing contact channels, the time is right to review how customer service is measured in the future. The responses to the key questions set out in the consultation are set out below:

Should it just measure customer satisfaction?

Depending on how a full service measure was designed, there is potential for uncertainty and overlap with the other, direct, performance measures. We believe therefore that it would be most beneficial to focus the new SIM on customer service only, and allow the other ODIs and a company's own customer engagement to provide the coverage of the wider service. If the new SIM was preferred to cover the wider service then it would be important to consider fully how the survey is designed and the interactions with the other direct ODIs.

Should it separate wholesale from retail?

We agree that the current set up of surveying both retail and wholesale customer service, and separating the two, is sensible and we support this approach going forward in the new measure.

Should it go beyond the water sector and use other markets as comparators?

We agree with the limitations raised in the consultation on this subject (underlying products need to be like-for-like to produce meaningful comparison, wholesale business fundamentally different to retail). If other market comparators are used, it is important that cross industry comparisons are fair and would yield benefits to customers.

Should we continue measuring the quantitative volume of complaints?

Most companies already measure the wider customer perceptions through engagement programmes. For example we have two ODIs for customer satisfaction and value for money/affordability measure which survey the views of all customers (via a sample). Companies' engagement programmes already seek to collate these wider views and do so in a structured way geared towards the needs of the company and its customers. We believe wider customer views are better served using this technique.

In respect of quantitative complaints, the metric currently only includes written or e-mail complaints. We believe that companies need to make themselves as accessible as possible to its customers and would support the inclusion of other forms of contact, for example telephone and social media. This would help to encourage engagement with customers more generally and not just in relation to complaints.

Should it widen the sample population?

As all customers receive the same service, we support the widening of the sample population to include other forms of contact in addition to inbound contacts only. However, the different contact channels could have different weightings to the measure, recognising that a customer contacting the company directly (active customer contact) is valued higher than the company contacting a customer (passive customer contact).

Should it be multi-channel?

We agree that the new measure should include social media contacts. However, these channels will need to be defined carefully, especially as new ones may appear over time. We also believe that it should only include direct channels with companies and not where a company may be mentioned indirectly in social media or websites. We are mindful here of the current debate around the ability to manipulate social media.

Incorporate vulnerability?

We agree that customer satisfaction with vulnerability support could be used within any new SIM measure. We also think that it could be made a specific measure in its own right to make it more transparent that this customer group's needs have been met.

We do also recognise that if companies are capturing more data on vulnerable customers that companies protect this data appropriately and ensure that it is used for legitimate purposes only.

Should it include retailers as well as end users?

At this stage we believe that any new SIM is best if it is focused only on household customers, with the customer satisfaction of other groups of customers measured separately, whether as bespoke or additional common ODIs. The customer service that developers and retailers will need to receive is different to that which household customers need to receive and will require different engagement and different questions to be asked in any survey. We also note Ofwat's latest consultation on its approach to monitoring the retail water market from April 2017 which includes the use of customer satisfaction data.

Q7: What is your view on the options for increasing the power of reputational and financial ODIs at PR19?

Options for making ODIs more powerful

In period ODIs

At PR14 and in consultation responses since, we have expressed the position revealed in our customer engagement which was that customers preferred stable bills over a price review period rather than year by year fluctuations. This general premise, we believe, still makes overall sense. However we recognise that there is more complexity to this. For example, customers understandably would not prefer a large step change in bill at the start of a price control period, nor would they not want to receive reductions in the bill for poor

performance as soon as possible. We also appreciate that in period ODIs more clearly links the bill fluctuations with performance levels, increasing transparency for customers.

We recognise therefore that further customer engagement is needed so that we can communicate this mechanism effectively to customers and our CCG, and so that we can effectively plan for how we take rewards or give back penalties to minimise impacts on customer affordability, whilst at the same time fairly remunerating the outperformance of the company.

We would like the flexibility of retaining the ability to put forward our own plans for delivering incentives that are not in-period, including on which measures we apply them. We will then be able to ensure that those incentives fairly reflect the nature of the investment, the service performance and gain the support of customers and our CCG in those decisions.

Linking ODIs to revenue rather than the RCV

We agree that ODIs should be linked to revenues rather than RCV so that there is a closer relationship between performance and reward or penalty.

Aggregate cap and collar on ODIs

We believe that setting an aggregate cap and collar has value to stakeholders as a safeguard (bill affordability, financial stability). In addition, if no glidepaths were applied or a dynamic frontier incentive was applied, the cap/collar may serve to mitigate large penalty shocks that some companies could face.

With regards to the RORE range, we would support this being wider than the current +/-2% range, particularly if the design of performance commitments is well constructed and allows the upper quartile targets to be considered achievable so that it drives performance.

An indicative range for rewards and penalties

We believe that there is a need to set indicative ranges for rewards and penalties at a meaningful level; this will allow companies to plan to target the “carrot” and avoid the “stick”. There is also a need to set these ranges in line with the wishes of customers as determined through engagement

Increasing the power of ODIs through detailed design features

We believe that deadbands could remain as part of the ODI design. Improving within a deadband could incentivise a company to improve away from the penalty threshold despite not being able to reach the frontier. It may also be an incentive to first improve within (through) the deadband in order to progress on into reward territory. For many aspects of service the improvement process is incremental and the deadband may be a useful tool. As has been identified, deadbands are also intended to provide an allowance for reasonable year on year variability which is not due to any significant variation in a company's efforts (e.g. weather impacts). Therefore we consider that appropriately sized deadbands remain a useful element of ODI design going forward.

Gated ODIs

We believe that it is the overall basket of performance that matters to customers. We do not therefore support the concept of gated ODIs as there is a risk that they could become a disincentive for companies to improve since all rewards are out of reach if one ODI is in the penalty range, potentially in spite of being a top performing company across the whole

basket of measures. There is also a risk to be noted that ODIs could be more transparent to customers if each financial incentive is independently identified with a target.

Linking service performance to the cost of equity

We recognise the benefits of linking service performance to the cost of equity. It provides the opportunity to earn a higher cost of equity, if an ambitious, innovative plan could be achieved. We particularly support rewards for good performance rather than for just a good plan, there should be real benefit to customers particularly if they are to pay more (to fund the reward).

Q8: What is your view on our proposals for better reflecting resilience within the outcomes framework?

We welcome the inclusion of long term commitments as we believe that the outcomes and ODIs should not be designed as short term incentives which encourage reactive behaviours at the expense of long term sustainable improvement in service. We welcome that Ofwat is looking at the longer term and we think that Ofwat should give due weight to service improvement and cost effective delivery, over the long term.

In terms of an ODI on resilience, we would welcome the opportunity to demonstrate innovation. We suggest that a single common ODI is not implemented top down by Ofwat and allow companies the flexibility to design their own resilience metric that reflects their individual needs and that they have engaged with customers and other stakeholders on. The resilience planning principles Ofwat has suggested are sufficiently high level not to stifle companies' flexibility and we support their inclusion in the July methodology.

We also agree that it is important to engage with customers on resilience. It is for companies to determine how to design their engagement programmes to ensure this challenge is met and in a way which ensures customer views are reflected back in companies' plans for the long term.

Q9: What is your view on the options and our preferred approach to asset health outcomes?

We agree that some standardisation of asset health measurement across companies would be beneficial given that on the whole all companies operate the same types of asset.

We agree that pipe bursts is the best available indicator of asset health, although recognise that this measure applies particularly to underground assets. We believe that there should be a measure for overground assets as well and would welcome the opportunity to be part of a working group to explore possible metrics.

Q10: To what extent do you agree with our proposals for making performance commitments more transparent to customers?

We recognise the importance of transparency and clarity in the engagement on outcomes and ODIs. We are in agreement with the principles Ofwat propose that performance commitments should be written in a clear language and be unambiguous, complete and concise.

On scheme specific performance commitments, we believe that these will be necessary to give accountability to customers on the delivery of major projects that form part of a company's plan, that are not otherwise well served by performance commitments on customer facing service. In particular we think this may apply to resilience based schemes, or larger capital maintenance projects.