



Draft determination of in period ODIs for 2017

An Ofwat consultation paper

Introduction

1. The Consumer Council for Water is the statutory consumer organisation representing water and sewerage consumers in England and Wales. The Consumer Council for Water has four regional committees in England and a committee for Wales. We welcome the opportunity to respond to Ofwat's draft determinations resulting from three companies' in-period Outcome Delivery Incentives (ODIs) for 2016-17.

General comments

2. ODIs are intended to focus companies' attention on delivering good outcomes on the services that matter to customers, financially rewarding companies for outperformance but financially penalising them when they fall short of their commitments.
3. While all water companies have ODIs as part of their 2014 price review (PR14) settlement, most financial ODIs will be reconciled at the 2019 price review (PR19), and will impact customers' bills from 2020. However, three companies (Severn Trent, Anglian, and South West) proposed some ODIs that would be paid 'in period' i.e. within the current control period of 2015-20.
4. CCWater recognises that Ofwat's intention behind in-period ODIs is to sharpen incentives on company management to deliver what matters to customers by generating a reward or penalty which has a more immediate effect on the company, and that is more obviously linked to recent service performance. In period ODIs may also help prevent a bill spike at the start of a price control period generated by rewards accrued over five years.
5. However, in period ODIs can create bill instability for customers, so in some cases it might be appropriate to spread in-period ODI bill impacts over several years, or to defer them, to smooth bills while still capturing some of the benefits of applying them closer to the performance that generated them.
6. The application of ODI rewards earned in 2016-17 should also be seen in the context of customers' views of the ODI model. At PR14 CCWater undertook research to establish consumers' views on ODIs. Our research showed that customers generally do not support the use of penalties or rewards as a method of driving companies' improvements in service. Customers tend to see improving services as an integral part of companies' activities and not something that requires additional reward.
7. Due to this, CCWater has consistently warned Ofwat of the risk of a negative customer reaction from both:
 - Setting ODIs that do not stretch companies and thus open the possibility of easy wins; and
 - The bill impacts that can be caused by ODI rewards, on top of the effect of RPI related increases each year.
8. Our analysis of the initial suite of ODIs indicated that many were easily achievable and that companies were likely to receive significant rewards for marginal improvements. This has been borne out by evidence of some companies' performance, particularly in relation to Seven Trent's consistent outperformance of its sewer flooding ODI which has accrued significant rewards.

9. The context of other financial pressures on customers' bills should also be taken into account when considering the customer impact of in period ODIs. Higher RPI levels mean that customers are already seeing substantial bill increases. In many cases RPI is rising faster than household income levels. This is putting pressure on household budgets generally and causing particular issues for those who are already struggling to pay. Our research indicates that around 3 million customers consider that their bills are already unaffordable. ODI bill impacts have significant potential to accentuate these bill pressures.
10. While the rewards and penalties set out in the draft determinations appear to be consistent with Ofwat's ODI methodology, the bill impacts of the ODI rewards in these draft determinations have the potential to generate customer complaints and increase customer dissatisfaction, especially when the ODI impact is compounded by higher RPI.
11. The risk of a negative customer reaction to ODI rewards could also be greater if multiple ODI rewards are accumulated over time and applied to revenue in one go, possibly increasing bills further.
12. As customers are unresponsive of the model, given the risks associated with such bill impacts we highlight in this response, both the companies concerned and Ofwat should focus on how best to spread the bill impact and explain to customers what they are getting in return for reward payments.
13. Our detailed comments on each of the three companies with 'in period' ODIs are given below, but the key points are:
 - **Anglian** - we note the bill impact (£1.26) of the outperformance of the leakage ODI, given that customers placed leakage as a higher priority at the 2014 price review.
 - **South West** - we note the small bill impact of the reward against its leakage ODI, but challenge the company to improve its performance against its ODI on pollution incidents given its poor performance and subsequent penalty. We support the company's intention to keep a smooth bill profile for customers in the way rewards and penalties are applied.
 - **Severn Trent** - we question whether the performance targets for its sewer flooding ODI were sufficiently challenging given the level of outperformance since PR14. While we support the deferment of the bulk of the reward for this, we question when and how the collection of the remainder of the reward will apply. We expect the company to improve on its performance in handling Drinking Water Quality complaints.
 - **All three companies** should communicate effectively with customers to explain the reason for the bill impacts and what specific improvements customers are receiving in return for any reward payments.

Comments on company Draft Determinations

Anglian Water

14. Anglian has achieved a reward of £2.575m for outperformance of its leakage ODI. The collection of this reward from revenue will add £1.26 on the average Anglian customers' water bill in 2018-19.
15. CCWater has engaged with Anglian on its approach to leakage reduction as this was a customer priority at the 2014 price review. We support the improved performance that has led to company exceeding its ODI target.
16. Given its small impact, the bill increase from this ODI reward does not need to be phased over time. However we would like to see the company inform its customers about the reason for the bill increase and show customers to what extent they have reduced leakage to meet customers' expectations.

South West Water (SWW)

17. SWW has achieved a reward of £1.081m for outperformance of its leakage ODI. The collection of this reward from revenue will add £1.60 on the average water bill in 2018-19.
18. However, SWW has also incurred a penalty of £3.168m for underperformance against its ODI covering Category 1 and 2 pollution incidents. Applying this penalty to revenue will lead to a reaction of £5.00 on the average wastewater bill in 2018-19.
19. We are pleased to see the work SWW has done to reduce leakage beyond its committed level, as research consistently shows that tackling leakage is a customer priority.
20. We are disappointed that the company's pollution incident performance fell below its target. We have challenged the company on this issue and the company is working to deliver a plan for improving its wastewater management and tackle ongoing legacy infrastructure issues. We are encouraged by the company's operating model for the handling of wastewater events, and expect to see the company meeting its committed performance level going forward.
21. We agree that it is sensible to apply the rewards and penalties earned in 2016-17 and those accrued in 2015-16 against charges in 2018-19. This is consistent with the methodology for in-period ODIs, and will avoid the risk of greater bill impacts should further rewards or penalties be accrued during the remainder of this price control period. Overall there is a net penalty which applied to the average bill will mitigate against bill increases calculated through RPI + K and so create a smoother bill profile benefitting customers.
22. We are aware that SWW is also seeking to share further outperformance (from totex efficiencies and cheaper financing) with customers under its WaterShare programme but will defer the sharing of these benefits to a later date given that the impact of the in-period ODIs is to smooth the bill profile in 2018-19. We agree that the WaterShare 'basket' of outperformance should be deferred and used to assist customers at a future point when its benefit will be greater for customers.
23. We expect SWW to be open and transparent in explaining the bill impacts of its in-period ODIs and the reasons for the rewards and penalties earned. While these have

been reported in its Annual Report, we will look to SWW to engage effectively through its customer bill wrappers, its customer newsletter 'WaterLevel' and through its website and e-newsletters. This should be in addition to its continuing promotion and targeting of affordability measures.

Severn Trent

24. Severn Trent has incurred a penalty of £1.678m for underperformance against its Drinking Water Quality complaints ODI. This will reduce the average water bill by £0.51 in 2018-19.
25. Severn Trent also achieved a reward of £12.994m for outperformance of its sewer flooding ODI. If applied to revenue in its entirety in 2018-19, this would add £12.85 to the average wastewater bill. However, Severn Trent proposes to spread the collection of this reward over a longer period so wastewater bills will increase by £2.67 in 2018-19 instead.
26. Severn Trent has made a step change in many areas of performance which has led to the achievement of the sewer flooding ODI reward, which reflects a customer priority identified at PR14.
27. However, the collection of this reward in one go from revenue would have a significant customer bill impact which many customers may find unacceptable or unaffordable. On this basis we support the deferment of the bulk of the reward but question when the remainder will be collected. Would accruing outstanding rewards and collecting them at the start of the next price control create a significant bill 'spike' in 2020-21? If so, there may be a need to spread the collection of rewards over a longer period if the potential customer bill impact is to be reduced, particularly in the context of higher inflation also affecting bills.
28. We also note that in the current price control period, ODI rewards have cap of 2% of the Regulated Return on Equity (RoRE). Given the level of reward Severn Trent has achieved in the first two years of this price control period (and the possible scope for further rewards in the remaining years), we question what Ofwat will do if and when Severn Trent reach the limit for rewards that the cap implies? This could possibly be as soon as next year if their performance trend for the sewer flooding ODI continues. Will Severn Trent just cease to receive any further rewards? We would welcome clarity on this in Ofwat's final determination.
29. We also think that Severn Trent and Ofwat need to consider the application of ODI rewards and penalties in the context of the proposed licence variation resulting from the acquisition of Dee Valley Water by Severn Trent. If the licence variation goes ahead, we would like reassurance that customers on the Wales/England border who receive a wastewater service only from Severn Trent would not carry more of the bill impact as a result of the ODI rewards received by the company because of their 2017 ODI performance.
30. It would be beneficial if Ofwat addresses this potential scenario in their final determination report as well as what the implications of future rewards could be on those bill payers. We would also like Ofwat to consider this within the context of the baseline ODIs it has asked SVT to set for the proposed license variation for a Wales only Severn Trent/Dee Valley license.

31. Similarly, we would like Ofwat to consider the impact that the 2017 ODI reward also has on the bills for customers in the South Staffordshire region. The majority of the reward sits on the wastewater side of the business, so without the counter penalties in water, this has an even bigger impact.
32. We expect Severn Trent to communicate effectively with customers to explain the rewards and penalties, and explain what tangible improvement customers are receiving in return for rewards. We also expect Seven Trent to improve its performance in terms of handling drinking water quality complaints, as we expect to see the incurring of a penalty incentive the company o improve in future years.

Enquiries

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