

Ofwat webinar: Delivering Outcomes

15 February 2019 10.00 - 12.00pm

Q and A

Areas covered:

- Delivering outcomes

[Webinar slides are available on our website.](#)

Question and answer session

Q. We are concerned that if companies accept Ofwat's calculated PC levels, in some cases they will not be targeting the efficient level of performance (based on cost-benefit analysis in line with the guidance) and so this will be a sub-optimal outcome for our customers. So, without evidence that Ofwat's calculated PC levels represent the efficient level of service, wouldn't you agree that it would be problematic to accept these?

A. Customers should receive service levels that efficient companies can deliver. Marginal cost estimates should reflect those of an efficient company, rather than those based on its own historical costs. Companies should also challenge estimates of benefits that the results of the IAP indicate are lower than most other companies, to ensure their own valuations are robust. If a company is not as efficient as other companies it should address this, rather than argue for lower standards of service for its customers.

Q. If a company's Willingness to Pay (WTP) clearly supports an ODI rate outside of Ofwat's initial view of range, will this be accepted?

A. The ranges set out in the IAP Technical Appendix 1: Delivering Outcomes for Customers represent our initial assessment of reasonable variation in ODI rates, based on information available from companies' September 2018 Business Plans. We will evaluate any further information companies provide in their April resubmission, in reaching a decision on ODI rates for Draft Determinations. This will include any supporting evidence companies submit to demonstrate the appropriateness of their rates, and the extent to which their proposed rates are representative of their customers' underlying preferences.

Q. Why did you pick 0.5 standard deviations?

A. We have explored whether differences in factors such as company scale, comparative and historical performance, household income and regional water stress provide an explanation for variation in ODI rates included in September 2018 business plans such that they would act as a basis for making an initial assessment of reasonable ranges. However, we have not been able to establish a significant relationship between the ODI rates proposed by companies and these factors. We have therefore used variation from the mean to assess a threshold for those ODIs where we are requesting more information from companies. The chosen threshold of 0.5 standard deviations is not determinative at this stage and we will consider the additional

information and evidence provided by companies in reaching a view for Draft Determinations.

Q. Could you please explain how you calculated the normalised leakage ODI rates in annex 2 of the outcomes technical appendix please, as I couldn't replicate it and we are missing from the table.

A. Our starting point for the calculation of the normalised ODI leakage rates in Annex 2 of the Delivering Outcomes for Customers Technical Appendix is the ODI leakage rates submitted by companies in the APP1 data table, expressed in £m/Mld. We have multiplied these rates by the AMP7 average values for distribution input (Mld) submitted by companies in the WN02 data table (divided by 100) to obtain a rate expressed in £m/% distribution input. Finally, we have divided this figure by companies' 2022-2023 Household Water Volumes (and multiplied by 10^6) to obtain a rate expressed in £/HH/% distribution input.

A value is not published in the table for South Staffs Water as it has proposed separate leakage ODIs (and associated rates) for its South Staffs and Cambridge operating areas. We have requested further information from South Staffs Water to allow us to derive normalised comparisons for Draft Determinations.

We have set out our calculation of normalised ODI rates for all common and comparable PCs in the spreadsheet accompanying this Q&A document.

Q. There is limited time for re-surveying customers prior to 1st April. What is Ofwat expecting to see in terms of additional testing of things like asset health and ODIs?

A. We recognise that limited time is available to companies ahead of 1 April and so expect that companies will generate the *most compelling* evidence possible in the available timeframe. It is, however, ultimately a matter for companies to determine what, if any, additional research is required to address our actions and how this should be prioritised. If companies require additional clarification on the nature of our concerns and actions for the Outcomes test area then they should submit a query using the formal process or request a bilateral meeting.

Q. What is the economic/mathematical justification for a 2x multiplier for enhanced ODI rates?

A. The multiple of 2x the standard ODI rate represents the level beyond which a company's enhanced ODI rate exceeds the implied marginal benefit to its own customers (assuming companies have applied the standard Ofwat formula for the calculation of standard outperformance rates, as set out in Appendix 2 of our Final Methodology). We are therefore using this at the IAP stage as a threshold to request additional information from companies on the appropriateness of the enhanced rates that they have proposed, given our concern that companies' own customers are adequately protected. The chosen threshold of 2x the standard ODI rate is not determinative at this stage

and we will consider the additional information and evidence provided by companies in reaching a view for Draft Determinations.

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