

July 2019

Trust in water

PR19 draft determinations

Accounting for past delivery technical appendix

PR19 draft determinations: Accounting for past delivery technical appendix

Contents

1	Introduction	3
2	PR14 reconciliations	4
3	PR14 service incentive mechanism (SIM)	13
4	Deliverability assessment	21

1 Introduction

This technical appendix provides an overview of the two parts of past delivery: the reconciliations of PR14 incentives – including the service incentive mechanism (SIM) – and our assessment of deliverability.

The reconciliation of PR14 incentives is necessary to ensure that customers only pay for the service that they received and so to make sure that companies feel the impact of their 2015-20 performance. It is therefore a vital part of ensuring that companies are properly incentivised to deliver for customers at PR19 and beyond.

The deliverability assessment allows us to look at past performance, and the companies' evidence of lessons learnt, and measures put in place to address performance, to assess whether the plan for 2020-25 is deliverable. It is therefore an important tool for challenging companies to ensure that they can deliver for customers.

All of the responses to the initial assessment of business plans, including all of the companies' revised business plans, provided by the 1 April 2019 are taken into account in our decisions where relevant. Where appropriate, we explicitly set out our response to points and issues raised by respondents.

Our decisions also take into account the representations made on the fast track draft determinations where the points and issues raised are relevant to the slow track and significant scrutiny draft determinations. We will deal with the other elements of the representations to the fast track draft determinations as part of the final determinations.

We have not necessarily been able to take full account of all late evidence, submitted after the 1 April 2019 business plans, and we will consider this information for the final determination.

This document proceeds as follows:

- section 2 provides an overview of the PR14 incentive mechanisms reconciliations;
- section 3 sets out our approach to implementing the out and under performance payments relating to the PR14 service incentive mechanism; and
- section 4 presents our methodology for assessing the additional evidence provided in response to actions we set at the initial assessment of business plans relating to deliverability.

2 PR14 reconciliations

In PR14, we set mechanisms to incentivise companies to do the right thing for their customers. These financial incentives cover cost efficiency, outcomes performance, revenue forecasting, customer service, water trading and land sales. In setting the 2019 draft determinations, we are applying reconciliation adjustments to revenues for the 2020 to 2025 period and to the regulatory capital value (RCV) to take account of these incentive mechanisms. We are also applying adjustments to reflect performance in the final year of the 2010 to 2015 period, which could not be fully taken into account in PR14 as the outturn data for 2014-15 was not available at the time of the PR14 final determinations.

To complete the reconciliations, we are following the '[PR14 reconciliation rulebook](#)' (the 'reconciliation rulebook'), which we originally published in 2015 and subsequently updated. The reconciliation rulebook sets out the methodology companies should use to calculate these adjustments. It describes the approach to the reconciliation of the mechanisms setting out how we treat inflation, tax, the time value of money and mechanism specific issues. We list the mechanisms in Table 2.1 noting whether each mechanism is reconciled through an adjustment to the RCV or allowed revenue.

Table 2.1: PR14 reconciliation rulebook mechanisms

Incentive mechanism	Purpose	Revenue or RCV
Outcome delivery incentives	Outcome delivery incentives provide outperformance payments for companies that exceed their stretching performance commitment levels, and underperformance payments for companies if performance is below their performance commitment levels. This provides incentives for companies to do the right thing for customers, the environment and wider society. We published ' Information Notice IN 16/07 ' about the limited circumstances in which companies can change their outcomes.	Revenue or RCV as defined by each performance commitment
Wholesale total expenditure (totex) sharing	Where a company over- or under-performed on its totex allowance, this mechanism shares the over- or underspend with customers.	Revenue and RCV
Wholesale revenue forecasting incentive mechanism (WRFIM)	This mechanism provides financial incentives for companies to make accurate forecasts for wholesale revenue, ensuring under- and over-recovery is reconciled.	Revenue
Water trading incentive	This mechanism provides financial incentive payments to encourage new water trades to start in the 2015-20 period.	Revenue
Residential retail revenue	This mechanism adjusts the total revenue allowance to reflect actual customer numbers so that companies can recover their allowed costs per customer for residential retail.	Revenue
2010-15 reconciliation	Further adjustments for performance against the PR09 incentive mechanisms, to reflect the update for actual 2014-15 performance as published in ' Updated 2010-15 reconciliation '. This also includes the RCV adjustment in respect of correcting the treatment of inflation in the PR09 capital expenditure incentive scheme.	Revenue and RCV
Land sales	This mechanism adjusts the RCV to share any proceeds from disposals of interest in land equally with customers.	RCV
Service incentive mechanism (SIM)	This is a financial incentive to incentivise good customer service performance relative to other companies in the sector.	Revenue

The PR14 reconciliation rulebook does not cover how the SIM will be reconciled for PR19. We describe how we will reconcile this mechanism for the first time in section 3 below.

We have used information from companies' April 2019 submissions for calculating the reconciliation adjustments in the draft determination for slow track and significant scrutiny companies. The fast track draft determinations are based on their September 2018 business plans and do not include an adjustment in respect of the SIM, as we had not calculated the SIM at that time. We set out the calculated values used in the slow track and significant scrutiny companies' draft determinations, and the indicative values for the fast track companies' final determinations in section 3 below.

Companies generally have undertaken the reconciliations consistently with the methodology in the reconciliation rulebook and provided sufficient and convincing evidence to support their proposed reconciliation adjustments. However, there are some differences between the companies' proposed reconciliations and the draft determination. Figures 2.1 and 2.2 illustrate the value of the reconciliation adjustments and the interventions we are making at the industry level. The key interventions for each company are set out in Table 2.2. These interventions are relative to the companies' business plans. We provide further detail in the 'Accounting for past delivery actions and interventions' company documents.

Figure 2.1: Ofwat's view of the value of PR14 reconciliation adjustments for draft determinations (net for sector, all companies)

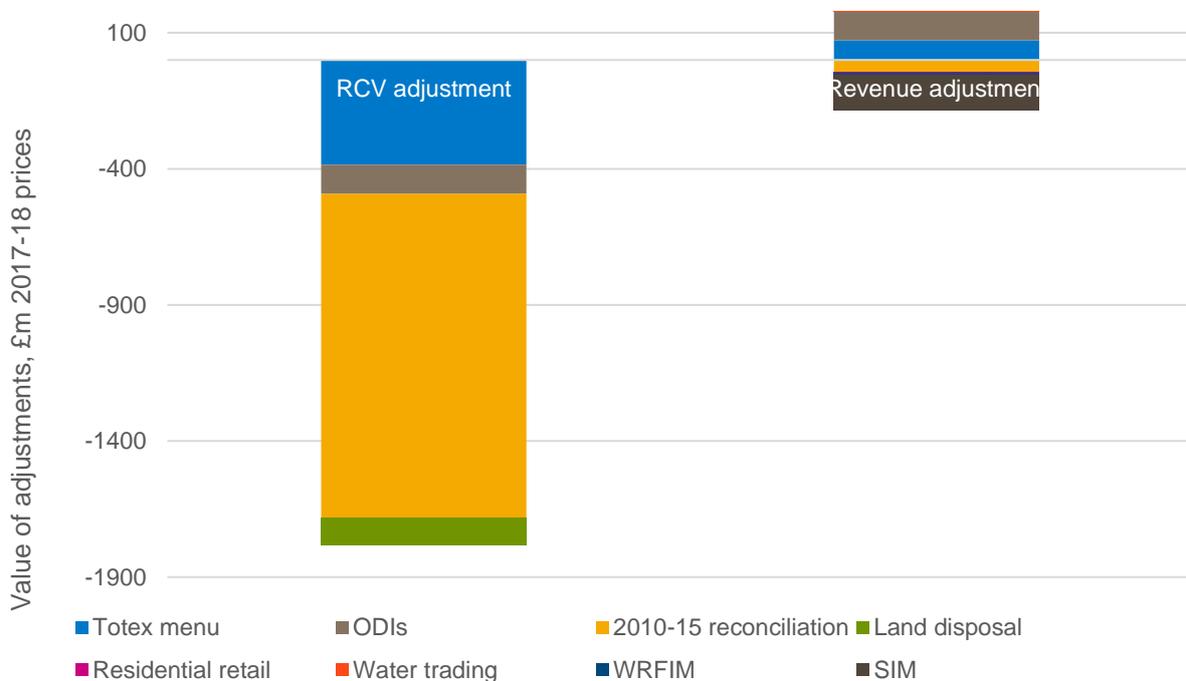


Figure 2.2: Value of our interventions in PR14 reconciliations for draft determinations (net for sector, all companies)

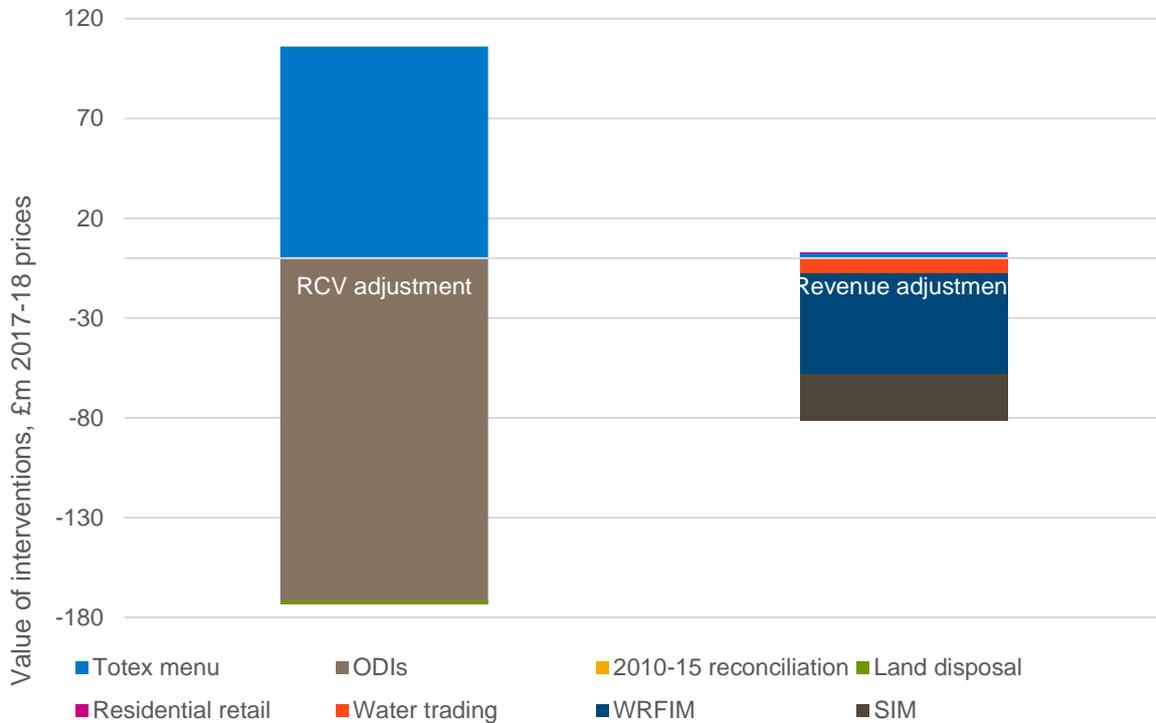


Table 2.2: Reconciliation of PR14 incentives, key interventions

Company	Key interventions
Anglian Water	We are intervening to decrease net PR14 reconciliation revenue by £5 million, driven by a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£10 million). This is partially offset by an increase in revenue from performance in outcome delivery incentives (+£5 million). These arise from the inclusion in the reconciliation of outperformance payments for the company's in period outcome delivery incentive relating to 2018-19 and 2019-20 performance, for consistency with other companies' treatment of in period outcome delivery incentives, and from the inclusion of outperformance payments for a value for money perception outcome delivery incentive that the company had erroneously excluded.
Dŵr Cymru	We are intervening to increase net PR14 reconciliation revenue by £26 million (+£1 million revenue and +£25 million RCV), driven by an increase in totex (+£3 million revenue and +£25 million RCV) arising from the intervention to include Loughor Estuary expenditure incurred in the 2015-19 period in the totex reconciliation. This consequentially reduces the transitional expenditure to be funded in 2020-25 from that proposed by the company. The totex revenue increase is partially offset by a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£2 million).

Company	Key interventions
Hafren Dyfrdwy	We are intervening to decrease net PR14 reconciliation revenue by £0.5 million, driven by a decrease in revenue for outcome performance (-£0.6 million) and partially offset by a small increase in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (+£0.1 million) ¹ .
Northumbrian Water	We are intervening to decrease net PR14 reconciliation revenue by £9 million, driven by the disallowance of the proposed water trading incentive for the reverse trade with Thames Water (-£7 million), and a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£2 million).
Severn Trent Water	The net impact of the interventions we made in the company's fast-track draft determination and our assessment of the service incentive mechanism is to increase the net PR14 reconciliation revenue by £2 million, driven by an increase in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (+£6 million). We included a zero value for the service incentive mechanism in the fast track draft determination. This is partially offset by a decrease in revenue for outcome performance (-£3 million) relative to the company's view. There is also a reduction on land sales as a result of the correction of an error in the original business plan table App9.
South West Water	The net impact of the interventions we made in the company's fast-track draft determination and our assessment of the service incentive mechanism is to decrease the net PR14 reconciliation revenue by £4 million driven by a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£4 million). We included a zero value for the service incentive mechanism in the fast track draft determination. There is also a decrease in revenue for outcome performance (-£1 million) and a reduction in land sales as a result of the correction of an error in the original business plan table App9. This is partially offset by an increase in totex revenue (+£2 million). (Differences in total due to rounding.)
Southern Water	<p>Our PR14 reconciliation interventions net to £0 million. This reflects an increase in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (+£5 million). There is also an increase in revenue from wholesale revenue forecasting incentive mechanism (+£1 million). This is offset by a reduction in totex revenue to correct transitional expenditure (-£6 million). There are also a number of smaller movements in the other reconciliations.</p> <p>We have separately issued 'Notice of Ofwat's proposal to impose a penalty on Southern Water Services Limited', a penalty notice inviting comments on our proposal to issue an enforcement penalty against Southern Water. In this notice we propose accepting undertakings from Southern Water. The first undertaking will deal with the price review underperformance payments that Southern Water avoided paying as a consequence of its misreporting performance of its wastewater treatment sites and which it must now incur based on restated performance data. This money will be returned to customers via bill rebates over the next five years. The second element is a payment to</p>

¹ Our draft determination financial modelling includes an adjustment for the service incentive mechanism of £0.0 million. The total adjustment should be - £0.2 million as confirmed in Table 3.1 in the 'Hafren Dyfrdwy draft determination'. We will correct this inconsistency for the final determination.

Company	Key interventions
	<p>customers, in lieu of a penalty, for the company's failure to meet its legal obligations This amount will also be paid to customers via bill rebates over the next five year period. The third element to the company's undertakings is a package of measures that Southern Water has and is putting in place. This includes investment in treatment works, and new operational and governance arrangements. The company will report to us regularly to demonstrate that the corrective actions it is taking are working and the company's reports to us will be independently assured.</p> <p>We have not included interventions in the draft determination as the consultation on the penalty notice is currently open. The outcome delivery incentive and PR09 blind year reconciliations included in this draft determination do not reflect the restated performance data covered by the penalty notice. We will reflect that restated data in the final determination.</p>
Thames Water	<p>We are intervening to decrease net PR14 reconciliation revenue by £155 million, driven by an adjustment for Counters Creek sewer flooding programme which we consider cancelled (an adjustment of -£150 million to RCV), and a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£5 million). There is also a disallowance of water trading incentive for the reverse trade with Northumbrian Water (-£0.4 million).</p> <p>Thames Water is also subject to a reduction (-£48 million) to implement its s19 commitment to return inefficient leakage spend and a reduction (-£7 million) to implement its s19 commitment for ex-gratia payment as part of the s37 leakage case. These are included correctly in the company's modelling and in the draft determination with no intervention.</p>
United Utilities	<p>The net impact of the interventions we made in the company's fast-track draft determination and our assessment of the service incentive mechanism is to decrease the net PR14 reconciliation revenue by £9 million driven by a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£8 million). We included a zero value for the service incentive mechanism in the fast track draft determination. There are also small reductions in revenue for outcome performance and for land sales as a result of the correction of an error in the original business plan table App9.</p>
Wessex Water	<p>We are intervening to decrease net PR14 reconciliation revenue by £3.5 million (-£3.7 million revenue and +£0.2 million RCV), driven by a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact.</p>
Yorkshire Water	<p>We are intervening to decrease net PR14 reconciliation revenue by ~£24 million (-£3 million revenue and -£21 million RCV), driven by our application of the drinking water contacts outcome delivery incentive underperformance payment as an RCV adjustment, as the company provides insufficient evidence that the adjustment it proposed will better achieve the desire of customers to see reinvestment (-£21 million). We are also reducing wholesale revenue as we are rejecting the company's wholesale revenue forecasting incentive mechanism claim for the correction of an error it made in its PR14 business plan new connection forecasts (-£10 million). This is partially offset by an increase in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (+£7 million).</p>

Company	Key interventions
Affinity Water	We are intervening to decrease net PR14 reconciliation revenue by £28 million, driven by a decrease in revenue as we reject the company's wholesale revenue forecasting incentive mechanism claim for £24 million in respect of the higher connection revenue as the company provides insufficient evidence. There is also a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£4 million).
Bristol Water	We are intervening to increase the net PR14 reconciliation revenue by £0.1 million, driven by an increase in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact.
Portsmouth Water	We are intervening to decrease net PR14 reconciliation revenue by £3 million. This is driven by a reduction in wholesale revenue as we disallow the company's claim against the wholesale revenue forecasting incentive mechanism for the correction of an error the company made in its PR14 business plan for new connection forecasts. It is also driven by a reduction in outcome delivery incentive revenue resulting from corrections we are making to the company's calculations of under and outperformance payments. This is partially offset by an increase in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact.
SES Water	We are intervening to decrease net PR14 reconciliation revenue by £2 million, driven by a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact.
South East Water	We are intervening to decrease net PR14 reconciliation revenue by £1 million, driven by a decrease in revenue from the service incentive mechanism relative the company's estimate of the mechanism's impact. There are a number of smaller adjustments to other incentive mechanisms.
South Staffs Water	We are intervening to decrease net PR14 reconciliation revenue by £16 million, driven by a decrease in wholesale revenue through the wholesale revenue forecasting incentive mechanism. We are rejecting the part of the company's claim relating to higher income from developers (for new connections) because we consider it to be out of scope of the mechanism, but we are accepting the element relating to higher volume of connections. There is also a decrease in revenue from the service incentive mechanism relative to the company's estimate of the mechanism's impact (-£0.7 million).

The reconciliations in these draft determinations are based on actual performance data for the three years 2015-18 and forecast performance for the final two years 2018-20. Alongside the annual performance reports on 15 July, companies provide updated data tables and reconciliation models on past delivery. These reflect the new actual data for 2018-19 and the latest forecast for 2019-20. For the final determination, we will update the reconciliations to reflect the July data submissions and take account of representations on our interventions in the draft determinations.

2.1 Fast-track company draft determinations representations

We published our draft determinations for fast-tracked companies on 14 April 2019. We have received representations on the fast track companies' draft determinations in relation to how SIM payments could be calculated, our approach to calculating Severn Trent and Hafren Dyfrdwy's residential retail reconciliations and from United Utilities on the treatment of indexation for residential retail outcome delivery incentives. The representations on how the SIM is calculated have been taken into account when developing our approach to the SIM as set out in section 3 below. We will consider and address the remaining issues for the final determinations, but invite specific feedback from stakeholders on our approach in the draft determination to the treatment of indexation for residential retail outcome delivery incentives as we recognise this is a complex issue.

Indexation of residential retail outcome delivery incentives is implemented in the revenue adjustment feeder model. For the draft determinations we are applying retail price index (RPI) inflation to outputs from the outcome delivery incentive mechanism which in turn presents outperformance and underperformance payments for companies' performance during 2015-20 in PR14 base year prices (2012-13 prices). This approach is consistent with the calculations set out on page 23 of the '[PR14 reconciliation rulebook](#)'.

We consider that applying an inflationary adjustment to all outcome delivery incentives across all price controls, including residential retail, is appropriate. Outcome delivery incentives are a means of compensating customers for the value of the service that they receive, or for underperformance, do not receive. Adjusting the value of incentives by a measure of inflation is appropriate as this takes account of the difference in the value of that compensation over time. The fact that costs for residential retail were not index linked to inflation for PR14 is a separate issue and we do not consider that this is relevant for the setting of the value of incentives. We welcome stakeholders' views on this.

2.2 Reconciliations for PR19

We have published the majority of the models which indicate how we could reconcile companies' performance in 2020-25 as part of PR24 and reflect this in the price controls we set from 2025.

We want to give stakeholders early sight of how we could implement these controls and incentives, and in particular how we could reconcile water companies' actual revenue with the amount that they should collect. We made progress towards this by publishing and updating a number of models alongside the fast track companies'

draft determinations as well as providing further clarity by bringing the published models together on our [website](#)² to make them easier to locate.

The models are draft at this stage. For this reason, we would welcome specific comments from stakeholders to be addressed to the contact details on each individual model's cover sheet. We plan to update the models that have been published, and to publish the outstanding models in the summer and autumn. We will consult on these models where appropriate.

² <https://www.ofwat.gov.uk/regulated-companies/price-review/2024-price-review/pr19-reconciliation-models/>

3 PR14 service incentive mechanism (SIM)

3.1 Introduction

The SIM is a regulatory incentive mechanism that encourages companies to:

- provide high-quality customer service;
- reduce customer complaints; and
- get things right first time.

The SIM was first used in the price control set for 2010-15 (PR09), when it successfully incentivised improvements in companies' retail customer service performance. Consequently, as set out in the '[PR14 final determinations](#)', we therefore retained a form of the SIM as a required household retail service outcome delivery incentive for all companies in 2015-20.

3.2 Household SIM

In '[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#)' we confirmed that we would use the SIM as a standard minimum national incentive for customer service for 2015-20. We also confirmed that its likely scale and scope would be similar to the PR09 SIM.

We incentivise companies to improve their performance by calculating a comparable measure of performance (the 'SIM score') which we then use to conduct a relative assessment by ranking companies in the sector against each other. This creates a strong reputational incentive. In addition, we use the scores to set a financial incentive of between -12% to +6% of residential retail revenue for 2015-20³.

SIM scores are made up of two components: a qualitative and a quantitative measure of the level of service provided to customers. The qualitative component is derived from surveys of the satisfaction of water customers that have contacted their water company. The quantitative component is derived from the number of written complaints and unwanted phone contacts (if the phone contact is unwanted from the customer's point of view). The quantitative component contributes 25% to the overall score, the qualitative component 75%.

The quantitative component uses a weighted average calculation of the numbers of unwanted telephone contacts, written complaints, escalated written complaints, and

³Calculated to be approximately financially equivalent to the PR09 SIM financial incentive of -1.0% to +0.5% of total company revenues.

escalated complaints to CCWater. The result is converted to a score out of 25 using a simple, proportional calculation.

Contact score calculation

$$\frac{[(\text{unwanted phone contacts} \times 1) + (\text{written complaints} \times 5) + (\text{escalated written complaints} \times 100) + (\text{CCWater investigated complaints} \times 1000)]}{(\text{connected household properties} / 1000)}$$

Quantitative component calculation

$$\{1 - [(C - CL) / (CH - CL)]\} \times WC$$

where:

C = total annual contact score (see above)

CL = contact score minimum (set at 0)

CH = contact score maximum (set at 500)

WC = contact score weighting (set at 25)

The qualitative component uses the four satisfaction survey scores for each company during the year, averages these, and expresses this number (which is out of 5) as a score out of 75 using a simple, proportional conversion⁴.

The two elements are summed to arrive at the aggregate SIM score, out of a maximum of 100.

3.3 What we said in our PR19 final methodology

In ‘[Delivering Water 2020: Our final methodology for the 2019 price review](#)’ (the ‘PR19 final methodology’) we concluded that:

- the SIM scores from the four years 2015-16 to 2018-19 will be used to calculate the financial incentives;
- revenue adjustments at PR19 will be in the range of -12% (underperformance payment) to +6% (outperformance payment) of residential retail revenues in 2017-18, and apply to each of the five years between 2020-21 and 2024-25; and

⁴For example, if a company averaged 4.00 out of 5.00, this is the equivalent of 60 out of 75 ($4.00 / 5.00 \times 75 = 60$).

- payments will be based on companies' performance relative to each other.

The PR19 final methodology set out our decision to introduce a new incentive mechanism at PR19 to incentivise water companies to provide an excellent customer experience to residential customers. This measure is called the customer measure of experience (C-MeX). In March we set out how the incentives would be applied on an annual basis. The approach is different to that for the SIM because:

- C-MeX is being reconciled each year and so the method needs to be clear and mechanical, whereas for SIM we have been able to understand performance before confirming the reconciliation;
- how C-MeX is set will influence behaviour and so it is appropriate for it to have stronger incentive properties. C-MeX is for a one year period and we expect companies to respond to the annual incentives and improve throughout the period. If a company has the lowest underperformance payment in one year we would expect it to respond so that this does not occur in subsequent years; and
- any decisions we make now on how we implement the SIM cannot influence how companies have already performed, so aligning the SIM with the design for C-MeX will not change outcomes for customers.

We confirmed in the PR19 final methodology that the SIM will not operate in 2019-20; instead we will run C-MeX in shadow form that year. Some companies have reputational incentives for SIM in 2019-20. We will use the contact survey part of C-MeX to proxy the qualitative part of SIM, and complaints data for the quantitative part of SIM. This will enable companies and their stakeholders to assess whether they had met their reputational incentives for SIM in 2019-20. No financial incentives for SIM will apply for this shadow year.

3.4 The SIM in fast-track companies' draft determinations

In the fast-track companies' draft determinations we assumed a zero performance payment as our approach to the SIM reconciliation at that time had not been published. This document provides our view of what the SIM reconciliations for the fast-track companies would be using the 1 April 2019 company submissions.

All companies' final determinations, including fast-track companies, will include a SIM performance payment which incorporates the 2018-19 SIM score from the companies' annual performance reports. We expect these to be published on 15 July 2019.

We have considered the representations from Severn Trent Water and United Utilities on their draft determinations on how to calculate the SIM when developing our methodology below.

3.5 How we are calculating draft determination SIM payments

We are using the full range of -12% (underperformance payment) to +6% (outperformance payment) of residential retail revenues to calculate SIM payments. We consider that there is a sufficient distribution of scores across the industry to warrant using the full range. While there is some clustering of companies, there is a clear distinction between the top cluster of companies and the top performing company - Portsmouth Water. There is an even clearer distinction between the majority of companies and the bottom four companies – SES Water, Affinity Water, Thames Water and Southern Water.

No scores are identical and distinctions can be drawn between all companies. To assign payments we have determined the percentage reward or penalty for each company based on its relative distance to the top performer – Portsmouth Water – and the worst performer – Southern Water, who are awarded the maximum reward and penalty respectively. We have multiplied these percentages by residential retail revenue to give the SIM payments. We set this process out in the following four steps.

Step 1: Calculate the four year average SIM score for each company.

Step 2: Calculate the relative distance for each company between the top and bottom performer and calculate the percentage performance payment using this, allocating a +6% outperformance payment for the best performing company's score, and a -12% underperformance payment for the worst performing company's score. See below for a graphical representation.

Step 3: Apply the company-specific percentage to each company's 2017-18 reported residential retail revenue.

Step 4: Multiply the results by five to produce results for five years (2020-25) in £m.

The results are presented in Figure 3.1 and Table 3.1 below.

Figure 3.1: Four year average SIM scores and % retail revenue adjustments

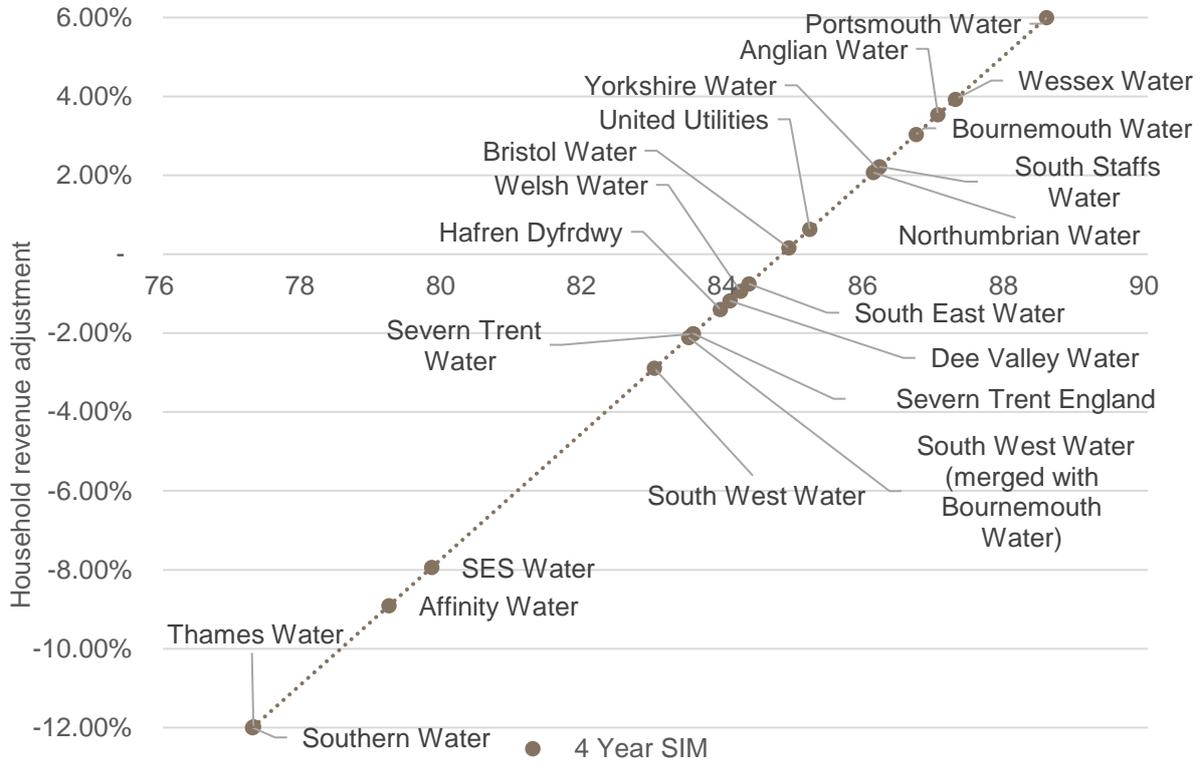


Table 3.1: SIM scores and calculation of retail revenue adjustments

Company	Step 1 (score out of 100)	Step 2 (%)	Step 3 (£m)	Step 4 (£m)
Portsmouth Water	88.56	6.00%	0.28	1.4
Wessex Water	87.27	3.93%	1.43	7.1
Anglian Water	87.02	3.54%	3.20	16.0
Bournemouth Water	86.71	3.04%	0.15	0.8
South Staffs Water	86.19	2.22%	0.34	1.7
Yorkshire Water	86.16	2.17%	1.38	6.9
Northumbrian Water	86.10	2.07%	1.22	6.1
United Utilities	85.20	0.63%	0.70	3.5
Bristol Water	84.90	0.16%	0.15	0.1
South East Water	84.33	-0.75%	-0.17	-0.8
Welsh Water	84.21	-0.94%	-0.42	-2.1
Dee Valley Water	84.06	-1.18%	-0.04	-0.2
Hafren Dyfrdwy	83.92	-1.40%	-0.03	-0.2 ¹
Severn Trent England	83.54	-2.01%	-2.45	-12.2
Severn Trent Water	83.53	-2.02%	-2.45	-12.2
South West Water	82.98	-2.89%	-0.97	-4.9
SES Water	79.82	-7.94%	-0.48	-2.4
Affinity Water	79.21	-8.91%	-2.44	-12.2
Thames Water	77.29	-11.98%	-20.16	-100.8
Southern Water	77.27	-12.00%	-7.20	-36.0

Note 1: Hafren Dyfrdwy's underperformance payment for the household SIM has not been included in the financial modelling for the draft determination. It will be included for the final determination.

3.6 Conclusion and next steps

This approach to allocating SIM payments is consistent with the PR19 final methodology.

It allocates payments in a way which clearly distinguishes between different performance levels and therefore the payments are proportionate. The

outperformance and underperformance payments are spread appropriately across companies (nine outperformance payments, nine underperformance payments).

We intend to use the same method to recalculate SIM payments for final determinations using actual data for 2018-19, as provided by companies to us on 15 July 2019. The majority of the data for 2018-19 was known, and this is only one of the four years. We therefore anticipate only small changes from the draft determination underperformance and outperformance payments for the final determinations.

3.7 Non-household (business customer) SIM

We stated that the SIM would apply only to the household (residential) customers for companies whose areas are wholly or mainly in England. For those companies whose areas are wholly or mainly in Wales, we confirmed that two SIMs would apply – one for household customers on the same basis for all companies, and one for non-household (business) customers. This is set out in the [‘PR14 final determinations’](#) for Dee Valley Water and Dŵr Cymru. Further details of both SIMs were published in [‘Service incentive mechanism – guidance for collating customer service information for calculating the SIM score’](#) and [‘Service incentive mechanism \(SIM\) for 2015 onwards – conclusions’](#).

The reconciliation of the non-household SIM will follow a similar approach to the household SIM as discussed above. The primary differences are that:

- the non-household SIM score is based only on customer complaints data, as set out in [‘Service incentive mechanism – guidance for collating customer service information for calculating the SIM score’](#);
- all business retailers in England and Wales will be used as comparator companies for the non-household SIM as far as is practicable; and
- the non-household SIM will only apply to Dŵr Cymru and Hafren Dyfrdwy.

The incentive payment range for the non-household SIM is +6% to -12% of business retail revenue. For Dŵr Cymru this is a range of £2.6 million to £-5.2 million (total revenue adjustment over five years) based on one year’s non-household retail revenue of £8.6 million (for 2017-18), and for Hafren Dyfrdwy £0.1 million to £-0.2 million based on £0.4 million (for 2017-18). The companies’ self-reported non-household SIM scores from the annual performance reports are set out in Table 3.2.

Table 3.2: Self-reported non-household SIM scores

Company	2015-16	2016-17	2017-18
Dŵr Cymru	83.0	94.3	97.2
Hafren Dyfrdwy	88.5	90.4	94.0

We will use the data for comparison companies published on the 3 July 2019 by the Consumer Council for Water to determine the performance payments for the final determinations.

We will issue a consultation on the non-household SIM on the 8 August 2019, which will set out the calculations for the non-household SIM and the resulting out and under performance payments for Dŵr Cymru and Hafren Dyfrdwy. This consultation will close on 4 September 2019.

4 Deliverability assessment

To maintain trust and confidence, it is important that companies not only have a high-quality business plans but also that customers have confidence that those business plans will be delivered. This confidence will come in part from how companies have performed in the past. In our deliverability assessment we consider what companies have learnt from their 2015-20 performance and whether they have appropriate measures in their business plans to improve performance where necessary so that they can deliver for their customers, environment and wider society in the future.

In our initial assessment of business plans, we therefore reviewed the deliverability of companies' business plans for 2020-25 taking account of their past performance in four areas:

- customer complaints handling;
- costs;
- major incidents handles; and
- outcomes.

Where we had concerns around companies' deliverability in any of our assessment areas, we required companies to submit additional evidence of their deliverability, and an action plan for continuous performance monitoring and improvement for 2020-25.

We placed these actions in two categories – required actions and advised actions – depending on the level of our concern with the evidence provided on deliverability. We assess the companies' responses to our actions differently depending on whether the action is required or advised.

Table 4.1 sets out the areas we gave companies actions on deliverability. The six companies with required actions had to respond to our actions by 1 April 2019, with the exception of South West Water which had to respond by 24 May 2019. The nine companies with advised actions had to respond to our actions by 24 May 2019. We have received responses to these actions from all relevant companies.

Table 4.1: Companies with required actions and advised actions

Company	Required actions	Advised actions
Bristol Water	Customer complaints, outcomes	
Hafren Dyfrdwy	Costs, outcomes	Costs, customer complaints
South East Water	Outcomes	Incidents handling
Southern Water	Incidents handling, outcomes	
South West Water	Incidents handling	
Thames Water	Outcomes	Costs, incidents handling
Anglian Water		Incidents handling
Affinity Water		Customer complaints, outcomes
Dŵr Cymru		Customer complaints, costs, outcomes
Northumbrian Water		Incidents handling, outcomes
Portsmouth Water		Incidents handling, outcomes
Yorkshire Water		Incidents handling

For companies with required actions, we assessed the additional deliverability evidence against the following criteria in our four assessment areas.

Table 4.2: Required companies' additional deliverability evidence assessment criteria

Customer complaints	
1	How well has the company understood the drivers of its complaints handling performance both in terms of the number of complaints and how well complaints are dealt with?
2	Has the company demonstrated that it has learnt lessons from good and poor past and current performance?
3	Has the company provided sufficient and convincing evidence that it has measures in place to achieve: <ul style="list-style-type: none"> • the CC Water customer complaints target of 95% of complaints dealt with on first contact; and • a falling or stable total number of complaints per 10,000 customers that compares well to industry average?
Costs	
1	How well has the company understood the drivers of its costs performance, including performance against allowances for all price controls?
2	Has the company demonstrated that it has learnt lessons from good and poor past and current performance?
3	Has the company identified the performance gap between current performance and proposed performance in the 2020-25 business plan and the measures planned or already in place to ensure deliverability of the 2020-25 business plan?
Outcomes – performance commitments where we had substantial concerns	
1	How well has the company understood the drivers of its past and forecast performance and has it learnt lessons from this?
2	Has the company provided convincing evidence of the measures to deliver the level of stretch included in the 2020-25 business plan is deliverable given past performance and targets?
Incidents handling	
1	Has the company provided sufficient and convincing evidence that it has identified the drivers of incidents performance and customer communication and support performance: <ul style="list-style-type: none"> • during and after major incidents and pollution incidents; • and where statutory and license obligations enforced by the EA/NRW, DWI and Ofwat have not been met?
2	Has the company demonstrated that it has learnt lessons from good and poor past and current performance?
3	Has the company provided sufficient and convincing evidence that it has measures in place to achieve: <ul style="list-style-type: none"> • 0 major incidents (category 1 and 2) per year by 2020 as defined by the Environment Agency / Natural Resources Wales; • 0 major incidents on drinking water quality as defined by the Drinking Water Inspectorate; and • a falling or stable number of pollution incidents (category 1, 2 and 3) that compared well to the industry average.

Table 4.3: Required companies' action plan assessment criteria

Customer complaints	
1a	How well has the company demonstrated it will continuously monitor performance, including with reference to CCWater analysis and targets, and those related to the delivery of C-Mex, including what evidence and best practice it will look for beyond itself and the sector?
Costs	
1b	How well has the company demonstrated it will continuously monitor cost allowances, including how this relates to section 2 and 4 of the Annual Performance Report and what evidence it will look for beyond itself and the sector?
Outcomes (performance commitments with material concerns)	
1c	How well has the company demonstrated it will continuously monitor performance against PR14 and PR19 performance commitments, including how this relates to section 3 of the Annual Performance Report and what evidence it will look for beyond itself and the sector?
Incidents handling	
1d	How well has the company demonstrated it will continuously monitor incidents performance and customer communication and support during and after major incidents and deliver targets set by the EA/NRW in the Environmental Performance Assessment (EPA), by DWI and by Ofwat's regulations, including what evidence it will look for beyond itself and the sector?
All areas	
2	How well has the company demonstrated it will identify drivers of performance and lessons learnt from both good and poor performance?
3	How well has the company demonstrated it will identify measures to improve performance and integrate these into its business?
4	How well has the company demonstrated it will ensure that this is a continuous rather than one-off process?

We have assessed the companies' responses to the actions against these criteria. Where we have identified concerns with the evidence presented against one or both of the action responses in an area, we have then considered whether an intervention is necessary to ensure that customers are sufficiently protected. In doing so, we have considered whether the company's existing incentive package, including any interventions we have made elsewhere within the outcomes package, provides sufficient incentives for the company to deliver for its customers and achieve the level of stretch in its 2020-25 business plan. In some cases, we conclude that the interventions we are making following our review of the outcomes package are sufficient to protect customers. We are only making additional interventions where we consider that our concerns about deliverability require companies to have stronger or additional incentives to protect customers. The key interventions that we are making as a result of our deliverability assessment are set out in Table 4.4.

Some examples of high quality evidence on deliverability were provided by Bristol Water and Southern Water. Bristol Water demonstrates good practice in providing bespoke action plans for each performance commitment (with the exception of mains repairs). Southern Water provides a thorough response for its incidents handling performance, with case studies of six major water incidents and nine serious pollution incidents that cover the details of the incident, the drivers of performance and lessons learnt, and the measures that it has put in place / will put in place to improve and ensure deliverability in 2020-25. Our assessment of Southern Water's evidence on deliverability provided to Ofwat in its April 2019 submission as part of the price review is consistent with the findings of our '[Notice of Ofwat's proposal to impose a penalty on Southern Water Services Limited](#)'. The penalty notice identified a number of failings in the company. We recognise that the company is putting in place measures to address these in response to the investigation and through its PR19 business plan.

We are taking a risk-based approach to assessing companies' responses to advised actions. We identified deliverability concerns in these areas, but that these represented a lower risk to customers than where we gave companies required actions. We will consider whether customers are sufficiently protected following our review of companies' responses to these actions ahead of the final determinations in December 2019.

Table 4.4: Required companies' action plan assessment criteria

Company	Key interventions
Hafren Dyfrdwy	<p>Pollution incidents performance commitment</p> <p>The company provides insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>An intervention is already being made through outcomes assessment, see HDD.OC.A37 within 'Hafren Dyfrdwy - Delivering outcomes for customers actions and interventions' for details.</p> <p>In addition, the company will be required to report the following information for each major incident in its Annual Performance Report during 2020-25 to address our concerns in this area:</p> <ul style="list-style-type: none"> • details on what the incident was; • the impact of the incident (including number of customers affected and length of time they were affected for); • the analysis the company has conducted to identify the cause of the incident; • how the company responded to the incident and its assessment of how effective this was; • the lessons the company learnt from the incident; and • the measures put in place following the incident to prevent future incidents.

Company	Key interventions
	<p>We would expect this to be subject to an appropriate level of governance and assurance.</p> <p>We consider that this protects customers by providing a stronger incentive for the company to achieve the level of stretch in the 2020-25 business plan.</p> <p>Water supply interruptions performance commitment</p> <p>The company provides insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>We are intervening to protect customers by increasing Hafren Dyfrdwy's outcome delivery incentive underperformance rate to the industry average (on a normalised basis) because we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan.</p>
South West Water	<p>Major incidents</p> <p>The company has had poor past performance in relation to pollution incidents. This is reflected in its Environmental Performance Assessment ('EPA') rating from the Environment Agency and the number of incidents the company has had. We therefore consider it necessary to intervene to protect customers and the environment.</p> <p>We intervened in the fast track determination to require the company to improve its Environment Agency EPA rating by including a penalty only performance commitment to achieve a four-star rating by 2024-25.</p>
Southern Water	No interventions.
Thames Water	<p>Leakage performance commitment</p> <p>The company provides insufficient evidence in its action plan for continuous improvement and insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>An intervention is already being made through outcomes assessment, see TMS OC.A16 within 'Thames Water - Delivering outcomes for customers actions and interventions' for details.</p> <p>Water supply interruptions performance commitment</p> <p>The company provides insufficient evidence in its action plan for continuous improvement and insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>We are intervening to protect customers by increasing Thames Water's outcome delivery incentive underperformance payment rate to the industry average as we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan.</p>
Bristol Water	<p>Leakage performance commitment</p> <p>The company provides insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p>

Company	Key interventions
	<p>An intervention is being made through outcomes assessment, see BRL.OC.A17 within 'Bristol Water - Delivering outcomes for customers actions and interventions' for details.</p> <p>Mains repairs performance commitment</p> <p>The company does not provide additional deliverability evidence or an action plan for continuous improvement for mains repairs. We therefore consider it necessary to intervene to protect customers.</p> <p>An intervention is being made through outcomes assessment, see BRL.OC.A11 within 'Bristol Water - Delivering outcomes for customers actions and interventions' for details.</p> <p>Meter penetration performance commitment</p> <p>The company provides insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>We are intervening to protect customers by increasing the company's outcome delivery incentive underperformance rate for meter penetration to its PR14 outcome delivery incentive rate as we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan.</p> <p>Customer complaints handling</p> <p>The company provides insufficient evidence to support the delivery of its targets for 2020-25.</p> <p>We are not intervening in the company's draft determination, however we are requiring the company to submit additional monthly data on 3 September to support the deliverability of its forecast improvement in customer complaints handling performance.</p> <p>Shortly before publication of this draft determination, Bristol Water submitted a draft policy proposal to introduce a performance commitment with a reputational outcome delivery incentive on a similar broad measure of complaints. The paper also considers the option of a performance commitment on a narrower measure covering only written complaints with an underperformance payment only outcome delivery incentive. This evidence was not considered in our assessment of deliverability for this draft determination, and we will consider it when making our final determinations.</p> <p>We will review the additional evidence provided by the company on and before 3 September before deciding whether or not to intervene in the final determination.</p>
South East Water	<p>Mains repairs performance commitment</p> <p>The company provides insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>We are intervening to protect customers by increasing South East Water's outcome delivery incentive underperformance payment rate to the top of the reasonable range (average +0.5*standard deviation) as we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan.</p>

Company	Key interventions
	<p>Discolouration contacts performance commitment</p> <p>The company provides insufficient evidence to support the deliverability of the stretch in its 2020-25 business plan. We therefore consider it necessary to intervene to protect customers.</p> <p>We are intervening to protect customers by increasing South East Water's outcome delivery incentive underperformance payment rate to the industry average as we consider that a stronger incentive is required for the company to achieve the level of stretch in the 2020-25 business plan.</p>

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

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