

July 2021

# Consultation on changes to per capita consumption performance commitments

## About this document

This consultation is about changes we propose to make to the timing of financial adjustments for performance against the per capita consumption performance commitments and the considerations we propose to apply when determining their value.

This consultation is applicable to the 17 largest companies operating in England and Wales.

## Responding to this consultation

**Please send responses by 6 September 2021** to [OfwatPandO@ofwat.gov.uk](mailto:OfwatPandO@ofwat.gov.uk), with the subject 'Response to consultation on changing the PCC performance commitments'.

We may publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the General Data Protection Regulation 2016, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our [privacy policy](#).

If you would like the information that you provide to be treated as confidential, please be aware that under the FoIA there is a statutory [Code of practice](#) which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

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## 1. Introduction and summary

Water efficiency is a key priority for the sector. Lower per capita consumption (PCC) means less water is taken from the environment and fewer resources are required to extract, treat and distribute it. It therefore improves the long-term water resources supply and demand balance, supports the transition to net zero and reduces customers' bills. To provide companies with strong incentives to help household customers to reduce their consumption, all companies have at least one PCC performance commitment and - with the exception of South West Water - associated in-period outcome delivery incentive (ODI) payments.

Since its emergence in late March 2020, the Covid-19 pandemic has impacted many aspects of society and the economy. During 2020 we conducted [joint work](#), led by Frontier Economics, with the 17 largest companies in England and Wales to understand potential impacts on the water sector. This work - and ongoing engagement with individual companies - highlight that in some cases, measures introduced to combat Covid-19 have shifted consumption from non-households to households.

We have carefully considered the situation to date. We accept that conditions since March 2020 have posed challenges for managing household demand but also recognise the importance of continuing to promote water efficiency and drive down consumption. We also note that a number of significant uncertainties remain, which limit understanding of the impact of measures introduced to combat Covid-19 and any enduring effects on PCC performance. It is important that companies retain the strongest incentives possible for managing household demand and so we propose that the current in-period financial incentives (outcome delivery incentives or ODI payments) for PCC should instead be determined at the end of the price control period.

Our proposals mean that we would make decisions on ODI payments during the 2024 price review. When deciding on ODI payments due for performance during 2020-25, we would take account of the impact of Covid-19; specific steps taken by companies during the price control period to reduce household demand for water, and; the extent to which the need to recover any remaining shortfall has been incorporated into their proposals made at the 2024 price review.

In the meantime, we would continue to expect companies to report against their annual targets. Moving decision making on ODI payments to the 2024 price review should not lead to a delay or easing in demand reduction activities now or in the remainder of the period. Companies should use this valuable opportunity for the sector to identify what more can be done and take collaborative and sustained action to deliver.

## 2. Background

At PR19, companies proposed performance commitments related to specific levels of service performance for the benefit of customers and the environment. The performance commitments were set in companies' PR19 final determinations for the 2020-25 price control period and are defined in each company's PR19 outcomes performance commitment appendix.

All companies have at least one PCC performance commitment, which is designed to incentivise them to help household customers reduce their consumption. The performance commitment is measured in each year of the 2020-25 price control as a three year rolling average reduction from a baseline. The baseline is composed of performance averaged over 2017-18, 2018-19 and 2019-20.

With the exception of South West Water, companies have 'in-period' financial incentives for the PCC performance commitment. In-period financial incentives are settled annually, bringing the financial impact closer in time to the performance that generated it. This is intended to focus management attention on service delivery and improve companies' accountability for their actions. South West Water accrues notional financial incentives annually to be applied at the end of the price control period, it therefore has 'end of period' incentives.

Since late March 2020, measures introduced to combat the Covid-19 pandemic – such as increased working from home, closure of schools and the leisure and hospitality sectors – have impacted how much and when we use water. To varying degrees, companies have seen non-household water use decrease and household water use increase. This affects PCC performance commitments – which measure and provide financial incentives on household consumption only.

Through our joint work with Frontier Economics, and our conversations with individual companies, we have heard the sector's concerns around the achievability of PCC performance commitments. However, efficient use of water also reduces customers' bills; leaves more water for the environment; supports the transition to net zero; and improves the long-term water resources supply and demand balance. Considering these factors together, the need to use water efficiently and reduce consumption remains a high priority. Indeed, in England the government proposes a personal water

use target of 110 litres per head per day by 2050<sup>1</sup>. Companies in both England and Wales are currently working to this planning assumption<sup>2</sup>.

It is important that companies retain the strongest incentives possible to promote water efficiency and drive down consumption. We have carefully considered the situation to date and, whilst we accept that conditions since March 2020 have posed challenges for managing household demand, we note that a number of significant uncertainties remain which limit understanding of the impact of measures introduced to combat Covid-19 and any enduring effects on PCC performance. Specifically:

- the relative influence of long hot spells of weather experienced during spring 2020 at the same time as Covid-19 related measures. We also anticipate variation between companies and within company areas depending, for example, on the extent to which customers may live within a company's operating area but typically work in an area operated by another;
- how long, and to what extent, changing consumption patterns will be maintained in light of the different types of restrictions later in 2020 and into 2021 and what this means for the performance commitment, given it is based on a 3 year average; and
- the extent to which the future path of the pandemic and the vaccination programme or UK and Welsh governments' plans to reopen the economy will impact the pace of future changes or how any long-term behavioural changes will lead to permanent changes in consumption patterns.

We must account for these uncertainties in any proposal to intervene on how companies are incentivised to reduce PCC.

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<sup>1</sup> [The government's strategic priorities for Ofwat \(2021 draft for consultation\)](#)

<sup>2</sup> As agreed by the national water resources framework senior steering group comprising representatives from England and Wales ([Meeting our future water needs: a national framework for water resources](#))

### 3. Our proposed changes

Having considered the issues highlighted above – rather than consider modifying the performance commitment definition, commitment levels or incentive rates – we propose that the timing of determination of the value of ODI payments for PCC performance commitments should be moved from in-period to end of period. If this proposal is implemented, companies would have an end of period PCC performance commitment with annual performance commitment levels and would accrue ODI payments for performance each year.

Under normal circumstances, accrued ODI payments would be determined as part of the 2024 price review (PR24) in accordance with the definitions set out in each company's PR19 outcomes performance commitment appendix. However, for PCC, companies would submit, as part of PR24, evidence to support how measures introduced to mitigate the impact of Covid-19 affected their performance against the PCC performance commitment across all years of the 2020–25 price control period. We propose to consider ODI payments based on evidence of:

- the impact of Covid-19;
- specific steps taken by companies during the price control period to reduce household demand for water, and;
- The extent to which the need to recover any remaining shortfall has been incorporated into their proposals for PR24 and beyond.

We consider that this approach would hold companies to deliver their targets despite the challenging situation while allowing them and wider stakeholders, including Ofwat, to more accurately understand actual water use impacts and trends, informing evidence based decisions.

We intend to set out more detail about our assessment approach, and therefore the evidence we will require from companies at a later date and it will therefore be subject to separate consultation. This allows our approach to be informed by companies' and wider stakeholders' – including Ofwat's – developing understanding of the impacts on PCC and the effectiveness of companies' actions.

Meanwhile, we have heard encouraging reports from companies of the range of measures they are using to manage demand in their operating areas, including behavioural science thinking and randomised control trials. We also consider there is a need for companies to share learning from their individual efforts and to take collaborative and sustained action, for example through delivering an effective and sustained multi-channel water efficiency campaign, building on existing national campaigns such as 'Water's worth saving'.

Moving decision making on financial incentives to the 2024 price review should not lead to a delay or easing in demand reduction activities now or in the remainder of the period. Companies should use this valuable opportunity for the sector to identify what more can be done and take collaborative and sustained action to deliver.

### 3.1 Which performance commitments does this affect?

The performance commitments set out in table 1 are measured and reported using the common methodology for the PCC performance commitment.

Table 1: Performance commitments measured and reported using the common methodology for the PCC performance commitment

Unique reference	Timing of ODI determination
PR19AFW_R-B1; PR19ANH_6; PR19BRL_PC19; PR19WSH_En5; PR19HDD_B3; PR19NES_COM07; PR19PRT_PRT-Water Resources 03; PR19SES_E.1; PR19SVE_G03; PR19SEW_E.1; PR19SSC_C3 <sup>3</sup> ; PR19SSC_C4 <sup>4</sup> ; PR19SRN_WR01; PR19TMS_BW05; PR19UU_B05-WN; PR19WSX_W2; PR19YKY_25	In-period
PR19SWB_PC C3	End of period

As stated in table 1, with the exception of South West Water, companies have in-period ODI payments. Our proposal aligns the timing of financial adjustments for all companies with that of South West Water. Our proposals regarding our approach to making decisions on incentives at PR24 apply to all companies

### 3.2 What is the impact of making decisions on incentives at end of period?

If the timing of in-period financial adjustments is changed to end of period then we would not adjust revenue annually to reflect performance on PCC performance commitments. However, companies would accrue notional ODI payments in each year and, following an assessment, we would decide on subsequent adjustments at PR24.

<sup>3</sup> Performance commitment for South Staffs region

<sup>4</sup> Performance commitment for Cambridge region

Annually, we would continue to require companies to report on their performance against the performance commitment levels set out in the PR19 final determination including any associated notional ODI payments and ODI RoRE impact. We would also require companies to include performance on the PCC performance commitment in their reporting of the percentage of performance commitments they have achieved. These requirements would apply throughout the current price control period.

This approach explicitly demonstrates the total potential risk companies are subject to and highlights the need for action. When communicating with their stakeholders about their performance, companies may wish to highlight the impact of PCC performance and the associated financial risk that may, or may not, crystallise. We expect this will be alongside the actions companies are taking to address water use challenges and the impacts these have had, and are forecast to have, on future performance. We consider that such an approach is transparent for all stakeholders.

## 4. Next steps

The closing date for this consultation is 6 September 2021. Please email us at [OfwatPandO@ofwat.gov.uk](mailto:OfwatPandO@ofwat.gov.uk) with your response, or if you wish to discuss any aspect of this consultation, or to arrange a conversation on the issues we have raised.

We will consider all responses carefully and publish our decisions on our [PR19 Outcomes performance commitments – changes and corrections website](#). If appropriate, we will publish an updated change log for each company. We demonstrate the changes we propose to make for all relevant companies in annex 1 of this document.

## Appendix 1 Proposed changes performance commitment definitions

We include below the changes we are proposing to make in each company's PR19 final determinations – Outcomes performance commitment appendix document, with the exception of South West Water.

### Changes to all relevant companies:

For per capita consumption performance commitments, in the 'Performance commitment definition and parameters' table for:

<b>Timing of underperformance and outperformance payments</b>	In-period
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Read:

<b>Timing of underperformance and outperformance payments</b>	End of period
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is a non-ministerial government department.  
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Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA  
Phone: 0121 644 7500

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