



The voice for water consumers
Llais defnyddwyr dŵr

CCW response to Ofwat's draft determinations of in-period Outcome Delivery Incentives for 2020-21

October 2021

1. Introduction

- 1.1 The Consumer Council for Water (CCW) is the independent voice for water consumers in England and Wales. Since 2005, we have helped thousands of consumers resolve complaints against their water company, while providing free advice and support. All of our work is informed by extensive research, which we use to champion the interests of consumers and influence water companies, governments and regulators.
- 1.2 We welcome the opportunity to respond to Ofwat's draft determinations on the 2020-21 in-period Outcome Delivery Incentives (ODIs). Below we offer comments on the customer bill impact resulting from net ODI payments, and what implications this has for the ODI model at PR24.

2. CCW's response

- 2.1 CCW supports appropriate ODIs which drive the right outcomes for customers and rewards companies proportionately for delivering real market leading improvements that customers' value. ODI outperformance payments should be a reflection of outstanding performance in areas of service customers' view as priorities.
- 2.2 We believe it is important that outperformance payments are carefully calibrated so that they provide a reasonable reward for stretching performance which has delivered demonstrable benefits to customers. We believe it is common ground with Ofwat that rewards earned by companies need to be commensurate with the benefits that customers receive.
- 2.3 Having reviewed Ofwat's draft decisions in relation to 2020-21, there are some outperformance payments which do not seem consistent with this criteria because, for example:
 - The performance level being attained for customers is not close to the industry leading position, but customers are funding an industry leading financial reward.
 - The metric on which a company is earning a reward is an intermediate performance measure which is only indirectly related to an improved customer outcome.
 - The scale of the performance payment – as a proportion of the customer bill – appears to be considerably greater than the incremental benefits being experienced by customers beyond the expected base level of service

Customer bill volatility and potential deferrals of outperformance payments

- 2.4 Ofwat included two elements of customer protection at PR19 in view of significant ODI outperformance, so if outperformance was greater than 3% of water or wastewater regulatory equity, 50% of that incremental outperformance would be shared with customers through bill reductions, while potentially financially significant PCs would be capped.
- 2.5 However, while the companies' outperformance in 2020-21 does not breach that threshold, for the majority of companies the impact of the ODIs in Ofwat's draft decisions is much more pronounced bill volatility between 2022-23 and 2023-24, which is not in customers' interests.
- 2.6 We are particularly concerned that whilst customer bills and company business plans are subject to careful scrutiny through the price review process, in some cases the financial incentives companies are receiving for specific metrics are much larger than envisaged either in Ofwat's determinations or as forecasted by companies and tested in research for customer acceptability and affordability. There are also a greater number of in-year variations now (e.g. Green Recovery, innovation fund) which have a cumulative impact on customers' bills.
- 2.7 The overall effect of this is that customers face bill increases that are significantly different to the bill profiles they were presented with when Final Determinations were set and could lead to affordability pressures for some customers.
- 2.8 It could also see more companies seek to defer ODI rewards/penalties to both smooth and/or keep bill increases in any given year more manageable. This would seem to undermine one of the key drivers of in-period ODIs - that there is more of a real-time link between performance and bill impact.
- 2.9 We agree with Severn Trent's proposal to defer its outperformance payments to reduce the impact on customer bills in 2022-23, during a time when many customers may already be facing financial pressures.
- 2.10 However, when deferring the collection of payments, consideration will need to be given to:
- Whether year-on-year deferrals, if taken in a single year (either at the end of the current price control period or at the beginning of the next) can lead to significant bill spikes
 - Cases where companies may seek on-going deferral of a single-year's rewards/penalties in view of bill impacts. Are the rules surrounding ODIs that companies may only defer by a single year? If this is the case do companies

effectively forego rewards, and what are the implications this may have for the incentive properties of in-period ODIs?

Where Ofwat has intervened in the 2020-21 ODI draft determinations

- 2.11 Ofwat has adjusted the ODIs for ten companies' across a range of common and bespoke Performance Commitments (PCs), where companies appear not to have followed the reporting guidelines for leakage, mains repairs, low water pressure and greenhouse gas emissions.
- 2.12 We agree that it is important that ODI rewards/penalties are reflective of the PCs that companies signed up to in the Final Determination. Where companies have been shown to have not supplied data in line with Ofwat's reporting guidelines, then the rewards/penalties that stem from that performance ought to be subject to detailed scrutiny.
- 2.13 However, we accept that much of the non-compliance with reporting guidelines did not have a material impact on the result, and where there are exceptions to this, we agree that Ofwat should either adjust penalties and/or outperformance payments, or allow deferrals pending the submission of improved performance data in 2022.
- 2.14 We agree with Ofwat's interventions to reflect the impact on company performance caused by the Covid-19 pandemic. We agree that deferring the ODI for Per Capita Consumption (PCC) is appropriate given the unforeseen changes to consumer consumption trends, and the disruption to sampling and analysis that affected the companies' bathing water quality PCs.
- 2.15 We also agree with the adjustments to three companies' education and recreation based ODIs, Thames' renewable energy PC, and South East's PC measuring 'void' business premises, given the disruption to these activities caused by the pandemic.

Implications for PR24 ODIs

- 2.16 We consider that where customers' bills are affected by rewards or penalties which are well beyond the expected range of returns for any particular measure, Ofwat should legitimately challenge whether the basis of the determination and the evidence underpinning the company's forecasting information was sufficiently sound.
- 2.17 This should occur where a company's proposed rewards/penalties are inconsistent with similar performance by other companies, or where the penalties/rewards are out of kilter with the value customers placed on these areas of service in research carried out during the price review process.

- 2.18 Where this is not the case, protecting customer interests may require that the terms of the determination should be revisited. This is especially the case where outperformance might be anticipated on a repeated basis across the entire price control period. We believe this merits consideration for Ofwat's PR24 methodology.
- 2.20 We think Ofwat should consider whether all ODIs at PR24 ought to be 'end of period' to help avoid year-on-year customer bill volatility. The issues we raise in paragraphs 2.4 to 2.10 raise questions as to whether there should be a reduction in the number of ODIs that need to be applied 'in period' in the future.
- 2.21 Aggregating incentives to 'end of period' may reduce 'in period' bill volatility and could help reduce the risk of outperformance payments 'in period' where non-company activity may have contributed. For example, a company may achieve an 'in period' outperformance payment relating to sewer flooding simply because it was a drier year. Ofwat has already changed the PCC ODI to 'end of period' in light of fluctuations in consumer consumption caused by factors outside of companies' control.
- 2.22 In our 'lessons learned from PR19' report, CCW highlighted that the Customer Experience measure (C-MeX) could be used as a 'gateway' to receiving ODI outperformance payments. This means a company would need to achieve good performance in terms of customer complaint handling and customer satisfaction before access to ODI outperformance payments is granted.
- 2.23 We are aware that Ofwat's Outcomes Working Group will look at these issues in the run up to the publication of the draft PR24 methodology in 2022, so we look forward to engaging further with Ofwat on these issues. CCW and Ofwat are both looking for an ODI model that incentivises companies to deliver ambitious targets that reflect customers' priorities and expectations, with rewards and penalties that align with the value that has been delivered to customers.

Enquiries

Enquiries about this consultation should be addressed to:

Steve Hobbs
Senior Policy Manager
CCW

Email: [REDACTED]

Telephone: [REDACTED]

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