

October 2021

Draft determination of Severn Trent Water's in-period outcome delivery incentives for 2020-21

About this document

This document provides our draft decision on the extent to which the price controls set by the [PR19 final determinations](#) need to be adjusted to reflect Severn Trent Water's performance for the 2020-21 charging year, under [Part 3A of condition B](#) of the company's licence. The specific changes, and our reasons for these, are set out in this document and in [Sector overview: Draft determinations of in-period outcome delivery incentives for 2020-21](#), which concerns the impact of our draft determinations across the companies.

We also publish models related to our draft determinations on our [website](#).

Executive summary

This section sets out the results of our 2020-21 in-period outcome delivery incentives (ODI) assessment for Severn Trent Water. ODIs are the financial or reputational consequences for companies of outperformance or underperformance against its performance commitments. Performance commitments are the pledges companies made to their customers and stakeholders at the 2019 price review (PR19) about service levels to make progress towards their outcomes.

'In-period' ODIs bring ODI payments closer in time to when customers experience a given level of performance. We do this through an annual reconciliation process between July and November following the relevant reporting year, in this case 2020-21. The results of our assessment for 2020-21 will affect Severn Trent Water's bills in the 2022-23 charging year.

For 2020-21 Severn Trent Water reported net outperformance payments of £59.716m against its performance commitments with in-period outcome delivery incentives, excluding C-MeX and D-MeX. We have assessed the company's performance against its performance commitments. In our draft determination, we are intervening on the following performance commitments:

- Reducing business void and gap site supply points – we are removing the outperformance payment of £0.154m for this performance commitment.
- Persistent low pressure – we are intervening to change the outperformance payment for this performance commitment from £5.143m to £2.828m.
- Per capita consumption – in line with our July consultation proposals, we are changing the timing of payments for this performance commitment to end of period.
- C-MeX and D-MeX – we are including no C-MeX payment (because Severn Trent Water is the median performing company) and a D-MeX outperformance payment of £3.881m, based on assessment of 2020-21 company performance in our draft determinations.

The company also receives £25.257m arising from our decisions on the green recovery. This is through a revenue adjustment related to a new performance commitment with in-period ODI payments, introduced for Severn Trent Water as part of our green recovery decisions. We explain this further in section 2.4.

The company also proposed to defer some of its outperformance payments to the following year to help manage the impact of bill changes on customers. Based on our assessment and interventions, we propose to defer £44.749m to the following year.

See sections 2.2, 2.3 and 3.1 for details of our interventions.

In our draft determination we propose that the amount of revenue the company can recover from its customers in 2022-23, as a result of its performance against its performance commitments with in-period ODIs in 2020-21, is increased by £25.276m. This figure includes C-MeX and D-MeX payments as well as deferrals and green recovery funding but is before adjustments for inflation, tax and other relevant factors.

Contents

1.	Introduction	4
1.1	Background	4
1.2	Purpose of this document	4
2.	Results of our assessment	5
2.1	Reported performance	5
2.2	Key interventions	5
2.3	Payment deferrals and abatements	6
2.4	Green recovery	7
3.	Impact of 2020-21 in-period ODI assessment on price controls	9
3.1	Our draft determination	9
4.	Next steps	13

1. Introduction

1.1 Background

Severn Trent Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Severn Trent Water - Outcomes performance commitment appendix](#).¹ Most of the company's performance commitments have financial incentives which are paid 'in-period'. This brings ODI payments closer in time to when customers experience a given level of performance. The remaining financial incentives are end of period.

Severn Trent Water reported its performance against these performance commitments in its annual performance report (APR) in July 2021. We have considered this information and, where necessary, further information from companies' answers to our queries. In our draft determination we set out relevant adjustments to the company's price controls, for one or more future years, in accordance with [Part 3A of condition B](#) of its licence (Performance Measure Adjustments, referred to in this document as 'in-period' determinations). Our determination, when finalised, will affect Severn Trent Water's customers' bills from the 2022-23 charging year.

As set out in the PR19 final determinations, outperformance payments above 3% of a company's wastewater or water regulatory equity for that year are shared with customers. This means companies receive 50% of outperformance payments above this threshold. This aggregate sharing mechanism automatically applies to all ODI payments except to the customer measure of experience (C-MeX), developer measure of experience (D-MeX) and those allocated to retail price controls.

1.2 Purpose of this document

This document provides detailed information relating to the extent to which the price controls for the 2020-25 period need to be adjusted to reflect Severn Trent Water's performance for the 2020-21 charging year. These changes are the result of the company's performance against its in-period ODIs as set out in the PR19 final determinations. This is our draft decision for consultation. We welcome your views by 21 October 2021 as set out in section 4. We will make our final determinations by 15 November 2021.

¹ We take account of performance commitments as set out in the PR19 definitions adjusted, if relevant, by the annex 2 process. Annex 2 of the company's performance commitment appendix provides for changes and corrections to be made to its performance commitment definitions during the 2020-25 period in certain circumstances. An overview of changes and corrections made to companies' performance commitment appendices can be found at [PR19 Outcomes performance commitments: changes and corrections](#).

2. Results of our assessment

2.1 Reported performance

Severn Trent Water's reported performance for 2020-21 against its performance commitments with in-period ODIs is set out in table 3.1 below. The company's largest individual underperformance payment was £5.249m for its water supply interruptions performance commitment. The company's largest individual outperformance payment was £39.113m for its sewer blockages performance commitment.

2.2 Key interventions

Business void and gap site supply points

In our draft determination we are intervening to remove Severn Trent Water's business void and gap site supply points outperformance payment of £0.154m. This is because our engagement with the company in this area identified some uncertainty in the reported performance figure. We require further evidence to support the reported performance. The company was not able to provide this to us in time for our draft decision. Consequently, as part of its response to the draft decision we expect Severn Trent Water to provide additional assurance, such as from a third-party auditor, that its reported performance is accurate. We will take this into account in reaching our final decision on reported performance and any associated payments for this performance commitment.

Persistent low pressure

We have engaged with Severn Trent Water in relation to its persistent low pressure performance commitment, for which the company reported an outperformance payment of £5.143m. We identified that, while the performance commitment definition required the company to report the number of residential properties only, the associated performance commitment level was set with reference to numbers for both residential and non-residential properties. There is, therefore, an inconsistency between the performance commitment levels and the scope of the performance commitment definition. Through our engagement with the company, Severn Trent Water indicated that it is open to amending the definition to ensure that the inconsistency is addressed for the remaining years of the control period and we expect this change to be taken forward.

For 2020-21, the company provided additional evidence that allows us to understand the allocation of performance between residential and non-residential properties. This suggests that if the performance commitment level and reported performance were on a consistent basis, then the outperformance payment would be £2.828m rather than £5.143m.

Consequently, in our draft decision, we are intervening to adjust the outperformance payment to £2.828m. We are expecting further information from the company on this issue and we will engage with the company to ensure we have a full understanding of the issue ahead of our final decisions in November.

Sewer blockages

In our draft determinations we are including the full outperformance payment of £39.113m for sewer blockages performance. We engaged with the company on this performance commitment to better understand the drivers of outperformance, how they relate to improvements in service to customers and the assurance associated with this. The company has provided further information to support its submission. There remains some additional evidence outstanding but subject to this providing us with the reassurance we require, we do not propose to intervene on this performance commitment.

2.3 Payment deferrals and abatements

As set out in our [PR19 final determinations](#) and the [PR19 Reconciliation Rulebook: Guidance Document](#), companies can ask us to defer outperformance or underperformance payments, or abate outperformance payments on individual performance commitments. A deferral results in us delaying when the adjustment will be made to companies' revenue. An abatement results in no adjustment to the company's revenues in relation to the relevant performance commitment in the subsequent charging year.

Severn Trent Water requested to defer £47.246m total outperformance payments, split across its water resources, water network plus and wastewater network plus price controls, to the following year. This figure excludes per capita consumption which we address below. The company stated this was an early view and reflected the net ODI payments it had earned in 2020-21 (including a draft view of D-MeX payments) and the impact of other mechanisms (such as the revenue forecasting incentive and the blind year reconciliation of 2019-20 performance) which it said would put upward pressure on customer charges in 2022-23.

In its submission, the company included estimates of likely bill impacts on customers if these payments were not deferred. With its proposed deferral, the company stated that annual average combined residential bills would rise by 2.7% (or £9 per customer) compared to 6.7% (or £24 per customer). The company also observed that unmetered customers are more likely to be exposed to bill increases due to the impact of other customers switching to meters throughout the year.

We have assessed the company's submission and considered the impact of other drivers on the company's revenue in 2022-23, such as the green recovery funding set out in section 2.4, the impact of PR19 reconciliation mechanisms and ODI deferrals from previous years. While we note that the company has the ability to manage the impact on customers of changes to

its allowed revenue when setting its charges, we recognise there is a risk that customers may be adversely affected if high outperformance payments are not spread over future years.

We consider the overall principle of the company's proposal to defer outperformance payments equal to the net ODI payments it has earned in 2020-21 minus the underperformance payments deferred from 2019-20 is reasonable, particularly given the existence of other upward pressures on allowed revenues in 2022-23, such as the operation of the revenue forecasting incentive correcting for revenue under-recovery in 2020-21. This deferral should reduce the short-term bill impacts on customers from high outperformance payments. However, longer term, we note the importance of ensuring that in-period ODI payments are applied close in time to when customers experience a given level of performance, a key aspect of the PR19 outcomes framework.

For our draft decisions we have replicated the methodology proposed by Severn Trent Water but reflecting our interventions on individual performance commitments set out in section 2.2 and the final performance data for D-MeX. We therefore propose to defer £44.749m in outperformance payments to 2022-23. We intend to adjust with our final view of the company's 2020-21 in-period ODI payments. We welcome views on this proposed approach. We also request that Severn Trent Water provides further evidence of likely bill impacts arising from our draft decisions.

Severn Trent Water also requested to defer underperformance payments for its per capita consumption performance commitment for 2020-21, separate to the requested deferral discussed above. In our [July 2021 consultation](#) on changing the timing of our determination of the value of ODI payments for per capita consumption performance commitments, we proposed that this should be end of period for all companies. Prior to our July 2021 consultation, we had asked relevant companies to include ODI payments arising from their per capita consumption performance commitments in the deferrals function of the in-period adjustments model. We now consider it would be more appropriate to reflect this proposed treatment through the ODI performance model, ensuring consistency with our policy proposals and ensuring that all ODI payments accrued during the 2020-25 period can be applied at PR24, when we will make our final decisions.

Severn Trent Water did not request any payment abatements. Based on our assessment of the company's performance, we do not consider any are required. As such, we do not apply any payment abatements in our draft decisions.

2.4 Green recovery

As part of our final decisions on the [green recovery](#), published in July 2021, we agreed to allow Severn Trent Water additional funding during the current (2020-25) price control period. Severn Trent Water receives this additional funding through a new performance commitment

with in-period ODI payments (PR19SVE_GR), introduced through a licence modification that came into effect on 1 September 2021.

The company has met the requirement for a revenue adjustment for the 2022-23 charging year by accepting our green recovery final decision by 8 August 2021 and we therefore include a positive revenue adjustment of £25.257m. We apply this through the in-period adjustments model, with relevant adjustments as set out in the overview document.

3. Impact of 2020-21 in-period ODI assessment on price controls

3.1 Our draft determination

In this section we outline the financial impacts of our draft decisions. First, we set out our view compared to the company's requested ODI payments in table 3.1.

Table 3.2 sets out the C-MeX and D-MeX payments included in our draft determination.

Table 3.3 summarises the overall ODI payments, after other payments and relevant adjustments, that the company is due based on its performance in 2020-21.

Table 3.4 sets out our draft decisions on deferrals and abatements and how we propose that these payments should be applied in 2022-23.

Table 3.5 sets out the impact of our draft decisions on the company's relevant price controls.

Unless otherwise stated all values are £m in 2017-18 FYA CPIH prices.

Table 3.1: In-period ODI payments for 2020-21 by price control (excluding C-MeX and D-MeX)

This table sets out the in-period ODI payments requested by Severn Trent Water for 2020-21, by price control, and our draft determination on these payments after any interventions.

Further detail on how these overall numbers have been derived is set out in the ODI performance model, which we have published on our website as part of the draft determinations. Where we have applied interventions, this is set out in "Ofwat_PC_Interventions" in the ODI performance model for this company.

Price control	Company's reported payments (£m)	Our draft decisions after interventions (£m)	Difference (£m)
Water resources	7.819	9.639	1.820
Water network plus	3.653	1.260	-2.392
Wastewater network plus	48.225	48.148	-0.077
Bioresources	0.000	0.000	0.000
Residential retail	0.019	0.019	0.000
Total payments	59.716	59.066	-0.649

See section 2.2 for details of our interventions on the company's performance commitments.

Table 3.2: C-MeX and D-MeX payments

Our draft determinations include the following C-MeX and D-MeX payments for this company:

Price control	C-MeX payments (£m)	D-MeX payments (£m)
Residential retail	0.000	n/a
Water network plus	n/a	2.969
Wastewater network plus	n/a	0.912
Total payments	0.000	3.881

We have taken the data from the APR submissions and compared this against the recorded data from our survey agent, Accent.

Further details on C-MeX and D-MeX can be found on the [Customer and Developer Services experience](#) pages of the Ofwat website and in the published C-MeX and D-MeX models.

Table 3.3: ODI payments including C-MeX, D-MeX, bespoke adjustments and deferrals from 2019-20 (before 2020-21 deferrals and abatements)

This table sets out the composition of total ODI payments, including C-MeX and D-MeX, brought forward deferrals and bespoke adjustments where relevant, but before our draft decisions on 2020-21 deferrals and abatements.

Price control	Ofwat view of in-period ODI payments (£m)	C-MeX and D-MeX payments (£m)	ODI payments deferred from 2019-20 (£m)	Bespoke adjustments (£m)	Total ODI payments (£m, before 2020-21 abatements and deferrals)
Water resources	9.639	0.000	0.434	1.445	11.518
Water network plus	1.260	2.969	-1.691	9.383	11.921
Wastewater network plus	48.148	0.912	-16.923	14.429	46.566
Bioresources	0.000	0.000	0.000	0.000	0.000
Residential retail	0.019	0.000	0.000	0.000	0.019
Total	59.066	3.881	-18.180	25.257	70.024

Table 3.4: 2020-21 ODI payments after deferrals and abatements

This table sets out our draft decisions on the ODI payments to be applied, after deferrals and abatements, as set out in the in-period adjustments model published on our website.

Price control	Total ODI payments (£m, before 2020-21 deferrals and abatements)	Ofwat proposed deferrals (£m)	Ofwat proposed abatements (£m)	Total ODI payments to be applied in 2022-23 (£m)
Water resources	11.518	10.073	0.000	1.445
Water network plus	11.921	2.538	0.000	9.383
Wastewater network plus	46.566	32.137	0.000	14.429
Bioresources	0.000	0.000	0.000	0.000
Residential retail	0.019	0.000	0.000	0.019
Total	70.024	44.749	0.000	25.276

See section 2.3 for our decisions relating to deferrals and abatements for this company.

Table 3.5: Changes to price controls (draft determinations)

This table sets out the impact of our draft decision on the company's price controls, as set out in the in-period adjustments model published on our website. See [Sector overview: Draft determinations of in-period outcome delivery incentives for 2020-21](#) for how we propose to apply adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
Water resources (K factors)	Previous determination	3.45	6.02	5.95	-7.80
	Revised	3.45	8.30	3.79	-7.80
Water network plus (K factors)	Previous determination	-0.50	-1.63	-1.70	0.28
	Revised	-0.50	0.29	-3.52	0.28
Wastewater network plus (K factors)	Previous determination	-1.85	-1.29	-0.98	1.02
	Revised	-1.85	1.41	-3.53	1.02
Bioresources (unadjusted revenue, UR_t – £m, 2017-18 Nov CPIH prices)	Previous determination	76.857	77.205	77.395	77.744
	Revised	76.857	77.205	77.395	77.743
Residential retail (total revenue, TR_t – £m, nominal prices)	Previous determination	105.067	106.062	107.008	107.922
	Revised	105.067	106.087	107.008	107.922

We have based Severn Trent Water's draft determination on the data and commentary provided to us by Severn Trent Water. Should any of this information be revised or restated in future years, we will take account of adjustments we have made to the relevant price control

in relation to the performance commitment(s) in question in making future in-period determinations.

4. Next steps

We welcome any written comments or representations on our proposals by **21 October 2021**. Representations can be made by all stakeholders. Representations can be sent to our inbox OfwatPandO@ofwat.gov.uk.

To ensure transparency, we expect companies to publish their representations in full. We also intend to publish all the written representations we receive on our website once we set out our final decisions.

In view of this, if respondents consider that some of the information in their representations should not be disclosed (for example, because they consider it is commercially sensitive information) they should identify that information and explain why. We would expect strong, robust reasons that are specific to the information concerned. We will take such explanations into account, but we cannot give an assurance that information included in representations will not be disclosed.

Information provided in response to this document, 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](#).

Where companies are making representations, they should consider what further evidence may be necessary to submit with their representations.

We will publish our final decisions by 15 November 2021, after considering representations from all stakeholders.

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