

November 2021

# **Final determination of Affinity Water's in-period outcome delivery incentives for 2020-21**

**Ofwat**

## About this document

This document provides our final decision on adjustments to Affinity Water's price controls for the company's performance for the 2020-21 Charging Year under Part 3A of condition B of the company's licence (Performance Measure Adjustments, referred to in this document as 'in-period' determinations). The specific changes, and our reasons for these, are set out in this document and ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#).

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

## Executive summary

This section sets out the results of our 2020-21 in-period outcome delivery incentive (ODI) assessment for Affinity Water. ODIs are the financial or reputational consequences for companies of outperformance or underperformance against their 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 Affinity Water's customers' bills in the 2022-23 Charging Year.

For 2020-21 Affinity Water reported net underperformance payments of £5.052m against its performance commitments with in-period outcome delivery incentives, excluding C-MeX and D-MeX. We assessed the company's performance against its performance commitments and, in October 2021, consulted on our [draft determinations](#) for companies' in-period ODIs for 2020-21.

Having considered the responses to our draft determination, in our final determination, we are intervening on the following performance commitments:

- Per capita consumption (PCC) – in line with our decision following our PCC consultation, we are deferring our determination of payments for performance against this performance commitment for the 2020-21 Charging Year
- Mains repairs – we are increasing the company's underperformance payment by £0.351m to include 'repairs on repairs' to the main, in line with the performance commitment definition.

- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £1.545m and a D-MeX underperformance payment of £0.094m, based on assessment of 2020-21 company performance in our draft determinations.

Our final determination is 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 reduced by £5.887m. This figure includes C-MeX and D-MeX payments as well as bespoke adjustments but is before adjustments for inflation, tax and other relevant factors.

Further details regarding the responses we received, our final decisions and the adjustments that we have made are presented in sections 2 and 3, and ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#).

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# 1. Introduction

## 1.1 Background

Affinity Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Affinity Water – Outcomes performance commitment appendix](#).<sup>1</sup> 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 incentives are end of period.

Affinity Water reported its performance against these performance commitments in its annual performance report (APR) in July 2021. We considered this information and, where relevant, further information from companies' answers to our queries. In October 2021, we consulted on our draft determination for Affinity Water's in-period ODIs for 2020-21. We have considered the responses we have received relating to our draft determination.

Our final determination sets out the adjustments to the company's price controls and will affect Affinity Water's customers' bills from the 2022-23 Charging Year.

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<sup>1</sup> 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

Affinity Water's reported performance for 2020-21 against its performance commitments with financial in-period ODIs is set out in table 3.1 below. The company's largest individual underperformance payment is £2.688m for its per capita consumption performance commitment. The company's largest individual outperformance payment is £0.357m for its water supply interruptions performance commitment.

### 2.2 Key interventions

#### 2.2.1 Mains repairs

##### Our draft decision

In our draft determination we intervened to increase Affinity Water's underperformance payments in relation to its mains repairs performance commitment by £0.351m. This is because the company confirmed that it had not included repairs on repairs to the main within its reported performance in its APR. Affinity Water's reported performance was based on a misinterpretation of its mains repairs (PR19AFW\_W-D4) performance commitment definition. The definition incorporates our [reporting guidance](#) on mains repairs, which is clear that repairs on repairs to the main should be included in the reported performance. Our intervention increases the company's underperformance payment for this performance commitment from £0.576m to £0.927m.

##### Stakeholders' responses

In its response, the company states that our reporting guidance does not refer to 'repairs on repairs'. It also states that the inclusion of 'repairs on repairs' moves this metric further from its intended position as an asset health measure because the efficacy and durability of repairs is not the same thing as the condition and performance of mains. It states that the inclusion provides more of an indication of customer impact through road disruption which is incentivised through C-Mex, so could be double counting.

The company also suggests that including repairs on repairs may provide a perverse incentive to focus on the repair rather than a return to service (for example, to provide a more permanent solution immediately rather than a temporary fix).

It goes on to state that the mains repairs guidance is not clear, and it requests a consultation with the sector to clarify the guidance going forward, in order to avoid inconsistent reporting between companies.

## **Consideration of responses and final decision**

On the basis of Affinity Water's mains repairs underperformance as set out in our draft determination, and our consideration of the responses we have received, our final decision on the company's performance payment for this performance commitment is as stated in our draft decision, above.

We consider that including 'repairs on repairs' does not provide a perverse incentive to delay returning supply to customers. We consider that together, the mains repairs and supply interruptions performance commitments provide a strong incentive to return customer supplies back to normal as quickly as possible and to implement the right solution first time when repairing a main, so further repairs and interruptions at later date are less likely. For the same reason we do not consider including 'repairs on repairs' shifts the focus of the measure to a customer service measure and there has been no change in this measure since the PR19 final determinations.

We also consider that the current mains repairs reporting guidance is sufficiently clear on this issue. The definitions for all common PCs will be consulted upon as part of the 2024 price review (PR24) process, providing the companies and other stakeholders with an opportunity to input into performance commitment development.

This decision has been considered alongside other companies' mains repairs performance commitments, as set out in the ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#). This includes responses to common issues such as asset health of water mains.

## **2.2.2 Taxation**

### **Our draft decision**

In our draft determinations we applied a uniform marginal tax rate of 19% in each company's in-period adjustments model to reflect the headline rate of corporation tax.

### **Stakeholders' responses**

In its response, Affinity Water notes that the assumed marginal tax rate we used is higher than the annual average effective tax rate in its December 2019 PR19 final determination.

The company also states that it now expects to make a loss in 2022-23 for corporation tax purposes and requests we adjust the marginal tax rate in its in-period determination to 0%. The company suggests the tax benefit resulting from the in-period determination will not be realised until 2024-25 at the earliest.

## Consideration of responses and final decision

In line with the policy set out in the PR19 reconciliation rulebook, we only consider marginal rates for the purposes of setting in-period determinations.

We do not consider the company has provided sufficient evidence that it will now incur taxable losses in 2022-23, particularly given the uncertainty around internal business forecasts. We want to maintain a targeted and proportionate assessment during the in-period determinations process. We also note that if the company is not liable to pay corporation tax in 2022-23 as it has no taxable profits, it can carry forward taxable losses to offset corporation tax liabilities in future years. As such, provided the company generates taxable profits in the coming years, we do not consider there is a strong case to change our assumption.

We will therefore maintain the 19% assumption in our final determination for this company. We also note that, as set out in the [PR19 reconciliation rulebook](#) (page 58), if there is a material impact on customers or companies as a result of a difference between the marginal rate of tax that a company pays in the following charging year and our assumption, we may consider reconciling this at PR24.

### 2.2.3 C-MeX and D-MeX

#### Our draft decision

Our draft determination included a C-MeX underperformance payment of £1.545m and a D-MeX underperformance payment of £0.094m, based on assessment of 2020-21 company performance in our draft determinations.

We have taken the data from the company's 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.

#### Stakeholders' responses

We did not receive any specific comments on this issue.



## Consideration of responses and final decision

Our final decision is unchanged from our draft determination, as stated above.

## 2.3 Payment deferrals and abatements

As set out in our [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.

Affinity 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 did not apply any payment abatements in our draft decision and we do not apply any in our final decision.

### 2.3.1 Per capita consumption

#### Our draft decision

In line with our July consultation proposals, we proposed changing the timing of payments for this performance commitment to end of period.

Affinity Water also asked us to defer underperformance payments for its per capita consumption performance commitment for 2020-21. 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.

#### Stakeholders' responses

We did not receive any specific comments on this issue.

## Consideration of responses and final decision

Our consultation on moving the timing of the PCC performance commitment to the end of the 2020-25 period has [concluded](#). After carefully considering the responses to that consultation, we have confirmed that ODI payments for PCC performance commitments will be determined at the end of the period for all years within the 2020-25 price control period. Consequently, we have not included any adjustment in relation to this performance commitment in our final determination.

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

#### 3.1 Our final determination

In this section we outline the financial impacts of our final 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 final 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 final decisions on deferrals and abatements and how we propose that these payments should be applied in 2022-23.

Table 3.5 sets out the changes that we are determining to the company's relevant price controls because of those decisions.

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 Affinity Water for 2020-21, by price control, and our final 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 final 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)	Our final decisions after interventions (£m)
Water resources	-0.778	0.029	0.029
Water network plus	-4.299	-2.767	-2.767
Residential retail	0.024	0.024	0.024
<b>Total payments</b>	<b>-5.052</b>	<b>-2.714</b>	<b>-2.714</b>

See section 2 for details of our interventions on the company's performance commitments.

**Table 3.2: C-MeX and D-MeX payments**

Our final 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	-1.545	n/a
Water network plus	n/a	-0.094
<b>Total payments</b>	<b>-1.545</b>	<b>-0.094</b>

See section 2.2.3 for further details on C-MeX and D-MeX.

**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 final 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	0.029	0.000	0.000	0.000	0.029
Water network plus	-2.767	-0.094	-1.534	0.000	-4.395
Residential retail	0.024	-1.545	0.000	0.000	-1.521
<b>Total</b>	<b>-2.714</b>	<b>-1.639</b>	<b>-1.534</b>	<b>0.000</b>	<b>-5.887</b>

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

This table sets out our final 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 for this company.

Price control	Total ODI payments (£m, before 2020-21 deferrals and abatements)	Ofwat final deferrals (£m)	Ofwat final abatements (£m)	Total ODI payments to be applied in 2022-23 (£m)
Water resources	0.029	0.000	0.000	0.029
Water network plus	-4.395	0.000	0.000	-4.395
Residential retail	-1.521	0.000	0.000	-1.521
<b>Total</b>	<b>-5.887</b>	<b>0.000</b>	<b>0.000</b>	<b>-5.887</b>

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

**Table 3.5: Changes to price controls (final determinations)**

This table sets out the changes to the level of the company's price controls that we are determining for the Charging Years beginning on 1 April 2022 and 1 April 2023. The details for other charging years are included for completeness and ease of reference. The in-period adjustments model published on our website shows how these changes reflect the impact of our final decisions. See ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#) for how we have applied adjustments for tax and inflation.

Price control		2021-22	2022-23	2023-24	2024-25
<b>Water resources (K factors)</b>	Last determination	10.58	14.67	9.29	-2.46
	Final determination	10.58	14.77	9.20	-2.46
<b>Water network plus (K factors)</b>	Last determination	1.40	0.59	0.96	3.27
	Final determination	1.40	-1.94	3.50	3.27
<b>Residential retail (total revenue, TR<sub>t</sub> – £m, nominal prices)</b>	Last determination	27.875	28.573	29.306	30.044
	Final determination	27.875	26.496	29.306	30.044

We have based Affinity Water's final determination on the data and commentary provided to us by Affinity Water (and, where relevant, other water companies). 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.

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