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Final determination of Hafren Dyfrdwy's in-period outcome delivery incentives for 2020-21

Ofwat

About this document

This document provides our final decision on adjustments to Hafren Dyfrdwy'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 Hafren Dyfrdwy. 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 Hafren Dyfrdwy's customers' bills in the 2022-23 Charging Year.

For 2020-21 Hafren Dyfrdwy reported net underperformance payments of £0.532m 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.
- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £0.035m and a D-MeX outperformance payment of £0.035m, based on assessment of 2020-21 company performance in our draft determinations.

We also set out how we apply Hafren Dyfrdwy's aggregate underperformance sharing mechanism within the company's final determination.

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 £0.750m. 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

Hafren Dyfrdwy's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Hafren Dyfrdwy - 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 incentives are end of period.

Hafren Dyfrdwy 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 Hafren Dyfrdwy'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 Hafren Dyfrdwy'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 performance payments above this threshold.

In addition to this, Hafren Dyfrdwy's [PR19 final determination](#) sets out that total net ODI underperformance payments to customers of more than 3% of the company's regulatory equity for that year are also to be shared with customers. We said this was to mitigate the risk to the company of excessive downside outcome delivery incentives due to the lack of long-term historical data and the small size of the company.

These sharing mechanisms automatically apply 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 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

Hafren Dyfrdwy'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 £0.618m for its water supply interruptions performance commitment. The company's largest individual outperformance payment is £0.150m for its performance commitment relating to the number of lead pipes replaced.

In its APR, Hafren Dyfrdwy reported that it had triggered both the aggregate outperformance sharing mechanism, which can apply to all companies, and its bespoke underperformance sharing mechanism, which is set out in section 1.1.

2.2 Key interventions

2.2.1 Leakage

Our draft decision

In our draft determination we said we had expected that all companies would have been compliant with our [PR19 common performance commitment definitions](#) when reporting 2020-21 leakage performance. In IN21/01 we said that "If the data submitted is not based on a fully converged methodology then companies should clearly state this and demonstrate that not being fully compliant does not have a material impact on the reported performance. If the move to convergence affects baselines for any performance commitments then companies should also show this clearly."

We noted that for leakage and per capita consumption reporting, Hafren Dyfrdwy had not achieved full compliance with this methodology and that the company had not been able to quantify the impact of non-compliant components on reported performance.

We said that as part of its response to our draft determination, we expected Hafren Dyfrdwy to quantify the impact of non-compliant components of its leakage performance commitment on its reported performance. We said that should the impact of the non-compliant components be material, in our final determinations we may defer our decisions on these performance commitments to 2022.

Stakeholders' responses

In its response regarding its leakage performance Hafren Dyfrdwy observes that we noted in the sector overview document that the majority of companies had not achieved full compliance with the PR19 common definition on leakage in 2020-21. The company confirms that it now has six months' data from its new unmeasured individual household monitors and that it continues to extrapolate Severn Trent Water's data until it builds a stable dataset to derive its new consumption values.

The company states that it has recently undertaken sensitivity analysis for the unmeasured consumption component and estimates the impact on leakage to be less than 1% of its leakage performance. The company does not expect a significant impact on its reported leakage once its new monitors and data sets are fully up and running.

Consideration of responses and final decision

We reviewed the additional information the company submitted in its response to our draft decision. Taken together with its responses to our previous leakage queries, we consider that Hafren Dyfrdwy has demonstrated that the areas of non-compliance do not have a material impact on reported performance for this performance commitment. We expect that the company will use its own specific data for 2021-22 annual performance reporting. We recognise the need, under specific circumstances, for companies to draw on data from across the sector in calculating their water balance. We note that in this case the company uses data from Severn Trent Water, which is a neighbouring company of Hafren Dyfrdwy.

Having considered stakeholder responses, our final decision for this performance commitment is to retain Hafren Dyfrdwy's reported performance and associated ODI payments for 2020-21.

As we explained in our draft determination, it is our expectation that there should not be any components of the company's leakage and per capita consumption methodology that are not fully compliant when reporting 2021-22 performance. We will closely assess any non-compliant elements in the 2021-22 APR submissions and will consider what interventions might be appropriate in light of our findings. Should any leakage information be revised or restated, we expect the company to clearly identify any reasons for the restatement and quantify the impact of any changes to data and/or assumptions on reported leakage and on the leakage baseline if applicable. We will take account of adjustments we have made to the relevant price control in relation to the leakage performance commitment in making future in-period determinations.

2.2.2 C-MeX and D-MeX

Our draft decision

Our draft determination included a C-MeX underperformance payment of £0.035m and a D-MeX outperformance payment of £0.035m, based on assessment of 2020-21 company performance in our final 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.

2.2.3 Underperformance sharing mechanism

Our draft decision

In our draft determination, we stated that we had assessed Hafren Dyfrdwy's reported performance with respect to its bespoke underperformance sharing mechanism. We said we considered that the company's calculations did not fully account for our PR19 final determination, where we stated that we will share total **net** ODI underperformance payments if they are more than 3% of regulatory equity in any year. This is in contrast to the outperformance sharing mechanism which is calculated on a gross basis.

We said we considered that it would be reasonable and broadly consistent with the outperformance sharing mechanism for the threshold for underperformance sharing would apply separately to water or wastewater regulatory equity.

We said we concurred with the company that it had not triggered underperformance sharing for its water-related performance commitments but that it had triggered underperformance sharing for wastewater-related performance commitments. However, we calculated a different amount of underperformance payments to be shared as follows:

- Based on notional regulatory equity of £0.617m for wastewater (wastewater network plus and bioresources), we calculated the sharing threshold to be £0.018m.
- With gross outperformance payments of £0.021m and gross underperformance payments of £0.056m for performance commitments allocated to either the wastewater network plus or bioresources price controls, we estimated total **net** underperformance payments to be £0.035m.
- Since this is beyond the sharing threshold of £0.018m, then underperformance payments beyond this threshold are to be shared equally between customers and the company. We calculated this to be £0.008m (or £8,300). This was less than the company's calculation of £0.009m (or £9,000).

For simplicity we proposed to apply this as a positive revenue adjustment using the new 'bespoke adjustments' function of the in-period adjustments model. The outperformance sharing mechanism will continue to be applied through the ODI performance model, consistent with all other companies.

Stakeholders' responses

Hafren Dyfrdwy welcomed the clarity on the workings of its underperformance sharing mechanism. It notes the difference between the two methodologies is small and suggests engaging on the precise calculations underlying the sharing mechanism.

Consideration of responses and final decision

We acknowledge that clarity was needed on how the bespoke underperformance sharing mechanism for the company was intended to operate. In our final determination we apply the same approach as our draft determination. Because there is no change to our interventions on individual performance commitments, the amount to be shared is unchanged.

For next year's in-period determinations, we will consider incorporating this calculation approach into the ODI performance model, consistent with the aggregate outperformance sharing mechanism, and will engage with the company on this in early 2022.

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.

Hafren Dyfrdwy 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 final decision.

2.3.1 Per capita consumption (PCC)

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.

Hafren Dyfrdwy reported underperformance payments relating to its per capita consumption performance commitment but did not include them as a payment deferral in its submitted in-period adjustments model.

In our [July 2021 consultation](#) on changing the timing of ODI payments for per capita consumption performance commitments, we proposed that they 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 Hafren Dyfrdwy 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	-0.326	-0.276	-0.276
Water network plus	-0.197	-0.147	-0.147
Wastewater network plus	-0.037	-0.037	-0.037
Bioresources	0.000	0.000	0.000
Residential retail	0.039	0.039	0.039
Business retail	-0.012	-0.012	-0.012
Total payments	-0.532	-0.432	-0.432

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	-0.035	n/a
Water network plus	n/a	0.034
Wastewater network plus	n/a	0.001
Total payments	-0.035	0.035

See section 0 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	-0.276	0.000	-0.003	0.000	-0.279
Water network plus	-0.147	0.034	-0.172	0.000	-0.285
Wastewater network plus	-0.037	0.001	-0.152	0.008	-0.179
Bioresources	0.000	0.000	0.000	0.000	0.000
Residential retail	0.039	-0.035	0.000	0.000	0.004
Business retail	-0.012	0.000	0.000	0.000	-0.012
Total	-0.432	0.000	-0.327	0.008	-0.750

See section 2.2.3 for details of the bespoke adjustments we have applied for this company.

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	-0.279	0.000	0.000	-0.279
Water network plus	-0.285	0.000	0.000	-0.285
Wastewater network plus	-0.179	0.000	0.000	-0.179
Bioresources	0.000	0.000	0.000	0.000
Residential retail	0.004	0.000	0.000	0.004
Business retail	-0.012	0.000	0.000	-0.012
Total	-0.750	0.000	0.000	-0.750

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
Water resources (K factors)	Last determination	-5.24	-26.84	-3.91	1.45
	Final determination	-5.24	-38.75	13.85	1.45
Water network plus (K factors)	Last determination	4.42	3.49	2.30	-0.96
	Final determination	4.42	1.30	4.45	-0.96
Wastewater network plus (K factors)	Last determination	1.50	8.14	3.95	6.18
	Final determination	1.50	-0.82	13.05	6.18
Bioresources (unadjusted revenue, UR_t – £m, 2017-18 Nov CPIH prices)	Last determination	0.761	0.769	0.776	0.784
	Final determination	0.761	0.769	0.776	0.784
Residential retail (total revenue, TR_t – £m, nominal prices)	Last determination	2.861	2.888	2.917	2.942
	Final determination	2.861	2.894	2.917	2.942
Business retail (allowed average retail cost component, rc_t – £, nominal prices)	Last determination – water: unmeasured and < 5 Ml/a	50.81	50.67	51.89	52.56
	Final determination – water: unmeasured and < 5 Ml/a	50.81	48.77	51.89	52.56
	Last determination – water: ≥ 5 and < 50 Ml/a	177.35	178.89	184.45	187.97
	Final determination – water: ≥ 5 and < 50 Ml/a	177.35	169.43	184.45	187.97
	Last determination – wastewater services: unmeasured supply and < 5 Ml/a	45.60	44.49	45.08	45.09
	Final determination – wastewater services: unmeasured supply and < 5 Ml/a	45.60	42.66	45.08	45.09
	Last determination – wastewater services: ≥ 5 Ml/a and < 50 Ml/a	188.19	192.69	199.48	203.84
	Final determination – wastewater services: ≥ 5 Ml/a and < 50 Ml/a	188.19	182.65	199.48	203.84
	Last determination – wastewater services: ≥ 50 Ml/a	60.83	61.69	63.25	64.20

Price control		2021-22	2022-23	2023-24	2024-25
	Final determination – wastewater services: ≥50 Ml/a	60.83	59.09	63.25	64.20

We have based Hafren Dyfrdwy's final determination on the data and commentary provided to us by the company (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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