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Final determination of Northumbrian Water's in-period outcome delivery incentives for 2020-21

Ofwat

About this document

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

For 2020-21 Northumbrian Water reported net outperformance payments of £1.862m 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 and conducted further analysis, 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 outperformance payment of £2.927m and a D-MeX outperformance payment of £0.354m, 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 increased by £6.509m. 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

Northumbrian Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: Northumbrian Water - Outcomes performance commitment appendix](#) (subject to any changes made by the Competition and Markets Authority).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.

Northumbrian 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 Northumbrian 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 Northumbrian Water's customers' bills from the 2022-23 Charging Year.

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

Northumbrian 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 £7.123m for its water quality compliance (CRI) performance commitment. The company's largest individual outperformance payment is £2.960m on pollution incidents.

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 Northumbrian Water 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 this draft determination, we expected Northumbrian Water 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 might defer our decisions on these performance commitments to 2022.

Stakeholders' responses

In its response regarding its leakage performance Northumbrian Water confirms it has two non-compliant components for its North East region and none for its Essex and Suffolk region. The company examines the non-compliant components in detail and provides its

sensitivity analysis to help explain the extent to which these gaps might drive material changes in its reported leakage.

The company provides evidence of testing hypothetical scenarios, and a conclusion that the few remaining non-compliant components within leakage reporting for 2020-21 do not have a material impact on the accuracy of its overall reported leakage. The company estimates that the difference in overall leakage is less than 1%.

Consideration of responses and final decision

The company's assessment of the impact of non-compliance on reported performance satisfies us that the elements of non-compliance with reporting guidance for its leakage performance commitment do not have material impact on reported performance.

Having considered stakeholder responses, our final decision for this performance commitment is to accept Northumbrian Water's reported leakage performance 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 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 Water Industry National Environment Programme (WINEP)

Our draft decision

In our draft determination, in App1 of Northumbrian Water's ODI performance model, we reset the targets for performance commitment PR19NES_BES31 (Water Industry National Environment Programme) to align with the PR19 outcomes appendix. This did not have a financial impact on the 2020-21 in-period ODI determinations but ensured that the targets shown in the model were correct.

Stakeholders' responses

In its response regarding its WINEP performance commitment Northumbrian Water states that although the Environment Agency has agreed new WINEP timescales with companies we have not adjusted the performance commitment levels for its BES31 performance commitment. The company comments that it is on track with the revised timeline and continues to commit to the delivery of all the agreed WINEP outputs by 2025, but acknowledges that this pushes more of the activity into later years. The company says that in

circumstances outside companies' control, like Covid-19, we should adjust companies' performance commitments and associated ODIs. The company's response to the issue was to agree an adjustment to the delivery schedule with the Environment Agency.

Northumbrian Water refers to its performance commitment NEP01 where targets update dynamically as being contradictory and undermining transparency for customers. The company asks us to clarify whether our objection is a procedural one (i.e. we require companies to make a formal annex 2 submission) or a more substantive one.

Consideration of responses and final decision

WINEP schemes hold significant benefits for the environment that customers value and these improvements should be implemented in accordance with the performance commitment levels set out in the PR19 final determination. The company's NEP01 performance commitment is non-financial and, in tracking the latest WINEP programme published by Defra, indicates clearly to customers the company is on track with the revised delivery schedule it has agreed with Government. Separately, the company's BES31 WINEP performance commitment is to incentivise the delivery of schemes in a timely manner and is based on the actual benefits accruing to customers and the environment in each year of the 2020-25 period.

As set out in our ['PR19 final determinations: Delivering outcomes for customers policy appendix'](#) we do not consider it appropriate to make specific provision for the WINEP performance commitments to be amended during the period. This remains our view. We were clear that changes will only be made in exceptional circumstances through a formal process of consultation. The company would need to be able to demonstrate that any proposal was in line with our approach to dealing with the impacts of the Covid-19 pandemic, as discussed in Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21. So while there is a process the company needs to follow, our focus will be whether the company can demonstrate a convincing case of why a change is in customers' interests and environmental improvements are not being delayed unnecessarily.

2.2.3 Greenhouse gas emissions

Our draft decision

In our draft determination, we did not propose any interventions for Northumbrian Water's greenhouse gas emissions (GHG) performance commitment.

Stakeholders' responses

In its response, Northumbrian Water states that it wrote to us with a formal Annex 2 submission requesting a change to its GHG emissions reporting performance commitment on

11 June 2021. It states that it was clear in this submission that it wanted us to consider this change as part of its 2020-21 determinations for ODI underperformance and outperformance payments. It notes that as part of that submission it highlighted that the proposed change would in its view:

- Align the definition with the latest guidance on GHG reporting rather than previous guidance for which clear flaws and errors have been highlighted;
- Be consistent with Ofwat's proposed approach for reporting for all companies including those that do not have a GHG performance commitment as per Ofwat's earlier consultation on the matter and the agreed Regulatory Accounting Guidelines going forward; and
- Result in a reduction to its ODI reward for 2020-21.

Northumbrian Water said it discussed and agreed this submission with its Water Forum before providing it to Ofwat. It said that whilst it is pleased that Ofwat is considering its approach to reporting in this area across the sector given the need for consistency, it is keen to ensure that this can be resolved quickly and that ideally the new definition would be reflected in its final determination for 2020-21. It says this will allow consistency of reporting across the 2020-25 period and avoid the need to explain to customers why its 2020-21 reporting and outperformance payment is different from subsequent years.

Consideration of responses and final decision

As set out in in the PR19 final methodology we expect that companies should commit to keeping the definitions of their performance commitments unchanged during 2020-25 and, if any unavoidable changes are required, to follow our procedures for changes. It is also important that companies have certainty of the basis upon which their ODIs are being assessed and so we do not consider it appropriate to make the retrospective change proposed by Northumbrian Water in relation to 2020-21 performance. However, we intend to consult all affected companies on whether to amend their operational carbon performance commitments to use a different version of the workbook for reporting in future years.

Having considered stakeholder responses, our final decision for this performance commitment is to retain our draft determination view based on the current GHG emissions reporting performance commitment definition.

2.2.4 Aligning customer and shareholder interests

Stakeholders' responses

Northumbrian Water states that where companies either incur penalties despite having comparatively strong performance relative to peers or gain rewards despite having comparatively weak performance relative to peers, this damages the credibility of the regime

and can be difficult to explain to customers impacting upon their levels of trust. The company considers that there are examples of this in the draft determinations for other companies and provides an example comparison of companies with sewer blockages performance commitments, suggesting a poor correlation between performance and ODI payments.

Consideration of responses and final decision

The in-period ODI determination process adjusts allowed revenue to reflect the out and underperformance payments due in light of a company's reported performance in relation to its PR19 final determination package of performance commitments and ODIs². The issue raised relates to the price control framework rather than the specific decisions we make in this process relating to Northumbrian Water. Therefore we consider this in section 2.2.3 of ['Sector overview: Final determinations of in-period outcome delivery incentives for 2020-21'](#).

2.2.5 C-MeX and D-MeX

Our draft decision

Our draft determination included a C-MeX outperformance payment of £2.925m and a D-MeX outperformance payment of £0.354m, 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

In its response regarding C-MeX, Northumbrian Water states that the calculation for the outperformance payment proposed used the allowed residential retail revenue from the December 2019 PR19 final determinations, rather than the value as determined by the Competition and Markets Authority. The company proposes that the updated figures determined by the Competition and Markets Authority should be used.

Consideration of responses and final decision

Having considered stakeholder responses, we have updated the C-MeX model to reflect the figures used in the Competition and Market Authority's redetermination. This has resulted in

² Or as amended through relevant corrigenda, annex 2 related changes or determinations by the Competition and Markets Authority.

an increased outperformance payment for this performance commitment from £2.925m to £2.927m. Payments for D-MeX are unchanged.

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.

The company 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 determination.

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.

Northumbrian 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 Northumbrian 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	0.241	0.241	0.241
Water network plus	-0.557	0.809	0.809
Wastewater network plus	0.637	0.637	0.637
Bioresources	0.059	0.059	0.059
Residential retail	1.482	1.482	1.482
Total payments	1.862	3.228	3.228

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	2.927	n/a
Water network plus	n/a	0.307
Wastewater network plus	n/a	0.047
Total payments	2.927	0.354

See section 2.2.5 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	0.241	0.000	0.000	0.000	0.241
Water network plus	0.809	0.307	0.000	0.000	1.116
Wastewater network plus	0.637	0.047	0.000	0.000	0.685
Bioresources	0.059	0.000	0.000	0.000	0.059
Residential retail	1.482	2.927	0.000	0.000	4.409
Total	3.228	3.281	0.000	0.000	6.509

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	0.241	0.000	0.000	0.241
Water network plus	1.116	0.000	0.000	1.116
Wastewater network plus	0.685	0.000	0.000	0.685
Bioresources	0.059	0.000	0.000	0.059
Residential retail	4.409	0.000	0.000	4.409
Total	6.509	0.000	0.000	6.509

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	-1.31	11.83	12.86	10.90
	Final determination	-1.31	12.24	12.47	10.90
Water network plus (K factors)	Last determination	0.39	0.67	0.42	0.83
	Final determination	0.39	1.14	-0.02	0.83
Wastewater network plus (K factors)	Last determination	0.41	3.39	2.01	2.56
	Final determination	0.41	3.80	1.63	2.56
Bioresources (unadjusted revenue, UR_t – £m, 2017-18 Nov CPIH prices)	Last determination	20.739	23.585	23.840	24.062
	Final determination	20.739	23.658	23.840	24.062
Residential retail (total revenue, TR_t – £m, nominal prices)	Last determination	56.015	56.901	57.758	58.634
	Final determination	56.015	62.921	57.758	58.634

We have based Northumbrian Water's final determination on the data and commentary provided to us by Northumbrian 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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