

November 2021

**Consultation on changes to per capita
consumption performance
commitments – our decision on
reporting performance and ODI timing**

About this document

In July 2021 we consulted on proposals to change the timing of, and considerations we would apply when, determining ODI payments (financial adjustments) for the PCC performance commitments. The proposal was applicable to the 17 water companies operating in England and Wales for whom we set individual price controls.

In this document we detail our decisions on changes to the timing and determination of the value of ODI payments for PCC performance commitments, following our consideration of respondents' views.

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Background

At PR19, companies proposed performance commitments related to specific levels of service performance for the benefit of customers and the environment. The performance commitments were set in companies' PR19 final determinations for the 2020-25 price control period and are defined in each company's PR19 outcomes performance commitment appendix.

All companies have at least one per capita consumption (PCC) performance commitment, which is designed to incentivise them to help household customers reduce their consumption. The performance commitments are measured in each year of the 2020-25 price control as a three year rolling average reduction from a baseline which is composed of performance averaged over 2017-18, 2018-19 and 2019-20.

With the exception of South West Water, companies have 'in-period' financial incentives for PCC performance commitments. In-period financial incentives are settled annually, bringing the financial impact closer in time to the performance that generated it. South West Water accrues notional financial incentives annually to be applied at the end of the price control period, it therefore has 'end of period' incentives.

Prior to our consultation, we had heard through our joint work with Frontier Economics, and our conversations with individual companies, the sector's concerns around the achievability of PCC performance commitments. Since late March 2020, measures introduced to combat the Covid-19 pandemic – such as increased working from home, closure of schools and the leisure and hospitality sectors – have impacted how much and when we use water. To varying degrees, companies have seen non-household water use decrease and household water use increase. This affects PCC performance commitments, which measure and provide financial incentives on household consumption only.

In the face of these challenges, we considered that companies should continue to have the strongest possible incentives to reduce PCC since efficient use of water reduces customers' bills; leaves more water for the environment; supports the transition to net zero; and improves the long-term water resources supply and demand balance. In proposing an intervention on how companies are incentivised, we considered we needed to account for a number of uncertainties which limit understanding of the measures introduced to combat the spread of Covid-19 and any enduring effects on PCC performance. Specifically:

- the relative influence of long hot spells of weather experienced during spring 2020 at the same time as Covid-19 related measures. We also anticipated variation between companies and within company areas depending, for example, on the extent to which customers began working from home;
- how long, and to what extent, changing consumption patterns might be maintained in light of the different types of restrictions later in 2020 and into

2021 and what this means for the performance commitment, given it is based on a 3 year average; and

- the extent to which the future path of the pandemic and the vaccination programme or UK and Welsh governments' plans to reopen the economy might impact the pace of future changes or how any long-term behavioural changes will lead to permanent changes in consumption patterns.

Having carefully considered the situation, we [consulted](#) in July 2021 on a proposal that the timing of our determination of the value of in-period outcome delivery incentive (ODI) payments (financial adjustments) for PCC performance commitments should be moved to end of period. We also proposed that, at the 2024 price review, in order to make a case for an intervention we would consider evidence of how measures introduced to mitigate the impact of Covid-19 affected companies' performance against the PCC performance commitment across all years of the 2020-25 price control period and the actions they had taken to manage demand. We proposed that we would consider this evidence when determining whether any intervention on ODI payments for PCC was necessary.

In this document we detail our decisions on changes to the timing and determination of the value of ODI payments for PCC performance commitments, following our consideration of respondents' views.

Our July 2021 consultation

In our July 2021 consultation, we proposed that the timing of the determination of the value of ODI payments for PCC performance commitments should be moved from in-period to end of period. We made this proposal for all companies except South West Water because that company's performance commitment is already designated as end of period. We advised that, if our proposal is implemented, all companies would have an end of period PCC performance commitment with annual performance commitment levels for which we would determine associated financial adjustments at the end of the 2020-25 period.

Under normal circumstances, accrued ODI payments would be determined as part of the 2024 price review (PR24) in accordance with the definitions set out in each company's PR19 outcomes performance commitment appendix. However, for PCC, we proposed to consider ODI payments based on evidence of:

- the shift in consumption due to the impact of measures to limit the spread of Covid-19;
- specific steps taken by companies during the price control period to reduce household demand for water; and
- The extent to which the need to recover any remaining shortfall has been incorporated into their proposals for PR24 and beyond.

Except for proposals to recover any shortfall, we advised that we expected this information for all years of the 2020–25 price control period. We advised we continued to require companies to report on their performance against the performance commitment levels set out in the PR19 final determination including any associated notional ODI payments and ODI return on regulatory equity (RoRE) impact. We also continued to require companies to include performance on the PCC performance commitment in their reporting of the percentage of performance commitments they have achieved.

Respondents' views

All 17 water companies operating in England and Wales for whom we set individual price controls responded to our consultation, in addition to the Consumer Council for Water (CCW).

All respondents agreed that we should change the timing of financial adjustments for performance against PCC performance commitments to end of period.

Our proposals on the approach to determining the value of ODI payments at end of period are welcomed explicitly by Anglian Water, Hafren Dyfrdwy, Severn Trent Water and United Utilities. Bristol Water also welcomes the proposed approach but seeks to clarify that any assessment of the impact of Covid-19 would include an estimate of a shift in consumption from non-households to households.

CCW, Dŵr Cymru, Southern Water, Yorkshire Water, South East Water, South Staffs Water, Affinity Water and SES Water make no comment on the suitability of the approach we have proposed. CCW advises that it supports an assessment of performance on PCC against all five years of targets within the 2020–25 price control period. Affinity Water suggests that any assessment of the impacts of Covid-19 should account for company-specific circumstances and, in addition to SES Water, it suggests that if we require additional data to understand the impact of Covid-19 then we should set out our requirements early.

Portsmouth Water and Northumbrian Water suggest that we should define new PCC baselines which reflect the increases in household consumption observed within their regions. Similarly, South West Water suggests that we should consider updating performance commitment levels to account for any enduring effects resulting from Covid-19. Thames Water and Wessex Water consider that PCC calculations will require significant annual research and adjustment to understand and account for the impact of Covid-19 with Thames Water suggesting that we should reflect the impact of Covid-19 on performance targets. Wessex Water highlights that lower PCC does not necessarily mean less water is abstracted from the environment since it considers demand has shifted from non-household to household locations; the company implies that an appropriate longer term solution is needed. The company also considers that

the impact of potential ODI payments should be excluded from ODI RoRE reporting since it considers this would be more transparent for stakeholders.

Northumbrian Water also calls for us to set out the methodology we will apply so that incentives are clear for company management teams to respond to. The company also considers that our proposal to include consideration of the extent to which companies have incorporated any shortfall into their proposals for PR24 and beyond conflates the incentive to reduce PCC with incentives to set stretching targets for the next price control period. Whilst it thinks this consideration is relevant it advises that this diverges from the approach for other performance commitments and suggests Ofwat might wish to trial an approach which specifies incentives for PCC across multiple price controls.

Our assessment and decisions

We have considered views from all respondents and below we set out our decisions and reasoning on changes to the timing of financial adjustments for performance against the per capita consumption performance commitments and our approach to determining their value.

Our decision on changes to the timing of ODI payments

All respondents agree to our proposal to make the timing of all financial adjustments for performance on PCC end of period and so we confirm that ODIs for PCC performance commitments will be end of period for all the relevant water companies.

Our decision on how we will determine the value ODI payments

Our consultation proposed that when we determine ODI payments for performance on PCC we would take into account three considerations when considering if any interventions are necessary (see 'Our July 2021 consultation'). We also committed to setting out more detail about our assessment approach and any evidence we will require from companies at a later date. Most companies agree or do not comment on this component of our proposal and we confirm our intention to apply the specified considerations when determining ODI payments and to set out any further information on our methodology and the evidence we will require in a timely manner.

In response to CCW's statement that it supports an assessment of performance on PCC against all five years of targets within the 2020-25 price control period, we confirm that it is our intention to consider performance against targets in each year of the price. When considering the need for any interventions we intend to draw on evidence

provided by companies to demonstrate the impact of Covid-19, and the actions they have taken to reduce household demand for water, in each year.

Two companies sought clarification on whether our proposal to consider the impact of measures to limit the spread of Covid-19 on performance includes an estimate of any shift in consumption from non-households to households and any company specific circumstances. We confirm that 'the impact of measures to limit the spread of Covid-19' includes the direct and indirect consequences of measures introduced to combat the spread of the disease, for example any shift in consumption that has arisen due to increased working from home. Our consultation also anticipated that the impact of Covid-19 may vary within and between company areas; we intend to take this into account when determining ODI payments and whether interventions are necessary. We will determine ODI payments at the end of the period rather than modify the performance commitment definition, levels, incentive rates or baselines because, as recognised in many companies' responses, there remains uncertainty about the extent to which changes in consumption patterns will be maintained during the remaining years of the price control period. For example, uncertainty remains regarding any further restrictions which might require working from home and long-term behavioural changes. We consider that any performance commitment adjustments made in-period would be subject to these uncertainties and would therefore not provide robust incentives for companies to reduce demand. Instead, moving the decision on ODI payments to end of period allows sufficient time for companies, and Ofwat, to understand the impact of Covid-19 to date and any future changes.

One company called for more specific details on how we will determine the value of ODI payments at end of period so that incentives on management are clear. We advised in our consultation that we would set out any further detail we might require when considering the need for interventions once we have received more information on the impacts on PCC performance and the effectiveness of companies' actions. To date, for example in their 2020-21 annual performance reports, some companies have provided some insight into the impact of Covid-19 in the first year of the price control and the steps they have taken to manage demand since the onset of the pandemic. However, many provided little insight. This, in combination with uncertainty about whether consumption patterns are changing as restrictions have eased, means we do not consider it feasible to set out a more specific methodology at this time without undermining incentives for reducing demand. However, we have specified the considerations we will apply when we determine ODI payments and the need to intervene and consider that, in the face of dynamic external conditions, our approach provides the strongest incentive for companies to reduce demand. Furthermore, companies have sight of – and are working towards¹ – longer term targets such as the UK government's proposed personal water use target of 110 litres per head per day² which will guide their current efforts.

We encourage all companies to conduct the work some have begun to understand the drivers of changes in consumption in their regions since the onset of the pandemic. As we have advised in our direct communications to companies and in our consultation document, we also expect companies to:

- take action to reduce water consumption and evaluate the benefits this delivers, for example using localised experiments and randomised control trials;
- share learning from their individual efforts; and
- build on existing water efficiency campaigns to deliver a collaborative, effective and sustained multi-channel approach.

We also maintain our expectation that companies include PCC payments in their ODI RoRE reporting. This approach explicitly demonstrates the total potential risk companies are subject to and highlights the need for action. One company suggested that this lacks transparency for stakeholders. However, as we suggested in our original consultation document, when communicating with their stakeholders about their performance, companies may wish to highlight the impact of PCC performance and the associated financial risk that may, or may not, crystallise.

We intend to set out further details on our approach when we have sufficient understanding of how water use is changing and the actions companies are taking to reduce it. We expect to hear this from companies in their annual performance reports and we consider information provided in 2022 will be key to setting out further information. When we come to make decisions on ODI payments during the 2024 price review we will require sufficient and convincing evidence of the impacts of Covid-19 and companies' mitigating actions for each year of the 2020-25 price control, in addition to their plans for recovering any shortfall beyond 2024-25.

One company suggested that our proposal conflates incentives to reduce PCC with incentives to set stretching targets for the next price control period. It stated this is not consistent with our approach for other performance commitments. It is correct that, under normal circumstances, when we determine ODI payments for performance commitments we do not consider a company's plans to recover any shortfall. For PCC, we consider that the potential impact of the Covid-19 pandemic on water consumption is sufficiently different from most other performance commitments, which supports taking our proposed approach. Finally, the same company suggests we pilot a multi-price control period incentive for PCC. We are considering how we can evolve the incentive framework for future price control periods to reinforce the focus on the long-term and will provide further details in the PR24 draft methodology next year.

Other issues raised by respondents

Related to the proposals in our consultation, Thames Water and Wessex Water suggest that Ofwat should consider an alternative measure to PCC for future price control periods. The companies suggest this because a component of water use which has, to varying extents, shifted from non-households to households.

Per capita consumption is a well-established metric which we expect to endure beyond the current price control in water resources management planning and for monitoring

progress towards proposed longer term water use targets. Through the development of the PR24 methodology we are considering how we can provide the strongest possible incentives for reducing all major sources of water use, including household and non-household consumption. We encourage companies to engage with the development of future performance commitments through our PR24 outcomes working groups.

Next steps

We have published an updated change log for each relevant company on our [PR19 Outcomes performance commitments - changes and corrections](#) website. We include below the changes we have made.

Our decisions on when and how we will determine ODI payments for PCC should not lead to a delay or easing in demand reduction activities now or in the remainder of the period. Companies should use this valuable opportunity for the sector to identify what more can be done and take collaborative and sustained action to deliver.

Changes to all relevant companies:

For per capita consumption (PCC) performance commitments, in the ‘Performance commitment definition and parameters’ table for:

Timing of underperformance and outperformance payments	In-period
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Read:

Timing of underperformance and outperformance payments	End of period
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¹ As agreed by the national water resources framework senior steering group comprising representatives from England and Wales ([Meeting our future water needs: a national framework for water resources](#))

² [The government's strategic priorities for Ofwat \(2021 draft consultation\)](#)

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