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Dear [REDACTED]

**Portsmouth Water response to the PR24 and beyond: a discussion paper on outcome delivery incentives (ODIs).**

Thank you for the opportunity to respond to this discussion paper. We welcome the opportunity to comment through both this consultation and also previously through the outcome working group.

We have structured our response to specifically answer the questions in the consultation document, but first provide a summary of our key points to raise at this stage of the process.

Addressing Balance of Risks and Rewards Between Water and Wastewater

There is currently disparity between ODI rates for water and wastewater. During AMP6, the industry has been in net penalty for water, whilst in net benefit for wastewater. Early indications is that we expecting a similar trend for AMP7.

This particularly impacts water-only companies and has meant we have had a less compelling risk/reward balance in previous price reviews. We very strongly feel that this current imbalance should be taken into account when considering ODI rates for PR24, through a reassessment of the structure of Performance Commitments (PCs).

We strongly feel that ODI rates should be structured to provide incentive to be industry leading in PCs. Rewards and penalties should be aligned to comparative performance, where high performing companies get rewards and low performance results in penalties.

Examples of how this has worked well in PR19 are C-MeX and Interruptions to Supply, and we believe this structure should be used for all PCs that have robust comparative data between companies. The result would be that companies would continue to be rewarded for strong performance, whilst poor performing companies would not be rewarded for moving from poor to average performance.

### Symmetric Rewards/Penalties

It is felt that ODI rates should also be symmetric, aligning rewards for excellent performance with penalties for poor performance. Obtainable ODI rewards incentivise continued increased performance and should be considered for all PCs where further improvements will benefit customers.

### Use of Price Control Deliverables

External factors such as Covid and weather should be taken into account when setting ODI rates, and considering which areas should be PCs and which should be Price Control Deliverables (PCDs). We believe where there is a high possibility of prolonged external influence (such as the effect Covid has had on PCC), there is a strong case to move from PCs to PCDs, measuring performance against the actions set out in a business plan and rewarding/penalising based on efficiency of delivery.

We also feel PCDs should be considered for asset health-based metrics, where the benefit of investment may not affect short term performance. Instead, PCs should be focused on customer facing metrics.

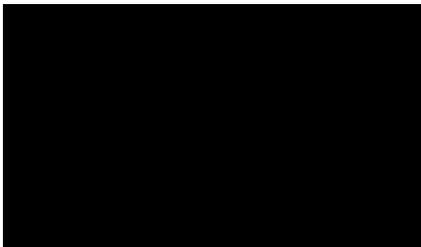
### Centralised Research Concern

Finally, we are concerned over the robustness of the centralised customer research currently proposed. Whilst we are supportive of the principle of centralised research, we believe only conducting a single survey to be a significant risk, considering the importance of the results in setting ODI rates.

The fieldwork will be completed during April and May, during a period where we expect substantial cost increases for customers across fuel, energy and food. It is felt it would be prudent to complete further research later in the year to provide a second reference point, or to allow companies to feed in their own research to offer checks and balances against the initial results.

Once again, thank you for the opportunity to respond to this consultation and we look forward to continuing the discussion on ODI's through future working group meetings.

Yours sincerely,



Regulation Manager

## **CONSULTATION RESPONSE**

### **Q1: Do you have any comments on what the purpose of Outcome Delivery Incentives (ODIs) should be for PR24?**

The purpose of ODIs should be to incentivise excellent customer service across all common Performance Commitments (PC). It should reward companies who are industry leading in a specific PC and penalise those with poor performance.

Rewards and penalties should be symmetric to ensure companies are appropriately incentivised to provide excellent customer service and not just avoid poor service.

ODIs should not be used to reward companies for poor past performance, by incentivising improved performance from poor to average. ODIs should not be used to penalise companies for excellence past performance, by setting penalties at levels of service where other companies would get rewards.

It is felt that ODIs work best for PCs where comparative performance can be measured. An example is C-MeX, where the ODI rewards the best performing companies and penalises the worst, whilst also challenging companies to go beyond industry leading performance through the opportunity of additional rewards.

It is felt that ODIs do not work for PCs where performance can be significantly influenced by external factors. An example is PCC which continues to be significantly impacted by Covid. It is felt that the use of Price Control Deliverables (PCDs) and associated reward/penalty mechanisms, rather than PCs and ODIs, would work better in these instances.

### **Q2: Do you have any comments on our observations on the standard ODI rate formula and how we are considering revising it?**

It is felt that simplifying the formula is a positive step.

We would like to see consistent sharing rates of 50% for rewards and penalties used as a starting point for all ODIs, with adjustments only made to avoid distorted incentives and correct for perverse outcomes.

### **Q3: What are the risks of unintended consequences from this approach? How can they be mitigated?**

As mentioned in our response to Q1, ODIs should not end up rewarding companies for poor past performance, or penalising companies for excellent past performance.

### **Q4: Do you have any comments on using a bottom-up approach based on marginal benefits for setting ODI rates?**

It is felt that this is the correct approach for PR24. Each PC should be considered on its own merit.

### **Q5: Do you have specific comments on setting ODI rates for asset health-related PCs?**

It is felt that PCDs would be a better option for measuring and incentivising the right level of asset maintenance. Companies would need to justify the investment through their business plan and set out a delivery plan to achieve this. The PCD would then assess against this appropriate level of work, and incentivise delivery efficiency.

It is also argued that PCDs should be used for PCC for PR24. The effect of Covid is still to be fully understood and companies should be incentivised to achieve their water efficiency actions set out in their business plan, rather than be rewarded/penalised for changes in customer behaviour out of their control.

**Q6: What are your views on using top-down allocation approaches for setting ODI rates or for other uses?**

It is felt that each PC should be considered on its own merit. Companies that are industry leading in multiple areas should not be penalised for being so.

Should a top-down approach be preferred, the use of RCV should not be used to set size of incentives, as this would result in disproportionate increases in bills across the country.

**Q7: How would we ensure that the performance increments for individual PCs are sufficiently robust and protect customers?**

It is felt that this question could be asked for both bottom-up and top-down approaches.

There is concern that using collaborative research results based on a single survey will bias the results when considered against the 2025-2030 period. The survey was undertaken at a specific time when cost of living is rapidly increasing and media coverage of the water industry is high.

**Q8: Should we retain enhanced ODIs and PR24? If we do, should they apply to all companies? And which PCs should have enhanced ODIs?**

Enhanced ODIs should remain and should be an option for companies for all common PCs when robust comparative statistics are available.

**Q9: How should we approach assessing and setting enhanced ODIs at PR24?**

Companies should be rewarded for beyond industry leading performance on PCs where further improvement is beneficial to customers.

**Q10: For water companies: how have enhanced ODIs influenced your company's decision making around achieving high performance?**

Whilst not specifically an enhanced ODI, the opportunity to obtain additional reward for beyond industry leading customer service (C-MeX), that aligns with high performance in the retail sector, has driven the aspiration for continued improvement despite being industry leading in 2020/21.