

October 2022

# **Draft determination of South West Water's in-period outcome delivery incentives for 2021-22**

## About this document

This document provides our draft determinations on the extent to which the price controls included in our [PR19 final determinations](#) need to be adjusted to reflect South West Water's performance for the 2021-22 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 adjustments, and our reasons for these, are set out in this document and in our [Sector overview: Draft determinations of in-period outcome delivery incentives for 2021-22](#).

On 3 June 2021, Pennon Group plc (the parent undertaking of South West Water Limited) acquired 100% of the share capital of Bristol Water Holdings UK Limited BWHUK (the parent undertaking of Bristol Water Limited). Paragraph 2.3 of the undertakings made by Pennon to the CMA and accepted by the CMA on 7 March 2022 states that South West Water and Bristol Water will continue to report their performance commitments and ODIs separately for the remainder of the 2020-25 price control period. Therefore, our draft determinations state separately the extent to which the PR19 price controls need to be adjusted to reflect Bristol Water's performance and South West Water's performance for the 2021-22 charging year.

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

We welcome your views by 21 October 2022. We will make our final determinations by 15 November 2022.

## Background

At the 2019 price review (PR19), companies' made performance commitments, or pledges, to their customers and stakeholders about the service levels they would meet to make progress towards their outcomes. South West Water's performance commitments for the 2020-25 period are set out in [PR19 final determinations: South West Water - Outcomes performance commitment appendix](#).<sup>1</sup>

Each performance commitment (PC) has an outcome delivery incentive (ODI) that provides either financial or reputational consequences for companies of outperforming or underperforming their performance commitments. Many of the financial ODIs are paid during the 2020-25 price control-period. The reason for this is to bring payments closer in time to

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<sup>1</sup> We take account of performance commitments as set out in the PR19 definitions adjusted, if relevant, in accordance with Annex 2 of the company's performance commitment appendix. Annex 2 provides for changes and corrections to be made to 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](#).

when customers experience a given level of performance. The remaining incentives are paid at the end of the period.

ODIs act as an incentive for companies to deliver their committed levels of performance, returning funding to customers for foregone benefits if they deliver less than is expected. Companies that go beyond and deliver greater benefits than expected to customers and the environment can receive outperformance payments.

South West Water reported its performance against these performance commitments in its annual performance report (APR) in July 2022. We have considered this information and, where necessary, further information from companies' answers to our queries. In our draft determination we set out relevant adjustments to the company's price controls, for one or more future years, in accordance with Part 3A of Condition B of each company's licence.

We will make our final determination by 15 November 2022. These will affect South West Water's customers' bills from the 2023-24 charging year.

## Executive summary

Having assessed the company's performance against its performance commitments in 2021-22, the ODI payments and performance are as reported by the company with the following exceptions:

- C-MeX and D-MeX – we are including a C-MeX underperformance payment of £0.576m and a D-MeX underperformance payment of £0.019 m, based on the assessment of 2021-22 company performance; and
- Water supply interruptions – we have intervened to include the impact of damage to watermains caused by a third party at Carland Cross. This increased ODI underperformance by £3.173m.
- Sewer blockages – we have intervened to reduce the outperformance by £0.087m because the reported value did not fully align with the performance commitment definition.

We are intervening to include the impact of the Carland Cross incident, which the company excluded from its reported performance, in the company's water supply interruptions and resilience in the round PCs. This ensures that there are no adjustments to the payments that ordinarily flow under the price control package in the PR19 final determination. In our draft determination we increase the company's underperformance payments on its water supply interruptions PC by £3.173m and on its resilience in the round PC by £4.899m.

See section 1 for details of our interventions and policy decisions

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## 1. Results of our assessment

### 1.1 Interventions and policy decisions

Table 1.1 below sets out our view of the payments due for performance commitments on which we have intervened compared to the values reported by South West Water.

**Table 1.1: Summary of interventions**

Performance commitment	Company's reported payments 2021-22 (£m)	Our draft determinations after interventions 2021-22 (£m)	Difference (£m)
Sewer Blockages	0.822	0.735	-0.087
Resilience in the round - water	0.234	-4.665	-4.899
Water Supply Interruptions	-0.300	-3.473	-3.173
<b>Total</b>	<b>0.756</b>	<b>-7.403</b>	<b>-8.159</b>

In our draft determination we are intervening on the following performance commitments:

#### Sewer Blockages

We are intervening to decrease South West Water's sewer blockages PC outperformance payment for 2021-22 from £0.822m to £0.735m. The decrease of £0.087m is because the company incorrectly excluded 87 blockages from the reported performance of 6458. The company stated that these were excluded because for some customers there is clear evidence of repeated and deliberate abuse of the sewers which causes restrictions in its use e.g. multiple incidents at the same address. The company says its approach aligns with provision in the Water Industry Act. We do not consider this to be relevant to the operation of the PC, which does not provide for this type of exclusion; nor do we consider that it should do so, because this does not incentivise the company to be proactive and innovative in resolving problematic customer behaviours. Therefore, we consider that these incidents should be included in the reported performance. The performance commitment requires that all contacts that result in a confirmed blockage are reported, including repeat blockages and those caused by third party interference. Only blockages that are proactively found by the company can be excluded.

## Requests for exclusions due to third party interruptions

### Background

South West Water excluded the impact of third party damage to its assets at Carland Cross from its performance on its common water supply interruptions PC and its bespoke resilience in the round PC. These exclusions reduced the company's underperformance on these PCs by £3.173m and £4.899m respectively.

South West Water states that "this third-party event has had an impact of orders of magnitude greater than third-party impacts in prior years, and the circumstances around it make the nature of it exceptional." Consequently, the company asked us to exclude its impact from the calculation of its ODI payment.

With regard to the water supply interruptions PC, the company considers that given the way it responded, it does not believe that the ODI regime would be best served by holding the company liable for the Supply Interruptions ODI impacts of this third-party damage. It says that there are no reasonable measures to prevent the interruption or connect customers that it is incentivised to put in place to avoid this happening again.

In relation to the resilience in the round PC, the company considers that the ODI regime would not be best served by holding South West Water liable for the impacts of the third-party damage, which it says was not foreseeable. The company says that no reasonable action by it could have avoided the incident and that there is no feasible action it could, or would, take now to avoid this happening again without considerable further investment in resilience in its network as part of PR24.

### Our assessment

We consider that the PCs and ODIs consulted on and set at PR19 were reasonable. As regards the treatment of events raised by the company, in general, PR19 performance commitments provide few exclusions, because we want companies to be incentivised to minimise the impact of adverse events on customers. Our PR19 methodology, confirmed in the PR19 final determinations, was to include the impact of events such as extreme weather in reported performance; asset failures caused by third parties are included in both PC definitions and so these should feature in reported performance.

At PR19, we also stated the importance of companies having confidence that performance commitments will not change during the price control period. We said that if there is a potential for such change, this could lead to a disconnect between the cost/service package specified at the start of the period and what is delivered; potentially incentivise companies to focus on convincing Ofwat of the need for a change as opposed to focusing on delivering what matters to customers; and add complexity. The same concerns apply to the potential for creating exceptions during the period by excluding events.

Nevertheless, we have considered South West Water's performance in relation to each relevant PC and whether, in light of our duties and policy objectives, we should exercise our discretion to depart from the outcomes that would ordinarily flow from operation of the ODIs, to make changes to payments. Our assessment focused on whether interventions beyond those protections already built into the PR19 final determination are necessary to ensure that the company bears the appropriate level of risk and remains incentivised to deliver for customers. Our consideration included the following:

- We reviewed the two PC definitions to understand the expectations in place for each PC.
  - The water supply interruptions PC, which incorporates the [reporting guidance for PR19 – Supply Interruptions, published on 27 March 2018](#), does not allow exclusions where asset failure is caused by third parties. It states that the default position is that the water company manages the risk of supply interruptions and there are no exclusions. This measure covers planned and unplanned interruptions. The cause of the interruption is not relevant to the calculation of the reported figure. That is, asset failure caused by third parties would be treated the same as the failure of the company's assets and planned or unplanned interruptions are the same.
  - Likewise, the resilience in the round PC definition does not allow exclusions where asset failure is caused by third parties. It includes the number of customers (properties) who experience continuous unplanned loss of mains water supply to their property for durations greater than 12 hours and states that this can be due to "flooding, or other events such as third-party damage, freeze and thaw conditions, catastrophic asset failure, lightning storms, etc."
- We considered South West Water's performance against the PC and note that the company's performance of 6 minutes and 47 seconds per property per year on its water supply interruptions PC. Although the company chose, through the fast-track process not to have a collar on this PC, we note that its performance is some way off triggering the standard collar of 16 minutes and 59 seconds per property per year in place for other companies on this PC. For the water resilience in the round PC, the company reported outperformance payments of £0.234m in 2021-22 compared to outperformance payments £0.684m in 2020-21. By its nature this bespoke PC cannot be easily compared to others and, as set out above, the PC was proposed without caps or collars.
- We considered South West Water's overall performance against all its performance commitments for 2021-22 (including C-MeX and D-MeX). The company reported a net underperformance of £4.617m. Reinstating underperformance of £8.072m for exclusions and including C-MeX and D-MeX underperformance payments, this increased to £13.284m. We note that this is not out of step with the range, calculated at PR19, of out/underperformance payments that the company might reasonably be expected to incur during 2020-25 and the broad potential RoRE five-year average range for ODIs set out in PR19 methodology of +/- 1 to +/- 3%. This is also the case, when we consider South West Water's overall performance across 2020-21 and 2021-22.

- We considered the impact of the event on South West Water's performance. We note that the biggest financial impact from these events (£4.899m) is from the bespoke resilience in the round PC, which the company proposed itself without any underperformance collar or outperformance cap. As noted above, the company also, through the fast-track process at PR19, chose not to have caps and collars on the water supply interruptions PC. This means that the company did not consider it needed protection against underperformance, as part of its risk and return package. When compared with the range of out/underperformance payments that the company might reasonably be expected to incur overall, we consider that the impact of these events was within the expected range for South West Water.
- We consider that loss of supply is perhaps the most serious water service failure, especially for vulnerable customers. The impact for customers of these service interruptions were severe. Up to 20,000 properties in the South West Water area were affected in some way. While South West Water was able to restore supply to most within 12 hours, over 3000 were affected for more than this length of time. This is why the PCs are designed to apply strong incentives to companies to minimise any impact or lack of supply and to protect the environment. This includes low probability high impact events, with resilience being a key part of the PR19 process. We consider that excluding the impact of these events may weaken the company's incentives in relation to such events in the future and managing the impact on customers.
- We considered whether not intervening was likely to create unwanted incentives to invest so as to minimise risk in an inefficient way, which would not be in customers' interests. We noted, in this regard, South West Water's comments about the extent to which the incident was foreseeable. Companies are subject to both upside and downside risk from ODIs. And companies need to manage resilience through base expenditure and, where appropriate, can request enhancement expenditure to reduce risk. We set out our criteria for resilience enhancement expenditure in the PR24 draft methodology. As part of this, companies will need to undertake a systematic assessment of risks to identify potential schemes. For each scheme, they will then need to quantify the impact on risk of the proposed expenditure. Proposed options will need to be cost beneficial, best value and have customer support.

## Our decision

Having reviewed the company's APR submission and supporting evidence, in light of the assessment described above, we consider that it is necessary to intervene to include the impacts of the Carland Cross incident in the relevant PCs. This means that there are no adjustments to the payments that ordinarily flow under the price control package in the PR19 final determination. Our decision ensures that the company bears the appropriate level of risk and remains incentivised to deliver for customers and the environment.

As a result in our draft determination we increase the company's underperformance payments on its water supply interruptions PC by £3.173m and on its resilience in the round PC by £4.899m.

Finally, we note that the company excluded the impact of the event from the data reported in its APR, Tables 3A-H and the in-period ODI models. For the avoidance of doubt, companies must include the impact of any such issue or event in the data submitted in their APRs. This ensures all stakeholders have a clear and transparent view of each company's performance when the APRs are published. Until Ofwat agrees, after consultation, to intervene there is no basis to exclude these impacts from reported performance (beyond those clearly stated within the definitions and reporting guidelines). Subject to consultation and final determination we would expect the APR to be republished and resubmitted with the impact included in the APR.

## **Leakage and per capita consumption (PCC)**

We are deferring our decision for South West Water's performance in relation to its leakage performance commitment and the associated ODI payment. This is to give us sufficient time to consider further information that we have requested. We expect that this will give us a clearer understanding of the data and the methodology the company has used for reporting its 2021-22 leakage performance commitment.

We continue to engage with South West Water to fully understand its methodology and ensure that any changes reflect real improvement in performance. The company is providing further information regarding its water balance data. We will consider this ahead of making our final determinations.

As a consequence of our deferral, our draft determinations retain the ODI payment for leakage performance reported by South West Water of £0.000m. Should any leakage or per capita consumption (PCC) information be revised or restated in future, our subsequent in-period determinations will take account of the company's relevant performance and the adjustments we have made to the relevant price control in relation to the leakage performance commitment.

## **Internal Sewer Flooding**

At PR19 we introduced enhanced ODI rates for some performance commitments. These rates apply when a company delivers excellent performance that will improve sector benchmarks. South West Water's 2021-22 reported performance has reached the level at which these rates start to apply. At PR19 we also specified that knowledge sharing is an important element of the enhanced ODI framework, and we said that we will take account of companies' evidence of their knowledge sharing activities when reconciling enhanced ODI payments. Having reviewed its submission, we queried the company asking it to clarify how it had met these requirements. The company provided us with information relating to the activities it had undertaken to reach this level of performance. In addition, we have seen evidence that South

West Water has shared knowledge with the sector. We expect this knowledge sharing to continue and, should the company claim any enhanced ODIs rates in future years, we will again scrutinise the quality of the knowledge sharing and make proportionate adjustments to ODI payments as necessary.

## 1.2 C-MeX and D-MeX

On 21 September we published the relative performance of all companies. Our draft determination includes a C-MeX underperformance payment of £0.576m and a D-MeX underperformance payment of £0.019m based on our assessment of 2021-22 company performance.

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.

## 1.3 Payment deferrals and abatements

As set out in our [PR19 final determinations](#) and the [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.

South West Water did not request any payment deferrals or 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 deferrals or abatements in our draft determinations.

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

### 2.1 Our draft determination

In this section we outline the financial impacts of our draft determinations.

Unless otherwise stated all values are £m in 2017-18 FYA CPIH prices.

**Table 2.1: Draft determinations on adjustment to 2023-24 price controls as a result of performance against ODIs**

This table sets out our draft determinations on the ODI payments to be applied to price controls in the 2023-24 charging year after accounting for:

- the in-period ODI payments for each company based on their performance in 2021-22;
- our draft determinations on these payments after any interventions; and
- our draft determination on C-MeX and D-MeX payments.

For further details on the interventions, deferrals, abatements and bespoke adjustments, see section 1.

This draft determination on the ODI payments to be applied for South West Water is also set out in the in-period adjustments model published on our website.

Price control	Company's reported ODI payments (£m)	Interventions (£m)	ODI payments deferred from 2020-21 (£m)	Ofwat DD deferrals (£m)	Ofwat DD abatements (£m)	Bespoke adjustments (£m)	C-MeX payments (£m)	D-MeX payments (£m)	Total ODI payments to be applied to customer bills in 2023-24 (£m)
Water resources	-0.300	0.000	0.000	0.000	0.000	0.000	0.000	0.000	-0.300
Water network plus	-1.009	-8.072	0.000	0.000	0.000	0.000	0.000	-0.009	-9.090
Wastewater network plus (WaSCs only)	-3.307	-0.087	0.000	0.000	0.000	0.000	0.000	-0.010	-3.404
Bioresources (WaSCs only)	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Residential retail	0.000	0.000	0.000	0.000	0.000	0.034	-0.576	0.000	-0.542
<b>Total</b>	<b>-4.617</b>	<b>-8.159</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.034</b>	<b>-0.576</b>	<b>-0.019</b>	<b>-13.336</b>

## Table 2.2: Breakdown of bespoke adjustments

This table provides a breakdown of the bespoke adjustments included in our draft determinations.

Price control	Prior year restatements (£m)	Prior year C-Mex indexation (£m)	Prior year D-Mex indexation (£m)	Prior year total (£m)	Time value of money adjustment on prior year total (£m)	Green recovery (£m)	Total bespoke adjustments to be applied to customer bills in 2023-24 (£m)
Water resources	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Water network plus	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Wastewater network plus (WaSCs only)	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Bioresources (WaSCs only)	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Residential retail	0.000	0.033	0.000	0.033	0.001	0.000	0.034
<b>Total</b>	<b>0.000</b>	<b>0.033</b>	<b>0.000</b>	<b>0.033</b>	<b>0.001</b>	<b>0.000</b>	<b>0.034</b>

The prior year C-Mex and prior year D-Mex values correct an error in how the C-Mex and D-Mex models applied indexation in 2020-21. Where applicable we adjust for the time value of money.

## Table 2.3: Changes to price controls (draft determinations)

This table sets out the impact of our draft determinations on the company's price controls, as set out in the in-period adjustments model published on our website. See [Sector overview: Draft determinations of in-period outcome delivery incentives for 2021-22](#) for how we are applying adjustments for tax and inflation.

<b>Price control</b>		<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>2024-25</b>
<b>Water resources (K factors)</b>	Previous determination	-2.54	1.65	-0.57	-0.23
	Revised	-2.54	1.65	-2.70	1.78
<b>Water network plus (K factors)</b>	Previous determination	0.58	-1.75	0.60	-0.18
	Revised	0.58	-1.75	-5.31	5.51
<b>Wastewater network plus (WaSCs only)</b>	Previous determination	-0.82	-6.35	5.92	-1.75
	Revised	-0.82	-6.35	3.74	0.16
<b>Bioresources (WaSCs only)</b>	Previous determination	23.360	23.372	23.691	23.911
	Revised	23.360	23.372	23.691	23.911
<b>Residential retail (total revenue, TRt – £m, nominal prices)</b>	Previous determination	30.516	29.772	30.516	30.477
	Revised	30.516	29.772	29.698	30.477

We have based South West Water's draft determination on the data and commentary provided to us by South West Water. 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.

### 3. Responding to this consultation

We would welcome any comments on this document. Please email them to [in-periodODIs@ofwat.gov.uk](mailto:in-periodODIs@ofwat.gov.uk) or post them to:

IPD2022 Consultation response

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[Or Ofwat, 11 Westferry Circus, Canary Wharf, London, E14 4HD if that is more appropriate.]

The closing date for this consultation is **21 October 2022**. If you wish to discuss any aspect of this consultation, please contact the In-period ODI team by post or by email at [in-periodODIs@ofwat.gov.uk](mailto:in-periodODIs@ofwat.gov.uk)

We intend to publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk). Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our [privacy policy](#) explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this draft determination, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for

disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

We will publish our final determinations by **15 November 2022**, after considering representations from all stakeholders.