

15 November 2022

# **Final determination of Affinity Water's in-period outcome delivery incentives for 2021-22**

**Ofwat**

## About this document

This document provides notice of our final determination on the extent to which the price controls set by the [PR19 final determination](#) are to be adjusted to reflect Affinity 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: Final determinations of in-period outcome delivery incentives for 2021-22](#).

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

## Background

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

Each performance commitment 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 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.

Affinity Water reported its performance against these performance commitments in its annual performance report (APR) in July 2022. We assessed the company's performance against its performance commitments and, in October 2022, consulted on our [draft determinations](#) for companies' in-period ODIs for 2021-22.

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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](#).

In our final 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 the company's licence. The results of our assessment for 2021-22 will affect Affinity Water's customers' bills in the 2023-24 Charging Year.

Further details regarding the responses we received, our final determinations and the adjustments that we have made are presented in sections 1 and 2, and in [Sector overview: Final determinations of in-period outcome delivery incentives for 2021-22](#).

In our [Sector overview Final determinations of in-period outcome delivery incentives for 2020-21](#) we deferred our determination of the value of companies' Per Capita Consumption (PCC) ODI payments for the 2020-21 to 2023-24 charging years to the end of the 2020-25 period. We set out this decision and the reasons for it in the [Consultation on changes to per capita consumption performance commitments – our decision on reporting performance and ODI timing](#) which we published after having considered stakeholder responses to our July 2021 consultation.

## Executive summary

Having assessed Affinity Water'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 £1.041m and a D-MeX outperformance payment of £0.034m, based on the assessment of 2021-22 company performance.

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

We are not intervening on Affinity Water's reported performance and ODI payments for 2021-22 in our final determination. The company has not requested any interventions.

We have the following comments on our policy decisions.

### Properties at risk of low pressure

#### Our draft determination

In our draft determination we stated that in its APR, Affinity Water requested that we correct the company's 2020-21 performance for its Properties at risk of receiving low pressure PC. This was because the company could not accurately predict how many properties were likely to continue to receive low pressure when it submitted its 2021 APR but now had the actual figures for 2020-21. The company proposed to make this retrospective adjustment in its APR for each subsequent year of the 2020-25 period, irrespective of any positive or negative impact. We accepted the company's proposal and made this correction with respect to 2020-21 performance. This correction did not affect the company's reported performance or ODI payments as the company's restated 2020-21 performance remains beyond the standard underperformance collar and so payments are limited to the level of the collar.

#### Stakeholders' responses

We did not receive any specific comments on this issue.

#### Consideration of responses and final determination

Since draft determination we have further examined the evidence provided by the company against the requirements set out in the reporting guidance (published in 2017<sup>2</sup> and the original June Return guidance which it references), in addition to reviewing reporting methods across other water companies. We now consider that Affinity Water may be interpreting the reporting guidance incorrectly. Therefore, in our final determination, we do not accept the company's proposed changes to its reporting methodology for low pressure. This means we do not change the 2020-21 reported performance. We will continue to engage with Affinity Water to clarify reporting issues before annual reporting next year.

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<sup>2</sup> [Properties at risk of receiving low pressure - Ofwat](#)

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

### **Our draft determination**

In our draft determination, we said that we had expected Affinity Water to have been compliant with the PR19 common performance commitment definitions when reporting 2020-21 and 2021-22 leakage and PCC data. The guidance sets out that where a company is not able to meet any part of the guidance then it is required to explain any shortfalls, its materiality, and plans to address this.

In its 2021-22 APR, Affinity Water identified that it had not achieved full compliance with this methodology. We queried the company, asking it to demonstrate the impact of non-compliance with the methodology on leakage data and provide its assessment of whether non-compliant components have a material impact on leakage values. Affinity Water was able to demonstrate that its reported performance represented the smallest leakage reduction, and therefore the highest underperformance payment, within the range produced from the sensitivity analysis performed.

As a result, our draft determinations included the leakage performance reported by Affinity Water and the associated ODI underperformance payment of £0.176m.

As stated in our draft determination, we expect all companies to be reporting full compliance with the leakage and PCC methodology. Should any leakage or per capita consumption information be revised or restated in future, 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.

### **Stakeholders' responses**

We did not receive any specific comments on this issue.

### **Consideration of responses and final determination**

Having received no stakeholder responses on this matter, our final determination on the company's performance payment for this performance commitment remains unchanged from our draft determination, above.

## **Taxation**

### **Our draft determination**

During our 2021 in-period ODI determinations Affinity Water requested that we adjust the marginal tax rate in our in-period determinations to 0% to align with its specific circumstances. In our 2021 in-period ODI final determinations we retained a tax rate of 19%. We retained the 19% tax rate for our 2022 in-period draft determination, because the

evidence the company submitted did not convince us that a different tax rate should be applied.

### **Stakeholders' responses**

In its consultation response, which is published on our [website](#), Affinity Water noted that last year we said 'if there is a material impact on customers or companies as a result of a difference between the marginal rate of tax that a company pays in the following charging year and our assumption, we may consider reconciling this at PR24.'. The company suggested that using the word 'may' creates uncertainty. It would prefer instead that we used the word 'will'. Affinity Water said that this would increase certainty and help it complete PR24 data tables and models relating to tax reconciliation.

### **Consideration of responses and final determination**

When describing our policy on tax reconciliation we deliberately used the word 'may' rather than 'will' because there are some scenarios where it may not be appropriate to reconcile this at PR24. For example, if a company moves from a non-tax paying position to a tax paying position within the AMP, we need to retain a tax adjustment for the company to be impacted by the full strength of the incentive. As, even if the company has no taxable profits in the year, increasing a penalty to reflect tax saving will create additional tax losses that can be utilised to reduce tax charge in the future. Also, if the company was not following our PR19 methodology on tax (e.g. utilising group tax losses or surrendering tax losses without payment etc.) with no benefit to customers, we may decide it is not appropriate to change the marginal rate of tax in our modelling.

Having considered stakeholders' responses on this matter, our final determination on the company's performance payment for this performance commitment remains unchanged from our draft determination, above. This is because the company's response refers to PR24 policy rather than our in-period ODI determinations for 2021-22 performance.

### **Risk of severe restrictions in a drought**

#### **Our draft determination**

We did not comment on this reputational PC during our draft determination.

#### **Stakeholders' responses**

In its response, Affinity Water requested a change to the performance commitment levels (PCLs) associated with this non-financial PC to correct what it thinks is an error. The company told us that, following conversations with its assurer, it thinks that the PCLs reported in the FD are at odds with the calculation method prescribed in our guidance.

## Consideration of responses and final determination

Because this PC does not have any financial incentives associated with it our decision on this request does not affect our in-period ODI final determinations. We have a separate change control process (described in annex 2 of [the Outcome performance commitment appendix](#)) that applies to requests of this sort and we have separately contacted the company suggesting a solution to this issue. However, we do not think that the circumstances described require a change to the PCLs set at PR19. This decision does not affect our final determinations.

### 1.2 C-Mex and D-Mex

#### Our draft determination

On 21 September we published the relative performance of all companies. Our draft determination includes a C-MeX underperformance payment of £1.041m and a D-MeX outperformance payment of £0.034m, 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.

#### Stakeholders' responses

Affinity Water did not comment on this issue. However, another company identified a minor technical inconsistency between the reporting of C-MeX scores in the reconciliation model and the expectation in the [RAG 4.10 guidance](#), which states that scores should be rounded to 2 decimal places.

#### Consideration of responses and final determination

To ensure the C-MeX reconciliation model operates consistently with RAG 4.10 and the [PR19 Reconciliation rulebook](#) guidance, we have updated the model to round the input scores to 2 decimal places. This has no impact on the payment values calculated by the model for Affinity Water and our draft determination remains unchanged for this PC.

### 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.

Affinity 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 final determination.

## 2. Impact of 2021-22 in-period ODI assessment on price controls

### 2.1 Our final determination

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

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

**Table 2.1: Change between draft and final determination on total ODI payments to be applied to customer bills in 2023-24 (£m)**

This table sets out the change between our draft and final determinations.

Price control	Draft determination on total ODI payments to be applied to customer bills in 2023-24 (£m)	Change between draft and final determination (£m)	Final determination on total ODI payments to be applied to customer bills in 2023-24 (£m)
Water resources	0.574	0.000	0.574
Water network plus	-0.450	0.000	-0.450
Residential retail	-0.894	0.000	-0.894
<b>Total</b>	<b>-0.770</b>	<b>0.000</b>	<b>-0.770</b>

**Table 2.2: Final determination on adjustment to 2023-24 price controls as a result of performance against ODIs**

This table sets out our final determination 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 final determination on these payments after any interventions;
- bespoke adjustments, including prior year restatements, where relevant; and
- our final determination on C-MeX and D-MeX payments.

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

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

Final determination of Affinity Water's in-period outcome delivery incentives for 2021-22

Price control	Company's reported ODI payments (£m)	Ofwat FD interventions (£m)	ODI payments deferred from 2020-21 (£m)	Ofwat FD deferrals (£m)	Ofwat FD abatements (£m)	Bespoke FD adjustments (£m)	C-MeX FD payments (£m)	D-MeX FD payments (£m)	Final determination on total ODI payments to be applied to customer bills in 2023-24 (£m)
Water resources	0.574	0.000	0.000	0.000	0.000	0.000	0.000	0.000	<b>0.574</b>
Water network plus	-0.490	0.000	0.000	0.000	0.000	0.006	0.000	0.034	<b>-0.450</b>
Residential retail	0.049	0.000	0.000	0.000	0.000	0.098	-1.041	0.000	<b>-0.894</b>
<b>Total</b>	<b>0.133</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.104</b>	<b>-1.041</b>	<b>0.034</b>	<b>-0.770</b>

**Table 2.3: Breakdown of bespoke adjustments**

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

Price control	Prior year restatements (£m)	Prior year C-Mex indexation (£m)	Prior year D-Mex indexation (£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	<b>0.000</b>
Water network plus	0.000	0.000	0.006	0.000	0.000	<b>0.006</b>
Residential retail	0.000	0.095	0.000	0.003	0.000	<b>0.098</b>
<b>Total</b>	<b>0.000</b>	<b>0.095</b>	<b>0.006</b>	<b>0.003</b>	<b>0.000</b>	<b>0.104</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 2.4: Changes to price controls (final determinations)**

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

Price control		2021-22	2022-23	2023-24	2024-25
<b>Water resources (K factors)</b>	Previous determination	10.58	14.77	9.20	-2.46
	Revised	10.58	14.77	11.15	-4.03
<b>Water network plus (K factors)</b>	Previous determination	1.40	-1.94	3.50	3.27
	Revised	1.40	-1.94	3.20	3.55
<b>Residential retail (total revenue, TRt – £m, nominal prices)</b>	Previous determination	27.875	26.496	29.306	30.044
	Revised	27.875	26.496	27.849	30.044

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

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Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA  
Phone: 0121 644 7500

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