15 November 2022

Final determination of South West 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 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: Final 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 final 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 final determinations on our website.

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.[1]

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 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.

[1] 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.

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 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.

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 South West 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 South West 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 £0.576m and a D-MeX underperformance payment of £0.019m;
- 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 final 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 determination after interventions 2021-22 (£m)	Our final determination after interventions 2021-22 (£m)	Difference between company view and our final determination (£m)
Sewer blockages	0.822	0.735	0.735	-0.087
Resilience in the round - water	0.234	-4.665	-4.665	-4.899
Water supply interruptions	-0.300	-3.473	-3.473	-3.173

In our final determination we have made policy decisions on the following performance commitment(s):

1.1.1 Sewer blockages

Our draft determination

We intervened 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 was 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 was clear evidence of repeated and deliberate abuse of the sewers which caused restrictions in its use e.g. multiple incidents at the same address. The company said its approach aligns with a provision in the Water Industry Act 1991.

We did not consider this to be relevant to the operation of the PC, which does not provide for this type of exclusion; nor do we considered that it should do so, because this does not incentivise the company to be proactive and innovative in resolving problematic customer behaviours. Therefore, we considered 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.

Stakeholders' responses

In its response, which is published on our website, South West Water says it is disappointed with Ofwat's conclusion. The company states that the resilience and consumer duty should not suggest that companies are responsible for the repeated and deliberate misuse of sewers when the Water Industry Act 1991 s.111 sanctions such behaviour.

Consideration of responses and final determination

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 provides no new evidence to underpin its claims that these types of incidents should be excluded. Going forward, we expect the company to report in line with the definition as set out in its PR19 final determination and include all incidents related to repeated and deliberate abuse of the sewers in its blockage reporting.

1.1.2 Requests for exclusions due to interruptions caused by a third party

In this section, we set out:

- our position at draft determination;
- stakeholders' responses to our draft determination;
- our consideration of the points raised in those responses; and
- our final determination.

Our position at draft determination

Background

In its 2022 APR submission, South West Water excluded the impact of third-party damage to its assets at Carland Cross from its water supply interruptions and bespoke resilience in the round PCs. These exclusions reduced the PC ODI payments by £3.173m and £4.899m respectively. South West Water stated 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." 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 considered that given the way it responded to the incident, it did 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 said that there were no reasonable measures to prevent the interruption or connect customers that it was incentivised to put in place to avoid this happening again. In relation to the resilience in the round PC, the company considered 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 said was not foreseeable. The company said that no reasonable action by it could have avoided the incident and that there was 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 draft determination

Having reviewed the company's APR submission and supporting evidence we included the impacts of the Carland Cross incident in the relevant PCs and did not adjust the ODI payments as the company had requested. As a result the draft determination increased 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. We said that the company should include the impact of any such issue or event in the data submitted in their APRs.

Stakeholders' responses to our draft determination

South West Water

In its response, which is available on our website, South West Water asks Ofwat to reconsider its draft determination decision not to allow its requested exclusion for the impact of the Carland Cross incident. It states that in its testing of relevant sections of Ofwat draft determination with its customers, their views strongly align with that of the company. The company repeats its assertion that it was not responsible for the supply outages, stating that there is nothing reasonable it could have done to prevent the incident and that it did all it could to restore water supplies promptly and pay compensation. It set out its arguments against specific statements in our draft determination decisions, all of which we have considered. In summary those are:

The application of the PR19 PC definitions

- The company said that Ofwat is taking a very precise interpretation of exclusions from the PR19 Final Determination definition. It agreed that weather events and asset failures should not be excluded, but said that Carland Cross does not fall into this category and said it has provided evidence that the incident was exceptional by its nature;
- The company said that there have already been examples of performance commitment changes, for example: ODIs for green recovery investment; taking into account Covid impacts; and likely further changes as a result of the early start programme to be agreed with Defra;
- The company argued the Carland Cross event is not an example of poor performance. The company said that the ODI regime is not being used to incentivise and communicate underlying performance but rather to highlight poor performance. It said that its recent research with customers and observations in the media following the publication of its draft determination demonstrate that the wider stakeholder community does register that penalties have been levied and, on that basis, conclude that the company was at fault (as otherwise there would be no reason to penalise South West Water).

The risk that should fall on the company and the scale of the underperformance payment

- The company said that there could not be an equivalent 'upside' event to Carland Cross, which reinforces the narrative that there is an inherent downside skew. It stated that it is an event so exceptional it could not be anticipated at PR19 and was not included in the RoRE modelling. It said its risk and reward package is based on P10 and P90 assessments and events of this magnitude were never included in these assessments and would only be included if a P0 / P100 approach was adopted. It noted the strategic resilience main is the product of asset planning for resilience.

The incentives created by Ofwat's approach

- The company said that its resilience planning did not cover the Cornwall Spine Main given the level of resilience inherent in the system (it is a duplicate main). It provided some examples of potential resilience solutions, all of which were not considered to be feasible. The company went on to say that not intervening creates the unwanted incentive to invest to minimise risk and it would argue that additional resilience would not be appropriate to be incentivised.
- The company made the point that its ‘resilience in the round’ measure is a voluntary, bespoke PC/ODI. It said this is relevant as the company did not have to put forward this particular measure, but its inclusion in the PR19 FD was in customers’ interests. If says that if it now suffers excessively as a result of its initiative, through no fault of its own, this could be expected to have unwanted impacts at future price reviews.

Application of our duties

- The company said that it "bore no responsibility for the cause of the incident or exacerbated its consequences. There was nothing that SWW could reasonably have done to prevent the incident and SWW did all it could to restore water supplies promptly and pay compensation using systems it had set up". It also suggested that Ofwat should consider its wider duties and use its discretion in order to exclude the Carland Cross event from its performance.
- The company said that its draft determination has some conflict with our WIA91 section 2 duties. It said as well as the finance duty it thinks the resilience and consumer objectives need further consideration and it referred to elements of the resilience duty that promote long-term planning and consider sustainable water resources. It suggested that our application of ODI in-period determinations could impinge on these through investment and operational responses not in customers' interests.
- In its response, the company referred to its initial submission which said that it had commissioned customer research following the event. The company said "in the customer research we informed customers that the chance of a main and its backup main being out of action was very small and that this had not happened at [South West

Water] before. When customers were then asked whether a third main should be installed as a matter of [South West Water] policy, which would also increase bills, 70% of those surveyed regarded this as 'unacceptable". This was without the precise bill impact being made explicit." In its response to our draft determination, the company went on to say, "[t]he consumer objective is therefore also not supported by the suggestion in the Draft Determination that enhancement expenditure could, with customer support, fund such additional resilience".

CCW

The Consumer Council for Water (CCW) responded to our consultation. In its response, which is available in full on our website, CCW agreed with our decision not to make exceptions for Northumbrian Water, South West Water, South East Water and Yorkshire Water where a combination of extreme weather events and third-party damage to company infrastructure contributed to failure. CCW supports this view by saying companies should carry this risk, as they can also gain benefits if they experience a period of good weather leading to reduced pressure on their water and wastewater networks.

Consideration of stakeholders' responses and final determination

In addressing the points made by respondents to our draft determination, we consider it helpful to start by setting out the overall framework within which we make our in-period determinations. As such, in this section we set this out:

- The overall regulatory framework within which we make our in-period determinations;
- The PC definitions: and
- Assessing whether an intervention is required.

The overall framework

Our price reviews specify the costs that we allow companies to recover from their customers, and the service that we expect them to deliver for that. Our policy objectives under our price reviews are set by reference to our statutory duties[2] and the UK and Welsh Governments' strategic priorities and objectives statements which we have to act in accordance with.

The outcomes framework

Within our price control regime, the outcomes framework holds companies to account for the level of service they provide. While this includes broad measures of customer satisfaction (C-Mex for households and D-Mex for developers), other performance commitments focus on

[2] The general statutory duties for most of our work as an economic regulator are set out in the Water Industry Act 1991: https://www.legislation.gov.uk/ukpga/1991/56/contents

more specific features of the underlying service, such as supply interruptions, and asset health measures to measure the operational resilience of companies' networks.

The determinations specify performance commitment measures and performance commitment levels that we expect companies to attain for several areas of service, based on the business plans that companies put forward. Performance commitments are linked to outcome delivery incentives (ODIs). If companies fall short of their performance commitment levels, they incur underperformance payments which are calculated using the specified ODI rate. This incentivises them to deliver the service levels expected of them. We also encourage companies to push themselves to provide even better service by providing outperformance payments where they go beyond the performance commitment level.

Where a company does not deliver the expected level of service this means customers are affected. A company's customers bear the impact of a reduction of service, in this case an interruption to supply, no matter what the cause or reason for that service failure.

Companies have a significant level of control over the delivery of the outcomes that we specify when defining performance commitments. However, in some cases external factors can also have an effect on the ability of companies to meet their performance commitment levels. Where appropriate, we maintain incentives on companies to mitigate the impact of external factors on customers through how they prepare and respond to such events. For example, in dry weather, mains may be more likely to burst and cut off supply to customers, but companies can reduce the likelihood of this happening through the way they monitor and maintain their assets, and if supply is cut off, they can mitigate the impact on customers by repairing the fault quickly.

Our 'base' expenditure allowance for maintaining the network allows for a level of resilience and has been sufficient for companies to maintain and improve performance and asset health metrics.[3,4] If overall industry costs are higher than forecast then this will impact on the base allowances for the next period which are based in part on historical efficient expenditure. Good management is critical to delivering resilient services. Companies can also put in enhancement claims to improve resilience or service quality further, although they will have to demonstrate this is in customers' interests, and they will be held to account for higher service standards if it is allowed.

South West Water argues "that it bore no responsibility for the cause of the incident or exacerbated its consequences and there was nothing that [it] could reasonably have done to prevent the incident and [it] did all it could to restore water supplies promptly and pay compensation using systems it had set up." But our regime does not aim or profess to insure companies against all risks outside of their control. Just like in a competitive market, there will be some risks that regulated companies bear the consequences of, even if the cause was not their fault. However, the flip side of the regime is that there are instances where

[3] Ofwat, PR24 draft methodology: Appendix 9: Setting expenditure allowances, chapter 3.
[4] Ofwat, Assessing base costs at PR24, chapter 5.

companies benefit from improved performance when the circumstances are more favourable and may gain outperformance payments as a result. For example, if there is a wet summer, per capita consumption, one of the performance commitments we measure, will be lower than normal, even without any company action, as people tend to water their garden less.

Our price review determinations recognise that companies bear risk, including some external risk, and so have a degree of variability in their returns that is outside of their control. What is important is that the upside and downside risks for an efficient company are broadly balanced so that it anticipates a "fair bet" on a forward-looking basis.

Although we consider companies should bear some risk, we limit the extent of this through a range of protection mechanisms.[5] This includes cost sharing, which means that customers bear a portion of any company overspend (generally 50%). It also includes collars on ODI payments to protect companies against large underperformance payments on specific performance commitments, as well as caps to protect customers against unexpectedly high payments.[6] Companies were able to propose caps and collars in their business plans at PR19, including on bespoke performance commitments[7].

South West Water also provides evidence it suggests shows that customers do not see a basis for underperformance payments to apply and do not see how they are best served with these monies being levied. Our framework does not envisage the use of customer research to determine ODI payments. We consider surveys conducted in this way are unlikely to elicit meaningful insights. Research suggests that areas which require technical expertise to understand may be less appropriate for customer research.[8]

Companies were able to refer their final determinations to the Competition and Markets Authority (CMA) for redetermination. Once the determination has been set, we consider companies should bear the consequences of their price review packages to avoid later unbalancing the package in companies' favour and that they should not seek to reset that balance by seeking exclusions from individual aspects of it in a manner which was expressly not envisaged. We do not rule out the possibility of a circumstance arising where intervention is required in light of our statutory duties and policy objectives. Nevertheless, in light of our approach (which we consider to be consistent with the principles of best regulatory practice, in particular those of consistency and targeting intervention at cases

[5] These include reconciliation mechanisms (such as inflation indexation of the cost of new debt, changes to tax rates and changes in customer numbers) protecting for circumstances that arise outside of management control; protections for changes in business rates, abstraction charges and wages; interim determination provision which allow price controls to be reopened in specific circumstances; along with the linked substantial effect provision which provide protection to both companies and customers where circumstances have a material adverse (or favourable) effect on a company.

[6] At PR19, we set caps and collars on performance commitments which we considered were financially material and uncertain. If the performance commitments proposed by companies did not meet these criteria, we generally did not add caps or collars.

[7] Both the common water supply interruptions PC and the bespoke water resilience in the round PC do not have caps or collars, and we note the company did not propose any in its original or revised business plans or subsequent representations on our PR19 draft determinations.

[8] Blue Marble for CCW, 'Engaging water customers for better consumer and business outcomes', May 2020.

where it is needed), we see this as being, in practice, a high bar for intervention in the application of the PC and ODI regime.

Impact on wider framework

In its response South West Water said that there was not an equivalent 'upside' event to Carland Cross, which it considers "reinforces the narrative that there is an inherent downside skew that needs to be accounted for elsewhere within the risk and return framework". It states that it is an event so exceptional it could not be anticipated at PR19 and was not included in the modelling of risk at that time.

We have considered the question of risk allocation above. We consider how the ODI regime interacts with the wider regime, including investor returns and incentives to invest. For example, in considering the package as a whole, we consider whether our outcomes regime may create unwanted incentives to invest so as to minimise risk in an inefficient way, which would not be in customers' interests. This applies both to the package as set and to our judgement about any interventions put forward by companies in period, as reflected in our draft determinations. In our draft determinations, we said we did not think our proposed decision would give rise to issues in this respect and we remain of that view.

In relation to supply interruptions, the package set at PR19 reflects the possibility of an intervention only in relation to the impact of a qualifying emergency. Indeed the guidance specifically states that there are no exclusions and that asset failures caused by third parties should be included and that the cause of the interruption is not relevant (see below).

Where a company provides evidence of the impact of an incident and the actions it took, a decision on whether to intervene has to be taken in light of what the PC definition says, and consistently with our stated policy objectives and statutory duties. Our decision in this final determination on whether or not to intervene reflects that.

Accordingly, by reference to the position we set out at PR19, we do not consider that the approach we have taken leads to companies bearing any more risk than assumed at PR19 or creates any broader consequences which distort the wider regime. Therefore investors will not require a higher allowed return at PR24 with respect to this.

Further, we do not consider that our decision in this final determination on whether or not to intervene will otherwise affect companies' incentives to invest at PR24. As now, companies will be funded to meet a level of resilience through base expenditure.

We will also consider companies' requests for additional expenditure to enhance resilience during our price review process. We set out our proposed approach to assessing these requests as part of the PR24 draft methodology.[9] Our criteria include a clear and systematic risk assessment process that shows the investment is a priority. Investments must address

[9] Ofwat, PR24 draft methodology: Appendix 9: Setting expenditure allowances, p62-63.

specific relevant hazards, and investments should be cost beneficial, and represent 'best value'. We would not expect to make enhancement allowances to be resilient to very rare events. Enhancement investments that prevent very rare occurrences are only likely to be value for money where customers place a very high value on the service.

Companies will therefore not be 100% resilient and may not meet their performance commitment levels in all cases. However, that does not necessarily imply customers should bear the risks of such events occurring under our outcome incentive package, although this package should be balanced in the round. Companies may incur underperformance payments due to events outside of their control, as under PR19 final determinations and reporting guidance. We link ODI incentives to customer valuations at a price review – so companies will only be incentivised to invest efficiently, i.e. where the likely change in ODI payments, which reflects customers' valuations of improving service, outweigh any associated incremental costs of the investment.

In the case of the Cornwall Spine Main, we have considered the question of incentives closely in view of the company's observations on the resilience and consumer objectives in section 2 of the Water Industry Act 1991 and its suggestion that our draft determination risks having implications for the sustainability of long-term resilience on water resources and/ or implies investment or operational responses that are not in consumers' interests. As the company points out in its response, there is already a duplicate main to ensure resilience to supply. We would therefore not necessarily expect to see further resilience enhancement expenditure proposals for this asset (the company sets out potential investment options in its response). We would, however, expect all companies to implement good practice asset management, including by reference to third party impacts, in their resilience planning to ensure the risk and impact of these types of incident are minimised.

The PC definitions

The water supply interruptions performance commitment guidance states:

> *"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.*
>
> *Companies may make a representation to Ofwat for an exception to be granted on the basis of a civil emergency under the Civil Contingencies Act 2004, where the supply interruption is not the cause of the emergency*."

The company says it agrees that weather events and asset failures should not be excluded, but that Carland Cross does not fall into this category. As can be seen from the text set out above, however asset failures caused by third parties should be included and the text states that the cause of the interruption is not relevant. The wording of the performance commitment is clear and we do not consider that it supports any other interpretation other than this event being within the scope of the performance commitment.

South West Water's bespoke performance commitment 'Resilience in the round – water' sets out that its purpose "is to incentivise the company to reduce the number of customer (properties) that experience an unplanned loss of supply of greater than 12 hours". It states that the "benefit of this performance commitment is that it will help reduce disruption to, and financial impact on, customers from extended supply interruptions". It sets out:

> *The number of customers (properties) who experience continuous unplanned loss of mains water supply to their property for durations greater than 12 hours. This can be due to flooding, or other events such as third-party damage, freeze and thaw conditions, catastrophic asset failure, lightning storms, etc. This measure captures all hazards that can impact on water supplies.*

Under the heading of "Specific exclusions" it says:

> *The company may make a representation to Ofwat for unplanned interruptions at properties to be excluded on the basis of a civil emergency under the Civil Contingencies Act 2004, where a supply interruption is not the cause of the emergency.*

The wording of South West Water's water resilience in the round – water performance commitment is explicit that reported performance should include the effect of events such as third party damage and all other hazards that can impact on water supplies. South West Water has not suggested that Carland Cross was a civil emergency.

On this bespoke performance commitment the wording is clear and we do not consider that it supports any interpretation other than this event being within the scope of the performance commitment.

The company noted that its ‘resilience in the round’ measure is a voluntary, bespoke PC/ODI. It said this is relevant as the company did not have to put forward this particular measure, but its inclusion in the PR19 FD was in customers’ interests. It said that if it now suffers excessively as a result of its initiative, through no fault of its own, this could be expected to have unwanted impacts at future price reviews. We note that, as a bespoke PC, we would have expected the company to have considered the implications of the promise of this outcome to customers and at PR19 it had the opportunity to mitigate the risk by proposing the use of a collar which it did not do.

The company says that changes to performance commitments and ODIs should be permitted under certain circumstances and that Ofwat has shown flexibility in changing performance commitments for example: ODIs for green recovery investment; and taking into account Covid impacts. The company also argues that "whilst there are no explicit exceptions specified in the ODI definitions there are wider considerations within Ofwat's duties that should explicitly be recognised by Ofwat, and complied with in reaching its final decision." We do not consider the changes the company refers to are comparable to these particular circumstances we are considering. We note that our decision to review company performance on per capita consumption at the end of period rather than on an annual basis (due to the potential impact of Covid) was intended to ensure the incentives set for PR19 in place during the control period[10]. The changes arising from the green recovery for example would be so that additional expenditure taken on by the companies after the PR19 final determination does not negatively impact the incentives in the performance commitments set at PR19, for example by reducing the appropriate level of stretch in the light of additional schemes being undertaken and additional expenditure allowed.

In any event, though, the draft determination stated that "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." In other words, despite there not being a basis for an exemption in the PC definition, we have nevertheless gone on to consider whether we should intervene. We therefore did precisely what the company argues we should do, albeit our conclusion in light our consideration was to not allow the exclusion.

Our approach to assessing whether an intervention is required

We have considered the representations made on our draft determination. As noted above, neither the definition for supply interruptions or the company's own bespoke PC 'water resilience in round' allows for any form of exemption related to third party impacts. But, as we did in the draft determination, we have considered the company's request in light of our statutory duties and our policy objectives. We have considered the third-party incident, including its impact on ODI payments and the company's response.

Although not necessarily determinative in this case, wider factors we take into account when considering our duties include the factors set out above concerning how the overall outcomes framework is intended to operate. They also include the fact that the PR19 final determination comprised a package over a five-year period and that some events over that period will in any given year benefit companies while others will not. We are also mindful of the natural information asymmetry between companies and regulators that favour companies in identifying circumstances that have a negative financial impact on them, but makes it harder to identify circumstances which provide fortuitous benefits. These benefits can arise for example in the event of favourable weather conditions making it easier to achieve outperformance against the performance commitment levels as set at the previous

[10] We also deferred a decision in relation to the impact of covid on South East Water's business void properties PC see our website for

price control. If we did not take such possibilities into account it could lead to one-off adjustments that asymmetrically favour companies.

This is why we consider it appropriate to assess overall risk in the PR19 package, as well as the severity and the impact on ODI payments of individual events[11]. This is in line with our PR19 determinations which set out the overall level of risk we would expect a company to face over the 2020-25 period. For example, if an efficient company, with notional levels of gearing, faced an individual event outside its control that risked its ability to finance its functions, that might well, depending on all the relevant circumstances, be a situation in which we considered it appropriate to intervene.

Our final determination

Having reviewed the company's requests and supporting evidence, we consider it is clear that there is no specific basis for an exemption in the performance commitment definitions. But we have, nevertheless considered whether we should intervene by reference to our statutory duties and policy objectives.

In its response, South West Water argues that previous performance on the measure should not be considered in these circumstances. Having considered the company's arguments and those of other respondents, while we consider that historic performance may be relevant in considering when to intervene in a particular case, we agree that, in these particular circumstances, we should consider carefully the specific financial impact of this event on the performance commitments in question.

Our price review set out the range of ODI payments that we expect companies to experience over the 2020-25 period, taking account of caps, collars and other relevant factors. In the PR19 methodology, we expected returns from ODIs[12] would generally be between ±1% and ±3% return on regulatory equity (RoRE).[13] [14] At the time of setting the PR19 package, we estimated companies' ODI risk range, and checked it fell within this range. For South West Water, we estimated a range of -2.12% to 1.84%.[15]

South West Water attributes £8.072m of underperformance payments to the financial impact of the incident across its two performance commitments. This is equivalent to -0.63%[16]

[11] When we made our draft determinations, we compared the size of the requested reduction in the underperformance payment against the size of the company's regulatory equity. Comparisons of this sort are normal practice in the water sector and in other regulated sectors.
[12] The expected returns for ODIs excludes expected returns for C-MeX and D-MeX.
[13] RoRE represents the return to shareholders as a proportion of the equity component of the regulatory capital value (RCV), calculated by reference to the notional capital structure. It is a well-established regulatory tool to provide insight on a normalised basis of the return that companies can earn.
[14] The lower limit of the company-level range reflected levels above which we would expect companies to be 90% of the time (the package P10) and the upper limit reflected where we expected companies to perform below 90% of the time (the package P90).
[15] 'PR19 final determinations: South West Water final determination', Ofwat, December 2019, page 64.
[16] We assess return on regulatory equity at a company level, consistent with the risk ranges in the company's final determinations and to reflect the level of equity invested in the regulated business.

return on notional regulatory equity (of £1,288m in 2021-22 in 2017-18 prices) at an appointee level for a single year. Even this would be well within the estimated range for the five-year period. In any event, though, because we assess and allocate risk over a five-year period, this would lead to an impact on the company's return on notional regulatory equity of -0.13%, before accounting for any other performance across the period.

Overall, based on the evidence provided, we recognise that the incident was caused by a third party and have reviewed evidence from the company that showed its efforts to mitigate the impact on customers. However, the relevant performance commitments do not single out third-party incidents as events that Ofwat must (upon receipt of a representation) consider further; indeed (and on the contrary), the wording of both the PCs explicitly states that events caused by third parties are not excluded from the operation of the PCs and ODIs. Nevertheless, we have considered whether there was anything else by reference to our statutory duties and wider policy objectives, in particular the financial impact of the ODI payments, that required us to intervene. However, the financial impact of the ODI payments does not appear sufficiently significant as to require us to intervene and we have concluded in all the circumstances that we do not need do so. Consequently, we have decided not to exclude the financial impact of the incident from the ODI payments.

Finally, in its response South West Water argues "the ODI regime is not being used as intended to incentivise and communicate underlying performance". It says that "the wider stakeholder community do register penalties have been levied and, on that basis, conclude that SWW was at fault, otherwise there would be no reason to penalise SWW". As we have set out above, ODI payments are applied in the context of the wider regime which is an outcomes regime covering both factors that are within and outside a company's control. The in-period determination, by its nature focuses on the ODI payments derived from reported performance against PCs (and subject to any interventions we make) to reflect the performance that customers have received. The process is expressly to determine any out or underperformance payments that need to be accounted for in a company's allowed revenue. We use a number of tools to incentivise companies to improve performance, such as the Service and Delivery Report which expressly focuses on performance, company specific engagement and where required enforcement action.

1.1.3 Leakage and per capita consumption (PCC)

Our draft determination

We deferred 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.

Stakeholders' responses

In its response, South West Water noted our deferral of a decision on the leakage performance commitment and ODI. The company stated it believes that it has provided sufficient information to demonstrate that the reported leakage is a real reflection of its performance. The company stated that it would expect further engagement once Ofwat has assessed the information that has been provided and any further information that we may request.

Consideration of responses and final determination

Having considered the company's consultation response and its responses to our queries, our final determination on the company's performance payment for this performance commitment remains unchanged from our draft determination, above.

We note the company's responses to our queries, which considered how the company accounts for the change in night flow period and requested water balance data. We will continue engagement with South West Water. This is because we want to ensure that the restated values for leakage and PCC truly represent the most accurate record for each year between 2017-18 and 2021-22. Given that a joint letter from Ofwat, Defra and the Environment Agency to South West Water in relation to the annual review of its water resources management plan (WRMP) has requested additional information, deferring our decision on these PCs will give us sufficient time to consider this. We will assess any additional information alongside that which the company has already provided, and we will have a clearer understanding of the datasets and methodologies for all components of the water balance when we make our in-period ODI determinations in 2023.

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.

1.1.4 Internal sewer flooding

Our draft determination

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.

Stakeholders' responses

South West Water did not comment on this issue nor did any other stakeholder.

Consideration of responses and final determination

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

1.2 C-Mex and D-Mex

Our draft determination

On 21 September we published the relative performance of all companies. Our draft determination included 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.

Stakeholders' responses

South West 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 South West 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.

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 final determinations.

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	-0.300	0.000	-0.300
Water network plus	-9.090	0.000	-9.090
Wastewater network plus (WaSCs only)	-3.404	0.000	-3.404
Bioresources (WaSCs only)	0.000	0.000	0.000
Residential retail	-0.542	0.000	-0.542
Total	**-13.336**	**0.000**	**-13.336**

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;
- our final determination on 2022-23 deferrals and abatements;
- 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 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)	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	-0.300	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**
Total	**-4.617**	**-8.159**	**0.000**	**0.000**	**0.000**	**0.034**	**-0.576**	**-0.019**	-13.336

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	**0.000**
Water network plus	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**
Bioresources (WaSCs only)	0.000	0.000	0.000	0.000	0.000	**0.000**
Residential retail	0.000	0.033	0.000	0.001	0.000	**0.034**
Total	**0.000**	**0.033**	**0.000**	**0.001**	**0.000**	**0.034**

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
Water resources (K factors)	Previous determination	-2.54	1.65	-0.57	-0.23
	Revised	-2.54	1.65	-2.88	1.95
Water network plus (K factors)	Previous determination	0.58	-1.75	0.60	-0.18
	Revised	0.58	-1.75	-5.78	6.00
Wastewater network plus (WaSCs only)	Previous determination	-0.82	-6.35	5.92	-1.75
	Revised	-0.82	-6.35	3.57	0.31
Bioresources (WaSCs only)	Previous determination	23.360	23.372	23.691	23.911
	Revised	23.360	23.372	23.691	23.911
Residential retail (total revenue, TRt – £m, nominal prices)	Previous determination	30.516	29.772	30.516	30.477
	Revised	30.516	29.772	29.633	30.477

We have based South West Water's final 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.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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