

Draft Determination Representations

WSH.DD.OC.2

Outcome Delivery Incentives

30 August 2019

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1. Introduction

1.1. Purpose and structure of this document

Ofwat's feedback of our ODI package consists of three key areas:

- i) The magnitude of several of our ODI rates;
- ii) The level at which collars are set; and
- iii) The application of financial ODIs (or not) to several measures

Ofwat have intervened on a number of our ODI rates, saying that they are below the industry average or are derived on a 'top down' basis.

We do not believe that a comparison with industry averages is justified as a rationale for intervening in our ODI rates and overwriting the views of our customers. It is at odds with the Strategic Priorities Statement issued by the Welsh Government, which clearly states that it expects Ofwat to challenge companies "while making appropriate allowances for differences in the operating and legal environments of companies in Wales, and taking into account variations in the priorities of customers and other stakeholders".

Where the changes are not material we have accepted the interventions. However, we are not able to accept interventions that result in material deviations from our customer research findings and we have proposed alternatives which would be acceptable and which better reflect the views of our customers. Section 2 outlines our approach to setting incentive rates to ensure they are reflective of our customer research and there is an appropriate balance of financial incentives between measures.

Ofwat have intervened on a number of our collars, we have considered these changes and revised the collars for a number of measures.

Ofwat have removed financial incentives on a number of our performance commitments (PCs). We have reinstated a number of the financial measures as our customer research shows support for the use of financial incentives on these measures. We have introduced three new ODIs to provide customer protection for the resilience schemes that we are including in our revised plan, these are outlined in section 13.

We have carefully considered Ofwat's interventions and this document sets out our approach. We firstly provide an overview of our approach to assessing the interventions. The document then provides further detail on each specific change we have made to our plan.

1.2. Summary of our position

The draft determination includes many financial incentives which differ substantially from our Business plan. Ofwat have intervened by removing or adding financial incentives on a number of PCs. Ofwat have also intervened by changing the magnitude of our underperformance and outperformance rates. Ofwat have also intervened on a number of measures by changing the collars.

In response to the DD, we have proposed targeted revisions to specific ODI rates, deadbands, caps and collars, to better reflect the views of our customers. Tables 1 to 3 provide a summary of the changes.

Table (1) summary of changes to rates

	Underperformance Rate (£m per Unit)		Outperformance Rate (£m per Unit)	
	Ofwat's DD	Our view	Ofwat's DD	Our view
Water Supply Interruptions	(0.745)	(0.325)	0.621	0.297
Sewer flooding on customer property (internal)	(5.484)	(3.639)	4.570	2.440
Sewer flooding on customer property (external)	(1.261)	(0.519)	1.051	0.365
Per Capita Consumption	(0.296)	(0.135)	-	-
Km of River Improved	(0.00296)	(0.2167)	-	0.2167

Table (2) summary of changes to collars

	Element	DD	Our view
Compliance Risk Index	Deadband	2/1.5	Top Third
Water Supply Interruptions	Underperformance Collar	31 Minutes	21 Minutes 36 Seconds
Sewer flooding on customer property (internal)	Collar/ Cap	3.35	2.14/1.20 (2024/25)
Sewer flooding on customer property (external)	Collar/ Cap	40.05	29.40/20.90 (2024/25)
Water Mains Repair	Underperformance Collar	190.1	160.5 (2024/25)
Km of River Improved	Collar/ Cap	NA	358/478 (2024/25)
Surface Water Removed	Collar/ Cap	357,000/ 503,000 (2024/25)	715,785/1,008,515 (2024/25)

Table (3) New and reinstatement of financial incentives

	DD	Our view
Asset Resilience (reservoirs)	Non-Financial	Financial
Asset Resilience (water network+ above ground)	Non-Financial	Financial
Asset Resilience (water network+ below ground)	Non-Financial	Financial
Asset Resilience (waste network+ above ground)	Non-Financial	Financial
Asset Resilience (waste network+ below ground)	Non-Financial	Financial
Community education	Non-Financial	Financial
Visitors to recreational facilities	Non-Financial	Financial
Delivery of our Hereford water supply resilience scheme	NEW	Financial
Delivery of our South Wales Grid water supply resilience scheme	NEW	Financial
Delivery of our new visitor centre	NEW	Financial

2. Determination of Outcome Delivery Incentive rates

2.1. Overall ODI package

The DD documents include an overview picture of Ofwat's proposed suite of PCs and the financial impact at the P10 and P90 level of performance. These are shown in Figures 1 and 2. Ofwat's interventions in the DD have resulted in two PCs having disproportionately large financial incentives compared to the wider suite of measures.

The PR19 final methodology specifies that ODI rates should be derived bottom-up using WTP and cost information. Whilst we recognise the principle of deriving ODI rates using a bottom-up approach, there are widely accepted weaknesses and limitations in the WTP approach which warrant a top-down 'sense check'. This top-down view of the overall package of ODIs is important to ensure that there is an appropriate balance of incentives and to ensure that undue weight is not given to a small number of PCs. A top down review also ensures that the ODIs are consistent with the results of customer engagement in terms of the importance they place on different service measures.

The DD places a significant proportion of the financial impact of ODIs at the P10 level on three measures: supply interruptions, internal sewer flooding and external sewer flooding. Whilst internal sewer flooding is not itself an outlier, it is highly correlated with external sewer flooding. The proposed ODI package places the second largest financial incentive on external sewer flooding, which is considered as only of medium importance to customers in our customer engagement.

Overall we believe that the current package proposed by Ofwat results in a significant imbalance of financial incentives which are not consistent with the views of our customers. Hence we propose a number of amendments described below.

Figure 1: ODIs overview for common PCs

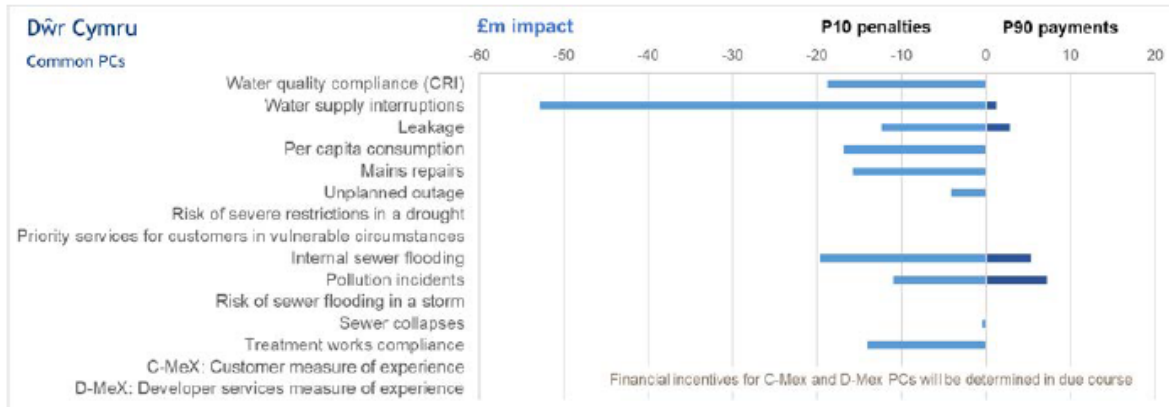
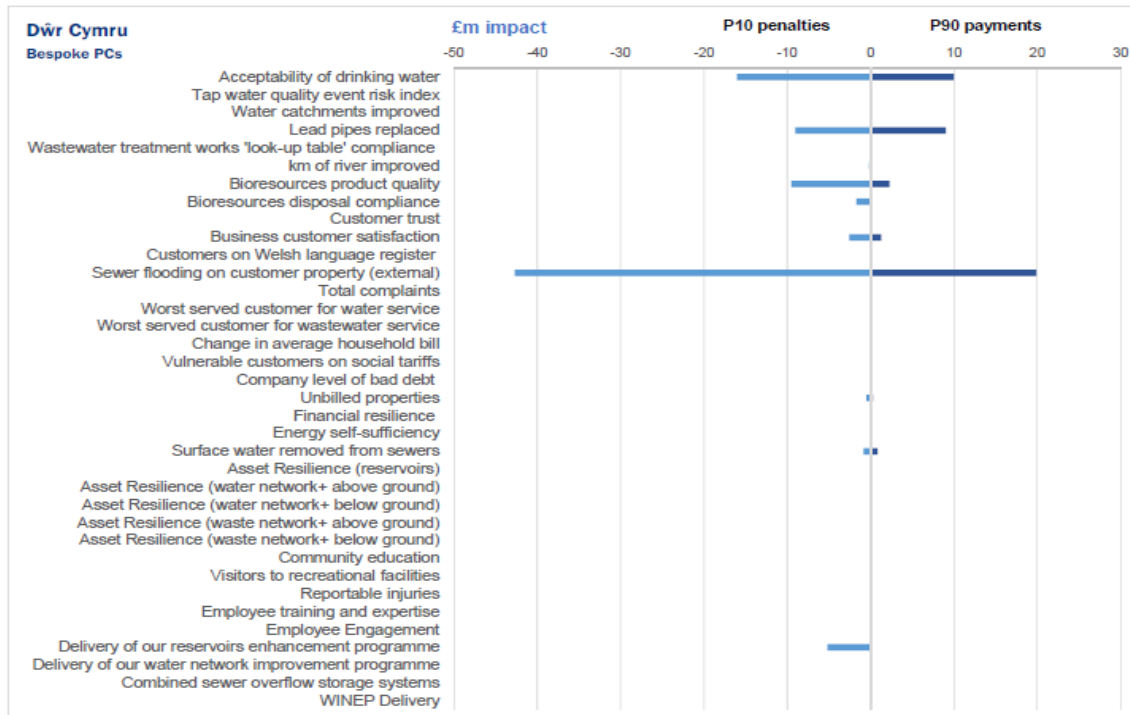
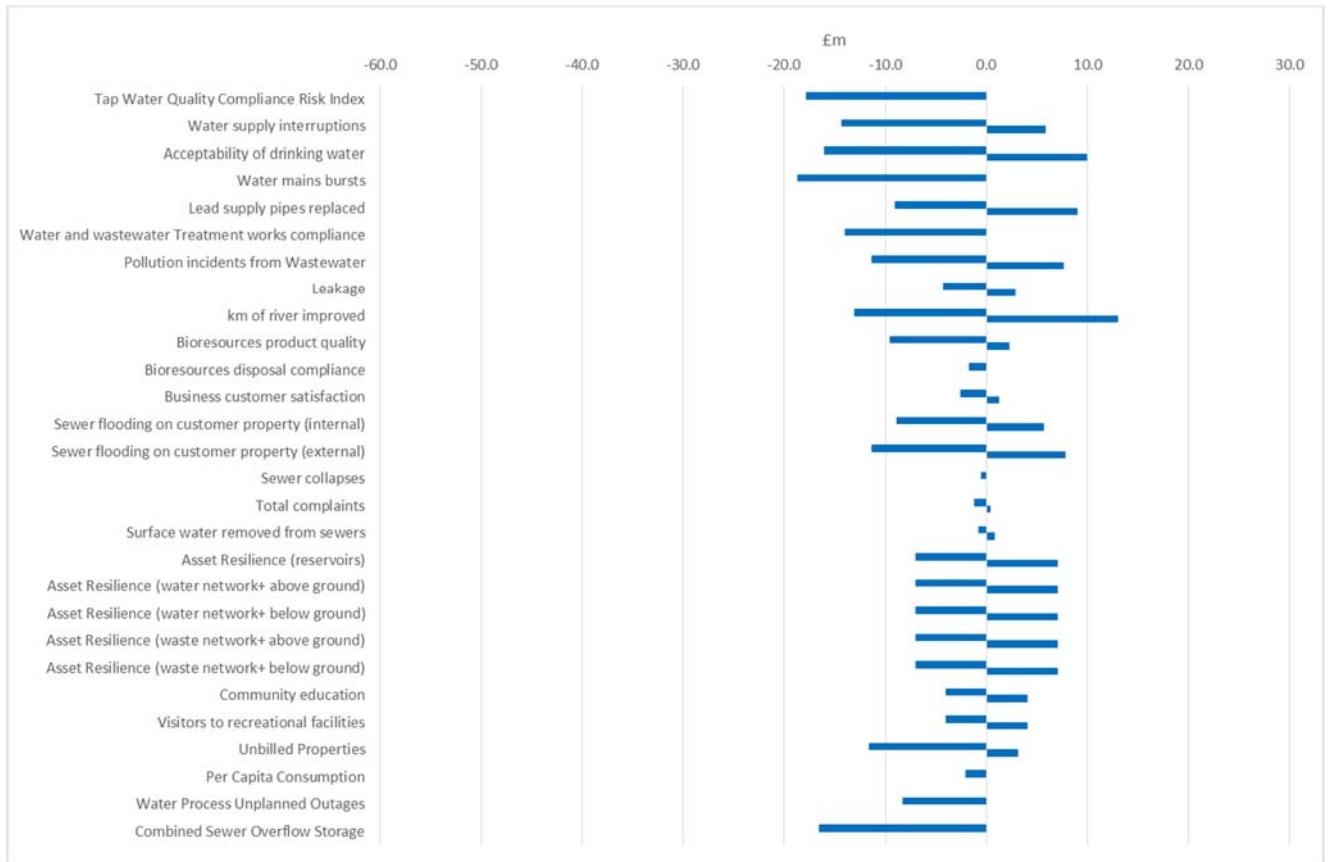


Figure 2: ODIs overview for bespoke PCs



To ensure that there is an appropriate balance of incentives we have revised a number of our ODI rates. Our approach to setting our ODI rates is outlined in section 2.4. Our revised package is shown in Figure 3. It ensures that the ODI rates reflect our customers' views and wider industry data whilst ensuring there is an appropriate balance of financial incentives across our PCs.

Figure 3: Balance of ODIs following our proposals



2.2. Ofwat’s approach to determining ODI rates

Ofwat state that they have intervened on a number of our PC targets and ODI rates, either where our rate is below the industry average, different to our WTP values or where rates have been set using a ‘top down’ basis.

Ofwat have revised our rates using information and criteria as shown in the table below:

Information	The approach is appropriate when:
Re-triangulation of rates based on company’s own research.	A company has a range of (diverging) WTP inputs and where they have confidence in the quality of the research.
Re-triangulation of rate incorporating the company’s equivalent PR14 rate.	A company has a single WTP value, or where its multiple inputs are tightly converged or considered as low quality.
Re-triangulation of rates using external information, such as the industry average.	A company does not have any primary WTP values or where Ofwat have significant concerns about the quality of the valuations.

The table below provides a summary for four key measures that were changed in the DD. When intervening on our ODI rates there is no discernible process as to how Ofwat has chosen the data it has used from the available sources. It could almost be described as a ‘pick-n-mix’ approach. For example, Ofwat uses the PR14 ODI rate for triangulation of

internal sewer flooding but does not use it for determining the ODI rate for supply interruptions.

Importantly, we do not agree that it is valid to reject our proposals because the rates arising from our approach, which is fundamentally based on customer research, can be rejected and overridden because it is below the industry average. As noted above, this appears at odds with the Welsh Government’s Strategic Priorities Statement.

PC	DD rationale for intervening	DD intervention basis
Internal Sewer Flooding	Below industry average	Outperformance rate - lower bound, WTP research and PR14. Underperformance rate - using the ratio for customer preferences
External Sewer Flooding	Below industry average	Outperformance rate - using the ratio of marginal benefit for external to internal sewer flooding. Underperformance rate - Adjustment for the average ratio of underperformance to outperformance.
Supply Interruptions	Set rate ‘arbitrarily’ at the lower bound. The WTP suggests that the rate is higher.	Underperformance rate - re-triangulating across the WTP values. Outperformance rate - set to reflect customer preferences between underperformance and outperformance.
Per Capita Consumption	No ODI rate proposed	Industry average.

2.3. Use of the PR14 rates

Ofwat notes that they use the PR14 rate where there is only a single WTP value or where the WTP values are close together, such as for internal sewer flooding. However, given the large variation in ODI rates from the WTP research we believe that the PR14 information is valid in this case, whether there is a wide range of WTP values or not.

However, care should be applied when making direct comparisons to PR19. The PR19 methodology for ODIs has substantially changed from PR14. Our PR14 measures have deadbands to ensure that companies do not receive penalties for small deviations from the target, which could be due to factors beyond their control such as weather. Ofwat’s PR19 methodology does not allow companies to have deadbands except where the target is to achieve full compliance. This approach penalises or rewards companies for any incremental deterioration or improvement in performance. This difference in the methodology should be taken into account when applying the PR14 rates. We propose that the rates should therefore be adjusted downwards to reflect the level of deadband at PR14.

2.4. Our approach to revising ODI rates

This section provides an overview of our approach to setting ODI rates, which reflects the results of our ODI customer research as submitted to Ofwat in September 2018 and April 2019. The key findings of that research may be summarised as follows:

- Customers had strong reservations about rewards and penalties in principle, and were reassured when told that the likely impact on bills would be minimal. That is, our customers have a preference for a smaller rather than a larger overall package of financial ODIs; and
- Customers found the revised ODI package tested with customers in March 2019 to be acceptable. However, given the choice, more customers would rather see a smaller bill impact than a larger one.

We have reviewed Ofwat's interventions and we have either:

- Accepted the intervention where the change is not material or where we are at the lower bound of the industry; or
- Set the ODI rate at a level informed by our WTP research and industry information as outlined below

We have reset our ODI rates using evidence from our WTP research, industry data and a 'top down' sense check. The table below outlines the information and weights used to derive our ODI rates. Ofwat's PR19 Final Methodology states that ODI rates should be derived bottom-up based on Willingness to Pay (WTP) research. Whilst we accept this as a guiding, there are widely accepted weaknesses and limitations in the WTP methodology. The IAP also noted that there was substantial variation in the ODI rates between companies. In deriving our ODI rates we have drawn upon our bottom-up research but have also used cross- industry available information. We have weighted the 'bottom-up' WTP ODI rates and industry data equally.

Our ODI rates were derived from two pieces of research described in our September Business Plan submission: our 'MOS research' (see Ref 1.1F PR19 Customer Engagement – Performance targets quantitative research) and the WTP research (see Ref 1.1A PR19 Customer Engagement – WTP). We have given these a relative weighting of 40% for the MOS research and 10% for the WTP research, using expert judgement following consideration of the validity of this research for the purposes of setting ODIs.

The other 50% is derived using industry information on ODI rates from PR19 and PR14. We place 40% of the total weight on industry PR19 data, using the 'lower bound' rates published by Ofwat, and 10% on the industry PR14 rates, which are adjusted to account for the existence of deadbands. We set out our methodology for making such adjustments in the relevant section below. We place a larger weight on the PR19 research as it is more recent and there are significant changes to the ODI framework since PR14. We use the PR19 lower bound instead of the industry average reflecting our customers' reservations about the use of financial incentives, particularly given our not-for-profit model. Where no PR14 rates are available, we apply 50% weighting to the PR19 research.

Source	Weight
MOS Research	40%
WTP Research	10%
PR19 Lower Bound	40%
PR14 Adjusted Rate	10%

This approach has been used consistently to derive the proposed revised ODI rates as explained in the subsequent sections.

3. Wt2 Supply Interruptions

3.1. ODI rate

Ofwat have intervened to increase our ODI rates (underperformance and outperformance) for supply interruptions on the basis that our rates were below the industry average. Ofwat have set our rate by triangulating our PR19 WTP research and reached values of 0.75 for the underperformance rate and 0.62 for the outperformance rate.

We have set our ODI rate using the approach outlined in section 2.4. The table below shows the ODI rates from the available information, the weights and our proposed ODI rate.

	Weight	Underperformance Rate (£m per Unit)		Weight	Outperformance Rate (£m per Unit)
Ofwat Lower Bound	40%	(0.31)	Ofwat Lower Bound	40%	0.24
PR14 Adjusted Rate	10%	(0.14)	PR14 Adjusted Rate	10%	0.12
MOS Research	40%	(0.16)	MOS Research	40%	0.16
WTP Research	10%	(1.37)	WTP Research	10%	1.37
Revised ODI Rate	100%	(0.33)	Revised ODI Rate	100%	0.30

PR14 Adjusted Rate

Our PR14 performance commitment has deadbands for under or outperformance. It is therefore appropriate to adjust the PR14 rates to take into account the deadbands, in order to make them more comparable with the PR19 values.

The table below shows the difference between the Performance Commitment (PC) and the collar/cap, and the deadband and the collar/cap. The total outperformance/underperformance payment calculates the maximum amount of financial incentive for the PC target and deadband. The table shows that maximum incentive from the deadband is £19.5 million for underperformance and £11.7m for outperformance. The ODI rate is adjusted by dividing the total underperformance incentive by the deviation from the PC and the collar (136 minutes and 96 minutes respectively).

	Total Difference (Minutes)	PR14 Rate (£ per Unit)	Total Outperformance/ Underperformance (£m)	Adjusted PR14 Rate (£ per Unit)
<i>Underperformance</i>				
Difference PC and Collar	136			
Difference Deadband and Collar	100	(0.195)	(19.5)	(0.14)
<i>Outperformance</i>				
Difference PC and Cap	96			
Difference Deadband and Cap	60	0.195	11.7	0.12

3.2. ODI Collar

Ofwat have intervened to change our collar for supply interruptions. Ofwat state that “performance has been particularly poor and there is greater risk that the company could exceed the collar that we would set using the standard approach. The collar has been set at 31 minutes which was the performance in 2016-17.”

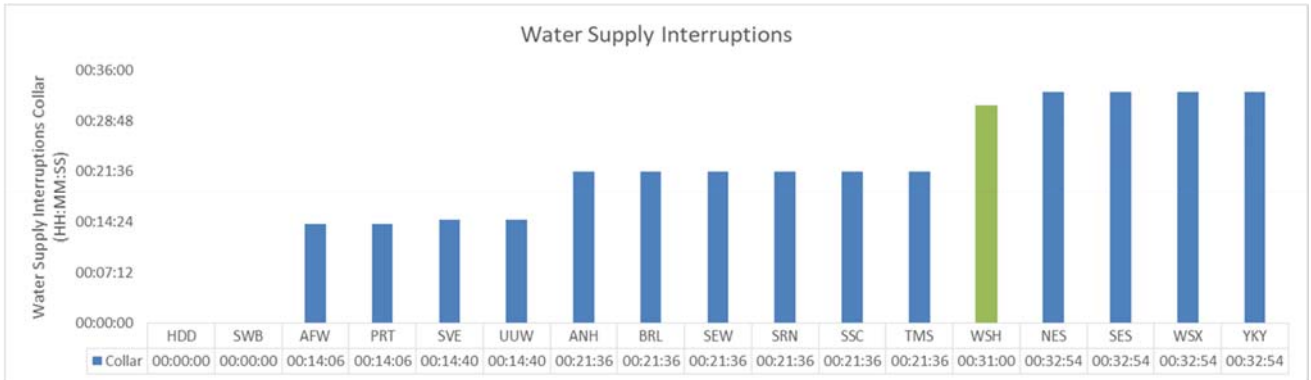
The table below reports our performance commitment target and performance over AMP6. Our performance in 2016-17 was 12.2 minutes. Hence Ofwat’s approach above appears to be erroneous.

The table shows that over the current AMP our performance has not significantly deviated from the target, except for 2017-18 which was due to the impact of well documented extreme weather events. We have improved performance significantly and are on track to hit the target, common to a number of companies, of 12 minutes in 2019-20, despite the difficulties posed by our operating conditions that we described in our IAP response (resubmitted as Annex to PCs document WSH.DD.OC.1). (This improvement in performance has required significant additional enhancement expenditure during the period, which was not included in our PR14 business plan and which is not reflected in the Botex costs reported by the company.) We also note that Bristol Water and Affinity Water have a lower collar but have a worse or similar historical performance.

	2015-16	2016-17	2017-18	2018-19	2019-20
Target (Minutes)	36	24	12	12	12
Actual (Minutes)	21.7	12.2	43.3	16	-

We propose a collar 21:36 minutes. This is the industry average collar as shown in Figure 4, and is also in line with our worst performance for the current AMP period of 21.7 (except for the weather affected 2017-18 year).

Figure 4: Industry collars for supply interruptions.



A performance of over 21 minutes would be a significant deviation from our target of 8 minutes at the end of the AMP. Supply interruptions in excess of 21 minutes would be due to factors beyond management control, such as a period of extreme weather. In these circumstances, the incremental penalties do not provide any meaningful incentive on management and merely penalise a company for circumstances beyond its control. In the case of an extreme event we would ensure that we take appropriate steps to compensate customers for any significant interruptions. In 2017-18 we experienced significant supply interruptions as a result of the extreme weather. After this significant event we compensated customers that were affected beyond the GSS payment. This approach also ensures that during significant incidents those customers that have received poor service are directly compensated rather than compensating all customers through an excessive ODI penalty.

4. Rt1 Internal Sewer Flooding

4.1. ODI rate

Ofwat have intervened in our ODI rate as it is “materially below the industry average” and the rate implies a “materially lower level of customer protection compared to the rates which apply to its equivalent 2015-20 performance commitment.” Ofwat sets the outperformance rate by triangulating the ODI rate using the PR19 WTP values, the lower bound, and the PR14 rates. The underperformance rate is set using the relationship between underperformance and outperformance rates from the September Business Plan.

We have set our ODI rate using the approach outlined in section 2.4. The table below shows the ODI rates from the available information, the weights and our proposed ODI rate. When compiling this response we noted an error in the information provided in the IAP which we have corrected below.

	Weight	Underperformance Rate (£m per Unit)		Weight	Outperformance Rate (£m per Unit)
Ofwat Lower Bound	40%	(3.70)	Ofwat Lower Bound	40%	3.70
PR14 Adjusted Rate	10%	(16.39)	PR14 Adjusted Rate	10%	4.60
MOS Research	40%	(0.84)	MOS Research	40%	0.80
WTP Research	10%	(1.83)	WTP Research	10%	1.80
Revised ODI Rate	100%	(3.64)	Revised ODI Rate	100%	2.44

PR14 Adjusted Rate

Our PR14 performance commitment has deadbands for under or outperformance. It is therefore appropriate to adjust the PR14 rates in order to take into account the deadbands.

The table below shows the difference between the Performance Commitment (PC) and the collar/cap and the deadband and the collar/cap. The total outperformance/underperformance payment calculates the maximum amount of financial incentive for the performance commitment target and deadband. The table shows that maximum incentive from the deadband is £38.6 million for underperformance and £10.9m for outperformance. The ODI rate is adjusted by dividing the total underperformance incentive by the deviation from the PC and the collar (352 incidents).

	Total Difference (Incidents)	PR14 Rate (£ per Incident)	Total Outperformance/Underperformance (£m)	Adjusted PR14 Rate (£ per Incident)	Adjusted PR14 Rate (£ per Incident per 10,000 Connections)
Underperformance					
Difference PC and Collar	352				
Difference Deadband and Collar	240	(0.161)	(38.6)	(0.11)	(16.39)
Outperformance					
Difference PC and Cap	352				
Difference Deadband and Cap	175	0.062	10.9	0.03	4.60

4.2. ODI collar

The DD has changed our underperformance collar. The Outcomes Policy Appendix notes that collars are set as a multiple of the performance commitment level relative to the first year of performance, and then applies the corresponding multiplier value as the collar in every year of the 2020-25 period.

Ofwat have set the collar at 3.35 incidents per 10,000 connections. It is unclear how Ofwat have determined the appropriate multiplier. Our PCs document (WSH.DD.OC.1) outlines our representations on the level of the performance target, proposing that we revert to our Business Plan target. This is justified by the presentation of new data from the Met Office which evidences the disproportionately high impact of severe rainfall in our area. We have accordingly revised our ODI collar to be in line with our original Business Plan value, which was based on the P10 level of performance derived in turn from monthly data. The detailed methodology is outlined in Business Plan document 5.5 - PR19 Outcome Delivery Incentives.

The table below shows our revised performance commitment level, cap and collar.

	Unit of measure	2020/21	2021/22	2022/23	2023/24	2024/25
Performance commitment	Number	1.86	1.81	1.77	1.72	1.67
Collar	Number	2.36	2.32	2.25	2.18	2.14
Cap	Number	1.40	1.36	1.30	1.23	1.20

A performance of over 2.14 incidents per 10,000 connections (at the end of the period) would be a significant deviation from our target of 1.67 incidents per 10,000 connections. In total number that is 315 incidents against a target of 252 incidents. Since the measure now does not exclude severe weather, an outcome of more than 315 incidents in a year would be overwhelmingly due to severe weather events, which as we have shown impacts our area disproportionately. In these circumstances, the incremental penalties do not provide any meaningful incentive on management and merely penalise a company for factors beyond its control.

5. Rt2 External sewer flooding

5.1. ODI rate

Ofwat have intervened to increase our underperformance and outperformance rates for external sewer flooding on the basis that our rate was below the industry average. Ofwat have set our outperformance rate by applying the ratio of the marginal benefit from external relative to internal sewer flooding from our primary WTP research. The underperformance rate has been set based on the average ratio of underperformance to outperformance in companies' September business plan submissions. The underperformance and outperformance rates chosen by Ofwat are substantially higher than our WTP values. The values implied are nearly at the maximum customer valuation for internal sewer flooding, which causes a significantly higher impact on customers than external sewer flooding.

Internal sewer flooding is highly correlated with external sewer flooding. These two ODIs currently have the second and third largest potential ODI penalty associated with them. This puts a disproportionate incentive on these measures relative to the other PCs that are of equal or higher level of importance to customers. These two measures are also significantly influenced by incidents of heavy rainfall which is beyond management control and which the new Met Office data supplied in our DD responses (see Supporting Appendix 2A and 2B) has a disproportionate impact in our company area.

We have set our ODI rate using the approach outlined in section (2.4). The table below shows the ODI rates from the available information, the weights and our proposed ODI rate. When compiling this response we noted an error in the information provided in the IAP which we have corrected below.

	Weight	Underperformance Rate (£m per Unit)
Ofwat Lower Bound	50%	(0.77)
MOS Research	40%	(0.23)
WTP Research	10%	(0.42)
Revised ODI Rate	100%	(0.52)

	Weight	Outperformance Rate (£m per Unit)
Ofwat Lower Bound	50%	0.46
MOS Research	40%	0.23
WTP Research	10%	0.42
Revised ODI Rate	100%	0.37

5.2. ODI Collar

The DD has intervened to change our underperformance collar. Ofwat's Outcomes Policy Appendix states that collars are set as a multiple of the performance commitment level relative to the first year of performance, then applying the corresponding multiplier value as the collar in every year of the 2020-25 period.

Ofwat have set the collar at 40.05 incidents per 10,000 connections. It is unclear how Ofwat have determined the appropriate multiplier. Our PCs document (WSH.DD.OC.1) outlines our representations on the level of the performance target, proposing that we revert to our Business Plan target. This is justified by the presentation of new data from the Met Office which evidences the disproportionately high impact of severe rainfall in our area. We have accordingly revised our ODI collar to be in line with our original Business Plan value, which was based on the P10 level of performance derived in turn from monthly data. The detailed methodology is outlined in Business Plan document 5.5 - PR19 Outcome Delivery Incentives.

The table below shows our proposed performance commitment, cap and collar.

	Unit of measure	2020/21	2021/22	2022/23	2023/24	2024/25
Performance commitment	Number	27.50	26.90	26.30	25.70	25.10
Collar	Number	31.90	31.30	30.70	30.00	29.40
Cap	Number	23.20	22.60	22.00	21.50	20.90

A performance of over 29.40 incidents per 10,000 connections (at the end of the period) would be a significant deviation from our target of 25.10 incidents per 10,000 connections. In total number that is 4447 incidents against a target of 3796 incidents. Since the measure now does not exclude severe weather, an outcome of more than 4447 incidents in a year would be overwhelmingly due to severe weather events, which as we have shown impacts our area disproportionately. In these circumstances, the incremental penalties do not provide any meaningful incentive on management and merely penalise a company for factors beyond its control.

6. En5 Per capita consumption

6.1. ODI Rate

In our September Business Plan we proposed a reputational ODI for this new common PC. Most of the other companies put forward financial ODIs. In the IAP Ofwat requested further evidence to justify the use of a non-financial incentive. We undertook further customer engagement in April 2019 to understand customers’ views on the use of a financial incentive. Our customer research showed that only 35% customers thought that we should have financial incentives. Accordingly, in our April Business Plan submission we did not apply financial ODIs on this measure. Ofwat note that we have not provided the underlying detail for the customer research.

Ofwat also states that we are a “comparatively poor performer with the forecast service level below upper quartile”. We do not believe it is relevant whether we are a “good performer” or not. Further, as noted in our Performance Commitments document (WSH.DD.OC.1), PCC as a measure is different in nature to most of the others. It is not in itself an indicator of ‘service performance’, in the same way as supply interruptions or sewer flooding. A lower level of PCC does not unambiguously constitute a better outcome for customers and the environment, given that consuming water is part of the service provided to customers. While the average amount of water consumed per customer in our area is higher than the industry average, this does not constitute ‘poor performance’, and indeed this may be the “right” level for our area, given our operating conditions compared to the wider industry.

The DD sets the underperformance rate at the industry average ODI rate. While we remain of the view that financial ODIs are not appropriate for a measure such as PCC for the reasons set out in our IAP responses, we have decided to accept the common requirement to apply a financial ODI. However, given our customer views which show little support for this measure and the less salient supply-demand issues in our operating area compared to most other companies, we believe it is appropriate for the rate to be set at the lower bound. Again, this approach is in line with Welsh Government’s SPS, which indicates that regulatory determinations should reflect circumstances and customer views in Wales, rather than being overwritten by the average value for companies in England.

	Underperformance Rate (£m per Unit)
Ofwat DD Value	(0.296)
Ofwat Lower Bound (proposed rate)	(0.135)

7. Wt4 Mains Repairs

7.1. ODI collar

The DD has intervened to change our underperformance collar. Ofwat’s “PR19 Draft Determination- Delivering outcomes for customers policy appendix” notes that collars are set as a multiple of the performance commitment level relative to the first year of performance, and then apply the corresponding multiplier value as the collar in every year of the 2020-25 period.

Ofwat have set the collar at 190.1 repairs per 1,000km of mains. It is unclear how Ofwat have derived the multiplier for each PC. We have revised our ODI collar to be in line with our April Business Plan value, which was based on the P10 level of performance derived in turn from monthly data. The detailed methodology is outlined in Business Plan document 5.5 - PR19 Outcome Delivery Incentives.

The number of mains repairs are significantly driven by factors beyond management control such as severe weather events. Any deviation beyond our proposed collars will be due to factors beyond management control and therefore any incremental underperformance payments will not provide any additional incentives to management

	Unit of measure	2020/21	2021/22	2022/23	2023/24	2024/25
Performance commitment level	Number	126.7	126.7	126.7	126.7	126.7
Collar	Number	165.3	165	163	162.7	160.5

8. En6- Km of River Improved

8.1. ODI Rate

In our Business Plan we proposed a bespoke outcome-based cumulative performance commitment on the km of river improved. The Draft Determination made a change to the definition to make this an output-based measure and proposed to exclude “amber” schemes and NEP schemes covered by our CSO storage schemes PC. In our PCs document (WSH.DD.OC.1) we explain why we propose to retain our original definition making this an outcome-based measure, and to remove the exclusions.

In the DD Ofwat proposed to include an underperformance in-period ODI with a rate of £0.00296m per km of river improved. This rate was derived following Ofwat’s standard approach for output-based ODIs. This is orders of magnitude smaller than the rate proposed in our Business Plan for outperformance and underperformance payments. Our rate was derived with reference to the overall balance of ODIs and the relative importance of this PC as expressed by customers.

Given our representations on the definition as an outcome PC, we believe that an outperformance and underperformance ODI is appropriate, and should be an end-of-period ODI. We submit that the rate proposed in the DD is inappropriately small and would not constitute an effective incentive. The rate put forward in our Business Plan is more in line with the costs involved and our other ODIs.

	Underperformance Rate (£m per km)	Outperformance Rate (£m per km)
ODI Rate	(0.217)	0.217

8.2. ODI type

We propose to change this to an end-of-period ODI as in our original Business Plan. This is more appropriate in view of the cumulative nature of the measure and the fact that the phasing of delivery may change as a result of ongoing consultations with our regulators. In particular, we note that the final version of the NEP, which will have a significant bearing on the timing of our performance on this measures, will not be published until 2021.

8.3. ODI Cap and Collar

We have reinstated our original target, ODI rate and cap and collar for the km of river improved.

	Unit of measure	2020/21	2021/22	2022/23	2023/24	2024/25
Performance commitment level	Km					418
Collar	Km					358
Cap	Km					478

9. Ft4- Surface Water Removed from Sewers

9.1. ODI Cap and Collar

We have proposed to change the flat profile proposed in the DD for surface water removed from sewers to a profile that reflects our latest view on the delivery of the programme. Further information is outlined in WSH.DD.OC.1.

The caps and collars have been updated to reflect the changes to the profile of the targets.

	Unit of measure	2020/21	2021/22	2022/23	2023/24	2024/25
Performance commitment level	Number	141,900	141,900	141,900	862,150	862,150
Collar	Number	117,810	117,810	117,810	715,785	715,785
Cap	Number	165,990	165,990	165,990	1,008,515	1,008,515

10. Ft5 - Ft9 Asset Resilience

10.1. Asset Resilience Financial Incentives

Ofwat has removed the financial incentives for the asset resilience PCs with the following explanation:

“While we welcome the development of this performance commitment, we consider a non-financial incentive is more appropriate at this stage to allow the company to prove that this measure can be an effective method of delivering improvements in resilience in the long-term. We are also concerned that there is an insufficient level of transparency and external assurance proposed given the material financial incentives associated with this measure.”

We do not agree that this rationale is justified. We developed the asset resilience scorecards during AMP5 and Ofwat accepted two measures in FD14, one for water assets (F3 water) and one for wastewater (F3 wastewater), as regulatory measures during AMP6. These have significant financial incentives attached, with £11 million and £15.5 million as maximum penalties. We have shown that we are able to report robustly and transparently on these measures through the assurance processes we use in our Annual Performance Report. The Reporter plays an important and independent role in ensuring that any judgements applied in the scoring are appropriate.

The five measures proposed for asset resilience for PR19 are disaggregated versions of the current FD14 measures, broken down for the different asset classes. (Note that initially we proposed a single combined PR19 measure for water assets (except reservoirs) and another for wastewater assets. These were each disaggregated into above and below ground assets in response to Ofwat’s feedback on the May 2018 PCs submission). The PR14 measures are based on the same scorecard methodology as the proposed PR19 measures. The detailed definitions for each have drawn on the lessons learned from our experience of the AMP6 measures, and are more specific allowing less room for judgement.

We therefore do not consider that Ofwat’s concerns around the need to prove the measures, and around the need for transparency and external assurance, are justified.

Ofwat also considers that we did not provide sufficient evidence of customer support for the use of financial incentives on each asset resilience measure independently. On the advice of the research agency, we did not include specific questions on each individual measure, as this would have stretched customers’ tolerance for repetitive questions. It would also suggest that customers would differentiate meaningfully in their responses to questions about different asset classes. We believe that the customer views on the asset resilience measures as a whole can legitimately be applied to the individual measures. There is no basis for considering that customers might support financial incentives for, say, below ground assets for water, but not, say, above ground assets for waste. We therefore consider that our customer research results are sufficient grounds for retaining financial ODIs for these measures.

We have delivered significant improvements in resilience against our existing measures in AMP6, and we believe that financial ODIs against the proposed new measures will help to incentivise further improvements to asset resilience in AMP7.

10.2. Asset Resilience (Water Network+ Below Ground)

We have updated our target for asset resilience network+ below ground as outlined in PCs document (WSH.DD.OC.1). We have revised our cap and collar given the updated target. Given the changes to the target, cap and collar we have updated our ODI rate to ensure that the financial incentives are aligned with the remaining measures.

	2020/21	2021/22	2022/23	2023/24	2024/25
Performance commitment	68.0%	68.0%	70.0%	71.0%	73.0%
Collar	65.3%	65.3%	67.3%	68.2%	70.2%
Cap	70.7%	70.7%	72.7%	73.8%	75.8%

ODI Rate

	Underperformance Rate (£m per Unit)	Outperformance Rate (£m per Unit)
Asset resilience (Water network plus below ground)	(0.5109)	0.5109

11. Ft11 Visitors to recreational facilities

11.1. Use of financial ODIs

In the IAP, Ofwat requested further evidence to justify the use of financial incentives for this PC.

We conducted further customer research and the results showed a strong level of support for the use of financial incentives for this PC, though slightly less than for some of the other measures tested. In view of this we reduced the level of the proposed outperformance and underperformance payments.

In the DD, Ofwat states that the customer research provides insufficient evidence, and that it is concerned that under the current definition it may not be sufficiently stretching and may not lead to long-term benefits.

We do believe that our target to increase the number of children and adults attending our visitor centres from the forecast 2019-20 level of 480,000 to 830,000 by 2024-2025 is stretching, requiring significant additional resources and representing a 73% increase in the number of customers that we are engaging in this way.

We maintain that on the basis of the customer research we have conducted, a financial ODI is justified and appropriate for this measure. Further, we propose that the quantum of potential underperformance and outperformance payments relative to other financial ODIs is appropriate given the relative level of customer support for financial incentives on this measure.

12. Ft10 Community education

12.1. Use of financial ODIs

In the IAP, Ofwat requested further evidence to justify the use of financial incentives for this PC, including evidence that customers support and are willing to pay for outperformance.

We conducted further customer research and the results showed a strong level of support for the use of financial incentives for this PC, though slightly less than for some of the other measures tested. In view of this we reduced the level of the proposed outperformance and underperformance payments.

In the DD, Ofwat states that the customer research provides insufficient evidence, and that it is concerned that under the current definition it may not be sufficiently stretching and may not lead to long-term benefits. At the same time, Ofwat states that it would reconsider this if the company could demonstrate that the performance commitment would lead to long term benefits.

We do believe that our target to increase the number of children and adults attending our education programmes from the current level of 67,000 to 75,000 by 2024-2025 is stretching, requiring significant additional teachers and other resources.

We commissioned a report from SIA partners to estimate the material benefits of customer education (see Supporting Appendix 4). The analysis is based on an earlier UKWIR project assessing the value of water efficiency education initiatives. It concludes that the programme has a net present social value of £2 million over a five year period, using the baseline figures for the effectiveness of the engagement. The averages savings on the household water bill of all pupils were shown to range from £1.68 per annum to £11.33 per annum. In our view this measure of the direct benefits understates the wider value of engaging with our customers on multiple levels in terms of building trust and the involvement of customers in service provision.

On the basis of the customer research results, and the clear value to customers of the programme as evidenced by the SIA report, we propose that a financial ODI is appropriate for this measure. Further, we believe that the quantum of potential underperformance and outperformance payments relative to other financial ODIs is appropriate given the relative level of customer support for financial incentives on this measure.

13. Proposed New Performance Commitments

13.1. Introduction

Three new PCs are proposed to provide customer protection for the resilience schemes that we are including in our revised plan.

The proposed PCs and the linked schemes are as listed in the table below:

Name of PC	Reference	Link to representation documents
Delivery of our Hereford water supply resilience scheme	PR19WSH_BI9	WSH.DD.CE.5
Delivery of our South Wales Grid water supply resilience scheme	PR19WSH_BI10	WSH.DD.CE.4
Delivery of our new visitor centres	PR19WSH_BI11	WSH.DD.CE.7

The three sections below provide proposed definitions and PC levels for each of these.

13.2. Delivery of our Hereford water supply resilience scheme

Purpose: This commitment incentivises the company to deliver a scheme to improve the resilience of the water supply or to return the expenditure in full to customers.

Benefits: The supply system in Hereford will become more resilient against low probability risks, reducing the risk of prolonged interruptions to supply to 117,000 customers in the area.

ODI Rate: The ODI rate is based on the total expenditure and a 50% cost sharing rate.

Definition

Unique Reference	PR19WSH_BI9
Detailed definition of performance measure	Has the company delivered the project to improve the resilience of water supply in Hereford.
Additional detail on measurement units	None
Specific exclusions	N/A
Reporting and assurance	No specific requirements
Measurement unit and decimal places	Text stating either “delivered” or “not delivered”. Delivered = 0, Not delivered =1
Measurement timing	Reporting year
Incentive form	Revenue
Incentive type	Underperformance payments
Timing of underperformance and outperformance payments	End of period
Price control allocation	100% water network plus
Frequency of reporting	Annual
Any other relevant information	NA
Links to relevant external documents	NA

Performance commitment levels

	Unit	Company forecast	Committed performance level				
		2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level	£m	NA	NA	NA	NA	NA	Delivered
Enhanced underperformance collar	£m		NA	NA	NA	NA	NA
Standard underperformance collar	£m		NA	NA	NA	NA	NA
Underperformance deadband	£m		NA	NA	NA	NA	NA
Outperformance deadband	£m		NA	NA	NA	NA	NA
Standard outperformance cap	£m		NA	NA	NA	NA	NA
Enhanced outperformance cap	£m		NA	NA	NA	NA	NA

Incentive rates

Incentive type	Incentive rate (£m/unit)
Underperformance payment - standard	-6.801
Underperformance payment - enhanced	NA
Outperformance payment - standard	NA
Outperformance payment - enhanced	NA

13.3. Delivery of our South Wales Grid water supply resilience scheme

Purpose: This commitment incentivises the company to deliver a scheme to improve the resilience of the water supply or to return the expenditure in full to customers

Benefits: The supply system in South Wales will become more resilient against low probability risks, reducing the risk of interruptions to supply to over 50,000 customers in the Western Cardiff area.

ODI Rate: The ODI rate is based on the total expenditure and a 50% cost sharing rate.

Definition

Unique Reference	PR19WSH_BI10
Detailed definition of performance measure	Has the company delivered the project to provide a bi-directional transfer of 30MI/d between the West (TCUS) and East (SEWCUS) conjunctive use systems?
Additional detail on measurement units	None
Specific exclusions	N/A
Reporting and assurance	No specific requirements
Measurement unit and decimal places	Text stating either “delivered” or “not delivered”. Delivered = 0, Not delivered = 1
Measurement timing	Reporting year
Incentive form	Revenue
Incentive type	Underperformance payments
Timing of underperformance and outperformance payments	End of period
Price control allocation	100% water network plus
Frequency of reporting	Annual
Any other relevant information	NA
Links to relevant external documents	NA

Performance commitment levels

	Unit	Company forecast	Committed performance level				
		2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level	£m	NA	NA	NA	NA	NA	Delivered
Enhanced underperformance collar	£m		NA	NA	NA	NA	NA
Standard underperformance collar	£m		NA	NA	NA	NA	NA
Underperformance deadband	£m		NA	NA	NA	NA	NA
Outperformance deadband	£m		NA	NA	NA	NA	NA
Standard outperformance cap	£m		NA	NA	NA	NA	NA
Enhanced outperformance cap	£m		NA	NA	NA	NA	NA

Incentive rates

Incentive type	Incentive rate (£m/unit)
Underperformance payment - standard	-9.954
Underperformance payment - enhanced	NA
Outperformance payment - standard	NA
Outperformance payment - enhanced	NA

13.4. Delivery of our new visitor centres

Purpose: This commitment incentivises the company to deliver a scheme to construct a new visitor centre.

Benefits: More people are able to benefit from access to recreational facilities.

ODI Rate: The ODI rate is based on the total expenditure and a 50% cost sharing rate.

Definition

Unique Reference	PR19WSH_BI11
Detailed definition of performance measure	Has the company delivered the project to construct a new visitor centre at the Llanishen / Lisvane reservoirs site.
Additional detail on measurement units	None
Specific exclusions	N/A
Reporting and assurance	No specific requirements
Measurement unit and decimal places	Text stating either “delivered” or “not delivered”. Delivered = 0 , Not delivered = 1
Measurement timing	Reporting year
Incentive form	Revenue
Incentive type	Underperformance payments
Timing of underperformance and outperformance payments	End of period
Price control allocation	100% water resources
Frequency of reporting	Annual
Any other relevant information	NA
Links to relevant external documents	NA

Performance commitment levels

	Unit	Company forecast	Committed performance level				
		2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Performance commitment level	£m	NA	NA	NA	NA	NA	Delivered
Enhanced underperformance collar	£m		NA	NA	NA	NA	NA
Standard underperformance collar	£m		NA	NA	NA	NA	NA
Underperformance deadband	£m		NA	NA	NA	NA	NA
Outperformance deadband	£m		NA	NA	NA	NA	NA
Standard outperformance cap	£m		NA	NA	NA	NA	NA
Enhanced outperformance cap	£m		NA	NA	NA	NA	NA

Incentive rates

Incentive type	Incentive rate (£m/unit)
Underperformance payment - standard	-6.150
Underperformance payment - enhanced	NA
Outperformance payment - standard	NA
Outperformance payment - enhanced	NA