

IAP Response

Ref B2.25.WSH.OC

ODIs: Supplementary research results and company response

29 April 2019

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1. Introduction

Ofwat provided detailed feedback on our Outcome Delivery Incentives (ODI) package in “Dŵr Cymru: Delivering outcomes for customers detail actions” as part of the IAP publication. We carefully considered Ofwat’s actions and responded to each on 1 April 2019 in our IAP response. In that submission we revised our ODI package reflecting the availability of new customer data from the industry. Our approach is described in “B2.4.WSH.OC Outcome Delivery Incentives IAP Response”. Whilst we revised our package on a number of performance commitments, a number of Ofwat’s actions required further customer research, and we reserved our position on these ODIs subject to the results of the research.

In its IAP feedback Ofwat required further evidence of customer support for:

- The acceptability of our ODI package as a whole; and
- Customer support for financial and non-financial outcome delivery incentives for a limited number of measures.

Our CCG determined that it was not possible to prepare, implement and respond to the results of this research exercise in a robust and fair manner in time for the 1 April submission to Ofwat and therefore we noted that we would submit the results no later than 30 April. We have now completed the customer research on the results are shown in IAP ODI Quantitative Research Final Results – April 2019 (Accent). Overall the results from the customer research show:

- Customers as a whole found the revised ODI package acceptable in total. However, given the choice, more customers would rather see a smaller bill impact than a larger one;
- There was strong customer support for having financial incentives for all three categories of service measures (most important), asset health measures and resilience measures (slightly less important);
- There was strong customer support for having financial incentives against each of the individual measures tested. The level of support varied slightly across measures.;
- Customers supported our proposal not to have financial incentives on three of the measures, as proposed in our original September Business Plan.
- Support for retaining caps and collars on our ODIs.

This document provides further details of our approach to responding to the IAP actions in the light of the customer research results. In summary we have:

- Retained financial incentives on those measures where we had proposed financial incentives, but for which Ofwat requested further evidence of customer support for our proposals;
- Reduced the ODI rates (from the September Business Plan proposals) for our five asset resilience measures, to reflect the lower level of customer support for this category of measures as compared with the support for the service and asset health measures;

- Reduced the ODI rates (from our September Business Plan proposals) for a) Community Education and b) Visitors to Recreational Facilities, to reflect the lower level of customer support for these specific measures compared to other service measures; and
- Retained non-financial incentives on Per Capita Consumption, Unbilled Properties and Water Process Unplanned Outages.

We discussed the results of the research with our CCG, which endorsed the proposed changes we proposed to make in response. The CCG Chair will be writing to Ofwat separately with the CCG's views.

We have updated our IAP Action Table and PR19 Data Tables in light of the above, and are resubmitting them at this time.

The full list of supporting documents we are submitting along with this document are:

1. Accent report on results of supplementary customer research on ODIs
2. Revised PR19 data tables
3. Revised data tables changes summary
4. Revised IAP Action Tracker.

Note that the supplementary research also included questions on customer acceptability and affordability of our proposed bill profile from 2020-2030. This responds to action WSH.AV.A1 in the IAP Action Table. The results are provided on pages 16 and 17 of the results report (item 1 above).

2. Customer support for financial incentives

Ofwat’s IAP feedback required further evidence to justify the use of underperformance and outperformance payments for ten of our measures. To understand customers’ views on the importance of financial incentives we asked customers their views on the level of importance of financial incentives for these measures. The table below outlines the results from the customer research on these ten measures. The final column shows the decision that we have made as a consequence of the results from the customer research. Overall, given the strong support in the customer research, we have retained the financial incentives. However we have reduced the incentives on seven measures as set out below in Sections 2.1 and 2.2.

	Decision
Customer Trust	Retain Incentives
Bioresources product quality	Retain Incentives
Total Complaints	Retain Incentives
Asset Resilience (Reservoirs)	Reduce Incentives (See Section 2.1)
Asset Resilience (Water Network+ Above Ground)	Reduce Incentives (See Section 2.1)
Asset Resilience (Water Network+ Below Ground)	Reduce Incentives (See Section 2.1)
Asset Resilience (Waste Network+ Above Ground)	Reduce Incentives (See Section 2.1)
Asset Resilience (Waste Network+ Below Ground)	Reduce Incentives (See Section 2.1)
Community Education	Reduce Incentives (See Section 2.1)
Visitors to Recreational Facilities	Reduce Incentives (See Section 2.1)

Table 1 Survey results - customer support for measures

2.1. Asset Resilience Measures

Our customer research explored customers’ views on the balance of financial incentives across the three categories of service measures, asset health measures and resilience measures. The customer research results below show that there is a strong level of support for having financial incentives on the asset resilience measures. Service measures are considered the most important for financial incentives followed by asset health measures and resilience measures.

The results indicate that customers view asset health and resilience at a lower level of importance than service measures. We reviewed the balance of financial incentives between asset health measures, resilience measures and service measures. As a consequence we have reduced the ODI rates for our five asset resilience measures to reflect customer views.

Q24. How important is it that Welsh Water has financial rewards and penalties against each of the following?
 0=NOT AT ALL IMPORTANT TO 10 = EXTREMELY IMPORTANT

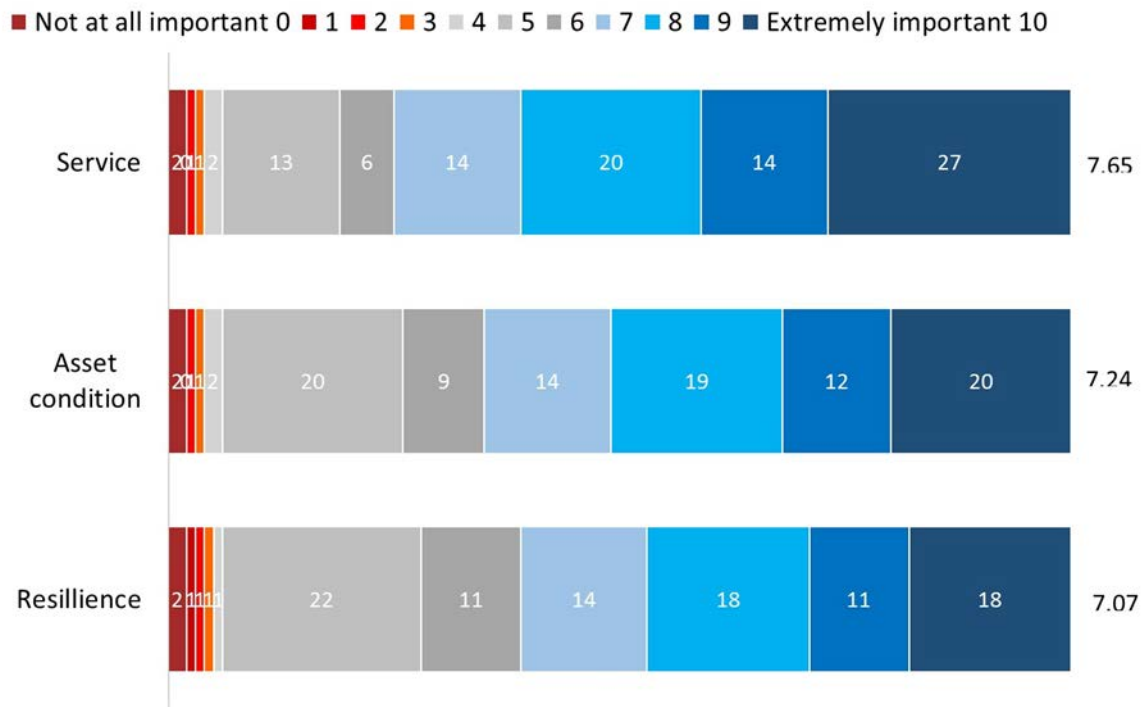


Figure 1 Relative support for three categories of measures

Table 2 below sets out the maximum underperformance and outperformance payments that can be achieved over the 5 years for the three categories of measures. The financial incentives are largest for the service measures. This is in line with our customer research and is expected given the large number of performance commitments for service improvements. Our ODI package submitted on 1 April had larger financial incentives on asset resilience compared to asset health. Accordingly, to ensure an appropriate balance between asset health and resilience that reflects customers’ views, we have applied a reduction to the ODI rate for our five resilience measures.

	1 April Submission		Revised April Submission	
	Maximum Underperformance Payments (£m)	Maximum Outperformance Payments (£m)	Maximum Outperformance Payments (£m)	Maximum Outperformance Payments (£m)
	Service	143	105	137
Resilience	65	65	35	35
Asset Health	40	18	40	18
Total	247	188	211	159

Table 2 Maximum financial incentives for three categories of measures

As set out in our September submission document “5.5 PR19 Outcome Delivery Incentives WSH”, we categorised each of our performance commitments into one of three bands based on the level of importance for customers derived from customer research. Measures in bands 1, 2 and 3 were assigned a maximum outperformance and underperformance incentive of £25m, £13m and £7m respectively. Customers categorised resilience as medium importance and therefore these measures were categorised in ‘band 2’ and assigned a maximum financial incentive of £13m. Given the customer research on the balance of financial incentives between asset health and resilience we have reduced the incentives on these measures to a ‘category 3’ measure with a maximum financial incentive of £7m over the AMP. The changes to the incentive rates are outlined in Table 3.

	1 April Submission		Revised April Submission	
	Underperformance Rate (£m)	Outperformance Rate (£m)	Underperformance Rate (£m)	Outperformance Rate (£m)
	Asset Resilience (reservoirs)	(1.53)	1.53	(0.82)
Asset Resilience (water network+ above ground)	(2.00)	2.00	(1.08)	1.08
Asset Resilience (water network+ below ground)	(0.58)	0.58	(0.31)	0.31
Asset Resilience (waste network+ above ground)	(2.17)	2.17	(1.17)	1.17
Asset Resilience (waste network+ below ground)	(0.31)	0.31	(0.17)	0.17

Table 3 Changes to incentive rates for asset resilience measures

2.2. Visitors to Recreational Facilities and Community Education

Ofwat’s IAP feedback requested further evidence to justify the use of financial incentives for Visitor to Recreational Facilities and Community Education. We had categorised these two measures in our lowest category, band 3, and assigned a maximum financial incentive of £7m over the five years. We have carefully considered the new customer research and we note that whilst customers support financial incentives on these measures, the level of support is lower than the other measures.

Q25. Please indicate how important you consider it to be that Welsh Water has financial rewards or penalties for each of the following measures.

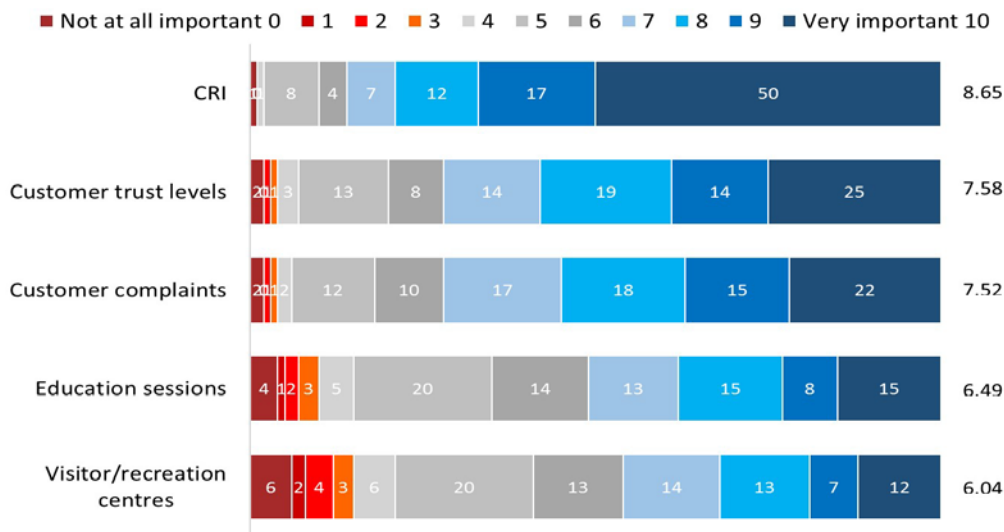


Figure 2 Customer support for financial incentives on service measures

Reflecting the customer research results we have reduced the ODI rates for these measures to £4m over the five years. This is consistent with our original range for WTP outperformance and underperformance payments outlined in Table 6 in “5.5 PR19 Outcome Delivery Incentives WSH”. The changes to the incentive rates are outlined in Table 5.

	1 April Submission		Revised April Submission	
	Underperformance Rate (£m)	Outperformance Rate (£m)	Underperformance Rate (£m)	Outperformance Rate (£m)
Community education	(0.048)	0.048	(0.028)	0.028
Visitors to recreational facilities	(0.039)	0.039	(0.023)	0.023

Table 4 Changes to education and recreational facilities incentive rates

3. Customer support for non-financial incentives

Ofwat’s IAP feedback noted that we should provide further evidence to justify the use of a non-financial incentive for the following measures and evidence of customer support for this approach:

- Per Capita Consumption;
- Unbilled Properties; and
- Water process unplanned outages

Our IAP response document “B2.4.WSH.OC Outcome Delivery Incentives” provided further justification of the use of a non-financial incentive on these measures. Our IAP response also noted that we would undertake further customer research to understand customers’ views on the use of financial incentives on these measures. The results show that only one-third of customers support the use of financial incentives on these measures. Accordingly we maintain our position of applying non-financial incentives on these measures.

Q27. There are some measures against which Welsh Water is proposing not to have rewards or penalties and these would simply impact on the company’s if they miss their target. These are shown below together with the reasons for not having rewards or penalties. For each please indicate whether you agree or disagree with Welsh Water

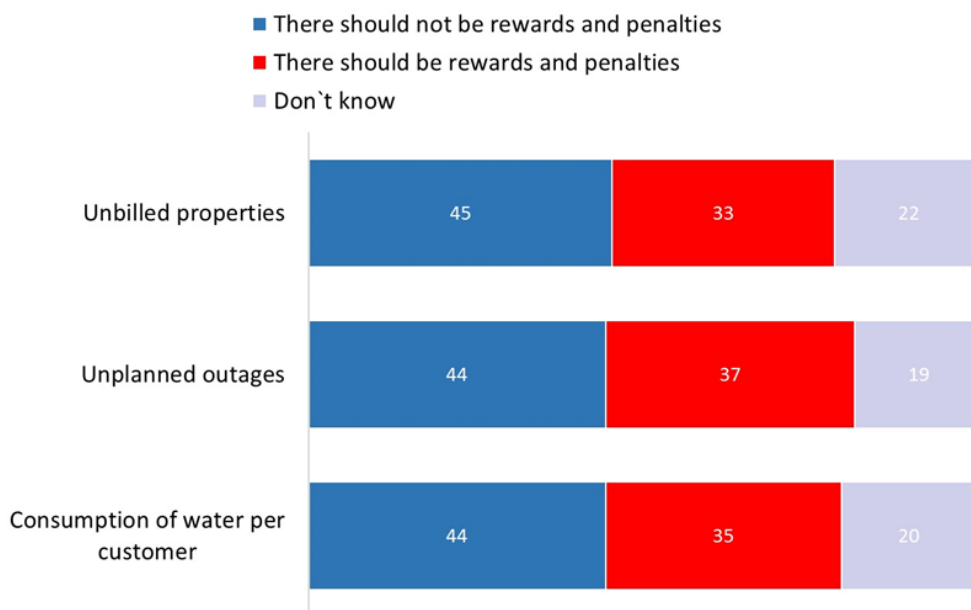


Figure 3 Customer support for non-financial incentives on 3 measures

4. Caps and collars

Ofwat’s IAP feedback requested further justification of the use of caps and collars. We provided further detail as to the applicability of caps and collars on individual measures in our IAP response on 1 April (Ref B2.4.WSH.OC). We also said that we would test our approach with customers in our supplementary research. The results related to this issue are shown below. These indicate that customers are satisfied with the use of caps and collars on the basis set out in our proposals.

Q26. Welsh Water has the option of setting limits for each measure on the amount of the reward (to protect customer bills going up too much) or the amount of penalty (to protect the finances of the company). They are proposing to set limits on rewards and penalties for each measure so that if performance is exceptionally good or exceptionally bad (defined as a level that would only occur once in ten years, usually due to extreme weather conditions) there would be no extra reward or penalty.

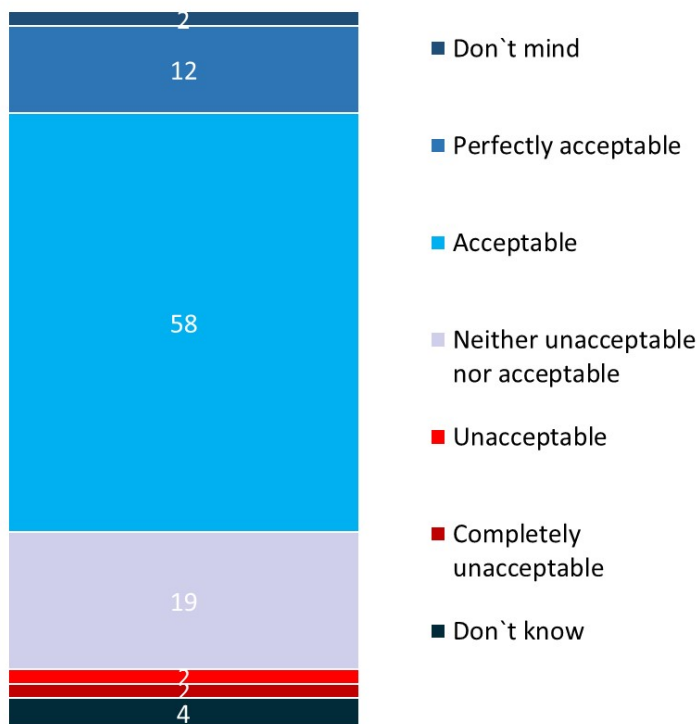


Figure 4 Customer support for caps and collars

5. Acceptability of ODI Package

Ofwat’s IAP feedback noted that we should provide further evidence on the acceptability and affordability of the overall size of our ODI package. Based on the interim revised ODI package submitted on 1 April our customer research tested a bill variability associated with ODIs of up to a £20 increase or a £30 decrease. The results show that a significant majority of customers find this bill range acceptable. However, given the choice, more customers would prefer a smaller bill range than a larger one. The maximum bill impact based on our final revised ODI package is an £18 increase (before WaterShare, which would reduce this to £9) or a £24 decrease per year.

Q22. As we have just seen the potential range for the impact of these rewards and penalties on the average bill could be up to a £20 increase or a £30 decrease, depending on Welsh Water’s performance. How acceptable do you find this range?

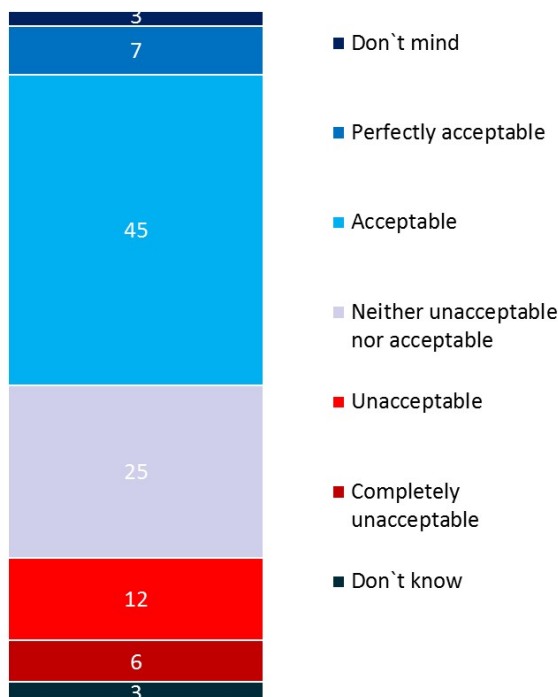


Figure 5 Customer acceptability of proposed ODI range