



# **Draft determination of Anglian Water's in-period outcome delivery incentives for 2015-16**

**An Ofwat consultation paper**

## Introduction

1. The Consumer Council for Water is the statutory consumer organisation representing water and sewerage consumers in England and Wales. The Consumer Council for Water has four regional committees in England and a committee for Wales. We welcome the opportunity to respond to Ofwat's draft determination of Anglian Water's in-period outcome delivery incentives for 2015-16.

## Executive Summary

- 2.1 Outcomes-based regulation was a major innovation at the 2014 price review (PR14). Water companies engaged with their customers and stakeholders to identify the high level outcomes they value. Desired outcomes are supported by performance commitments (PCs), many of which have reputational and financial incentives attached to them. These are called Outcome Delivery Incentives (ODIs).
- 2.2 ODIs are intended to focus companies' attention on delivering good outcomes on the services that matter to customers, financially rewarding companies for outperformance but financially penalising them when they fall short of their commitments.
- 2.3 All water companies have ODIs as part of their 2014 price review (PR14) settlement. They broadly reflect extensive engagement with customers and local stakeholders. Most financial ODIs will be reconciled at the 2019 price review (PR19), and will impact customers' bills from 2020. However, three companies, including Anglian Water, proposed some ODIs that would be paid within the current control period of 2015-20 - the so called 'in-period' ODIs.
- 2.4 At PR14 CCWater undertook research to establish consumers' views on ODIs. Our research showed that customers generally do not support the use of penalties or rewards as a method of driving companies' improvements in service<sup>1</sup>. Customers tend to see improving services as an integral part of companies' activities and not something that requires additional reward.
- 2.5 In our 2013 response to Ofwat's consultation on setting price controls for 2015-20<sup>2</sup>, our assessment of the 2014 price review published in August 2015<sup>3</sup>, and most recently in our response to Water 2020 - Regulatory Framework for wholesale markets and the 2019 price review<sup>4</sup>, CCWater warned of the risk of setting ODIs that did not stretch companies and opened the possibility of easy wins.
- 2.6 Our analysis of the initial suite of ODIs indicated that many were easily achievable and that companies were likely to receive significant rewards for marginal improvements. Ofwat's subsequent horizontal audit and requirement that ODI rewards were linked to upper-quartile performance ameliorated but did not remove our concern. There remains the prospect of customers being faced with bill spikes in 2020-21 (or earlier in the case on in-period ODIs) for a regulatory initiative which they did not support. Customers are, therefore, unlikely to react positively to this round of determinations, and both Ofwat and the companies will need to recognise this when communicating the outcome and effect of both in-period and end of period ODIs.

- 2.7 CCWater recognises the intention behind in-period ODIs is to sharpen incentives on company management to deliver what matters to customers by generating a reward or penalty which has a more immediate effect on the company, and that is more obviously linked to recent service performance.
- 2.8 CCWater recognises Ofwat's view that a balance is required between linking incentives more closely in time to performance and maintaining a smoother path of bill changes year on year which customers tend to indicate they prefer. We agree that, in some cases, it might be appropriate to apply in-period ODIs over several years, or to defer them, to smooth bills while still capturing some of the benefits of applying them closer to the performance that generated them.
- 2.9 We are happy that the draft determination shows that the correct process has been followed in Anglian Water's application and in Ofwat's consideration of it. We have no concerns with the way in which Ofwat has reached its conclusions described in its draft determination.
- 2.10 **Our detailed comments are given below but key points are;**
- **We agree with Ofwat's draft determination**
  - **We accept there is no requirement for bill smoothing**

## **Comments on Draft Determination**

- 3.1 Anglian Water has 39 PCs of which 22 have financial ODIs applied to them. Of these only one has an in-period ODI for 2015-16, covering leakage.
- 3.2 Anglian Water has outperformed its single in-period ODI, receiving a reward of £0.515m. This will result in an indicative increase in household water bills of £0.27.
- 3.3 CCWater welcomes the company's continuing efforts to reduce leakage. Customers identify this as a key priority. The company operates in a region which is both water-constrained and likely to experience significant population growth over the next 30 years. As such, Anglian Water needs to manage its water balance carefully, and active leakage control is a key component of the company's water conservation strategy.
- 3.4 While customers indicate that they do not like bill volatility year on year, we agree with Ofwat's determination that the 27p increase in water charges does not require smoothing. However, the company must be transparent in communicating with customers on the reasons for the reward and the potential for further, and possibly greater, in-period rewards in future years of this price control period.
- 3.5 Given the results of our research, customers will also need reassurance that the ODIs for which rewards have been given were set at the right levels, given that outperformance has been achieved in the first year of the control period.

## Enquiries

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1. <http://www.ccwater.org.uk/wp-content/uploads/2014/03/Outcome-and-Delivery-Incentives-Report-FINAL.pdf>
2. <http://www.ccwater.org.uk/wp-content/uploads/2013/12/Setting-price-controls-for-2015-20---framework-and-approach...pdf>
3. <http://www.ccwater.org.uk/wp-content/uploads/2015/08/A-Step-In-The-Right-Direction-CCWaters-assessment-of-the-2014-Price-Review.pdf>
4. <http://www.ccwater.org.uk/wp-content/uploads/2015/08/A-Step-In-The-Right-Direction-CCWaters-assessment-of-the-2014-Price-Review.pdf>