Abstraction Incentive Mechanism (AIM) - an Ofwat Consultation
1. Introduction

1.1. The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales. We welcome the opportunity to comment on Ofwat’s consultation on the Abstraction Incentive Mechanism (AIM).

2. Executive summary

We support

2.1. the creation of a measure that encourages companies to reduce the environmental impact of their abstractions. It seems sensible that the proposals for the AIM are based on a ‘local approach’ giving companies autonomy to decide how best to use and apply the AIM. This includes setting their own trigger levels and consulting with local stakeholders.

2.2. the premise that the AIM might also be an opportunity to review (and increase where appropriate) demand management activities. This includes leakage reduction and interventions designed to help customers use water wisely, and thus reduce the amount of water that is abstracted, treated and supplied. For this reason, it is important that the AIM is not looked at in isolation from other incentives and/or performance indicators.

2.3. the proposal for the companies to work with the Customer Challenge Groups (CCGs) and CCWater given that this is the way their performance commitments are set in other areas. We would encourage an even broader consultation with local interest groups and organisations.

2.4. the proposal for companies to publish the reasons for rejecting abstraction sites from the AIM.

2.5. the AIM taskforce’s recommendations for companies to report on and publish their performance both at site and company level (at AIM covered abstraction sites) as this increases the transparency of the AIM.

Issues that raise concerns

2.6. if the development and implementation of the AIM causes detriment and/or an increased risk of detriment to water customers. We would like clarity on how companies would supplement the reduced abstractions if there was a need to do so.

2.7. clarity on what the reputational incentive seeks to achieve, considering the reduction in the (self-reported) number of AIM sites, from 195 in companies’ Business Plans to 47 from 1 April 2016 or later.

2.8. how comparisons could be made given natural variations amongst companies. It would be more meaningful to compare the year-on-year performance or trend over time of each individual company in meeting its AIM commitments, linked to other performance indicators such as reductions in leakage and per capita consumption.

2.9. whether the ‘aspiration’ for the AIM to become a financial incentive at the 2019 Price Review (PR19) to ‘drive increased benefits for the environment’ will have customer support. We suggest that research is commissioned into customers’ views to inform a further consultation on the development of the AIM.

2.10. how the AIM would potentially fit with existing mechanisms, such as the Revenue Correction Mechanism and companies’ ODIs. Theoretically, companies could be paid three times for the same outcome in AMP7 if the incentive (penalty/reward) is not designed carefully.
3. Questions

Q1 - What are your views on the AIM taskforce’s proposals? (Chapter 2)

3.1. In general, we support the creation of a measure that encourages companies to reduce the environmental impact of their abstractions. This is a step in the right direction to protect the water environment and towards achieving Water Framework Directive (WFD) commitments.

3.2. It seems sensible that the proposals are based on a ‘local approach’, giving companies (some degree of) autonomy to decide how best to use and apply the AIM. This includes setting their own trigger levels and consulting with local stakeholders to ensure transparency.

3.3. We also welcome the interaction of the AIM with broader objectives for the water sector (i.e. Ofwat’s 2020 water strategy, water trading, abstraction reform, meeting WFD objectives) as these reforms should be considered jointly.

3.4. The incentive might also be an opportunity to review (and increase where appropriate) demand management activities. These include leakage reduction and interventions designed to help customers use water wisely, and thus reduce the amount of water that is abstracted, treated and supplied. For this reason, it is important that the AIM is not looked at in isolation from other incentives and/or performance indicators, especially those that relate to water resources and demand management.

3.5. We would be concerned if the development and implementation of the AIM were to cause detriment and/or an increased risk of detriment to water customers due to the potential increase in customer bills to maintain reliable supplies to their customers. For this reason, we would like more clarity on how companies would supplement the reduced abstractions if there was a need to do so. The issues these proposals raise include:

- Do these reductions imply a need for more resource development and/or sharing resources between companies? If yes, where would these resources come from and how would their development be funded?
- If the company cannot ‘readily meet the demand that would normally come from the AIM source’
- What are the reputational (and potential financial) consequences of companies not being able to include any AIM sites in their plans?

Q2 - How could Filter 3 be defined more precisely, and what assurance is required to make sure any additional filters included in Filter 3 are appropriate (Chapter 2)

3.6. We do not have anything else to add to the suggestions in the consultation.

Q3 - What are your views on the number of abstraction sites that water companies are proposing for the AIM? (Chapter 3)

3.7. We would like more clarity on what the reputational incentive seeks to achieve, considering the reduction in the (self-reported) number of AIM sites (47 from 1 April 2016 or later) when

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1 As per the definition of Filter 2 contained in the consultation document.
compared to the number of AIM sites reported by companies in their Business Plans (195).

3.8. As such, it would have been helpful for the consultation to show the number of abstraction sites by band in each of the three columns. One could then see whether the significant reduction in sites was due to the application of Filters 2 or 3 or of WFD bands 1 or 2.

3.9. One of the objectives of the AIM is to ‘harness a water company’s aspiration to enhance its reputation by demonstrating that it is changing its operational practices in a way that benefits the environment and in a way that helps to achieve WFD objectives’. But how will these changes affect a company’s ability to provide a reliable and affordable service to its customers? Could customers be ‘penalised’ with higher bills in order for companies to be able to develop resources to maintain the supply/demand balance?

3.10. We would welcome a periodic assessment of companies’ abstraction sites (in England and Wales) to ensure that the information remains up to date and includes relevant sites in the AIM when and as required.

Q4 - What are your views on our proposal that water companies should engage with their customer challenge groups (CCGs) on the abstraction sites they are proposing to include in and reject from the AIM and the reasons for doing so? (Chapter 3)

3.11. We support the proposal for companies to work with the CCGs and CCWater, and would encourage an even broader consultation with local interest groups and organisations. Doing so can potentially establish at an early stage the impacts of any changes to abstractions and identify and gauge customer understanding and support for the potential solutions to mitigate them. This is also important when explaining the reasons for excluding sites from the AIM. This proposal links with the way in which companies set their performance commitments in other areas.

Q5 - What are your views on our proposal that water companies should publish their reasons for rejecting abstraction sites from the AIM? (Chapter 3)

3.12. We support the publication of this information by companies as it should promote transparency of the AIM.

Q6 - What are your views on the AIM’s taskforce’s reporting and monitoring requirements? (Chapter 4)

3.13. We support the AIM taskforce’s recommendation for companies to report their performance (relative to the self-defined AIM baseline) on an annual basis and on a cumulative basis from 2016-17 - both at site and company level (at AIM covered abstraction sites).

3.14. The proposal for companies to report through their annual reviews of Water Resources Management Plans (WRMPs) and the annual reporting process seems sensible, and in line with what companies do already.

3.15. The autonomy that companies will have to choose their own AIM eligible sites, triggers and baseline reinforces the local nature of the incentive and the need to include local stakeholders such as CCGs in the process.
Q7 - What are your views on our additional proposals to increase the transparency of the AIM (that companies should consult with their CCGs and publish information relating to their proposed abstraction sites, trigger points and baselines? (Chapter 4)

3.16. We agree with the Taskforce’s proposals to publish information to increase the transparency of the AIM. We also support the expectation for companies to consult with CCGs, the EA and other stakeholders where appropriate.

3.17. We also support companies adopting the current approaches to assurance that are used for other areas of their work. This, and the publication of the relevant AIM information, will help stakeholders understand the basis for companies’ AIM scores.

3.18. We agree that, to promote transparency, companies should publish the reasons for rejecting AIM sites as well as the calculations used to determine the baselines and triggers for each site. This is information already held by companies, so publishing it would not necessarily create additional work.

3.19. It would also be useful for Ofwat to publish on its website the collation of companies’ annual reports, not only to be able to see an overview of companies’ performance but also to make the AIM information easier to find at an industry level. To avoid misinterpretation of the collated information, it would be helpful (as suggested by Ofwat) if there is an acknowledgement/explanation of companies’ local differences.

Q8 - What is your view on the use of AIM as a comparator for company performance? (Chapter 4)

3.20. It is not clear how comparisons would be made given the variations in local operating conditions, customer base and demand, water resources availability, environmental characteristics/pressures and performance commitments.

3.21. It would be more meaningful to compare the year-on-year performance of each individual company in meeting its AIM commitments and compare relative trends over time, linked to other performance indicators such as reductions in leakage and per capita consumption. Doing this at company level can help put the AIM reductions in context and give a broader indication of what the company is doing to manage its resources and demand levels. This will help raise awareness to the challenges faced and potential impacts on customers and the local environment.

Q9 What are your views on Ofwat publishing AIM outturns on our website? (Chapter 4)

3.22. Please refer to the answer given to question 7.

Q10 What are your views on the future development of the AIM? (Chapter 6)

3.23. There seems to be an ‘aspiration’ for the AIM to become a financial incentive at PR19 to ‘drive increased benefits for the environment’. However, for this to work, it is important to reach a balance between the benefits for the environment, and ultimately what this means for customers (and the support they give to the AIM).
3.24. Customers need to be informed about the AIM’s objectives, what it means for them and how it may impact on bills. Without customer support, the AIM may be seen as an imposition resulting in a loss of trust and confidence in the sector. We believe that, before Ofwat consults on (and commits to) introducing a financial incentive for the AIM, it should seek customer research to gauge customer support for it.

3.25. It remains to be seen how it would potentially fit with existing mechanisms, such as the Revenue Correction Mechanism as well as companies’ ODIs. Theoretically, companies could be paid three times for the same outcome in AMP7 if the incentive (penalty/reward) is not designed carefully.

3.26. Financial incentives that are intended to help drive improved company performance for customers and the environment should work together as a ‘package’. One incentive should not inadvertently clash with another incentive, and the size of the rewards and penalties on offer should not lead to a company concentrating on one area of the service at the expense of a (less incentivised but equally important to customers) area of service.

3.27. Should AIM evolve to a financial incentive, we would expect to see an evaluation of:

- Whether AIM is consistent with company behaviour driven by incentives for water trading (likely to be developed in a new wholesale water resources market) and existing ODIs.
- The effect on company behaviour of the financial rewards and penalties on offer across all incentives - does one incentive effectively negate another because a greater reward or penalty is in place? Ofwat will need to see how these incentives work in tandem with each other, rather than in conflict.
- How evidence from customers can inform the extent to which financial incentives should be applied to the AIM (the parameters for rewards and penalties), and when reward and penalties should be applied.

3.28. We, therefore, consider that Ofwat should seek research into customers’ views to inform a further consultation on the development of the AIM.

Enquiries

Enquiries about this submission can be addressed to:
Dr Ana-Maria Millan
Email: anamaria.millan@ccwater.org.uk
Telephone: 07810 655309