



CCWater's response to Water Services Regulation Authority (Ofwat) consultation:

Draft Determinations of in-period ODIs for 2018

Introduction

- 1.0 The Consumer Council for Water is the statutory consumer organisation representing water and sewerage consumers in England and Wales. We welcome the opportunity to comment on this consultation on the draft determination of in-period ODIs for Anglian Water, South West Water and Severn Trent Water (including Hafren Dyfrdwy) and on Severn Trent Water's proposal to amend its wastewater ODI cap.

Executive Summary

- 2.1 In 2014 CCWater undertook research to establish consumers' views on regulatory performance incentives for water companies. Our research showed that customers generally do not support the use of penalties or rewards as a method of driving companies' improvements in service¹. Customers tend to see improving services as an integral part of companies' day to day activities and not something that requires additional reward. During the development of business plans for the PR19 price review companies' engagement with customers continued to show that many customers do not support the principle of ODIs and the bill impacts they can generate.
- 2.2 Although we understand Ofwat's regulatory rationale for Outcome Delivery Incentives (ODIs), to prompt water companies to deliver better service performance and rewarding those that do not, it is in the context of customers' concern with the concept of ODIs that we respond to this consultation.
- 2.3 Given these concerns by many customers over ODIs, it is important that water companies are transparent about their ODIs and how these affect bills, and to explain clearly to customers what improvements they are getting in return for any reward companies are receiving. Customers will need to be reassured that any rewards are justified and reflect their willingness to pay in order to retain their trust in companies.
- 2.4 In our 2013 response to Ofwat's consultation on setting price controls for 2015-20², our assessment of the 2014 price review published in August 2015³, and in our response to Water 2020 - Regulatory Framework for wholesale markets and the 2019 price review⁴, CCWater warned of the risk of setting ODIs that did not stretch companies and opened the possibility of easy wins, and so rewards.
- 2.5 Customers consistently indicate that they prefer bills which change smoothly over time. CCWater recognises Ofwat's view that a balance is therefore required between linking incentives more closely in time to performance with maintaining a smoother profile of bill changes year on year. In some cases, it might be appropriate to apply in-period rewards or penalties over several years, or to defer some or all of them, to smooth bills while still capturing some of the benefits of applying them closer to the performance that generated them.
- 2.6 **Our detailed comments are set out separately for each company below, but key points are;**
- **We note Ofwat's draft in-period ODI determinations**
 - **We acknowledge Ofwat's decision to defer payments where these would create bill volatility for customers.**
 - **We expect South West Water to improve its environmental performance.**

- We expect Severn Trent Water to improve its performance against those water service commitments where it has underperformed.
- We expect companies to be open with customers in communicating Ofwat’s determinations, particularly Severn Trent Water where rewards and penalties are polarised between water and wastewater services.
- We note Ofwat’s proposal regarding the amendment of Severn Trent Water’s wastewater ODI cap.

Comments on Draft Determinations

3.0 Anglian Water

- 3.1 Anglian Water has 39 PCs of which 22 have financial ODIs applied to them. Of these only one, covering leakage, has an in-period ODI for the period 2015-20.
- 3.2 Anglian Water has outperformed its single in-period ODI, equating to an outperformance payment of £4.635 million. This will result in an indicative increase in household water bills of £2.45. This is in addition to the £11.98 increase in average bills already proposed for next year.
- 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, and the view of ANG’s Customer Engagement Forum (CEF), that the additional £2.45 increase in water charges does not require smoothing given that the total increase in bills. However, we expect ANG to be transparent in communicating with customers on the reasons for the reward and on the range of impacts this could have on customers, and in how they handle possible negative feedback they might receive.

4.0 South West Water

- 4.1 South West Water has 42 PCs of which 25 have financial ODIs applied to them. 11 have in-period ODIs for the period 2015-20.
- 4.2 We are disappointed that South West Water’s continuing poor environmental performance has resulted in in-period ODI penalties. While these are offset by improved leakage performance and for improved first time handling of water contacts, the company has earned a net penalty of £270,000 as shown in table 1 below.

Table 1: ODI rewards and penalties: Water and Wastewater

Measure	Reward (£m)	Measure	Penalty (£m)
Handling water contacts	0.133	Pollution incidents (cat. 1 or 2) (waste water)	-0.346

Leakage level	0.403	Pollution incidents (cat. 3 or 4) (waste water)	-0.367
		Pollution incidents (cat. 3 or 4) (water)	-0.022
		Handling wastewater contacts	-0.071
Total	0.536	Total	-0.806

- 4.3 We expect South West Water to do more to improve its environmental performance in future years, as it continues with the improvement plan the company has put in place to achieve this.
- 4.4 The reward for outperformance will add 67.5p to the average water bill and the penalty incurred by SWW will reduce the average wastewater bill by £1.125 in 2019-20. This gives an overall bill reduction of 45p.
- 4.5 Separately, SWW is returning £9m to customers through its WaterShare framework - which shares the benefits of outperformance. Following engagement with customers and with its WaterShare Panel SWW is proposing to defer this payment to future years, to offset potential end of period rewards in 2020, and to apply only the 45p reduction to bills in 2019-20.
- 4.6 We support this proposal (subject to adjustment for inflation and interest to reflect the lost benefit to customers of not returning the additional £9m now) and agree that there is no further requirement for bill smoothing in 2019-20.

5.0 Severn Trent Water & Hafren Dyfrdwy

Severn Trent Water Ltd.

- 5.1 Severn Trent Water has 45 PCs of which 33 have financial ODIs applied to them. Of these 15 have in-period ODIs for 2015-16. The company's performance has resulted in 12 ODIs attracting financial rewards or penalties in the period as shown in tables 2 and 3 below.

Table 2: ODI rewards and penalties: Water service

Measure	Reward (£m)	Measure	Penalty (£m)
Customer at risk of low pressure	0.036	Complaints about drinking water quality	-2.411
		Repairing visible leaks	-1.398
		Carbon footprint (water)	-0.494
		Minutes water supply lost	-23.579
		Leakage	-1.712
Total	0.036	Total	-29.594

The overall impact of the net underperformance penalties is an £8 reduction in the average household water bill in 2019-20.

- 5.2 For wastewater services the company earned outperformance rewards totalling £87.815m, as is shown in table 2 below

Table 3: ODI rewards and penalties: Wastewater service

Measure	Reward (£m)	Measure	Penalty (£m)
Internal sewer flooding	12.760		
External sewer flooding	72.866		
Cat 3 pollution incidents	2.533		
Carbon footprint (wastewater)	0.044		
Total	87.815	Total	0.000

- 5.3 SVT has proposed to defer £62.925 million of its total accrued reward to mitigate the impact on the average household bill. We acknowledge this and note Ofwat’s proposal to accept the company’s proposal.
- 5.4 SVT’s deferment seems to recognise that customers may react negatively if rewards are collected in one go and have a substantial impact on bills. We note that this is a further deferral of in-period ODI outperformance payments, following those made in previous years, and that the total amount now deferred is substantial. We will be expecting the company to mitigate the impact of this deferral on future bills, and to be open and transparent in communicating this effectively to customers.
- 5.4 The outperformance reward the company proposes to take next year will be set against its underperformance penalties and so will provide for a smoother profile of the average combined household bill. The company has stated that the indicative bill impact from incorporating the payments from its ODIs and other factors (RPI, Water Revenue Forecasting Mechanism (WRFIM), etc.) is a decrease of £0.50 to the average household combined water and wastewater bill. However, the impact on bills differs between water and wastewater services.
- 5.5 While SVT has earned very significant rewards for its wastewater performance, we are disappointed to see underperformance in many of its water service commitments and the negative impact on customers these represent. We expect, and will be challenging the company to take positive action to improve performance in these areas of key importance to customers.

Hafren Dyfrdwy Ltd.

- 5.6 In June 2018 Ofwat made variations and modifications to the Conditions of Appointment (licences) of Severn Trent Water Ltd and Dee Valley Water Ltd, and also granted a new wastewater licence to Dee Valley Water. This allowed Dee Valley Water to become a water and wastewater services company based wholly in Wales and for SVT to become a water and wastewater services company based wholly in England. The company based wholly in Wales is now called Hafren Dyfrdwy.
- 5.7 As a result of the licence change, SVT became the water supplier for the previous Dee Valley Water’s water supply area in England in and around Chester. This includes 49,700 households and 4,000 business customers (including charities and public sector organisations). For Hafren Dyfrdwy, the changes mean the company is able to provide water and wastewater services to the previous SVT’s water and wastewater supply areas in Wales - in and around Powys and Monmouthshire. These changes, which came into effect on 1 July 2018, have implications for the application of in-period ODIs. The adoption by Hafren Dyfrdwy of the Severn Trent Water ODIs that apply to customers in and

around Powys and Monmouthshire means that Ofwat’s draft determinations of in-period ODIs this year includes Hafren Dyfrdwy.

The proportional allocation of in-period ODIs between SVT and Hafren Dyfrdwy was established in an earlier consultation by Ofwat⁵, is set out in the following table, and has been used by Ofwat in making its draft determinations;

Price control	Severn Trent England	Hafren Dyfrdwy
Wholesale water	99.42%	0.58%
Wholesale wastewater	99.56%	0.44%

- 5.8 We acknowledge Ofwat’s proposal to decrease Hafren Dyfrdwy’s wholesale water price control, applying an underperformance payment of £0.172 million (2012-13 prices, net of tax) to wholesale water bills in 2019-20 for one year only. Hafren Dyfrdwy estimates the ODI underperformance payment will reduce its annual average household water bill by around £1 in 2019-20.
- 5.9 We note Ofwat’s proposal of an increase in Hafren Dyfrdwy’s wholesale wastewater price control, applying a net outperformance payment of £0.110 million (2012-13 prices, net of tax) to bills in 2018-19 and deferring the remaining £0.278 million to future years. Hafren Dyfrdwy estimates that the impact on the annual average household wastewater bill is an increase of £3.50 in 2019-20, if the company’s proposals to defer £0.278 million of its wastewater ODI payment is accepted.
- 5.10 We note that Ofwat’s draft determination would result in the customers who were Severn Trent’s customers until 1 July (and for that period) receiving similar bill impacts to if they had remained as Severn Trent customers. We are note that this outperformance will not affect the bills of previously Dee Valley customers who are now customers of Hafren Dyfrdwy.
- 5.11 However, in our response to the 2017 Ofwat determination consultation⁶ we had said that if a licence variation for Dee Valley Ltd. went ahead, we would like reassurance that customers on the Wales/England border who receive a wastewater service only from Severn Trent would not carry more of the bill impact as a result of the ODI rewards received by the company because of their 2017 ODI performance. It seems that this is not the case and that there is now a decision that those customers will be affected by Severn Trent’s outperformance despite the licence variation.
- 5.12 Finally, we would like to understand how the deferral of rewards might affect Hafren Dyfrdwy wastewater customers in the future and what steps the Severn Trent/Hafren Dyfrdwy management is taking to mitigate any impacts on those customers in the future, from 2020. It is at the company’s discretion to find ways to protect wastewater customer bills in Hafren’s area from 2020, in line with their commitment to ensure that the licence variation will not affect customers bill in Hafren Dyfrdwy’s area.

6.0 Amending SVT’s Wastewater ODI Cap

- 6.1 SVT has consistently outperformed against its PR14 wastewater PCs. The resulting outperformance rewards it has earned are now approaching the cap placed on them in the

PR14 Final Determinations. SVT has applied to amend the cap, to raise it and allow continuing outperformance to be financially rewarded and incentivised.

- 6.2 We acknowledge that the rationale behind ODIs means that SVT should continue to be incentivised to outperform through the remainder of this price control period, but any reward must be in the long term interests of, and acceptable to, customers. We consider that a reward cap is in customers' interests as protection against the risk of reward payments which go beyond a level they find acceptable.
- 6.3 We do not consider that SVT's preferred option, removal of the cap, is either appropriate or reasonable. While the proposal would see a welcome additional investment in supporting vulnerable customers, it exposes the company's wastewater customers to potentially substantial reward payments without the company needing to improve its performance against current levels, and even if its performance deteriorates but remains above its PR14 commitments.
- 6.4 Ofwat has set out a counter proposal in its consultation which will effectively reset the base performance level for determining out- or under- performance for the remainder of this price control period to the level achieved in 2017/18. This will continue to incentivise improvement by SVT but protects customers from the risk of the company earning outperformance rewards for a deterioration in service from current levels but which remain above its PR14 commitments.
- 6.5 We acknowledge that Ofwat's proposal will also reduce the outperformance incentive rate for external sewer flooding by 85%. This brings the reward more in line with other companies' comparable performance commitments, while still incentivising continuing improvement by SVT.
- 6.7 We note Ofwat's proposal to limit the underperformance rate by 85% for performance between the PR14 base and the revised 2017/18 level. This limits the risk to the company in the event of deteriorating performance which remains above its original commitment, but reflects customers' interests in encouraging service improvement.
- 6.8 We understand Ofwat's proposal to raise the reward cap from 2.0% of RoRE to 2.6% in the specific circumstances of this determination and when coupled with the other elements of their proposal. This will allow SVT to earn additional outperformance payments through improving service with a direct customer benefit.
- 6.9 We are disappointed that the additional investment to support vulnerable customers proposed in SVT's original application will be lost as a result of Ofwat's determination. We would encourage the company to consider if any additional investment is still possible under the terms of Ofwat's proposal.

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>
5. <https://www.ofwat.gov.uk/consultation/consultation-section-13-water-industry-act-1991-proposed-modification-severn-trent-water-limiteds-severn-trent-water-licence-include-powys-site-proposed-modifi/>
6. <https://www.ofwat.gov.uk/wp-content/uploads/2017/10/CCWater-response-to-Ofwat-ODI-draft-determinations-2017-FINAL.pdf>

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