Appendix RA07

Outcomes, performance commitments and ODIs

1 April 2019

Contents

Introduction

This document presents the changes we have made post Ofwat's feedback of our original submission. It also provides additional information where requested. The purpose of this document is to provide evidence to specifically address the challenges SSC.OC. A1 – 57 as set out in Ofwat's Initial Assessment of Plan (IAP). Given the large number of actions in this area, we have structured this document as follows:

1. A summary of the key challenges and changes we have made
2. New performance commitment for priority services register;
3. Compliance risk index specific challenges;
4. Action log challenges relating to PC definitions and stretch targets;
5. Action log challenges relating to deadbands, caps and collars;
6. Action log challenges relating to ODI rates;
7. Action log challenges relating to ODI timing;
8. Overall package balance and RORE range;
9. Asset health RORE range;
10. Customer protection strategies; and
11. Data tables

The numbering above links to the chapter numbering in this document.

To help highlight areas of change/additional evidence we have referenced Ofwat's action reference ID codes throughout so recommend that this document should be read in conjunction with Ofwat's action log.

1. Summary of our position

In Ofwat's IAP feedback, there are a number of actions to address on both our package of Outcomes and on individual ODI's. This chapter of our resubmission looks to address these challenges and we recognise how important this is to demonstrate that our plan delivering a balanced approach that delivers the best outcomes for our customers.

The most significant areas we have reconsidered are:

1. The use of scaling factors – in our original submission we increased the level of incentives in order for the package to fall within Ofwat's prescribed RORE range of ±1 to 3%. We have reflected on Ofwat's challenge and agree that the use of scaling factors does move us away from our how our customers value the service package. We have therefore reverted back to the natural willingness to pay data and used Ofwat's formulae to work out the level of incentives.

2. In addition to the scaling factors, we also looked to balance the level of incentive across the package to reflect qualitative customer priority on each measure. We have also removed the balancing across the package.

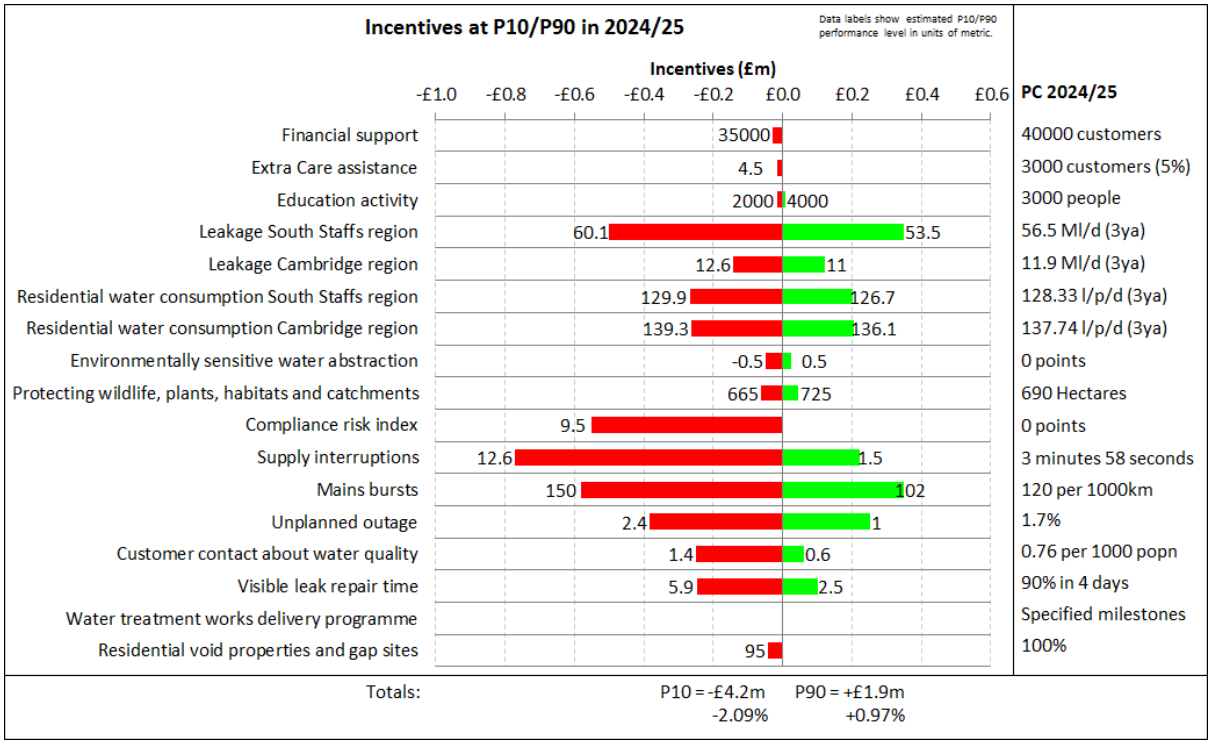
3. Ofwat challenged our proposal for not taking in period incentives, querying the level of customer engagement we have to support this. We are confident in the level of support we have around maintaining a flat stable bill for AMP7. However with Ofwat's challenge in mind we further tested the flat bill profile compared to a bill level that is subject to having in period incentives applied. The engagement again supported maintaining a flat bill. We are committed to delivering improvements in the service we offer our customers, and will be extremely transparent with our in period performance.

4. Ofwat challenged us for proposing a reward for our asset health measures stating that we didn't evidence enough customer support to warrant us having these. We have carried out further customer engagement specifically on incentives, including the use of caps, collars and rewards. Customers supported the rewards, both the level of service required to achieve it and the rate of incentive. We have however reviewed our proposal of a three year rolling average for the mains burst performance commitment and removed approach this from out revised package.

5. We agree to adopt the Ofwat proposed mechanism for outperformance payments whereby 50% of the outperformance payment is shared with customers if 3% RORE threshold is reached.

6. We are in agreement with Ofwat about making PSR a specific performance commitment and we have now included this measure within our package.

We provide a more detailed response to these challenges, and others within this document. However the overall effect of removing the balancing and scaling factors has left us with an ODI package that is skewed to penalty. The chart below shows the P10 and P90 levels, value of incentive and our performance commitments for the 2024/25 year. The full range of P10/P90 levels and values for each year and with the supporting information is contained in the business plan tables App1 and App1a.



Throughout our review of the IAP, both with regards to outcomes and potential funding, we have not wavered from our original proposals that were borne out of our extensive customer engagement. This includes maintaining our stretching target on leakage, in particular within our South Staffs region where we have committed to a 25% reduction.

2. New performance commitment for priority services register

All companies are required to adopt a performance commitment measuring the number of customers on the priority services register.

We will adopt Ofwat's standard definition for the two components of this performance commitment. This is a non-financial performance commitment as directed by Ofwat.

For PSR reach, our performance commitment is to achieve 60,000 households on the register by 2024/25 from a projected 38,000 in 2019/20. This is over 8% of our projected household customers. We agree to report the breakdown of PSR membership alongside our performance commitment in our APR each year.

For PSR data checking, our performance commitment is to check 90% of customers on the PSR every two years, as per Ofwat's requirement. We will however go further and check customers categorised as 'priority one' (for example those on dialysis), once per year. We will report this additional categorisation alongside our performance commitment in our APR each year.

3. Compliance risk index specific challenges

3.1 SSC-OC-A16 and SSC-OC-A17

In our September 2018 business plan we proposed a deadband of 3.6 points and an underperformance collar of 9.2 points. We discussed the volatility and unique sensitivity to this measure that we have due to the reliance on two surface water works that supply a high proportion of customers in the SST region. Ofwat has proposed a deadband at 1.5 points and an underperformance collar of 9.5 points as action SSC-OC-A17. Ofwat has also challenged our rebalancing and scaling of ODI rates in action SSC-OC-A16.

We recognise that water quality compliance is one of our customers' highest priorities. It is extensively regulated by the DWI and internally an area that is given the highest possible priority.

About CRI and how our asset configuration interacts with the scoring mechanism

The new compliance measure, Compliance Risk Index (CRI) has been designed to facilitate a risk based approach to water quality compliance. The calculation of CRI performance is based upon compliance with all regulatory determinands (i.e. coliforms, iron, taste, turbidity etc) which are assigned a weighting based upon public health risk. This value is then multiplied by the volumetric output or proportion of our population supplied, there is then a further multiplication based upon the DWI assessment of the failure which ranges from 1 where no further failure is likely to occur to 5 where additional enforcement action is required. An overview of this process is shown below:

For each individual failure

Failure risk score = Parameter score x DWI assessment score x Population affected/ volumetric output

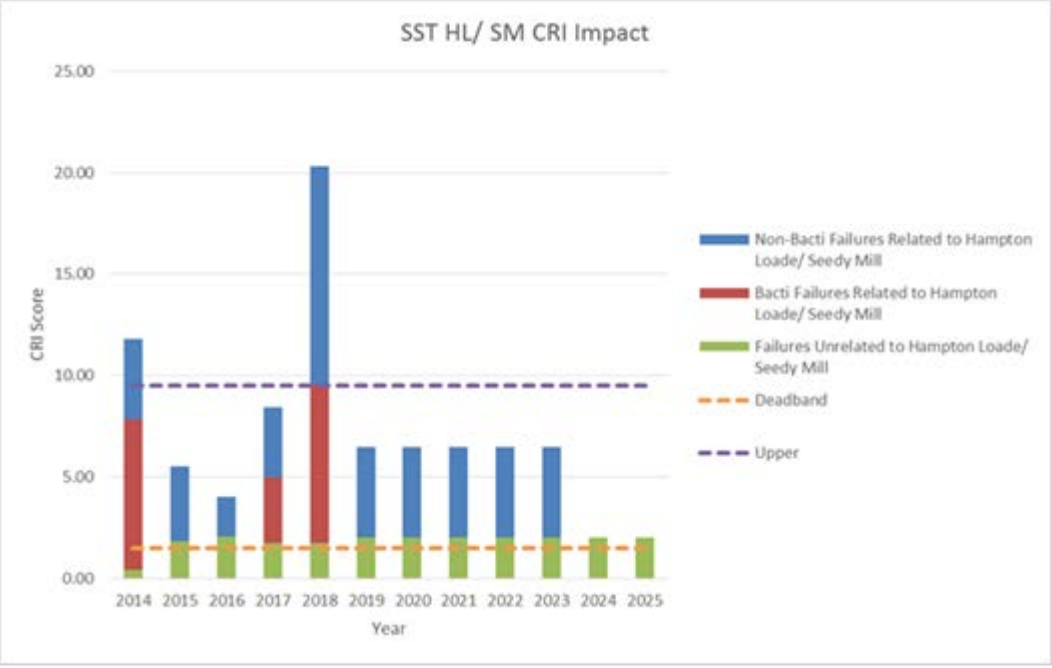
Score 0 to 5	Score 1 to 5	multiplier used
based on health risk	Unlikely to recur=1	dependent on the type of site
e.g lead = 5	Suggestions made=2	Where 'population' is used
Iron = 3	Recommendations made=3	need evidence to
taste/odour = 3	Enforcement considered/	demonstrate extent of
Coliforms = 2/4/5	Legal instrument in place =	failure or use zonal
Gross alpha = 0	4	population
	Enforcement= 5	

$$CRI = \frac{\text{failure risk score}}{\text{total population supplied/total volumetric output for site type}}$$

Seedy Mill and Hampton Loade are our largest sites and used to supply approximately 60% of our customers, both works require investment and we have submitted a cost adjustment claim to support this expenditure, in order to support our submission the DWI will be putting in place enforcement notices at both works and the associated distribution network. Based upon the calculation detailed above all compliance failures covered by the notice will not only be multiplied heavily based upon the proportion of population served but also automatically multiplied by 4 due to the enforcement notices being in place. As an example a single turbidity failure at Seedy Mill would incur a CRI score of approximately 4 carrying a significant financial penalty, which does not appear reflective of the impact on customers or comparative to similar scenarios elsewhere in the industry where a works of this size actually supplies a much smaller proportion of the population served.

We are doing the right thing in investing, with our customers support and also in working with the DWI to give Ofwat and our customers confidence in delivery, yet perversely this will significantly increase the CRI risk for an extended period within the business whilst the enforcement notices remain in place and these essential works are completed.

The chart below illustrates our historic and forecast CRI performance, with a particular focus on those failures attributable to our two largest works – either at source or within the network. From 2018 we have not forecast any microbiological compliance failures at the two large works following the installation of UV treatment, which has significantly reduced this risk. Despite this, our forecasts clearly show that our annual estimated CRI values (using a pragmatic estimation methodology) are likely to be significantly above deadband for a number of years.



Challenges to our ODI rate

As Ofwat challenged our use of rebalancing and scaling factors in its IAP, we have removed these and reverted to the natural rate that was derived from our original willingness to pay surveys. We note however that our natural rate is below Ofwat's indicative industry range, and that Ofwat has also widened the working range of the metric by lowering the deadband to 1.5 (our September proposal was 3.6) and raising the collar to 9.5 (our September proposal was 9.2).

Our ODI rate has been derived from our willingness to pay surveys, where we tested a range of water quality based valuations. We feel that it would not be appropriate for Ofwat to override our CRI ODI rate with an industry derived value, as the exposure on CRI is already disproportionate to other companies, despite the ODI rate being lower than others', and to increase this exposure further becomes punitive in light of how the scoring methodology works with our reliance on two large works that are under notice for improvement with customer support.

Options for ensuring an appropriate balance of financial risk in CRI

We have considered further options to bring our CRI risk exposure more in line with other companies.

1. Scaling the ODI rate. We have accepted Ofwat's challenge and removed the rebalancing and scaling on all of our ODI rates. Our CRI ODI rate is now directly linked to the original WTP valuation, therefore it would not be appropriate for us to rebalance in this way, nor for Ofwat to break the link and apply an industry derived rate.

2. Increase the deadband and / or lower the collar. Both of these options, used separately or together, reduce the working range of the measure. We recognise that as a common measure across the industry, Ofwat wants as much consistency in reporting as possible and the level of deadband and collar is a very visible parameter of the reporting.

Both of the above options affect all failures under CRI, not just failures at our two large works (which are what cause the systematic over exposure), and also failures which are not part of our enforcement notices. This is not our desire, as we recognise the general importance of water quality compliance across all of our assets. We therefore have a third option which seeks to isolate the enforcement notice issue.

3. It is important that our CRI reporting is consistent with other companies across the industry and we accept that this must remain intact, however for the purposes of calculating underperformance penalties we are proposing that all failures relating to Hampton Loade, Seedy Mill and the associated networks that are covered within the scope of the DWI notices are excluded from the calculation. This will allow the deadband and collar proposed by Ofwat to remain in place whilst avoiding magnification of penalties resulting from enforcement notices.

Broader concerns with CRI and customer perception

The natural volatility of CRI for all companies, in combination with financial incentives and a proposed very narrow deadband, risks fostering a view, amplified by the current political debate about the legitimacy of the sector, that companies are failing to deliver a high standard of water quality. The nuances about what CRI represents (including risk as well as absolute compliance) will likely be lost in any adverse coverage of the performance.

The nature of the CRI scoring system means it is also a more difficult measure for customers to comprehend than the previously used MZC index, which customers could quite quickly recognise as a simple percentage level of compliance from zero to 100%.

We would support further discussion between Ofwat, DWI and water companies on how to ensure that the reputation of the UK water industry is not inadvertently damaged by how CRI is presented and how it is understood by stakeholders, customers and the media. We believe that there remains a case to re-examine the parameters of the performance commitment, such as the level deadband and use of financial incentivisation, to meet this overall objective.

Our CRI proposal

We propose to adopt option 3 above, which removes all failures relating to Hampton Loade, Seedy Mill and the associated networks that are covered within the scope of the DWI notice, from the calculation of underperformance penalty only. We propose this to remain in place until the deadline of the DWI notices for each component.

This means that Ofwat's industry standard performance commitment, deadband and collar all remain intact for comparative reporting purposes. We also adopt our ODI rate which is derived from customer WTP.

Each year, in our APR, we will set out the impact of Hampton Loade and Seedy Mill failures on the CRI score and be transparent if the notified parameters exclusion process has resulted in a reduction to the underperformance penalty.

4. Action log challenges relating to PC definitions and stretch targets

4.1 SSC-OC-A19 – Supply interruptions

We have concerns about the appropriateness of Ofwat's upper quartile assessment. Two companies driving the UQ assessment have an unrealistic level of step change to deliver their targets given their starting points and history.

- Bristol, with a forecast of 01:48 yet a three year average of around 24 minutes
- Affinity, with a forecast of 03:00 yet a three year average of around 35 minutes.

Whilst it is not for us to determine whether other company's forecasts are realistic to achieve, and noting that volatile years can occur, we feel it is legitimate to question whether it is reasonable to allow forecasts not underpinned by a good track record to be used to drive industry targets given the scale of the financial incentive associated with the supply interruptions performance commitment.

If Bristol and Affinity are excluded the upper quartile becomes the following:

2020/21	2021/22	2022/23	2023/24	2024/25
04:20	04:20	04:20	04:20	03:58

We suggest a glidepath from 04:20 to 03:58 would be more appropriate, so we propose the following performance commitment:

2020/21	2021/22	2022/23	2023/24	2024/25
04:20	04:15	04:10	04:04	03:58

4.2 SSC-OC-A23 – Mains bursts

We agree to remove the three year averaging on our mains bursts measure, which was intended to bring the measure in line with other measures that display weather volatility, such as leakage and PCC.

4.3 SSC-OC-A32 – Customer contact about water quality

We included illness contacts in our definition because this is the long standing method of measuring the metric that DWI used prior to Discover Water and which is still the method used for the annual Chief Inspectors report. Our current AMP6 performance commitment also uses this definition. We do not know why it was elected not to include this element in Discover Water and to move away from the DWI components.

Illness is an average of 5.175% of water quality contact as shown below, therefore we have reduced our future performance commitment by 5.175% in all years, compared to the September business plan, to account for the removal of illness contact from our definition.

	2015	2016	2017	2018
Appearance, taste and odour, and illness (nr/1000 population)	1.9576	1.6596	1.4148	1.5119
Appearance and taste and odour only (nr/1000 population)	1.8571	1.5696	1.3414	1.4361
Percentage difference	-5.1%	-5.4%	-5.2%	-5.0%

	2020/21	2021/22	2022/23	2023/24	2024/25
September 2018 business plan PC (nr/1000 population)	1.20	1.17	1.14	1.00	0.80
Reduction for removal of illness from our definition	-5.175%	-5.175%	-5.175%	-5.175%	-5.175%
Revised April 2019 business plan PC (nr/1000 population)	1.14	1.11	1.08	0.95	0.76

4.4 SSC-OC-A35 – Financial support

There are broad links across our package of customer affordability and vulnerability support. We were one of only four companies, in September, to include a specific performance commitment on bad debt to challenge ourselves to reduce it, and we have also developed an innovative additional support package to help vulnerable customers called Extra Care. We will also now adopt Ofwat's common performance commitment on PSR. Our package of

customer support proposals and performance commitments goes together with this financial support activity to give customers a strong and broad package of affordability and vulnerability support.

Our social tariff is dependent on the level of contribution for which we can gain customer support. We plan to retest this level in 2019/20, and if customers support an increased contribution we will then increase this and pass it on in the form of increased support.

We have also analysed how our social tariff and other forms of financial help compare to the industry. We could identify eight companies that use a performance commitment measuring number of customers helped as ours does. Other companies used alternative versions, such as the proportion of vulnerable customers supported or the proportion of those in water poverty. We do not have the information from companies to directly convert these ways of measurement into a comparable format to our own.

We have however pulled data from wider business plan narrative and on financial support we are 6th in the industry in terms of the level we offer. However we do not know for certain whether these numbers across companies are comparable to our own measure.

Company	Properties @ 24/25	Financial support @ 24/25	%
Anglian	2,296,135	388307	16.9%
Wessex	555,861	85000	15.3%
Southern	1,132,290	94482	8.3%
South East	1,015,757	65000	6.4%
Severn Trent	3,575,728	198575	5.6%
South Staffs	749,043	40000	5.3%
Affinity	1,491,955	74500	5.0%
South West	1,023,481	49935	4.9%
Northumbrian	2,036,462	95000	4.7%
Bristol	541,929	25529	4.7%
United Utilities	3,285,218	152567	4.6%
Thames	4,032,520	127323	3.2%
Portsmouth	315,994	8210	2.6%
Yorkshire	2,288,889	48000	2.1%

4.5 SSC-OC-A37 and SSC-OC-A38 – Extra Care assistance

We have reviewed our Extra Care target and are now proposing to increase this already challenging target further.

Our Extra Care package is an additional retail offering for vulnerable customers that is bespoke to SSC. Customers that are eligible for Extra Care may also be eligible for financial support, hence the two are not mutually exclusive. However this Extra Care measure does not include the financial support element of the service these customers receive, as this is captured by our separate financial support performance commitment.

We have expressed the Extra Care target as 5% of our PSR registered customers. As this is new, we have based this on an assessment of the data we have from our existing support activities, such as those customers who need a home visit to help them fill in their social tariff application, and the learning we have had from our operation of the Community Hub in Wednesbury where we also complete application forms face to face with customers. These indicate that approximately 5% of customers need this additional face to face support compared to the total number of applications.

Our PSR target is increasing to 60,000 registered customers by year 5 following Ofwat's introduction of a separate PSR performance commitment. We are not proposing to alter our 5% target for Extra Care, meaning in absolute terms the number of customers we are proposing to help will increase. The table below demonstrates this:

	2020/21	2021/22	2022/23	2023/24	2024/25
Original PSR forecast September 2018 BP	33271	36549	39827	44105	45387
% on Extra Care	5%	5%	5%	5%	5%
Nr of customers on Extra Care – September 18 BP	1664	1827	1991	2205	2269
Revised 1st April PSR forecast	45000	48000	52000	55000	60000
% on Extra Care	5%	5%	5%	5%	5%
Revised nr of customers on Extra Care	2250	2400	2600	2750	3000

This is a 32% increase in the number of customers we will help by 2024/25, from our September business plan. Our Extra Care target is a percentage of our PSR, so if we achieve more PSR registrations than expected our Extra Care target in absolute terms will also rise.

4.6 SSC-OC-A41 – Education activity

We did not receive customer support for going beyond our proposed performance commitment of 3000 people educated per year, therefore we are not proposing to change our target.

Our educational activity is designed to help support our water efficiency programme. We spend a number of days in each school, not just delivering short assembles but also working in the classrooms with the children doing practical activities, such as building their own miniature water filters from household materials. We have found that this approach really cements the concepts presented in the assemblies and provides a richer form of engagement. We have had very positive feedback from the schools we have visited.

4.7 SSC-OC-A43 – Environmentally sensitive water abstraction

We apologise for the typographical error in the September plan. As Ofwat has identified, the correct units should be £ per point, which will be corrected in republished documents. The business plan table App1 has the correct units of measure. We are using the same AIM calculation that we currently use in AMP6 as per the APR table 3C.

4.8 SSC-OC-A45 – Protecting wildlife, plants, habitats and catchments

Our environmental activity is a significant increase from this planning period and will be a stretching target for us to deliver. This PC is based upon the principles of our AMP6 Biodiversity ODI, and builds upon the area of coverage by extending activities to achieve environmental benefits. The performance levels are built from various elements, a baseline of continued activities to protect sites that are under management, and also brings in new areas of activity.

For example:

- Around 50 hectares of our AMP6 target have been delivered by supporting biodiversity projects in the community, these have benefits beyond just environmental improvements, such as education, health and social benefit. In AMP7 we are proposing to increase this by at least four times.
- The AMP7 target includes implementing around 60 hectares of invasive non-native species (INNS) and national environment research council (NERC) improvements, as identified in WINEP investigations – this stretches our statutory obligations to investigate in AMP7 and implement in AMP8.

- Our catchment management programme will be extended to include options that have a biodiversity benefit in farmland and to improve the river environment, we expect this to include an additional 390 hectares of improvements in the AMP7 PC target.

4.9 SSC-OC-A52 – Bad debt

We were one of just four companies to propose a specific performance commitment on bad debt in our business plan, as we want to challenge ourselves, given we are one of the higher bad debt companies due to deprivation, to reduce it.

Our Customer Panel challenged us to compare to other water only companies. Our level of deprivation is far higher than all water only companies and higher than most water and sewerage companies as well. The table below shows how we compare to other companies for the deprivation and household default cost drivers that Ofwat has used in its retail cost models. We are 3rd and 4th highest.

Company	WoC or WaSC	Ranks (high to low)	
		Deprivation	Household Default
NES	WaSC	1	2
UU	WaSC	2	1
SSC	WoC	3	4
YKY	WaSC	4	5
WSH	WaSC	5	8
SWT	WaSC	6	6
SVT	WaSC	7	7
TMS	WaSC	8	3
DVW	WoC	9	11
SWB	WaSC	10	15
ANH	WaSC	11	12
BRL	WoC	12	14
SRN	WaSC	13	13
AFW	WoC	14	9
PRT	WoC	15	10
WSX	WaSC	16	16
SES	WoC	17	18
SEW	WoC	18	17

Ofwat's retail cost models have funded all companies at the upper quartile level of efficiency for retail costs, using the econometric models which include (as stated above) deprivation cost drivers. We note that as at September, only four companies had included a

specific bad debt performance commitment as shown below. We are starting at the highest level out of these four companies and we were proposing an improvement of 0.5% by 2024/25 which is the 2nd highest improvement of the four.

	Current	2024/25	Change
South Staffs Water	3.45%	2.95%	-0.50%
Yorkshire Water	3.10%	2.79%	-0.31%
Welsh Water	2.90%	2.00%	-0.90%
SES Water	0.64%	0.80%	+0.16%

As can be seen in the comparative deprivation table, SES is very low ranked on deprivation, therefore we do not consider their situation to be comparable to our own. However the two remaining companies, Yorkshire and Welsh, are just slightly below us on the comparative ranking so their targets are a legitimate comparison.

We have reconsidered our bad debt performance commitment in light of this new information. We are a more deprived area in the two deprivation cost drivers than both of these companies, however we propose to further stretch our performance commitment to ensure we remain a comparatively strong performer when deprivation is accounted for.

We will stretch our performance commitment further in all years by an additional 0.2% compared to our September plan.

	2020/21	2021/22	2022/23	2023/24	2024/25
Original PC in September plan	3.21%	3.06%	2.99%	2.96%	2.95%
Revised performance commitment	3.01%	2.86%	2.79%	2.76%	2.75%

This is now a 0.7% improvement from the current bad debt level, by 2024/25.

4.10 SSC-OC-A55 - Trust

Ofwat has challenged whether our performance commitment for trust overlaps with the new customer service metric, Customer Measure of Experience (CMEX).

Throughout all our PR19 engagement household customers have told us that they need to be able to “trust us” to deliver the service they expect. The main reason for this (drawn from comments on our extensive qualitative research) is the fact that they are unable to

switch supplier and so have no option if they are not happy with the service, price or long-term investment plans of their water company.

The net promoter score (NPS) metric in CMEX alone will not always give us an accurate reading of the level of trust customers have in us to deliver the service they expect and deserve. NPS is also a hypothetical question, so it is different in nature to asking about trust, which is a material view on how things are to customer at the moment they answer the question.

The UKCSI's data analysis also highlights, that whilst the NPS is a good industry benchmark, it is a commercial metric for competitive markets based on a future propensity to continue to do business with a company. Trust is shown through customer feedback to be a different metric, in that is aligns more to a customers' overall view of a company from an ethical and overall experience perspective.

As a result of these insights, we have made trust a bedrock of our business plan for 2020-25. There are two further strong reasons for having trust as a separate measure.

- We will be able to combine our on-going tracker survey results with CCWater's annual Water Matters survey, which also measures trust separately from NPS; and
- The stand-alone metric will enable us to compare our trust scores with wider sectors through UKCSI's regular benchmarking reports.

We strongly believe that our business needs a trust performance commitment to enable us to effectively track our customers' trust perceptions with a high degree of confidence and accuracy. It will also help us understand what actions we need to take to improve agreement with this measure over time.

4.11 SSC-OC-A56 and SSC-OC-A57 – Value for money

Our current customer service tracker is run by the independent research agency Accent and aligns fully to research best practice. The questionnaire and sampling approach were challenged and approved by our customer panel (and CCWater) in March 2017 and the 3 year contract with Accent ends on the 31st March 2019.

We are currently in the process of re-tendering our customer service tracker to appoint an independent research agency to run the project from April 2019 for a 3 year period (with a 12 month break clause). The tracker is an integral part of our business as usual customer engagement, so we are making some significant improvements to the approach which will further enhance the value and robustness of the insights – these include:

- Increasing the sample size from 600 to at least 1,200 customer interviews per year (400 business with the remainder residential) with representative samples

of customers being contacted for feedback in both South Staffs and Cambridge supply regions. This change will allow greater confidence in the quarterly data at a regional and HH/NHH customer level

- Adopting a mixed methodology approach, telephone and on-line. At least 600 interviews will be carried out by telephone to ensure we can continue to track customers' perceptions over time
- Inclusion of more open ended questions to deepen the level of insight gained.

The tracker will continue to adhere to all the key principles of research best practice (sampling, questionnaire design, weightings used and analysis techniques). Once a preferred external supplier is appointed our customer panel (CCG) will be invited to challenge the new approach to confirm the study adheres to research best practice and then review the quarterly results provided by the independent agency. The first year of the contract from 2019/20 will allow us to shadow report on our PR19 performance commitments, including customer perceptions for value for money – which we have been tracking since 2015/16.

We have also examined the level for this performance commitment. The targets in our business plan are already stretching when compared to the combined South Staffs and CCWater historic scores. Our acceptability testing (July 2018) informed score for VFM shows 85% agreement with the AMP7 flat bill profile - although this is a customer forward looking view, so may not transpire during the AMP. Having reconsidered the historic data we will lift our annual target for 2020/21 to match the highest point in the historic data of 78%, but we view the 2024/25 target of 85% as extremely challenging to hit for the following reasons:

- the nature of surveys makes it potentially volatile given wider industry reputational impacts and political coverage .
- we know from our profiling insights during PR19, when the economy has been performing well that around 8-11% of customers struggle to always pay their water bill on time. Any downturn in the UK economy will mean that a greater number of customers will be struggling to pay their household bills. Even with an effective social tariff and bill payment plans options in operation to support these customers there will be an increased number saying, that due to their current financial situation, that their bills not be as good value for money as during the years when the economy is stronger (our customer service tracker shows a correlation between affordability and value for money perceptions).
- there are a proportion of customers (1 in 15 indicatively from our qualitative groups) who believe, no matter what evidence is shown to them about the activities of a water company, that water should be free to all. These customers, out of principle, say that any bill they pay for water is not good value for money.
- 85% agreement is seven percentage points higher than any past historic data for this measure and we have only ever achieved a score of 80% or higher in one year. To maintain this level of agreement over most years of an AMP will be very stretching.

5. Action log challenges relating to deadbands, caps and collars

5.1 SSC-OC-A21 – Supply interruptions

In our September business plan we explained that a collar was appropriate for this ODI because it has sensitivity to external events. We put the collar at the 5th percentile which is 14 minutes and 36 seconds. We do not feel that the incentive mechanism is intended to excessively penalise companies at the extremes when driven by external events beyond company control. We have set the collar well above our historic service delivery range. If performance above this collar occurred this would have been most likely due to a relatively widespread event and all customers directly affected would be compensated through GSS payments, which have recently been reviewed and uplifted.

For our April submission we have carried out additional customer support testing on the level of collar we propose. 64% of customers found our level of collar acceptable. 11% explicitly found the collar unacceptable and in these cases the free form comments reveal that those customers are generally against the principle of ODIs altogether.

We also tested customer support for not capping the outperformance payment on this measure (it is naturally capped at zero). 60% of customers found this acceptable. 16% found it unacceptable and again in these cases the free form comments reveal that those customers are generally against the principle of ODIs altogether.

5.2 SSC-OC-A26 – Mains bursts

As with supply interruptions, we explained in September that a collar was appropriate for this ODI because it has sensitivity to external events. We have re-evaluated our penalty collar in light of the removal of the three year averaging from our definition and we propose to lift the collar to 170 bursts per 1000 km, well above our recent historic level of performance.

For our April submission we have carried out additional customer support testing on the level of collar we propose. 60% of customers found our level of collar acceptable. 9% explicitly found the collar unacceptable and in these cases the free form comments reveal that those customers are again generally against the principle of ODIs altogether.

In our September plan we also implemented a cap on outperformance payments at 102 bursts per 1000 km. We have carried out additional customer support testing on the level of cap we propose. 55% of customers found our level of cap acceptable. 16% explicitly found

the cap unacceptable and in these cases the free form comments reveal that those customers were observing that the ODI rates used in the September plan (the scaled rates) were asymmetric. Due to the short time we had available to commence the customer research we were unable to include the revised incentive rates in this retesting. As the revised incentive rates are no longer scaled, the bill impact at the outperformance collar would be smaller than the bill impact at the underperformance penalty, and we would expect the acceptability to rise, based on the customer comments received.

Please note that section 9 of this document covers wider challenges on our asset health performance commitments.

6. Action log challenges relating to ODI rates

6.1 SSC-OC-A1 – ODI rates

At the September submission we considered that scaling factors were necessary to balance the package of incentives proportionately across all financial performance commitments, and to achieve Ofwat's guidance range of +/- 1-3% of regulated equity. As explained in section 1 of this document, this was necessary because our customer willingness to pay did not naturally land within the expected range nor provide for a balanced level of risk across the package. Following this challenge, we have now removed our top down scaling and rebalancing factors.

As a result of this there are no longer any outperformance ODI rates which are higher, in absolute terms, than underperformance ODI rates.

There are no changes to any ODIs as a result of our cost adjustment claims.

Where marginal cost calculation challenges have been made against individual ODIs these are addressed under the relevant action point, corresponding to Ofwat's action log ID numbers.

6.2 SSC-OC-A6 and SSC-OC-A9 – Residential water consumption

We have engaged with our customers and have support to maintain our proposal of having outperformance payments for this measure.

We recognise that outperformance payments for customers' lowering water consumption can be counter intuitive. We have attempted at length to explain to customers that the incentive is there to incentivise our additional activity on water efficiency covering for example education, promotional material and in home devices. The incentive is not there to directly reward us for customers' independent water saving choices and action. We have gained approximately 58% customer support for outperformance payments which is a majority support. There were a significant proportion of those surveyed who did not express a preference, with only around 10% of customers explicitly choosing that the proposal was unacceptable. The free text comments we received indicated that this is due to the counter intuitive nature of the topic and again demonstrating an aversion to the principle of ODIs altogether.

We believe that if it is regulator and government policy to improve water efficiency then it is an area where Ofwat may need to override short term customer views to deliver long term benefits. An incentive is appropriate if companies are to deliver step changes in this area

through step changes in water efficiency activity and innovation, otherwise there is a disconnect between policy and practice. On this basis, and with 58% acceptability, we have retained our outperformance incentives on water consumption.

6.3 SSC-OC-A7 and SSC-OC-A10 – Residential water consumption

The SST and CAM specific residential counts are as follows. This will allow Ofwat to calculate the normalised ODI rates for benchmarking.

'000s	**2022/23**
SST for R1	579.217
CAM for R1	135.556
Total (original R1)	714.773

Further to challenge SSC-OC-A1 we have removed our top down scaling and rebalancing on this incentive valuation.

Ofwat has asked for additional detail of our marginal benefit and marginal cost estimates. We derived our marginal benefit estimate from our customer WTP values for metering and supplying better usage data to customers, as this is the most direct mechanism we have for influencing customer water use. We estimated how much water our meter optant activity would be expected to save, averaged across the customer base, and using the WTP from the customer research we converted this into a WTP per 1 litre per person per day value. For marginal costs, we took our annualised AMP7 costs for meter optants and water efficiency activity which delivers a 1 litre per person per day change. We then used Ofwat's standard incentive formulae for both underperformance and outperformance incentives. We undertook the calculation for both regions (as the level of meter penetration and optants is different for each region) and took an average of the two estimates which we have used for both the SST and CAM version of this ODI.

6.4 SSC-OC-A12 and SSC-OC-A14 - Leakage

The SST and CAM specific residential property counts are shown above. The regional distribution input values are as follows. This will allow Ofwat to calculate the normalised ODI rates for benchmarking.

	2020/21	2021/22	2022/23	2023/24	2024/25	5 year average
SST DI (Ml/d)	296.15	293.31	290.63	288.18	285.72	290.80
CAM DI (Ml/d	82.38	82.49	82.50	82.52	82.56	82.49
Total (original WN2)	378.53	375.80	373.13	370.71	368.27	373.29

Further to challenge SSC-OC-A1 we have removed our top down scaling and rebalancing on this incentive valuation. Our removal of these has resulted in an outperformance rate that is now lower than the underperformance rate in absolute terms.

6.5 SSC-OC-A20 – Supply interruptions

We have removed the overall package scaling that was influencing this ODI rate.

For this ODI valuation we found that the marginal cost estimate was far in excess of the marginal benefits estimate. This meant the standard ODI formulae for penalties did not work correctly. We have therefore made the penalty rate symmetrical with the outperformance payment rate for this measure.

6.6 SSC-OC-A33- Customer contact about quality of water

We have removed the rebalancing between CRI and customer contact about water quality, now utilising the raw WTP as derived from customer valuation of appearance and taste and odour.

The main marginal cost driver for our service level improvement here is the annualised cost of our cost adjustment claim for Hampton Loade and Seedy Mill treatment upgrades. This value was far in excess of the WTP value resulting in a negative ODI rate using Ofwat's standard formula. We have therefore adopted an underperformance rate that is symmetrical with the outperformance rate in this case.

6.7 SSC-OC-A39 – Extra Care assistance

There may have been some confusion in this ODI rate as there was a units of measurement discrepancy. Our performance commitment units are in percent, as we are reporting the percentage of customers on Extra Care out of our total priority services register. However the rate in our business plan was presented as £ per customer. We have converted the £ per

customer into a £ per percent, using the revised PSR target also, and re-presented the rate, which is now higher as would be expected.

We are delivering the Extra Care package out of retail base costs. Therefore it is funded via Ofwat's retail cost allowance. We were not able to calculate a customer WTP value for the Extra Care package as it is very bespoke, so our underperformance ODI rate is calculated entirely from the marginal cost. We have calculated the cost of delivery on a per customer basis and the incentive therefore becomes a refund to customers of the funded activity should we underperform our target.

6.8 SSC-OC-A42 – Education activity

Ofwat challenged us that our Education Activity performance commitment should be a financial measure. We have reflected on this challenge and have now added a financial ODI to this performance commitment. This is calculated directly from the WTP for education activity we obtained in our previous customer research.

We have included a marginal cost calculated directly from cost of delivery, which is predominantly made up of salary of our delivery resource, with a small allowance for consumable materials that are used in the schools. We have then used Ofwat's standard formulae.

6.9 SSC-OC-A46 – Protecting wildlife, plants, habitats and catchments

For our April submission we have carried out additional customer testing the level of support for outperformance payments. 71% of customers found our level of collar acceptable. 10% found the outperformance payment unacceptable and in these cases the free form comments reveal that those customers are again generally against the principle of ODIs altogether.

6.10 SSC-OC-A48 – Visible leak repair time

We have reflected on Ofwat's challenge of our ODI rate, and we have strengthened the process we have used.

In our original customer research we did not explicitly ask customers about leak repair times. We did ask them about leakage, interruptions and traffic disruption, all elements that

we could use to help value the leak duration. In our revised submission we did not have time to retest a willingness to pay value with our customers and so we engaged with Paul Metcalfe, who compiled the comparative industry willingness to pay study earlier in 2018 and who we commissioned to carry out our triangulation activity, to determine whether there were any alternative sources of customer valuation for this measure. We identified that one other company had tested this metric with customers, albeit in a slightly different form. With Paul's assistance we were able to convert the value obtained externally into a compatible value with our own measure and incorporate it into our triangulation.

6.11 SSC-OC-A50 – Water treatment works delivery programme

Ofwat's challenge does not provide any detail on what the missing information may be for this ODI. Our business plan appendix A26 described the approach we had taken to valuing this ODI, which is of a different form to all of our others, existing to ensure delivery of our cost adjustment claim schemes.

The basis for the valuation is to return money to customers in full (via an RCV adjustment for the capex part of the schemes and a revenue adjustment for the opex component of the scheme) if the schemes are not delivered, and to compensate customers (via a revenue adjustment) if the schemes are delivered late. The table below shows the components which make up this ODI.

	Fail to deliver	**Late delivery rate**
Seedy Mill	£31.4m RCV adjustment £1m revenue adjustment	£254k per year delay
Hampton Loade	£25.6m RCV adjustment £2m revenue adjustment	£282k per year delay
Mains cleaning	£1m RCV adjustment £3m revenue adjustment	£204k per year delay

The incentives above reflect:

- Full refund of the capital costs and operational costs of our claim value if we do not deliver the scheme.
- A late delivery payment which is twice the time value of money of the revenue we would have collected from customers up until the scheme delivery deadline, for each year that the project is delayed.
- If we fail to deliver the scheme or miss our notified deadline, we are also at risk of further enforcement action, extending to prosecution, from the DWI.

In our September business plan we did not apply any rebalancing or scaling to this ODI, so it remains as presented originally. We also have not assigned any P10 level to this ODI, because it is fundamentally an all or nothing ODI in terms of scheme delivery, and we do not envisage any late delivery as we are bound by our DWI notices.

6.12 SSC-OC-A53 – Residential void properties and gap sites

Our ODI rate is calculated from the foregone reduction in bills arising from the voids and gap sites.

This calculation assumes that 75% of void properties are genuinely empty, leaving 25% that would be billed when discovered. Our recent experience is lower than this rate however we want to ensure the incentive can reflect future improvements in checks that may increase the level of non-genuine voids we discover.

Our process compliance measure is to check 100% of voids and gap sites each year, through desk and field activity. In assuming that 25% of our approximately 23,000 voids will be found to be occupied, we can calculate that this is worth 25% x 23,000 x £147 average bill which is £845.3k. We can then convert this into our percentage compliance measure, where each 1% of voids checked is then worth 0.01 x £845.3k = £8.453k. This value is the marginal benefit value, per 1% of voids checked per year.

In our September business plan we included a marginal cost deduction using Ofwat's standard penalty formula, however we have now removed this as there is no cost sharing in retail so the marginal cost estimate is not relevant, and the marginal benefit value becomes the penalty ODI rate.

7. Action log challenges relating to ODI timing

Ofwat has challenged our use of end of period incentives on all of our financially incentive performance commitments. This section therefore covers actions: A3; A8; A11; A13; A15; A18; A22; A27; A31; A34; A36; A40; A44; A47; A49; A51; and A54.

We recognise Ofwat's policy principle that brings both underperformance and outperformance incentive payments closer in time to the performance that generated them.

However our customer evidence definitively shows that customers favour the certainty of a flat bill over one which may be volatile each year due to the effect that in-period ODIs could have. For this April resubmission, we tested this again in conjunction with additional research on what level of transition customers would find acceptable when stepping between AMP7 and AMP8. It is important to note that bill volatility can also arise from penalties – if a company should incur penalties which drop the bill, and then in the following year do not incur those penalties, then the bill will rise back to its previous level but customers would see a potentially significant bill increase from the previous year. The issue of bill volatility is therefore not just resigned to outperformance payment.

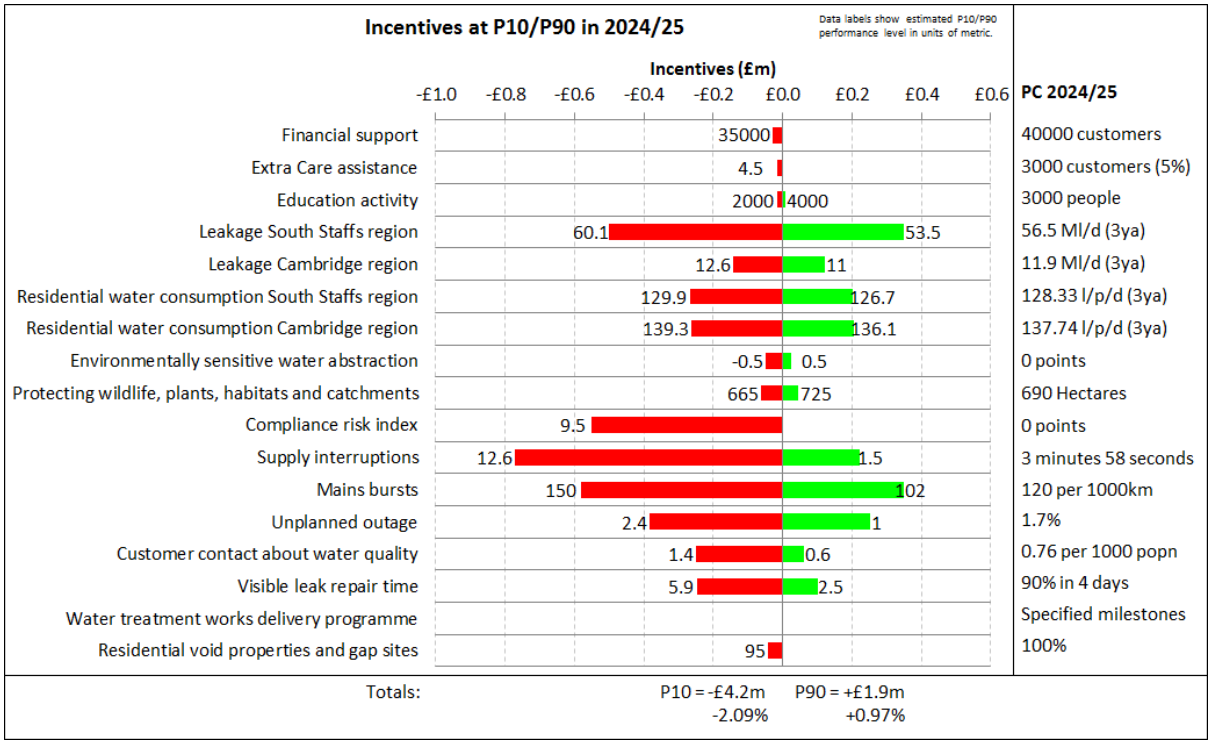
We note that in practice, Severn Trent has made extensive bill smoothing to mitigate the effect of its net in-period rewards in this price control period – and so there is already precedent for this process to occur. We have taken the view, supported by our customers, that we will remove all volatility and give our customers certainty over their bill over five years, which includes inflation and other in-period true ups.

Our customers support this provided the transition between 2024/25 and 2025/26 is not more than £3. We therefore propose a system whereby we will monitor the level of ODI incentive we are incurring, as well as inflation forecasts and other true up forecasts, to determine if we are likely to transition more than £3. We will then revert to the in-period mechanism, with appropriate smoothing to minimise the volatility, to mitigate the transition. We commit to reporting this assessment each year in our APR, and engaging with our Customer Panel, Ofwat and customers further if the forecasts warrant this.

8. Overall package balance and risk and return range

8.1 SSC-OC-A2 – Overall package

The following graphic shows the P10 and P90 incentive value in 2024/25, along with the performance commitment level (right), and the P10 and P90 levels of performance that are generating the P10 and P90 levels of incentive. At the bottom we show the total level of P10 and P90 as a value and as a percentage of our regulated equity in 2024/25. The complete P10 and P90 position is shown in the business plan tables.



We remain concerned that the ODI package which results from our application of the standard methodology has created a skew towards penalty financial risk across the package of measures and that there are some measures which are particularly exposed and approaching a level that could be considered punitive.

Fundamentally we are concerned that the methodology in place creates an incentives system which is focused on penalty avoidance rather than positive incentivisation of genuine outperformance and innovation. The way in which incentives are calculated and applied relative to the stretching service targets means that service improvement, in many cases very material service improvement, is being driven by penalty avoidance rather than outperformance opportunity.

We recognise the importance of protecting customers against deterioration in service from existing levels, and we fully support penalty incentivisation for this purpose. However the

current methodology also incentivises service improvement from the current position through penalty incentives. This means that companies are incentivised to achieve a significantly step changing and challenging target only through penalty avoidance. Ofwat's rationale for this is broadly one of comparative performance, whereby the policy position is that service levels should be homogenous across all companies at levels approaching the industry best performance. No real regard has been given to the legacy, current or future differences across companies, arising from geographical, demographic, environmental, historic investment priorities or customer preference that may have influenced relative service performance and therefore the starting position.

Outperformance incentives are then only earned for going beyond the already very stretching targets. In practice this means that outperformance opportunity is severely curtailed, as it will be difficult enough to achieve the significant step change in performance that is built in to the targets, let alone going beyond. We note also that several of the core service levels (water quality, supply interruptions) are already very close to limit values, so it is even harder to outperform.

On top of this already very difficult outperformance situation, there is reticence, primarily due to customer legitimacy and support, to allow outperformance incentives at all on some measures where there is room for outperformance to occur. By removing these incentives as a matter of policy, the scope for any outperformance payments becomes even smaller. There are also issues here with links to regulatory and government policy, with reducing water consumption being an example of a central government policy which will require extensive customer engagement and innovation, yet with the positive outperformance incentivises, which can encourage the necessary activity to take place, at risk of being removed.

The lack of outperformance opportunity then becomes at odds with assumptions made in the WACC, where an element of the return on equity has been moved across to outperformance incentives.

9. Asset health

9.1 SSC-OC-A4 – Asset health

Also including actions A24 and A25 (mains bursts), and A28, A29 and A30 (unplanned outage)

In our September business plan we included a technical appendix on asset health (appendix 30). The rationale presented in this appendix remains valid for this April resubmission and in addressing Ofwat's challenges.

We have engaged extensively with customers on asset health, which Ofwat recognises in the test question assessment against item OC3 (page 5, 6th para). Post IAP, we have carried out further testing of customer support for our proposed asset health outperformance payments in response to Ofwat's challenges. We received majority acceptability for outperformance payments on both mains bursts and unplanned outage (both 55% acceptability). From our original customer research, 72% of residential customers found the proposed performance commitment for unplanned outage was stretching, and 67% found the proposed performance commitment for mains bursts was stretching. Where customers did not find our proposals acceptable (approximately 17% across the two metrics) we collected free form comments, and we found that unacceptability was driven by an aversion to the principle of outperformance payments altogether. We have experienced this view from some customers across all of our engagement.

Ofwat has asked us to justify why outperformance payments are appropriate for asset health measures. Across all of our engagement, customers have understood and support the need to maintain asset health. Customers recognise the links between asset health and 'today's service' but also to future sustainability of service levels and the need to ensure the right investment in infrastructure for future generations.

Historically, regulatory reviews have sought a stable asset health outcome in the majority of cases. We generate this outcome by investing in our assets, either maintaining them or upgrading them, and we have always undertaken extensive optimisation of this programme to ensure bills are kept low whilst meeting the stable asset health objective. In our business plan, we have not sought direct funding for a step change in asset health as to do so as a deliberate investment exercise would be expensive for customers. We do however believe that innovation, particularly in smarter technologies, could play a part in delivering both improved asset health and improved resilience outcomes, from the minimum standard. It is this innovation to that the outperformance incentives on asset health will encourage. This has long term benefits for the assets themselves and for customers, helping to ensure bills are kept low for future generations and in particular, ensuring we are less likely to reach a point in the future where a step change in bills is needed to generate a step change in asset health.

Mains bursts can be a volatile measure as it is sensitive to external weather conditions. In 2017/18 we experienced a swing of +300 bursts from the previous year due to the severe winter ('Beast from the East') in February 2018. This was a common pattern experienced by all companies, and it happens because of ground movement caused by temperature changes and ground moisture content. In 2017/18 we calculated the upper quartile level for mains bursts as approximately 124 bursts per 1000 km of pipe. Our target is 120 bursts per 1000 km of pipe, which we have never been below so it is stretching given than weather effects are not excluded from the measure. An incentive on mains bursts outperformance would only apply beyond this target. Our aim is that smarter technologies that generate additional data and insight into network performance means that we can take more pro-active action to mitigate bursts.

Unplanned outage is a new performance commitment for companies in this price review, and we recognise Ofwat's concerns on the data reliability and consistency. We will be submitting our latest data by 15th May 2019 as Ofwat requests, however throughout the development of the metric we have been fully involved in the definition working groups ran through Water UK. We are confident that our reported performance level and future targets are robust and consistent with the definition, and while we do have work to do on internal data collection and process improvement, we do not anticipate material effects on the reported values at this time. Our target of 1.7% outperforms the industry upper quartile of the AMP7 performance commitments that were proposed by companies in September, which is 1.74%. We are currently at approximately 1.9%, so this represents a 0.2% (11%) reduction. Our outperformance incentive on this measure would only apply if we outperform this target.

As we said in our September plan, we also believe that a number of other performance commitments in our package are partly attributable to asset health. These are:

Leakage: Leaks result from an aged network developing minor condition deterioration over time. We normally target these via leak detection activity and burst repairs, which acts to restore a small portion of the pipe to better condition. We also use leak data to better target mains renewal activity, and mains renewal activity undertaken because of general poor condition would also be expected to remove some leakage. Therefore there is a link between the activities we undertake to detect and repair leakage, with the overall condition of our network and therefore asset health.

Compliance risk index: CRI measures water quality compliance, and contains components which have a direct link to the performance of treatment works and service reservoir assets. Deterioration in these assets' condition can result in water quality issues and failures over time, and therefore CRI is also an asset health indicator.

Supply interruptions: This is a measure of reliability of supply, as perceived by customers at their taps. A supply interruption is caused by operational

events, which can have a cause rooted in asset deterioration (commonly a burst main but also potentially booster asset or service reservoir asset failure). Supply interruptions is a less direct measure of asset health than the other measures, however over the long term a systematic deterioration in asset health could manifest as worsening supply interruption performance.

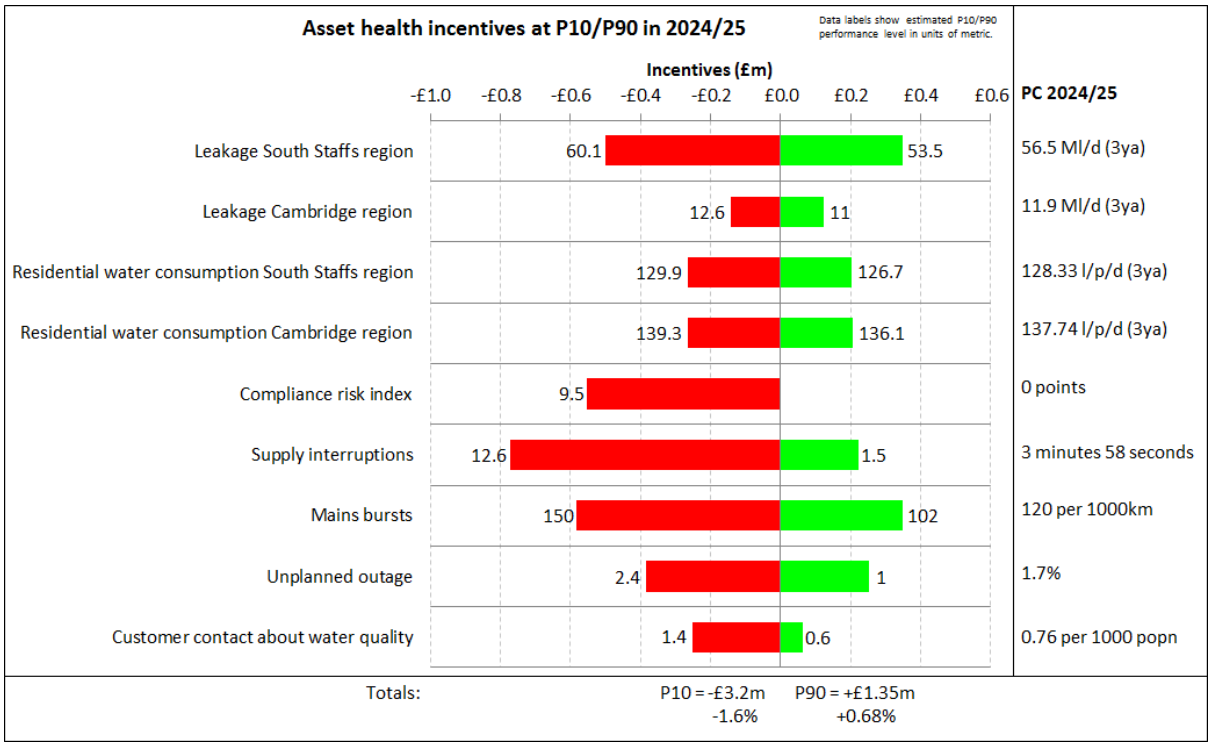
Risk of severe restrictions in a drought: This is primarily a resilience measure, but does also have a link to long term asset health. This is because for us to be resilient to drought conditions, we also need to ensure our water production assets can operate reliably when they are needed, and we need to maintain a broad range of sources available so that we can respond effectively to localised drought issues. The activities we undertake in our maintenance programme, and for our water resources management plan help mitigate risk of restrictions and help maintain asset health.

Customer contact about water quality: This measure reacts to both short term and long term water quality causes in the network. In the short term, it is primarily driven by acute changes, such as bursts, which cause pressure and flow surges and allow sediments to be lifted, causing discolouration. However these sediments are a long term issue, and they relate to the condition of the pipe network (in terms of corrosion) and to the performance of our water production assets (in terms of final water quality). Our cost adjustment claim discusses the long term link between our treatment works, the build-up of sediments and the hotspots of contact. Over time, improvements in our treatment works and renewal of deteriorated network assets will seek to improve this metric, and therefore it is also an asset health indicator.

This demonstrates that our asset health package is broad and covers the asset health aspects of all elements of our day to day service.

As part of our review of asset health incentives for this April resubmission, we have considered how the broad range of asset health is incentivised and the balance between these incentives. As per Ofwat's general challenge, we have now removed all top down scaling and rebalancing and therefore our incentives, both under and out-performance, are now directly reflective of the underlying willingness to pay valuations that we had from our extensive customer engagement programme.

The P10 and P90 levels of all measures (direct or part) that contribute to asset health are as follows:



We believe this demonstrates that the balance across direct asset health measures and the part asset health measures is reasonable, both for underperformance penalties and outperformance payments. Specifically, our proposed asset health outperformance incentives on mains bursts and unplanned outage are not excessive alongside other metrics, and the rates have reduced from our September plan due to removal of scaling factors. With mains bursts being capped at 102 bursts per 1000 km of pipe and unplanned outage having a natural cap at zero percent, customers are protected from large outperformance payments on these measures, as we explain further in chapter 10 of this document.

10. Customer protection strategies

10.1 SSC-OC-A5 – Customer protection

We agree to adopt the Ofwat proposed mechanism for outperformance payments whereby 50% of the outperformance payment is shared with customers if 3% RORE threshold is reached.

Ofwat's outcomes technical appendix, published at IAP, discusses customer protection for excessive outperformance. The main threshold test is that caps should be considered where the P90 outperformance payment is greater than 10% of the total outperformance P90s in the price control. However we are concerned that this test does not take into account the customer impact in terms of bill impact. We consider that it is not the P90 level itself which presents the customer protection issue, but how likely it is to go beyond this level and what the bill impact is, if it occurs.

Ofwat's 10% threshold test results are presented below for all of our proposed outperformance measures. To demonstrate our concern, we have also presented the customer bill impact alongside this test. This demonstrates that whilst an ODI may be material against other ODIs, it is not necessarily material on the customer bill. We therefore go beyond Ofwat's test in considering the need for outperformance caps.

Performance commitment	**2024/25 PC**	**2024/25 P90 level**	**Outperformance payment at P90**	**% of total P90**	**Customer bill impact £**
Education activity	3000 people	4000 people	£8,440	0.43%	£0.01
Leakage SST	56.5 Ml/d	53.5 Ml/d	£348,827	17.96%	£0.44
Leakage CAM	11.9 Ml/d	11.0 Ml/d	£121,330	6.25%	£0.15
Residential water consumption SST	128.33 l/p/d	126.7 l/p/d	£203,217	10.46%	£0.26
Residential water consumption CAM	137.74 l/p/d	136.1 l/p/d	£204,464	10.53%	£0.26

Environmentally sensitive water abstraction	0 points	0.5 points	£24,544	1.26%	£0.03
Protecting wildlife, plants, habitats and catchments	690 Hectares	725 Hectares	£43,750	2.25%	£0.06
Supply interruptions	3.97 minutes	1.5 minutes	£220,791	11.37%	£0.28
Mains bursts	120 per 1000km	102 per 1000km	£349,002	17.97%	£0.44
Unplanned outage	1.7%	1%	£253,644	13.06%	£0.32
Customer contact about water quality	0.76 per 1000 popn	0.6 per 1000 popn	£61,876	3.19%	£0.08
Visible leak repair time	90% within 4 days	90% within 2.5 days	£102,402	5.27%	£0.13

The maximum impact on the customer bill of any of our outperformance ODIs, at the P90 level, is £0.44, or 0.3% of a £147 bill. The total customer exposure, at the P90, is £2.44 (which would require all P90's to occur simultaneously – highly unlikely), which is still just 1.66% of a £147 bill.

For this April resubmission we have therefore undertaken an alternative test that is more directly related to customer's actual bill impact from individual measures, to determine where an outperformance cap might be necessary to protect customers from excessive exposure well beyond the P90 level. The level of exposure for customers is dependent on the ODI rate, whether a natural cap exists (i.e at zero), or how likely it is to achieve excessive outperformance beyond already stretching targets.

In our latest customer research we have tested the threshold at which customers would find a bill step change unacceptable. The result was £3. We can use this value to test each ODI to determine at what level of performance a £3 bill impact would be generated and assess how likely this is to occur. This can then indicate whether an additional cap is required.

The table below summarises this exercise for all of our proposed outperformance ODIs.

Performance commitment	2024/25 PC	Level of performance to affect bill by £3	Our views
Education activity	3000 people	285000 people	The outperformance rate on this measure is significantly smaller than other measures, reflecting the fact that it is not a core hygiene factor. We would need to reach 285000 people to generate a £3 bill impact, which is over double our assessment of the number of primary school children in our regions. We believe a cap is unnecessary on this basis.
Leakage SST	56.5 Ml/d	36 Ml/d	The performance commitment for leakage is already very stretching at c. 25% reduction over AMP7. It is highly unlikely that we can go beyond this level which is already a significant step change and incredibly challenging to deliver. To generate a £3 bill impact, we would have to achieve performance of 36 Ml/d, which is a further 36% reduction of our performance commitment. We consider a cap unnecessary on leakage due to the very low likelihood of significant outperformance payments.
Leakage CAM	11.9 Ml/d	Even zero leakage does not reach threshold	The performance commitment for leakage is already very stretching at c. 15% reduction over AMP7. It is highly unlikely that we can go beyond this level which is already a significant step change and incredibly challenging to deliver. Even with zero leakage in CAM, which is impossible to achieve, we generate a £2.02 bill impact which is below our threshold. We consider a cap unnecessary on leakage as even a zero level does not reach our designated bill materiality threshold.
Residential water consumption SST	128.3 l/p/d	109.3 l/p/d	SST is already at the industry frontier for PCC. To affect bills by £3 would require a significant step change down to c.109 l/p/d which would be an unprecedented level. We consider the likelihood of achieving this level to be so low that it is unnecessary to include a cap.

Residential water consumption CAM	137.7 l/p/d	118.6 l/p/d	To affect bills by £3 would require a significant step change down to c.119 l/p/d which would be beyond the frontier position of the SST region. We consider the likelihood of achieving this level to be so low that it is unnecessary to include a cap.
Environmentally sensitive water abstraction	0	Cannot reach threshold	The maximum outperformance score achievable under our AIM calculation is a score of 1 per site. We have two sites, one not being used however putting this to one side the maximum score would be 2. This only gives a bill impact of £0.12 per customer so there is no need for an additional cap.
Protecting wildlife, plants, habitats and catchments	690 Hectares	2600 Hectares	Delivering a £3 bill increase from this measure would require us to deliver over 3.7x higher level of activity than our already stretching target.
Supply interruptions	3 minutes	Even zero supply interruptions does not reach threshold	Supply interruptions is naturally capped at zero, which would generate a bill impact of £0.45 per customer in 2024/25. On this basis it is not necessary to implement an additional cap.
Mains bursts	120 bursts per 1000km	Even zero bursts does not reach threshold	We would need to eliminate bursts to zero to generate a £2.93 bill increase. We did already test a cap with customers at 102 bursts per 1000km, which generates an outperformance payment of £0.44 per customer. We have not tested any alteration to this cap so we propose to keep it at 102 bursts per 1000km. This should also help assure Ofwat that our asset health outperformance proposals are not excessive from a customer perspective.
Unplanned outage	1.7%	Even zero unplanned outage does not reach threshold	Unplanned outage is naturally capped at zero and this level of performance would generate a £0.78 bill impact per customer, well below our designated threshold. We therefore consider a cap unnecessary in this measure, and this should also help assure Ofwat that our asset health outperformance proposals are not excessive from a customer perspective.

Customer contact about water quality	0.76 per thousand	Even zero contacts does not reach threshold	Customer contact about water quality is naturally capped at zero and this level of performance, which is impossible to achieve, would generate a customer bill impact of £0.37 per customer. On this basis we consider an additional cap unnecessary.
Visible leak repair time	90% within 4 days	Even same day repair does not reach threshold	The number of days we take to repair leaks is naturally capped at zero (i.e repairing same day as reported), which would generate a bill impact of £0.34 per customer. On this basis we consider an additional cap unnecessary.

This analysis, using additional threshold bill information from our latest research, supports our position that no additional caps are required on our measures. Ofwat's proposed sharing mechanism operating beyond 3% RORE will capture combined outperformance across multiple measures however we expect that reaching 3% RORE on outperformance is very unlikely, being well beyond our P90 level.

We believe Ofwat does need to acknowledge that by imposing caps on outperformance payments at the P90 levels where they breach the 10% test, and by removing outperformance payments altogether on PCC or asset health, it is removing a very significant proportion of our ability to earn outperformance payments. If this scenario was to be realised, we would question what incentive there is left on the table for us, as our outperformance opportunity would be severely curtailed leaving a very disproportionate underperformance penalty risk.

We recognise the customer protection angle, and the perspective of CCWater and CCGs on the principle of incentives, however Ofwat risks undermining the incentive system altogether if it goes too far in removal or capping of outperformance opportunity.

If Ofwat has concerns about this proposed incentive package in our April resubmission we would desire and appreciate early dialogue, before our draft determination is published, to come to a mutually acceptable position that leaves an appropriate level of outperformance opportunity available.

11. Data tables

Table App1

We have updated table App1 with our revised performance commitments, any changes to levels, ODI rates and the new information on P10 and P90 levels.

We have one validation error on the AIM ODI rate as the table is not expecting to see a rate entered in this table. We have however left it in to contextualise the P10 and P90 assessment. The rate is identical to that shown on table App3.

Table App1a

We have completed this new table with our marginal benefit and cost information, and entered comments where the calculation we have used differs to Ofwat's standard formula, which it does in a few cases.

We have calculated our rates using the total number of billed customers in 2022/23 which is 754,840 (WS3 lines 1 through 5). This is appropriate because both residential and business customers will contribute to incentives, and our willingness to pay values include both residential and business customer valuation.

Table App1b

There is only one of the performance commitments within the list on the guidance sheet for App1b that is a different units of measure than the standard unit Ofwat requires, and this is our bespoke performance commitment for AIM, called 'environmentally sensitive water abstraction'. We are using the normalised AIM scoring system that is currently in use in table 3C of the APR. For table App1b, we have calculated the equivalent performance commitment, ODI rate and P10/P90 levels in the units of megalitres per year as required. The conversion we have undertaken calculates that 1 AIM point is approximately 14 megalitres per year, using the single operational site that we have in our AIM list (Hagley is not an operational site and is not likely to be operational within AMP7).

Please note that we have validation errors on the ODI rates in table App1b. We copied the ODI rates in from table App1 (as negatives for the underperformance penalty and as positives for the outperformance payment), however they are showing as highlighted red in table App1b. We do not know why this is, but the rates are correct and align to App1.