

PR19 Customer Challenge Group

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Paper No: 6

Agenda No: 9

Title: Outcomes definitions

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What is this paper about:	The Outcomes and the draft definitions proposed to be used by the Company for the submission to Ofwat in May.
What is the context of this paper:	Following the Outcomes meeting in December and sharing our proposed Outcomes with the Group at the January meeting this paper is to update the group on work carried out since these meetings.
What is the relevance of this paper:	The company has a requirement to submit its Outcomes definitions to Ofwat in May.
Action needed from the CCG:	The Company has produced this paper for information and further discussion with the CCG. The Customer Challenge Group are asked to comment on the proposed definitions shown on slides 16 and 17

PR19 outcomes / performance commitments update



Purpose

- The purpose of this presentation is to update the CCG on our proposed performance commitments for PR19 in readiness for submission to Ofwat on 3rd May 2018
- This presentation covers the following key areas:
 - Reminder of Ofwat requirements
 - SEW approach
 - Next steps
 - Appendix 1 - Customer research findings linked to performance commitments
 - Appendix 2 - Ofwat comments on bespoke performance commitments

Purpose – continued

- This presentation follows on from a CCG outcomes workshop held in December 2017 where the following was covered:
 - overview of outcomes/performance commitments
 - how targets and incentives are set
 - SEW proposed approach and draft performance commitments
 - how customer research findings have shaped our choice of performance commitments
- The Customer Challenge Group are asked to comment on the proposed definitions shown on slides 16 and 17

Performance commitments - overview

- Performance commitments (PCs) are made up of 3 distinct parts
 - The definition of the measure
 - The target
 - The outcome delivery incentive (ODI)
 - financial/reputational
 - size of the outperformance reward or underperformance penalty
 - application of enhanced outperformance rewards and underperformance penalties
- Ofwat require companies to submit performance commitment definitions by 3rd May 2018
- Targets and ODIs will be submitted as part of the business plan on 3rd September 2018

Reminder of Ofwat requirements

Ofwat requirements

- Ofwat are prescribing 14 common performance commitments (PCs)
- PCs require 10 year projection in addition to next five years



Area of focus

■ Customer experience ■ Day to day performance ■ Future performance/resilience

1 to 6 and 9, 11 and 12 apply to WoCs and WaSCs

7, 8 and 10, 13 and 14 apply to WaSCs only

Ofwat requirements – bespoke performance commitments

Bespoke performance commitments must cover the following

- the different price controls
- vulnerability
- the environment
- resilience
- the abstraction incentive mechanism (AIM)
- new requirements for gap sites and voids introduced in Final Methodology (see slide 8)

Bespoke commitments must also include a selection of additional asset health measures:

- Water quality Event Risk Index (ERI)
- Properties at risk of receiving low pressure
- Customer contacts about water quality (as included in Discover Water)
- Sub categories of the water quality Compliance Risk Index (CRI)
- Unplanned maintenance – non-infrastructure

Gap sites and voids

- Gap site is a property where water and/or wastewater services are being consumed, but the property is not on a water company's system and is therefore not billed
- Voids are properties classed by water companies as being vacant
- Ofwat has concerns about water companies' management of gap sites and voids and the incentives they have to manage them appropriately
- New requirement for companies to propose bespoke performance commitments on gap sites and voids, for residential retail and the business retail market, or, justify why this is not appropriate

Ofwat requirements – transparency

Additional requirements in relation to performance commitments

- Performance commitments should be clear, unambiguous, complete and concise
- Companies should not aggregate their performance commitments
- Companies should explain in their business plans how they will publicise their performance information during the 2020-25 period to make sure it is visible to customers, CCGs and other stakeholders
- Companies should commit to keeping the definitions of their performance commitments unchanged during 2020-25 and to follow our procedures for any changes
- Companies should commit that their ODI payments will only relate to real performance changes and not definitional, methodological or data changes in the performance commitment

Ofwat submission – definitions of performance commitments

- Ofwat require companies to submit the definitions of their performance commitments on 3 May 2018
- They are requiring this so that they can review the definitions to check, for example, that companies are using the standard definitions for the common performance commitments and that there are no inappropriate exemptions in the definitions of their bespoke performance commitments
- Ofwat will provide companies with feedback about their performance commitment definitions before they submit their business plans, where it is appropriate to do so

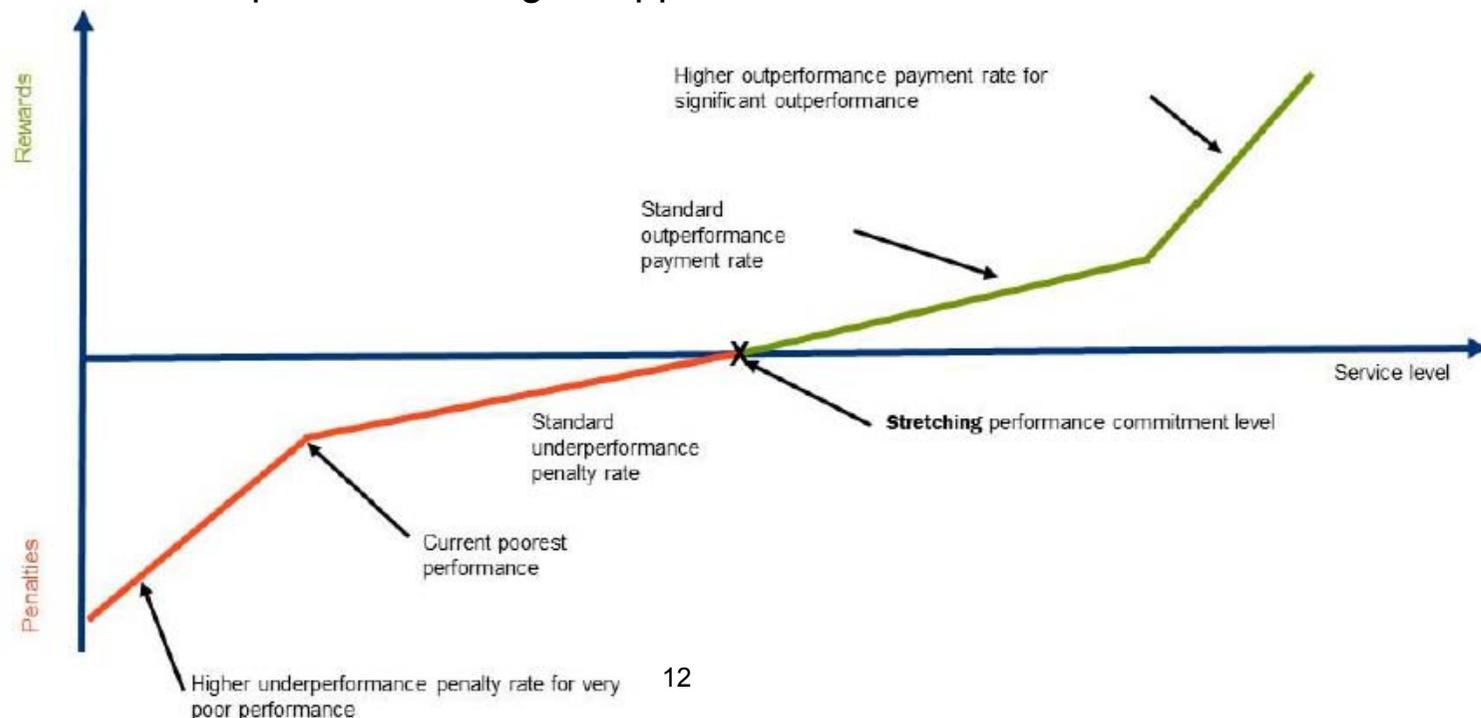
Outperformance payments and underperformance penalties

- Ofwat require a greater emphasis on financial ODIs
- Companies should justify, with supporting evidence, whenever a performance commitment is not supported by a financial ODI
- At PR14 Ofwat specified an overall range for ODI outperformance and underperformance payments of between $\pm 1\%$ and $\pm 2\%$ of RoRE, with an aggregate cap and collar set at $\pm 2\%$
- The aggregate RoRE cap and collar has been removed for PR19 to give companies an opportunity to propose higher outperformance and underperformance payments in their business plans, where customers support this
- Ofwat suggest an indicative range for the size of companies' ODI outperformance and underperformance payments of $\pm 1\%$ to $\pm 3\%$ of RoRE at PR19
- This indicative range excludes CMeX and D-MeX, which have an additional impact on of $\pm 0.5\%$ of RoRE
- The upper end of the outperformance payments range will only be achievable in extremely stretching circumstances, where companies deliver step changes in performance across all their performance commitments

Note: 1% RORE = c£9.3m per annum

Enhanced outperformance payments and under performance penalties

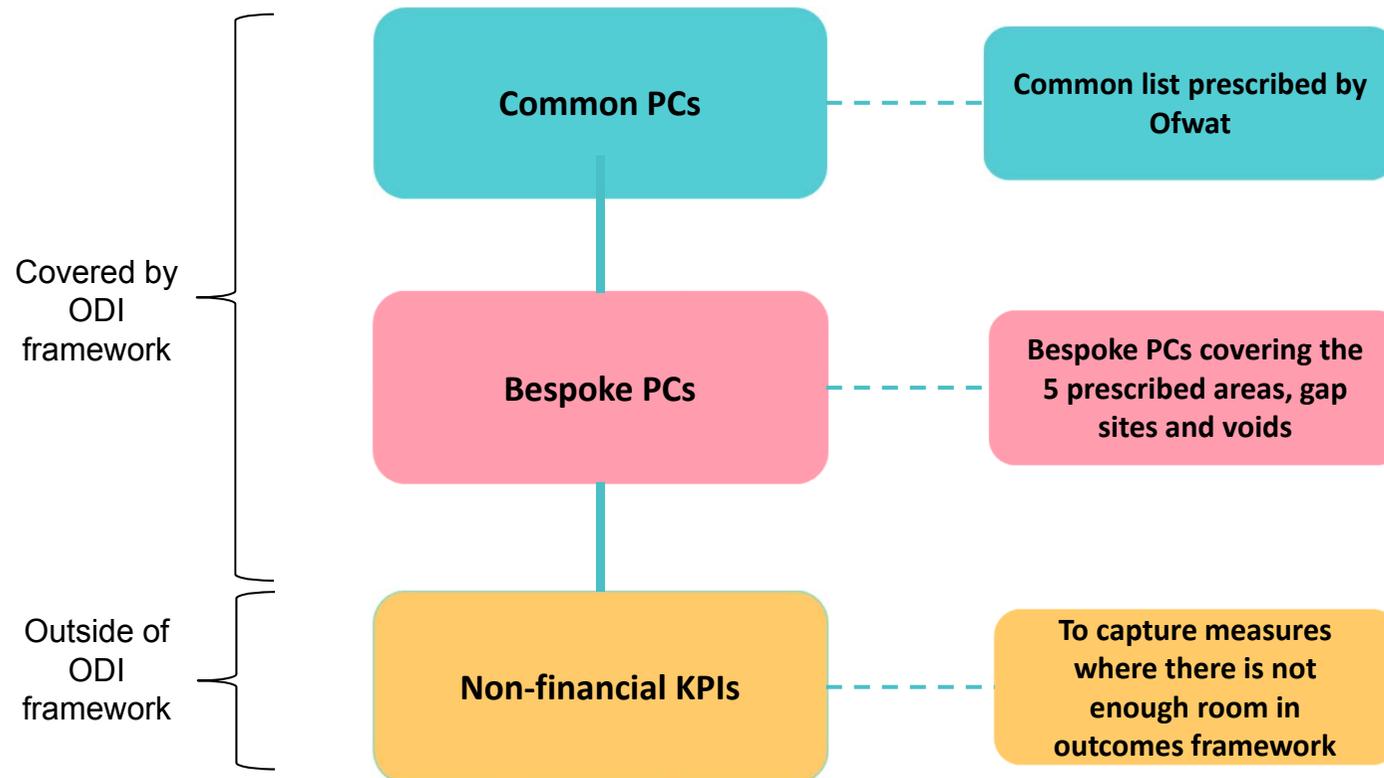
- New concept of enhanced outperformance and underperformance payments introduced for PR19 - only appropriate for the common performance commitments
- Enhanced outperformance payment rate will be accompanied by an enhanced underperformance rate
- A company should propose its threshold for the enhanced outperformance payments at the performance level of the current leading company, or preferably higher
- Companies proposing these payments should explain in their business plans how they will share the knowledge behind their success with companies across the sector by the end of the 2020-25 price review period or soon after. Receiving the enhanced outperformance payments will depend on whether the company has a credible plan for sharing its approach with the sector



SEW approach

SEW proposed approach - reminder

- We have been working with Frontier Economics to develop our approach to setting the Performance Commitments (ODIs) for PR19
- Each measure has been assigned into one of three types as shown below
- Our proposed performance commitments are outlined on the following slides



How we have developed our proposed measures

- Bringing together 3 important elements
 - Strategic intent of the Board – e.g. build on satisfaction measures
 - Reflect customer's priorities
 - Reflect Ofwat's guidance
- Developed through iteration and discussion
 - PR19 Board Committee and Executive Directors
 - Workshops with Senior Managers and area specialists (e.g. environment)
 - Review and critique from Frontier Economics
 - Discussion with Natural England and ODI document from Environment Agency
- Vulnerability measures to be further reviewed after co-creation workshops in March
- Environmental measures to be further reviewed after discussion at the Environmental Focus Group in March

Proposed performance commitments

Area	Measure	Description
Common measures	Customer experience (C-MeX)	Definition as prescribed by Ofwat
	Developer experience (D-MeX)	
	Water quality compliance (CRI)	
	Water supply interruptions	
	Leakage	
	Per capita consumption	
	Risk of severe restrictions in a drought	
	Mains bursts	
	Unplanned outage	
Different price controls	All measures will be % split across each of the 3 price controls as appropriate – water resources, network plus, retail	
Vulnerability	Financial vulnerability	Based on the number of customers who are in water poverty at the start of the period with a target to increase take up of social tariff/Watersure to reduce the number of customers in water poverty
	Non-financial vulnerability	Based on the number of customers who are registered on one of our support schemes at the start of the period with a target to increase take up by the end of the period
	Satisfaction	Satisfaction of customers on schemes for vulnerable customers

Proposed performance commitments

Area	Measure	Description
Environment	Greenhouse gas emissions	Operational greenhouse gas emissions (KgCO ₂ e) per megalitre of treated water
	Deliver the WINEP programme	% completion of WINEP programme
	Encouraging and working with landowners to improve the environment – <i>note: measure under review</i>	Proportion of land owners actively engaged
	Protecting wildlife and increasing biodiversity	Produce a net gain on biodiversity/wildlife from a combination of the land we own and the schemes we undertake Or: Number of hectares of land enhanced to increase biodiversity
Resilience	Single source of supply	% of customers on a single source of supply
	Company sites at risk of flooding	Number of sites
Asset health	Water appearance (white/air and discoloured)	Number of contacts per 10,000 people supplied
	Water taste and odour	Number of contacts per 10,000 people supplied
	Properties at risk of low pressure	Number of properties
	Event Risk Index	As per new DWI definition
AIM	Abstraction Incentive Mechanism	As per current definition
New	Gap sites	Measure to be confirmed Or: Demonstrate why this is not required for SEW (activity captured as part of CMP programme and proposed new process to capture new gap sites)
	Voids	% of void properties

Proposed non-financial KPIs

Area	Measure	Comments
Satisfaction by segment	Overall satisfaction - segment 1 Overall satisfaction - segment 2 Overall satisfaction - segment 3 Overall satisfaction - segment 4 Overall satisfaction - segment 5 Overall satisfaction - segment 6	New innovative measures introduced for PR19
Satisfaction by service attribute	Appearance of water Taste and odour of water Level of leakage Direct interaction experience Water supply is of sufficient pressure Frequency and duration of supply interruptions Frequency of water use restrictions	No longer included in Performance Commitments due to duplication with C-MeX

Attribute	Total	Segment					
		Mindful optimists	Global thinkers	Not on my radar	Me, myself & I	In the dark	Keeping it simple
Appearance of water	4.49	4.39	4.53	4.44	4.63	4.61	4.69
Taste and odour of water	4.3	4.03	4.3	4.28	4.56	4.41	4.54
Level of leakage	3.91	3.59	4.03	4.07	3.27	4	3.9
Customer satisfaction	4.39	4.3	4.48	4.27	3.88	4.51	4.18
Water supply is of sufficient pressure	4.33	4.2	4.39	4.19	4.63	4.33	4.39
Frequency and duration of supply interruptions	4.65	4.57	4.66	4.47	4.63	4.73	4.85
Frequency of water use restrictions	4.46	4.29	4.47	4.42	4.21	4.57	4.55
Overall satisfaction	4.44	4.33	4.5	4.37	4.38	4.56	4.15

Measures from PR14 that will not be included

Measure	Reason
Number of pollution incidents (category 1-2)	Removed, as compliance measure
Number of breaches of abstraction licences, discharge consents and environmental permits	
Number of breaches of H&S regulations	
Number of breaches of National Security obligations	
Number of compliance breaches with statutory obligations	
Service incentive mechanism	Replaced by C-MeX
Above ground asset performance assessment	Replaced by ne asset health measures
Mean zonal compliance	Replaced by CRI
Discolouration contacts	Replaced by appearance contacts
Meeting the water resource deficit	Replaced by resilience measures

Next steps

Next steps

March 2018

- Final comments from Customer Challenge Group on performance commitment definitions
- Finalise evidence base for setting ODIs (e.g. historical and comparative information) to inform how targets and ODIs will be set
- Triangulation of customer research to begin drafting cost-benefit analysis (CBA) for ODI design (willingness to pay, supercharge research, daily interactions)
- Review draft PCs to see if any need amending based on customer valuation results and CBA evidence

April 2018

- Drafting targets and ODIs using the customer valuation evidence and data on marginal costs
- Begin calculation of the overall scale of the draft ODIs (RoRE range)

May 2018

- Ofwat submission on PC definitions (3rd May)
- Draft targets and ODIs produced

Appendix 1

Customer research findings linked to performance commitments

How our proposed measures reflect customers' current priorities

Type of priority	Priorities identified in customer research	Comments
Hygiene factors	Tackling leakage	<ul style="list-style-type: none"> Covered by leakage measure
	Satisfying customers (effective service)	<ul style="list-style-type: none"> Covered within – C-Mex, D-Mex, segmented satisfaction
	Keeping bills affordable	<ul style="list-style-type: none"> Covered within C-Mex, vulnerability measures
	Security of supply - meeting increased demand	<ul style="list-style-type: none"> Covered by resilience measures
	Clean water/good taste	<ul style="list-style-type: none"> Covered by water quality compliance measure (CRI)
	Investing in network/treatment works	<ul style="list-style-type: none"> Covered within – supply interruptions, bursts, leakage, unplanned outage, resilience, asset health measures
Enhancing factors	Investing in new water sources	<ul style="list-style-type: none"> Covered within resilience measures
	Tackling implications of climate change	<ul style="list-style-type: none"> Covered within environmental measures
	Educating customers to reduce water usage	<ul style="list-style-type: none"> Part of consideration of societal impact Further discussion needed whether measure could be developed regarding wider societal impact
	Protecting the natural environment	<ul style="list-style-type: none"> Covered within environmental measures
	Water softening	<ul style="list-style-type: none"> Water quality aspects covered within CRI measure Potential to be included as additional service
	Water neutral schemes	<ul style="list-style-type: none"> Covered by per capita consumption
	Investing in new technology	<ul style="list-style-type: none"> Example of method of achieving performance commitments rather than standalone measure. Will be key part of 'innovation framework/toolbox' to be included in overall business plan.
	Smart meters	<ul style="list-style-type: none"> Example of method of achieving performance commitments rather than standalone measure. Will be key part of 'innovation framework/toolbox' to be included in overall business plan.

How will future priorities be covered?

Findings from future priorities research

In addition to everything we deliver today customers expect us to meet new emerging expectations such as:

- artificially-intelligent customer service
- water/waste recycling
- smarter pipework (self-fixing infrastructure, no leaks)
- water efficiency measures
- environmentally friendly/reducing carbon footprint/reduce wastage
- smart meters
- protection against terrorism
- modern, honest company image
- enough supply to meet demand (new water sources eg desalination vs. population demand)
- clean water/good taste
- using science to progress treatment/maintenance (eg desalination)
- solar powered purification
- community projects – conservation/recycling centres
- a pollutant free service – dedicated to the environment

The future-focussed research discussions also revealed the opportunity to delight customers even further by:

- offering a tailored product to their door e.g. softer, flavoured water, health benefits, two grades of water
- promoting (and installing) products for self-sufficient houses
- rewards and credits for efficient water usage
- diversify into other utilities to keep costs down

Future priorities mainly cover aspects that are about how services could be delivered rather than priorities that would be covered by performance commitments – for example artificial intelligent customer service would be a method to achieve increased satisfaction and lower cost to serve.

This insight shows potential new services that customers may be interested in

Appendix 2

Ofwat comments on bespoke performance commitments

Ofwat requirements – bespoke performance commitments

Areas	Rationale	Example metrics
The different price controls	Companies need to show what they will deliver for the revenue they receive from customers under each price control. This does not necessarily need to be a performance commitment specific to each control. It could be one that is split across price controls	<ul style="list-style-type: none"> ▪ Bioresources example: compliance with sludge disposal standard. ▪ Water resources examples: restrictions on use of water; resilience of impounding reservoirs; abstraction licence compliance.
Vulnerability	We want companies to provide sensitive, well-designed and flexible support and services for customers in circumstances that make them vulnerable. After engaging with their customers and local stakeholders, companies can propose bespoke performance commitments to address vulnerability issues	<ul style="list-style-type: none"> ▪ Appendix 1 of the methodology statement includes six common metrics for vulnerability, which we will collect through the business plan tables. <ol style="list-style-type: none"> 1. Percentage of customers aware of the non-financial vulnerability assistance measures offered. 2. Number of customers on special assistance register / priority service register (SAR/PSR). 3. Percentage of customers on SAR/PSR. 4. Number of customers receiving the following services through the SAR/PSR: <ol style="list-style-type: none"> a) Support with communication; b) Support with mobility and access restrictions; c) Support with supply interruption; d) Support with security; and e) Support with 'other needs'. 5. Percentage of customers satisfied that the services provided by their company are easy to access. 6. Percentage of customers on SAR/PSR contacted over the past two years to ensure they are still receiving the right support. ▪ However, we encourage companies to propose innovative, bespoke performance commitments on vulnerability.

Ofwat requirements – bespoke performance commitments

Areas	Rationale	Example metrics
Environment	<p>A company's actions can impact on the environment both positively, through good stewardship of the natural environment, and negatively, through impacts such as pollution incidents. Water companies' businesses are inextricably linked with the environment. Companies' customer research at PR14 showed that customers value the protection of the environment.</p>	<ul style="list-style-type: none"> ▪ Operational carbon emissions (ktCO₂e). Energy intensity for water produced / carbon emissions. ▪ Examples suggested by Natural Resources Wales: <ul style="list-style-type: none"> – Kilometres of river with water quality improved as a result of wastewater investment. – Volume or proportion of surface water diverted/removed from the public sewer system. – Number of permit breaches or CSO discharges in Shellfish and Bathing Water. ▪ Examples suggested by the Environment Agency: <ul style="list-style-type: none"> – Kilometres of river enhanced or protected through completion of measures agreed in the Water Industry National Environment Programme (WINEP). – Percentage of schemes incorporating sustainable urban drainage (SuDs). – Number of water bodies improved or protected by catchment management. ▪ Examples suggested by Natural England: <ul style="list-style-type: none"> – Number of Sites of Special Scientific Interest (SSSIs) or number of hectares of land designated as SSSI that changed from unfavourable to unfavourable recovering condition, or from unfavourable recovering condition to favourable condition, as a result of actions taken by the water company. – Specified increase in one of more of the following provided by catchment management delivery actions taken by the water company: the area of priority habitat and / or pollinator habitat; length of naturalised watercourse length or area of more naturally functioning water body / wetland (including for flood management); projections of quantity of stored carbon. (This could include delivery of one or more large-scale catchment projects that enable biodiversity enhancement and wider public benefits). – Specified increase in the total score of Defra's biodiversity offsetting metric, when it is applied to land managed and/or owned by the water company. ▪ Examples suggested by Blueprint for Water: <ul style="list-style-type: none"> – Water Framework Directive water body status improvement. – Proportion (%) of total investment delivered through third sector partnership projects or number of partnerships. – Natural capital account created and commitment to grow it through investment period

Ofwat requirements – bespoke performance commitments

Areas	Rationale	Example metrics
Resilience	<p>Resilience is one of the four themes of PR19. While we have a number of common performance commitments relating to resilience, we recognise that resilience has many facets. We expect companies to reflect the resilience issues that are most relevant to their region and customers, in their bespoke performance commitments.</p>	<ul style="list-style-type: none"> ▪ UKWIR published a report in July 2017 on resilience performance metrics. The metrics included: ▪ Expected average number of customers affected by large scale interruptions > 12 hours (number per year). ▪ Percentage of population supplied by single supply system >25,000. ▪ Unprotected works within flood risk zones (number or population served). ▪ Wastewater treatment works sites made resilient to future extreme rainfall events. ▪ Number of customers affected by loss of containment from the wastewater system (over a given time), possibly limited to events excluded due to extreme weather. ▪ Percentage of pipes under capacity for a 1-in-30 year or 1-in-50 year rainfall event.
Abstraction incentive mechanism (AIM)	<p>Reducing abstraction at environmentally-sensitive sites, at times of low flows, is important to protect the environment, especially given the challenges of climate change and population growth.</p>	<ul style="list-style-type: none"> ▪ We expect each company to suggest a bespoke performance commitment, in line with the AIM guidelines we published in February 2016 (updated for improvements to site identification as described below). There is more