



# The approach to outcomes at PR19

21 November 2016



The outcomes framework was introduced at the 2014 price review ("PR14") to encourage companies to build their long-term plans around what their customers want and need. It is essential that customers' and stakeholders' views continue to be front and centre in companies' plans, particularly in determining outcomes and associated performance commitments and incentives.

We consider the water industry can do more to broaden their engagement with customers and stakeholders. On this front, we were pleased to recently host an industry-wide customer engagement workshop on 10 November 2016. This workshop allowed companies, Customer Challenge Group representatives, customer engagement experts and regulators to explore how existing methods of customer engagement can be refined and improved, and what new and innovative methods are available to use.

We are undertaking a significant programme of customer engagement, to capture the views of customers and stakeholders from everyday interactions, as well as more targeted research on future planning options. We consider that this broader and deeper two-way engagement will have a number of benefits, including more robust customer valuations and measurement of priorities, a better understanding of the needs of our different types of customers, and greater trust and confidence in our plans by our customers and stakeholders.

Ofwat is currently considering the outcomes framework for the 2019 price review, ("PR19"). To support Ofwat, we commissioned Economic Insight (a specialist consultancy) to assess a number of issues relevant to the design of the outcomes framework at PR19. The Economic Insight report and summary presentation contain a number of useful insights.

We set out below some key points we have taken from Economic Insight's report and our own planning work.

**1. Performance commitments that are built up from customer research and set at PR19 should provide greater benefits for customers than comparative outcomes with changing targets.**

As far as possible, we consider that companies should determine performance commitments to be fixed over AMP7, so that they can reflect the preferences and valuations placed on those commitments by their customers and stakeholders. This approach also balances trade-offs between cost and performance to reflect genuine differences in companies' costs due to factors such as geography and historical investment, and genuine differences in how companies currently measure performance.

Companies would need to demonstrate that performance is sufficiently stretching. This could be achieved in various ways, including benchmarking against historical performance and relevant comparators, third party assurance of the planning process, and review by the Customer Challenge Group and other stakeholders.

**2. However, if Ofwat determines that all companies adopt particular performance commitments, these should be defined clearly and early in the PR19 process to facilitate efficient planning.**

We need clarity early in the PR19 process to ensure that companies can plan their customer engagement activity to take into account these performance commitments and avoid undertaking unnecessary activity.

To provide this early clarity, Ofwat could consider establishing a working group for outcomes, as this approach has proved useful for supporting Ofwat in developing other parts of the PR19 framework.



**3. Companies should be responsible for developing transparent measures to protect current and future customers from deterioration in asset health.**

The measurement of asset health is a key area for improvement across the industry. We are carrying out work to improve our approach to the measurement of asset health for PR19. For example, we are looking to pilot approaches to replace some of the lagging service measures with leading indicators.

We consider that the outcomes framework should encourage companies to continue to propose new and innovative ways to measure asset health, rather than adopting prescriptive, industry-wide approaches that might discourage this.

**4. Output measures will continue to be important for particular major or innovative programmes**

We agree with Ofwat that performance commitments should focus on the outcomes to customers, not how companies deliver these outcomes. However, output-based measures will continue to play an important role where they:

- protect customers from delayed, partial or non-delivery of major enhancement projects; and
- they encourage companies to propose new and innovative solutions in plans where the impacts of the programmes are uncertain (e.g. sustainable drainage).

**5. Companies' totex allowances should be consistent with their performance commitments to deliver the best result for customers.**

To incentivise the delivery of service improvements that customers are willing to pay for, the totex allowances for each company should reflect the efficient cost to deliver their committed performance targets. This requires an explicit link between cost and performance.

This link could be achieved by making adjustments to cost allowances for committed performance levels or by adjusting performance to reflect allowed costs. We would welcome clarity on Ofwat's preferred approach and expectations for companies' plans in this area.