

4.3 INTERNAL SEWER FLOODING PENALTY COLLAR

30 August 2019

DRAFT DETERMINATION - NORTHUMBRIAN WATER REPRESENTATION

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Ofwat challenge

Our App1 submission in April 2019 detailed both caps and collars to ODI payments related to internal flooding incidents. In our Draft Determination, Ofwat said:

'We consider that the performance commitment is not financially material and we do not consider caps and collars are appropriate, unless evidence of specific customer support is provided.'

'We are intervening to remove the collar'.

Company response

To align ourselves with other companies proposing standard only incentives we are submitting a new performance collar of 3.35 per 10,000 connections.

We also propose to revise our level of the performance cap to the industry average for those companies with standard incentive rates against this measure.

Note: Ofwat's action log does not indicate the cap should be removed but it is not present within the Draft Determinations tables.

Penalty Collar

We have reviewed all WASC's Draft Determinations and find that all companies proposing standard incentives have a set standard collar of 3.35 per 10,000 connections each year between 2020-21 to 2024-25.

In the 'Delivering outcomes for customers policy appendix' we note that as United Utilities did not opt in for the early certainty principle their collar will also move to 3.35. This would leave Northumbrian Water as the only company in the industry with a standard only incentive rate without a collar. It would unfairly expose us to significantly more penalty risk than others. This is shown in the table below.

	2020	2021	2022	2023	2024
Anglian Water	3.35	3.35	3.35	3.35	3.35
Hafren Dyfrdwy	3.35	3.35	3.35	3.35	3.35
Northumbrian Water	no collar	no collar	no collar	no collar	no collar
Severn Trent Water *^	1.89	1.89	1.89	1.89	1.89
Southern Water	3.35	3.35	3.35	3.35	3.35
South West Bournemouth*^	2.85	2.85	2.85	2.85	2.85
Thames Water	3.35	3.35	3.35	3.35	3.35
United Utilities*	3.35	3.35	3.35	3.35	3.35
Welsh Water	3.35	3.35	3.35	3.35	3.35
Wessex Water^	2.40	2.40	2.40	2.40	2.40
Yorkshire Water^	2.40	2.40	2.40	2.40	2.40
* Fast Track Companies					
^ Proposing enhanced incentives					

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The following table shows that those companies with enhanced performance incentives, have further collars on performance.

	2020	2021	2022	2023	2024
Severn Trent Water **^	2.35	2.35	2.35	2.35	2.35
South West Bournemouth**^	8.47	8.47	8.47	8.47	8.47
Wessex Water^	4.30	4.30	4.30	4.30	4.30
Yorkshire Water^	4.30	4.30	4.30	4.30	4.30
* Fast Track Companies					
^ Proposing enhanced incentives					

Both Severn Trent Water and South West Water opted in to the early certainty principle as part of their fast track status, therefore the collars from their Draft Determination remain the same.

The new Ofwat incentive rates alongside a penalty collar of 3.35 exposes us to a potential penalty of almost £30 million over the five years, as shown below.

	2020/21	2021/22	2022/23	2023/24	2024/25	Total
Internal Flooding	£5,422,490	£5,584,840	£5,747,190	£6,201,770	£6,526,470	£29,482,760

The value of potential penalty for poor performance against this measure is the third highest penalty associated with our package of Outcomes. Should our P10 performance scenario represent the 3.35 over the five years, then this would account for over 13% of our total P10 penalty scenario. This collar retains a penalty that is financially material.

Reward Cap

As we propose a penalty collar, fairness dictates that we also introduce a reward cap. Within our submission in April 2019 we submitted the following reward cap:

	2020	2021	2022	2023	2024
April Submission cap	1.30	1.25	1.20	1.17	1.15

We compare this to the reward caps proposed across the WASCs in the industry that only propose standard incentives against this measure.

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	2020	2021	2022	2023	2024
Anglian Water	1.58	1.44	1.31	1.17	1.04
Hafren	1.17	1.13	1.10	1.00	0.93
Southern Water	1.38	1.33	1.28	1.14	1.04
Thames Water	1.43	1.35	1.28	1.20	1.13
United Utilities*	no cap	no cap	no cap	no cap	no cap
Welsh water	1.40	1.36	1.30	1.24	1.20
NW April Submission	1.30	1.25	1.20	1.17	1.15
Average Cap	1.38	1.31	1.25	1.15	1.08
* Fast Track Companies					

From the ‘Delivering outcomes for customers policy appendix’ we note that as United Utilities did not opt in for the early certainty principle, their cap could be aligned with others across the industry. We have averaged the industry cap, including our April submission but not including United Utilities as no cap is shown in their Draft Determination.

We propose to review our cap to the industry average for those companies with standard incentives as shown in the table above. This would also become our new P90 performance position, reducing our potential P90 ODI from £4m to £3.8m. However we continue to re-iterate that this is an extremely challenging performance level to achieve.