IS THIS THE END OF ODIs AS WE KNOW THEM?

Implementing the Cunliffe review recommendations on the outcomes approach

September 2025

Background

One of Sir Jon Cunliffe's recommendations is to rationalise the overall number of outcomes performance commitments and to dampen the financial incentives on them. His reasoning is that there remains a case for specific economic incentives on some water sector outcomes, but that the current framework has become overcomplicated and the overall variability of returns needs to be reduced.

In contrast to some other recommendations, the Cunliffe review is quite specific in terms of what it would like to see in this area. The suggestions are that:[1]

- there is a simpler framework of fewer performance commitments with ten used as an illustrative example;
- performance commitments should be common across all companies;
- ensure minimal overlap between performance commitments and enforcement, on both environmental and water quality performance, and
- financial incentives are dampened and clearly linked to returns, individually and directly set as a fixed percentage of RoRE[2] (without the need for aggregating impacts).

In addition to this, there is a separate recommendation to ensure the customer service measure (currently named C-MeX) better reflects customer experience, and that the supervisory approach monitors companies against the customer-focused licence condition.

In this note, we have considered the rationale for keeping the current outcomes framework and provided our initial thoughts on how the approach could evolve to meet the Cunliffe recommendations. Our view is that these issues need to be debated further as changes to the incentive framework can have wide-ranging consequences, and we have posed some questions for the industry and policy makers to consider at the end.

1 See Independent Water Commission, Final Report, Recommendation 22, p.216

2 Return on Regulatory Equity

Should we keep the current outcomes framework?

Ofwat introduced an outcomes-focused approach at PR14 to:[3]

- focus companies more on what customers want;
- encourage companies to focus on longer term planning;
- allow companies greater freedom to innovate and find more sustainable solutions; and
- reduce the regulatory burden.

This thinking was aligned with the findings in the Gray review,[4] in which it was recommended that companies should be given more ownership over their business plans, and the flexibility to change them without detailed Ofwat monitoring. This was in response to findings that Ofwat "goes too far into the detail of company business plans" and that as a result companies are very "Ofwat-focussed and very cautious and conservative in their approach".[5] The Gray review also found that "we are sympathetic to the suggestion that the balance of risk and reward is tilted too far towards uncertain and potentially large penalties for failure, with relatively limited rewards for outperformance or innovation."[6]

Are the principles that underpinned the recommendations of the Gray review still valid? In principle, we do not disagree with the findings of the Gray review. In the first best world, companies would be given ownership and flexibility to find the most efficient solutions within the price control period to deliver the outcomes that customers and society care about most. In this world, there would be a clear logic for using outcomes metrics to measure company performance, and applying financial incentives to these metrics so companies are focused on outcomes delivery.

However, for a number of reasons, we have moved away from that world. The context around the water industry has clearly shifted in many ways. The enhancement programme has grown substantially from £9.8bn at PR19 to £43.6bn at PR24 (both in 2022/23 prices) and as a result delivery is a much higher priority. There is less trust between companies, society and regulators. As a result, the policy focus articulated in the Cunliffe review has shifted to one of turnaround and trust building. This is evidenced by Cunliffe's recommendations on the wider regulatory toolbox including a move away from the "totex" approach and the flexibility that provided, and shift toward an expansion of price control deliverables, which require companies to deliver specific pre-agreed inputs and outputs.

Within this changed world, how could the outcomes approach evolve to reflect the changing world we find ourselves in? A useful thought experiment is to consider what gaps would arise if we removed the outcomes framework altogether, and adopted other related

[3] Ofwat, Setting price controls for 2015-20 – framework and approach: A consultation

[4] Defra, Review of Ofwat and consumer representation in the water sector

[5] Defra, Review of Ofwat and consumer representation in the water sector, p. 6

[6] Defra, Review of Ofwat and consumer representation in the water sector, p. 30

recommendations in the Cunliffe review. Even without the outcomes framework there are a range of regulatory mechanisms holding companies to account, as summarised below.

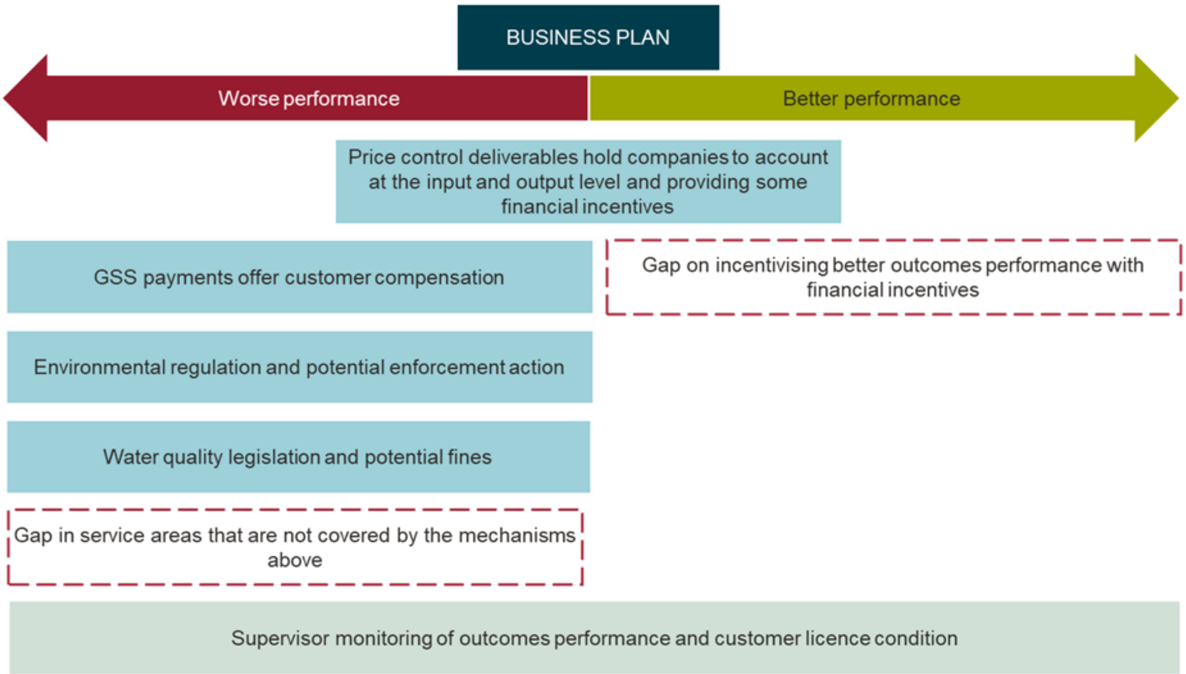
- Companies will be held to account to deliver the inputs and outputs in their business plans through the expanded price control deliverables.
- Customers will be compensated if they personally experience service disruptions through the guaranteed standards scheme (GSS) payments. GSS payments were increased up to tenfold in July 2025[7] so it’s difficult to argue that customers do not receive appropriate compensation for the service failures covered by the GSS payments.
- Environmental regulation is in place to monitor company performance and enforcement action can be used where this is not the case. Relatedly, the Cunliffe review recommends that the regulator should significantly reform the system of Operator Self-Monitoring, and develop and strengthen the approach to monitoring (recommendation 25). The Government has confirmed it will introduce this change. This means that companies should be held to account in this area, even without the outcomes framework.
- There is water quality legislation to hold companies to account in this area, even without the outcomes framework.
- The regulator and supervisors will monitor company performance against the customer service licence condition.
- The supervisory approach in general will mean that the regulator has a closer relationship with companies, and this offers an opportunity for the regulator to regularly monitor outcomes performance.

We illustrate this in the following diagram. The blue boxes illustrate mechanisms with a potential financial impact on companies. The grey box covering the supervisory approach would be reputational in impact.

---

[7] See press release here. For example, supply interruptions lasting 48 hours would lead to a GSS payment of £50 under previous rates, and £250 under the new rates. Households receiving consistent low water pressure will be eligible to receive up to £250, compared to the previous compensation rate of £25.

Figure 1 Gap in regulatory mechanisms without outcomes framework



Source: Frontier Economics

Companies will be held to account to deliver their business plans, at the input and output level, through the price control deliverables. The supervisory approach offers an opportunity for the regulator to monitor company performance at the outcomes level as well, but this would not need to have a financial implication for companies. The GSS payments will provide compensation on specific service issues, such as supply interruptions and internal/external sewer flooding. Companies will also face potential enforcement action and fines on water quality and environmental issues if performance deteriorates significantly.

Overall there are already a lot of mechanisms to hold companies to account. However, without the outcomes framework there would be a lack of incentives for: innovation or for strong performance; and for poor performance in service areas that are not covered by GSS payments, or potential enforcement fines. More generally, removing the outcomes framework that companies have had in place for three price controls would add uncertainty to the regulatory regime. We also know that company Boards have placed a lot of focus on (financial) ODIs, and removing the financial incentives would likely reduce this focus in future.

How should we implement the Cunliffe review recommendations?

We have considered how to implement the recommendations in the Cunliffe review on the outcomes framework, in a way which is consistent with the wider regulatory mechanisms and other recommendations in the review. Our initial thoughts are illustrated in the diagram below, with our proposed adaptations to the existing outcomes framework in purple.

Figure 2 Initial thoughts on how to implement the recommendations

Source: Frontier Economics

- We think that the supervisory team should monitor outcomes performance across a suite of service areas. This could be the rationalised list of performance commitments, or a similar list to PR24. In another paper we have explained how we think the supervisory approach could work overall. One option would be to apply no automatic financial penalties to these measures, but the supervisor could have sufficient powers and resources to investigate cases where performance deteriorates below targets. This should offer customer protection over and above the price control deliverables. For example, there could be instances where companies deliver the inputs/outputs that were agreed in the business planning process but the higher level customer focused outcomes are not achieved. This could be because of poor choices in exactly what the company delivers, inefficiency, weak links between price control deliverables and outcomes, or something else outside of the company's control such as the weather affecting their ability to deliver the outcomes. The supervisor could do deep dives into company performance when it dips below a certain level to understand what is causing the poor performance, and develop a mandatory turnaround plan with the company to ensure it improves in future. We think this would give the supervisors more responsibility than in the Cunliffe review recommendations, would provide companies with reputational incentives and also the risk of financial implications for significant poor performance. This kind of supervisory approach may negate the need for automatic underperformance payments through the outcomes framework.

- With the shift of focus to building trust and company turnaround, there is a risk that truly innovative performance is no longer sufficiently incentivised, and that strong performers feel less recognised. We think the industry should identify the service areas where companies should be incentivised to test and try out new solutions, such as how to reduce leakage further when all known activities have been done and mains replacement is the only remaining option. Rewards for this kind of behaviour could be designed as a unit incentive rate, but it may be challenging to decide ex-ante what would be considered sufficiently stretching performance to receive a reward. An alternative would be for the regulator / supervisor to carry out an ex-post review of performance to determine where performance has been sufficiently strong to receive a reward, which could be a lump sum award.

  We recognise that financial rewards may be challenging in the current political context, however this would not be an additional incentive but would be to replace the unit incentive rates that are currently included in the outcomes framework. The Cunliffe review in recommendation 22 recognises that companies should still receive financial rewards for outperformance.

- Another potential way to add some opportunity for financial rewards, is for the supervisor to offer relatively small rewards to companies that have performed comparatively strongly across the suite of outcomes metrics. The supervisor could potentially set the reward amounts in advance for the top 3-5 firms across the suite of measures, and then assign the rewards once the performance has been reviewed. There could be an element of judgement for the supervisor to decide which are the top performing firms, taking into account relative performance across the measures, or alternatively a composite measure could be developed to summarise overall performance.

- In this world, the list of performance commitments could be rationalised to a lesser extent. For example, there is probably still a case to remove the close overlap between outcomes performance measures and environmental regulation, and also water quality legislation.

The next step is debating these issues

The key next step for the industry is to develop an outcomes approach for the future which is consistent with the changes to the wider regulatory framework and reflects the current political context around the industry. We have provided our initial thoughts on how this could look. The next step is for the industry to debate these issues and agree collectively what is best for companies, customers, society more generally and the environment.

The issues that we think need to be debated are as follows.

- How would management teams and Boards react to measures that are no longer ODIs but part of supervisory monitoring? What impact would this have on decisions made by companies?

- Would customers receive sufficient protection from price control deliverables and GSS payments?
- How strong is the case for incentivising innovation and what can we learn on the impact of ODIs on innovation in the past?

AUTHORS

Annabelle Ong

Director

annabelle.ong@frontier-economcis.com

Anna Northall

Manager

anna.northall@frontier-economics.com