

Ofwat

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By email: PR24@ofwat.gov.uk

**Re Performance Commitments for future price reviews – discussion paper**

We would like to take the opportunity to submit some comments on the proposals set out in the discussion document ‘PR24 and beyond: Performance commitments for future price reviews’. We welcome the approach Ofwat is taking with the early publication of a series of discussion papers on various aspects of the PR24 methodology, of which this is one. It summarises proposals already discussed and largely agreed within the Outcomes Working Group. We would note that there are a number of important areas where work is ongoing, and it will be important to ensure companies have the opportunity to comment also on those areas in due course.

We support the overall approach to focus on the common performance commitments for PR24, and to reduce the number of bespoke performance commitments. We believe it is better for companies to focus on a manageable number of measures, with incentives where appropriate. This makes performance more transparent and incentives more effective. We agree with Ofwat’s assessment of the circumstances in which it may be appropriate to have bespoke PCs. It is also right to commit to continuing to use these core measures in future price reviews, as this supports long-term planning and ties in with the Long Term Delivery Strategies.

We support the option to include common performance commitments that are specific to companies in Wales. This possibility could be explored through the ‘collaborative process in Wales’, but they should be subject to the same criteria as bespoke PCs and included only if they genuinely add value. It may also be appropriate to adjust the definition of PCs that apply in England for application in Wales, to meet differences in legislation or policy, and similarly to consider whether different common PCLs should apply in Wales in some limited cases.

For the common performance commitments, we agree with the three categories of outcomes. As a point of principle, it is important to recognise that not all of the proposed ‘outcomes’ actually measure genuine outcomes for customers and the environment. We understand the reluctance to remove financial incentives from widely recognised measures such as leakage, but as an industry we should be seeking to measure what actually matters (in the sense of environmental impact and service to customers), such as water abstracted or energy used, and allow companies maximum flexibility to target those outcomes in the way that is most efficient in their particular context.

Of the three categories, by far the most important one is asset health and operational resilience. These two things are related but are different concepts, and should not be confused. Both are difficult to measure directly, and rely on proxies. A cautious and thoughtful approach is therefore required, recognising the particular challenges in this area. We look forward to engaging with Ofwat on this as proposals are developed.

With a focus on a limited number of common PCs, all of which will have financial incentives attached, there is potentially quite a big shift in the risk profile compared to PR19, with potentially more financial risk attached to individual measures.

As a final general point, we would note that there are some important long-term 'outcomes' that are difficult to capture within measurable performance commitments. These could include avoiding deterioration of raw water quality in catchments, developing workable nature-based solutions, harnessing innovation, and adapting to climate change (avoiding what would otherwise be an increase in risk of low-probability, high-impact events). These kinds of outcomes are likely to feature in our long-term vision, and in our review of Welsh Water 2050. We support the use of Price Control Deliverables to track outputs that contribute to these kinds of outcomes.

Below we provide more detailed comments on a subset of the measures, mostly those that are still in development.

### **River water quality, Bathing Water Quality and Combined Storm Overflows**

This is a particularly important and complex area, as the focus of considerable public and regulator interest currently. A working group is currently considering options for a measure that best captures companies' progress in reducing adverse impacts on water environments, potentially not just rivers but also surface, ground and coastal waters. We support the production of a measure that is implementable and understandable, while also focusing on the actual impact of companies' operations.

For bathing water quality, this has not been included as a common PC in the past, for good reasons, and our position is that it should not be a common PC at PR24. The number and type of bathing waters vary greatly between companies, and it is also very difficult to separate out and capture the impact of company operations on bathing water quality. We would support the inclusion of bathing water quality as part of a wider water quality measure (see above).

The use of Combined Storm Overflows is a related area, also being discussed by the water quality working group. We already have a measure which focuses on the delivery of a programme of improvements under the Storm Overflow Assessment Framework. We would also urge a note of caution that if a measure is proposed that works for the Environment Agency and companies in

England, this may not be the best solution for Wales, where the focus is on improvement to water quality rather than the number of discharges. It is vital to get this right to ensure that the incentives for companies are aligned with the desired environmental outcomes.

### **EPA star rating**

Our position is that including the EPA star rating as a common performance commitment would not add value beyond the existing pollution and other environmental measures. Pollution self-reporting is one element of the EPA star rating that is not currently covered in the common performance commitments, but this is not appropriate to have as a common measure as a significant proportion of it is outside company control, and it is difficult to compare across the industry. We would also add that the EPA is due to be revised for the 2026-30 period.

### **Sewer flooding**

We note the work of the Working Group on sewer flooding, that has proposed a measure that reflects some aspect of 'severity' and reflects repeat incidents. We welcome this proposal but note that it has not made a proposal concerning how the different categories of incident should be combined, whether weighted or otherwise, and what incentives would be appropriate. We would welcome further consultation with Ofwat on whatever is proposed in this regard.

### **Carbon emissions (operational and embedded)**

For operational emissions, the definition refers to the Carbon Accounting Workbook as the standard methodology. We would highlight that the Carbon Accounting Workbook is constantly being reviewed and updated, as our understanding of the impact of different gases, processes and energy sources used by the industry is continuing to evolve, and this will need to be taken into account. We would advocate the ability to "re-baseline" the PC by holding a fixed, audited, baseline data set that can be inputted into any updated methodology, to ensure that it aligns with current understanding and that the current year reported carbon footprint can be compared "like-for-like" throughout the AMP. To ensure alignment with the Science-Based target-setting that aligns with limiting global warming to less than 1.5 deg C, it would be appropriate to use a PC that tracks the relative reduction in "Net annual emissions - Overall total (market based)" over time, i.e. a percentage reduction target.

For embedded emissions, a much tighter definition and scope (similar to the Carbon Accounting Workbook for operational emissions) is needed.

An embedded emissions PC should be a fair and comparable metric, and should be normalised to better enable comparisons taking account of company size, location and makeup of the investment programme. It would also work best as an end of AMP target, rather than an annual reported measure. This will take into account the phasing of construction activities and allow for any new technologies to become embedded. We would also recommend that Ofwat adopts the terminology in the new UKWIR Whole Life Carbon project, including recognition of the subtle difference between Capital and Embedded carbon. This would help build a common understanding across the industry and the wider supply chain. We believe there is further work to do in this area.

## **Distribution input**

It has been suggested that distribution input could be used as an alternative to, or in addition to, measures that capture leakage and consumption. We would strongly support this, as it would be a move towards the genuine 'outcomes', and would allow some companies to focus on reducing leakage, where there is a sound economic case to do so, and others to focus more on reducing per capita consumption or business consumption. It would also avoid many of the reporting complexities and imperfections that are inevitable in estimating the split between consumption (much of which is unmeasured) and leakage (very little of which is directly measured).

## **Business customer water efficiency**

As flagged in the Outcomes Working Group, we will need to discuss what the appropriate approach is in Wales, given that only a few of the largest customers are eligible for the competitive retail market. We agree with those companies that have expressed concerns about the appropriateness of a business customer water efficiency measure. We would welcome engagement with Ofwat on this point.

## **B-Mex and R-Mex**

We note that consideration is required as to what is appropriate in Wales with regard to B-Mex and R-Mex. Our current B-Mex measure works well and we would propose to keep it, but this is different to the 'B-Mex' that is being proposed for England. We would also need to consider to whether the 'R-Mex' measure is appropriate in Wales, and if so, whether it would need to be adapted to account for the very small number of retailers that we work with.

## **Biodiversity**

We note that there is ongoing work in a separate working group looking at whether a consistent and meaningful measure can be developed to reflect company impacts on biodiversity. If the challenges can be overcome, then we would strongly support such a measure, based as far as possible on established methodologies.

## **Event Risk Index (ERI)**

We agree that ERI should be considered for inclusion in the suite of common measures. We understand the concerns expressed in the document around volatility and suggest that these could perhaps be overcome by the use of caps and collars, and this might be a candidate for a reputational measure.

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