PR24 Draft Methodology consultation response

Dwr Cymru Welsh Water

7 September 2022

Chapter	#	Question	Agree/N/A/ Disagree	Comment
2. Regulating through the price review	Q2.1	Do you agree with the challenges facing the sector and the ambitions for PR24 we have identified?	Agree	Yes, we agree with Ofwat's identification of the key challenges facing the sector. We take "combatting climate change" to mean both the water sector's role in climate change mitigation (by reducing greenhouse gas emissions), and adapting to the impacts of climate change. These are very different in nature but both important. We would suggest the sector faces an additional key challenge of ensuring asset health is being maintained so as to sustain service and affordability over the long-term. These challenges, including protecting and enhancing the environment, and meeting rising customer expectations will inevitably put upward pressure on customer bills, notwithstanding the opportunities for efficiency improvements. Balancing addressing these challenges with delivering affordable bills is the crucial question at the heart of PR24.
2. Regulating through the price review	Q2.2	Do you agree that continuing to use our three building blocks helps push companies to meet our ambitions for PR24? (Please provide detailed comments on specific building blocks to the relevant chapters.)	Agree	Yes, the building blocks of outcomes, costs, and risk & return provide a good approach to meeting the challenges of PR24. The application of the methodology in each of these areas, and the interactions between them, need to be carefully considered to ensure an outcome which is balanced fairly between companies, customers and investors.

2. Regulating through the price review	Q2.3	Do you agree that we have struck the right balance between what's in and what's outside of the price control?	Agree	Yes, we welcome the proposals to focus and simplify the price review in a number of areas, and deal with a number of issues outside the price review, including non-core performance and delivery areas, debt management, and companies' approaches to supporting vulnerable customers. In addition, we welcome the recognition that a wider range of regulatory tools, including markets, licensing, monitoring and enforcement all play an important part in regulation alongside the price review methodology.
2. Regulating through the price review	Q2.4	Do you have any comments on our approach to evaluating progress? What specific evaluation questions (based within the four key ambitions) do you think an evaluation should look to answer?		We agree it is important to have a structured and robust approach to evaluating the extent to which a price review is successful in driving forward Ofwat's and the sector's objectives. We would support the idea that any such evaluation should be carried out by an independent third party. The four ambitions set out in the consultation should be part of that review, but they probably do not form the optimal framework around which to structure the review itself. In our view it might be better to structure the review around the fulfilment of Ofwat's duties and other considerations such as legitimacy. Much depends on when the review takes place – i.e. how long after PR24 to wait to see what the impact has been. Sometimes in the past reviews have taken place before the next price review, with conclusions hastily drawn in time to be applied there. We would argue that 2027 (say) would be too early to be able to assess the impact of PR24 on the four themes. A review during the course of AMP8 could focus on the process for PR24, but in terms of the impact of the review, it could do well to look back over PR19 and PR14 as well to see how the regulatory framework has changed, how companies responded to that change, and what the impact has been – to the extent that outcomes can be attributed to different features of the price review.

3. Design and implementation of price controls	Q3.1	Do you agree that in our final methodology we should commit to introducing either an adapted water trading incentive or a new water trading incentive at PR29? If you have a preferred approach, please provide reasons, including any thoughts on how the options we set out in Appendix 2 could be improved.		We agree that the final methodology should set out what incentive mechanism should be adopted. Our preference is for option 1 – adapting the current incentive – along the lines set out in Appendix 2.
3. Design and implementation of price controls	Q3.2	Do you agree with our proposals to: a) Continue to include network reinforcement in the network plus price controls? b) Remove wastewater site-specific developer services from the wholesale wastewater network plus price control?	Agree	a) Yes, we agree this proposal is appropriate given the limitations on competitive activity in this area. b) Yes

3. Design and implementation of price controls	Q3.3	Do you agree that the inclusion of network reinforcement in cost sharing would be enough to manage uncertainty around the volume and mix of network reinforcement work to be delivered?	Agree	Yes, we would not expect differences between allowances and outturn expenditure to be material, and so agree that the general cost sharing arrangements provide sufficient mitigation.
3. Design and implementation of price controls	Q3.4	For water site-specific developer services: a) Do you agree with our proposal to exclude new developments of more than 25 properties from the wholesale water network plus price control at PR24, but with transitional arrangements for companies with low levels of competition? b) Do you think that new developments of 25 properties and fewer should remain in the wholesale water network plus control or be removed? If they were	a) Agree b) Disagree	Yes We feel that in practice, the threshold of 25 properties would not be possible to apply. For example, where developments are completed and charged in stages these may be less than 25 properties, but cumulatively more. This proposal will add complexity for all parties which may not be justified. The use of properties rather than connections for the threshold could also create unintended effects, as for example an apartment block with one connection and 26 flats could be outside of price controls, whilst an estate of 24 large houses could be within price controls. Significant costs would be required to develop and manage separate systems for two different groups of properties, both for appointees and for developers, which would be disproportionate to the income received in this area. We therefore suggest that it would be more straightforward to remove the threshold, and if water new connections are to be outside of price controls then this should apply to all developments. We agree that indexation of the charges set for 24/25 in the period 2025-30 would provide protection to developers. However, in the event that there is a material movement in costs in this period, for example through new external contracts, we suggest that a mechanism is in place to allow for these changes to be implemented with appropriate regulatory oversight, particularly where they are to an extent outside of companies' control. The protections offered by the charging rules should provide

		removed from the price control, what alternative protections could we introduce to protect new connection customers from monopoly power?		this, and allow for movements in costs to be recognised in charges. If charge increases are capped to CPIH, the direct link to costs would be broken, which creates risk that companies are forced to charge below the level of actual costs, which could give rise to Competition Act concerns.
3. Design and implementation of price controls	Q3.5	Do you agree with our proposals: a) To raise the size threshold above which companies should deliver schemes through DPC to around £200m lifetime totex? b) For companies to deliver schemes through DPC by default above this threshold?	Agree Neither agree or disagree	a) We agree that the threshold should be raised. Our experience as a pathfinder project has highlighted the significant level of cost and activity required for the DPC process compared to standard capital delivery projects, and as such we agree that it is most likely to be beneficial for larger projects. Particularly given the impact of inflation it may be appropriate to increase this threshold further to £500m, and it would be beneficial to be clear on the price base to which it applies. b) Water industry projects of large scale are likely to have significant interfaces with existing assets. This creates issues with the intended discrete nature of DPC projects, as they are not always clearly separable from activities which should remain with the appointee – it may not always be possible to separate an element of operations for management by a CAP. The model lends itself best to clearly standalone assets rather than those intertwined with the rest of the network. Much debate has been made around how interfaces are managed and risks carried by the Appointee. There is a trade off between the level of prescription that appointees can provide for the required solution, in order to minimise risk, against the greater opportunities for innovation that can be offered through allowing the CAP a greater role in the initial design, planning and surveys. As such, we would caution that the opportunities for benefits from DPC may vary according to the type of project to be delivered, and so it may not always be appropriate for DPC to be the default option.

3. Design and implementation of price controls	Q3.6	Do you have any views on any other aspect of our proposals in relation to: a) The design of price controls; b) Water resources; c) Developer services; d) Retail activities; e) Bioresources; f) Other controls; g) The revenue forecasting incentive mechanism; or h) Direct procurement for customers?	**a) Design of Price Controls** We broadly agree with the design of the price controls however we disagree with the proposal for the indexation of costs in retail which is outlined in section d and we have concerns with regards to the proposed changes to the bioresources price control (section e). **b) Water Resources** We welcome the proposal to retain the current boundary. **c) Developer Services** The proposals in this chapter are based on the assumption that the new connection charges rules that apply in England are implemented by Welsh Government from 2025. In the event that the Welsh government chooses not to implement the new charging rules, it is not currently clear whether the proposals set out in the methodology would apply in Wales. These changes are largely to reflect the potential impact of competitive activity on developer charges, without implementation of the new charging rules then this may not occur in Wales. As such, we request clarification from Ofwat of what, if any, alternative arrangements may be implemented in Wales, and what the timescale for such a decision would be. **d) Retail activities** The draft methodology proposes no automatic indexation of allowed revenue for the retail price control. We disagree with this proposal and have provided further information in question 6.1. *Non-HH Retail not eligible for competition*- We welcome the proposals for the simplification of the business retail control, provided the application of the new approach produces allowed revenues that are adequate to cover the efficient costs of serving all non-household customers. We disagree with the proposal of no automatic indexation of allowed revenues. We note that the consultation for the review of the business retail exit code in England proposes to index revenues by CPIH, it is unclear why the proposals differ.

			Large Non-HH Retail – we note the proposed change in approach for large business customers in Wales to no longer set price caps including an allowed gross margin. We agree that it is appropriate to align the approach for customers in the competitive market to that used in England. **e) Bioresources** The draft methodology proposes substantial changes for the bioresources price control. The consultation outlines that a supplementary document for bioresources will be published by 2 September 2022. We welcome the publication of additional detail in the publication given the complex nature of the changes and will provide a detailed response in due course. We raise two points for consideration within this response in question 6.1. **f) Other controls** No comments. **g) Revenue forecasting incentive Mechanism** We agree with exclusion of Developer Services revenue from this mechanism. In-period ODIs can result in bill volatility for customers, so to mitigate this a company may choose to temporarily abate revenue to smooth bill volatility between years. However, a consequence of this is to increase the risk that a RFI penalty will be triggered. We believe that the request for interventions should also be extended to where revenue deviations are as a result of managing bill volatility from in-period ODIs in customers' interests. **h) Direct procurement for customers –** covered in response 3.5 above

4. Reflecting an understanding of customers and communities	Q4.1	Do you agree with our approach to making sure that companies' price review submissions and our determinations reflect an understanding of customers', communities' and environmental concerns?	Agree	Broadly yes. We have welcomed recognition of the importance of proportionate and meaningful customer research, as well as the importance of high quality research. While we support the aims of the collaborative research, we do have concerns about the methodologies that have been or will be adopted for some of the research. On the ODIs research we have provided feedback on the research methodology via the relevant Working Group. As an overall point, the methodology makes a number of conceptual 'leaps of faith' in getting from customers actual feelings about service issues, to a robust valuation that is appropriate to apply in the ODI framework. These include pivoting off just two anchor valuations to generate values for a wide range of differing service issues, based on customer responses to the choices presented. Concerning the open challenge sessions, we welcome meaningful and constructive challenge, and see the open challenge sessions as a further opportunity to gain feedback and challenge. The sessions will need to be carefully managed and prepared in order to ensure that they are productive and give time for companies to hear a range of views and viewpoints. In view of the above, we think it is important to ensure that the results of the research and the open challenge sessions are interpreted with care, applied proportionately, and cross-checked against other sources of information.
4. Reflecting an understanding of customers and communities	Q4.2	Do you agree with our proposal to conduct open challenge sessions?	Neither agree nor disagree	This all depends on how the sessions will be prepared and managed, and what will be done with the results. We welcome challenge from customers and stakeholders on our plan. Many of the issues are complex, however, and the judgements to be made involve difficult trade-offs. The sessions will need careful management and preparation to ensure they are meaningful and informative. We look forward to further engagement with Ofwat on the detail.

4. Reflecting an understanding of customers and communities	Q4.3	Do you have views on open challenge sessions can align with the collaborative approach in Wales?	N/A	We would suggest that the open challenge sessions are based on a version of the draft Business Plan that has been discussed with the PR24 Forum and approved for consultation by our Board. We would propose to use the same version of the plan for affordability and acceptability testing. Ofwat, CCWater and the company would then bring a report on the Open Challenge session and (if timelines allow) the affordability and acceptability testing, to the PR24 Forum for discussion. One possible response could be that the PR24 Forum decides to revise its view of the pace of delivery of outcomes, with a consequent impact on long-term bill profiles.
4. Reflecting an understanding of customers and communities	Q4.4	Do you have views on how the outcome of collaborative customer research can contribute in the context of the collaborative approach in Wales?		As noted above, if the timelines allow, the PR24 Forum should be given the opportunity to review the results of the affordability and acceptability research to consider if that influences its views on the right balance between outcome delivery and expenditure and bill levels in the next AMP and beyond. ODI rates are not mentioned in the PR24 Forum's Terms of Reference. However, if the valuations generated by the collaborative research on customer valuations generates ODI rates which appear to be inconsistent with the Forum's view of priorities, or would generate perverse incentives, the PR24 Forum could provide a useful forum for a discussion on best way forward. We would also note that the PR24 Forum may recommend amendments to the common PCs, or bespoke PCs for companies in Wales. Any such variations will naturally need to be reflected in the applicable ODI rates.
5. Delivering outcomes for customers	Q5.1	Do you agree with our proposed package of common performance commitments? Is water demand best incentivised through separate performance commitments on household and domestic	Neither agree nor disagree	Broadly we agree with the proposed Common PCs, and welcome the simplification in the PC framework with the reduction in the number of PCs overall, but have comments on some of the specifics: **CSO spills**: As discussed at the PR24 Forum, and as noted by Ofwat in the consultation documents, this measure is not appropriate in Wales, where the focus of the Better River Quality Taskforce is on reducing the overall harm from spills, rather than reducing the absolute number. This means that companies should target investment on assets that are causing most harm, rather simply targeting those that spill most frequently. Efforts are also directed at all the causes of poor river water quality, not just storm overflows. We are already working with Ofwat, NRW and other stakeholders

		consumption and leakage or through a performance commitment measuring total demand?	to propose an alternative measure that appropriately incentivises progress in line with the approach being followed. **River water quality**: This measure is appropriate to the policy context in England, where the UK government has consulted on a statutory target for water companies to reduce phosphorous loadings. Ofwat acknowledges in Appendix 6 that the policy context is different in Wales, and is right that the Welsh Government also wants to see improvements in river water quality. However we believe this is best achieved by looking at a wider range of elements that contribute to river water quality and the impacts on the environment, rather than focusing solely on phosphorous removal. We have a current (PR19) measure on 'kilometres of river improved' which monitors the implementation of measures set out in the NEP and WINEP to make contributions within company control to improvements in river health and aesthetics. We propose this as a as suitable alternative common measure for 'Welsh' companies. We would welcome a discussion on this at the PR24 Forum. Should the option of a P reduction measure be favoured instead, notwithstanding the above, it should reflect the company's "Fair Share" level of removal of P achieved from all interventions, based on the modelling of SAC rivers in Wales, and in line with the proposed policy for the Habitats Review of Permits that NRW plans to carry out in the coming months. Our understanding is that NRW are not minded to follow the EA's "non Uniform" revised policy in which water companies would have to remove 80% of P discharges compared to a 2020 baseline. Our proposal would provide a target for load removed expressed against the element of environmental need DCWW is expected to deliver, under a 'Wales collaborative approach', and would be in line with our legal obligations. It would also allow us to pursue partnership approaches to establish the most beneficial approaches to reducing nutrients. **Bathing water quality**: We have excellent bathing water quality at around 80% of designated bathing waters. It would be very expensive for us to invest in our assets to make further improvements, and this is not likely to represent good value. Where further

			improvements are required, these will be covered by the NEP. We are accountable for the benefits delivered by historic investment through compliance with the related permits. We are not convinced therefore that a measure to incentivise improvements in bathing water quality is necessary. That said, should Ofwat in any case with to implement this measure, we set out our views on the different options for a measure under QA6.8 below. **External sewer flooding:** we are content with having a common measure here, but do not agree that all companies should be expected to achieve the same performance commitment level from base expenditure, for the following reason. There are no exclusions proposed in the measure for severe weather; severe weather has a very significant impact on external sewer flooding, and; severe weather occurs to a varying degree across companies. While this is also true for internal sewer flooding, the impact of internal sewer flooding is more serious for customers, and therefore there are cost beneficial investments that companies can and have made to mitigate the impact of hydraulic overload on internal sewer flooding. For external sewer flooding the impact is a great deal lower (in many cases customers are not directly affected at all), and the cost-benefit of investment that would be needed to reduce incidents further is negative. Companies have not therefore made the historic investments that would be have been needed to address the impacts of severe weather and achieve the same level of performance. There should be company specific targets for this measure which consider differences in company specific circumstances including rainfall. **Operational GHG emissions**: We support the measure, and the choice of operational emissions only given that at this stage there is no suitable and reliable measure of embedded emissions available. The definition includes Scope 1 and Scope 2 emissions, and selected Scope 3 emissions, but the Scope 3 categories to be included need to be specified, with reference to the GHG sub-categories in the Carbon Accounting Workbook, or the ISO standard categories. We also argue for the measure to take the form of a % reduction in total emissions against a suitable baseline year, rather than normalising the measure using water volumes. This appears to be consistent with the intention Ofwat expressed in its recent publication “Ofwat's

			regulatory framework and net zero" (see page 8 – "*At PR24 we propose to set a common reduction level for operational emissions…..*"). We make more detailed comments in Appendix A on these points, and on market-based reporting. **Biodiversity**: We are in favour of having a measure on biodiversity. The details of the definition are yet to be finalised, but we note that the measurement tool, the Biodiversity 3.1 tool, is not likely to be applicable in Wales. We therefore may need a separately defined measure for Wales, using the appropriate assessment tool, which we understand is under consideration by NRW. The target, too, will need to take into account differences in legislation and policy approaches in Wales. **D-Mex:** At PR19 we made representations to Ofwat that while we welcomed the introduction of the D-Mex measure, companies in Wales are disadvantaged compared to England owing to the different legislative and regulatory framework in Wales, which negatively biases customer responses to questionnaires on the service provided by water companies in Wales. Issues such as compulsory fire sprinklers, sewer adoption standards and sustainable drainage, mean that developers in Wales face higher costs and more burdensome processes compared to England. We have evidence that these difficulties wrongly but inevitably 'contaminate' their views of the water company and the service that the company is providing to developers. We provide this evidence as Appendix B. This means that we are not on a level playing field when it comes to D-Mex with companies in England. This is a problem, as it is a comparative measure, with significant penalties for those who score in the lower half of companies across England and Wales. It also means that the rewards for us are effectively out of reach, despite providing what we believe are objectively very high service standards to customers. We would welcome the opportunity for dialogue with Ofwat on options to address this point. These could include taking companies based in Wales out of the D-Mex measure, or making changes to the scoring system to address responses that are biased by the circumstances in Wales. **Water demand**: We believe that water demand is best incentivised through a performance commitment measuring 'total demand' (which appears to be the same as Distribution Input from a water balance point of view). This allows companies the flexibility to undertake the best value interventions that deliver the biggest reduction

				in demand, whether they be leakage, NHH demand or HH demand. It also better aligns the incentive with the outcomes that we are seeking to achieve, which is to reduce the impact of abstraction on the environment, and the use of energy and chemicals in water production. We recognise that leakage remains important to stakeholders, so companies would still need to report leakage and companies could be expected at a minimum not to allow leakage to rise.
5. Delivering outcomes for customers	Q5.2	Do you agree with our proposed guidance for bespoke performance commitments?	Agree	No comment.
5. Delivering outcomes for customers	Q5.3	Do you agree with our proposed approach to setting standard rates?	Neither Agree nor Disagree	We broadly agree with the proposal to set ODI rate using the bottom-up approach, however we note that marginal benefits are difficult to calculate and therefore cross checks should be undertaken. These cross checks should ensure that the ODI rates between performance commitments reflect key priorities. Cross checks should also be undertaken to ensure that the overall ODI package is balanced. We disagree with the proposal to set the benefit sharing rate in the calculation of the ODI rates at a level greater than the overall cost sharing rate. Deviating from the cost sharing rate distorts incentives within the framework. The proposal will increase the ODI rate for both underperformance and outperformance. This proposal alongside the proposal of increasingly stretching performance commitment levels from base expenditure (with a frontier shift applied), removal of caps, collars and deadbands and exclusions increases the level of asymmetric risk. We propose that the ODI rates should be set using the actual cost sharing rate to align the incentives within the framework.

5. Delivering outcomes for customers	Q5.4	Do you agree with our proposed approach to the measures of experience performance commitments, including to increase the size of C-MeX?	Disagree	We believe that the current level of incentives for C-MeX of up to +/-12% of retail residential revenue is appropriate. The current methodology for C-MeX enables companies to earn up to 6% of retail revenue for outperformance. There is an opportunity to earn up to 12% of retail revenue by meeting three additional criteria. One criterion is that companies' must be above the upper quartile for the UKCSI score. The additional criterion for meeting the UKCSI upper quartile is very difficult to achieve for utility companies due to the nature of our services and interactions with customers (and therefore introduces further asymmetry into the ODI framework). The CSI methodology consistently results in much better scores for sectors with positive, discretionary interactions with customers in person (such as retail, tourism and leisure) than for universal service sectors with often more remote contact channels (such as utilities, transport and public services). We believe that no water company has ever achieved upper quartile result on the UKCSI. This additional requirement therefore weakens the intended incentive effect of the enhanced rewards on offer for C-Mex, and should in our view be amended or removed.
5. Delivering outcomes for customers	Q5.5	Do you agree with our proposed approach to estimating marginal benefits for common and bespoke performance commitments?	Neither	Ofwat proposes to use the collaborative research as the basis for marginal benefit estimates for almost all common PCs. In the steering group, companies have expressed significant concerns with the methodology being used, many of which we agree with. The methodology makes a number of conceptual leaps in getting from customers actual feelings about service issues, to a robust valuation that is appropriate to apply in the ODI framework. These include pivoting off just two anchor valuations to generate values for a wide range of differing service issues, based on customer responses to the choices presented. 'Mapping' the service failures used in the research to the common PCs presents an additional challenge. Given these concerns, we believe that Ofwat should consider the results carefully, and cross check against other sources of information before committing to use the resulting valuations directly for ODI rates. Ofwat notes that the rates can be varied effectively by the sharing factor. "If there are significant concerns with the overall size of the valuations, we can vary the benefit

				sharing factor". This is true but would apply a standard adjustment across all ODIs, whereas there may be a small number of ODI valuations that are disproportionate to the others, and may need adjustment. Ofwat proposes to consider varying ODI rates across companies where they are statistically different and where they do not introduce disproportionate complexity or create perverse incentives. This seems reasonable. Ofwat proposes to use external valuations for biodiversity and greenhouse gas emissions. For biodiversity net gain, the valuations used will need to be aligned with whatever biodiversity frameworks are adopted in Wales.
5. Delivering outcomes for customers	Q5.6	Do you agree with our proposed approach to incentivising asset health performance?		The calculation of ODI rates for asset health performance is challenging. We note that Ofwat is working in developing a wider range of measures for PR29. In the meantime the proposed approach appears reasonable. A wide range of evidence should be used to determine the rates. We welcome the proposal to use additional information including the top-down RoRE impacts as a cross check to the calculation and think that this should be strengthened so that all the information can be triangulated to calculate the ODI rate.
5. Delivering outcomes for customers	Q5.7	Do you agree with our proposal to retain, expand and streamline enhanced incentives?	Disagree	Our customers are sceptical of ODIs in general (as evidenced at PR19), so we would not support the use of enhanced ODIs. We would welcome the simplification of the price review framework wherever it is straightforward to do so and this is one such opportunity. We would be in favour of dropping enhanced incentives at PR24.

5. Delivering outcomes for customers	Q5.8	Do you agree with our proposed approach to selecting performance commitments for enhanced incentives?	Neither agree nor disagree	No comment.
5. Delivering outcomes for customers	Q5.9	Do you agree with our proposed approach to setting enhanced thresholds, rates and caps?	Neither agree nor disagree	No comment.
5. Delivering outcomes for customers	Q5.10	Do you agree with our proposed approach to knowledge sharing?	Agree	We welcome knowledge sharing for enhanced performance.

5. Delivering outcomes for customers	Q5.11	Do you agree with our proposal to set caps and collars on a targeted basis, and apply a two-sided aggregate sharing mechanism to all companies?	Disagree	We disagree with the proposals that caps and collars are only applied on a targeted basis for those measures that are new and less established. Caps and collars provide protection for companies and customers for financial risk. A number of the proposed performance commitments can have a high level of volatility based on factors beyond management control, for example supply interruptions as experienced from the Beast from the East and sewer flooding resulting from extreme weather events. A number of measures have natural outperformance caps and therefore the absence of underperformance collars creates asymmetry within the framework. For example, supply interruptions has a target of 5 minutes for 2024-25. This measure therefore has a natural maximum outperformance payment limit of 5 minutes below the target, however it has a significant large potential for underperformance payments. We propose that caps and collars are introduced for supply interruptions, internal sewer flooding and external sewer flooding as these can be significantly impacted by weather and factors beyond management control. **Aggregate Sharing Mechanism** We welcome the proposals for an aggregate sharing mechanism. The proposal is that companies can earn or incur up to +3% or -3% RoRE without any sharing of payments, this rate is in line with the rate at PR19. However, chapter 7 raises the possibility of a reduction in the notional level of gearing which would substantially increase notional regulatory equity. A commensurate reduction in the RoRE threshold would be necessary to ensure that the value at risk remains at the intended level. In addition, the framework proposes to remove caps and collars for a number of measures which are influenced by weather and other factors beyond management control. To reflect this change in the potential level of risk faced by companies, we propose that the level of the standard threshold should be reduced from +/-3% to +/-2% of RORE, and the higher threshold is reduced from +/-5% to +/-4%. This reduction would need to be applied before considering any further reductions needed to reflect the reduction in gearing (see above).

5. Delivering outcomes for customers	Q5.12	Do you agree with our proposal to not set deadbands on any performance commitment?	Strongly disagree	We disagree with the proposal to remove deadbands for the statutory compliance performance commitments. The target of full compliance is appropriate for the measures but the removal of the deadband does not reflect the measure's methodology and operational issues. CRI measures water quality at both our assets and customer properties. Performance at customers' taps can be due to customers' internal plumbing, which companies have little control over (e.g. taste and odour, bacterial, nickel and lead failures). We believe that it is inappropriate for companies to incur penalties for factors beyond their control. The consultation notes that nearly half the companies' performance in 2020-21 was within the deadband. This is not an argument for eliminating the deadband. We would note that the measure is volatile – nearly 50% of those companies that were within the deadband in 2020-21 exceeded the deadband in 2021-22. We do not believe it to be the case that if there are deadbands, incentives are weakened. When operational decisions are being made that could affect CRI performance, the individuals involved are unlikely to be aware as to whether the forecast performance for the year is 'within deadband', or if they were aware, whether this would have any impact on the decision-making. In any case, at a basic reputational level companies are incentivised to avoid penalties, especially for measures such as drinking water quality. In the absence of a deadband, for a measure such as CRI, that incentive is taken away straight away as companies are rarely likely to achieve zero, and when they do there is a strong element of chance involved. The DWI's view on this issue should be carefully considered by Ofwat. Regarding discharge compliance, the issue is not so much that some of the factors affecting performance are absolutely out of company control, but that the incentive framework is one-sided, and companies again are highly unlikely to ever get to 100%. A deadband set at an achievable level will provide a stronger incentive to improve performance and avoid penalties.

				The reputational consequences for the industry should also be considered within the proposals. Companies still have large incentives to achieve full compliance, which include reputational incentives and financial penalties from the DWI, EA and NRW.
5. Delivering outcomes for customers	Q5.13	Do you agree with our proposed approach to estimating ODI risk?	Agree	We agree with the proposal of taking a lighter touch and more consistent approach to estimating ODI risk across the industry and therefore welcome option 1. However, the level of ODI risk is a key component of companies' business plan submission and financeability assessment. Therefore, transparency of the methodology and assumptions to be applied is required. Companies will have their own view of ODI risk and companies may want to challenge the assumptions applied at the draft determination.
5. Delivering outcomes for customers	Q5.14	Are there instances where providing greater clarity over our intended approach to incentive rates in PR29 would clearly be in the interests of customers? Please explain why and provide supporting evidence.	Disagree	We would not be in favour of this. We do not believe it would be in the interests of customers to limit Ofwat's room for manoeuvre on ODIs at PR29 at this stage.

5. Delivering outcomes for customers	Q5.15	Do you have any comments on our proposed approach to implementing and streamlining payments at PR24?	The application of in-period ODIs enables financial incentives to be passed onto customers earlier, however it does have an impact on bill volatility for both outperformance and underperformance payments. The application of an underperformance payment in one year will have a corresponding bill rise following the removal of the penalty. We welcome the proposal to allow companies to request to defer the impact of in-period ODI payments between years to help manage affordability issues and cashflows. We propose that the threshold is reduced from +/-1% of RORE to +/-0.5%. As outlined in our answer to question 3.6 we believe that the request for interventions for the application of RFI penalties should also be extended to where revenue deviations are as a result of managing bill volatility from in-period ODIs in customers' interests. We welcome the proposal for streamlining the overall in-period determination process and allowing companies to manage payments in-period through their charges. The revenue reconciliation models can be modified to include in-period ODI adjustments.
5. Delivering outcomes for customers	Q5.16	Do you have any wider comments about the ODI framework at PR24?	The approach to taxation in the in-period ODI model differs from the general approach taken to taxation for the price review. Our preference would be for the approach to ODI determinations to be brought into line with that used in price reviews, and for any inflated penalties applied during AMP7 to be corrected at PR24. Further comments are provided in question 7.7.
6. Setting expenditure allowances	Q6.1	Do you agree with our proposed approach to setting efficient expenditure allowances at PR24?	We broadly welcome the high-level approach to setting cost allowances and welcome the engagement and early sight of the base cost models. We have concerns with the approach in a number of areas; in particular retail and bioresources as we set out below. On a more general point, we note Ofwat's expectation that the industry needs to deliver a "step change in efficiency" at the outset of AMP8, "in order to allow the sector to do more". The evidence that this is achievable cited by Ofwat is weak. The

			innovation fund, while welcome, has so far focused on quite specific initiatives in technical or operational areas. The impact of these innovations is not likely to be material when it comes to overall company base costs in AMP8. There is no evidence that Ofwat's "greater emphasis on markets" will deliver a step change in efficiency, particularly when it comes to base costs. And efficiency incentives through cost sharing rates are not new – the RPI-X approach to economic regulation has always had built-in incentives for companies to improve efficiency. We agree that companies should be challenged to be efficient through a comparative modelling approach across the industry. However, it is unclear that the whole industry can be expected to deliver a 'step change in efficiency'. While this would indeed help to free up 'headroom' for investment to address some of the wider challenges facing the sector, there is a danger here of wishful thinking that creates unrealistic expectations that damages the investability of the sector and the ability of companies to deliver. The appropriate level of 'stretch' on efficiency should be determined using the agreed and most robust modelling approach, supported by other evidence (such as productivity frontier shifts – see also below) without any preconceptions about what the sector "needs to" deliver in terms of efficiency. **Retail indexation** The draft methodology proposes no automatic indexation of allowed revenue for the retail price control. The consultation outlines that this approach provides appropriate incentives for retailers to manage input costs proposing that they are best placed to manage them. Whilst we did not agree with the lack of indexation at PR14 and PR19, the decision was less problematic while inflation remained low and stable at approximately 2% as this provided retail functions with a presumed cost efficiency challenge of broadly 2% per annum – not an unreasonable expectation. But inflation has turned out to be much higher than this, and retail functions are being faced by a significantly increased efficiency challenge which is not evidence based. Inflation measured by CPIH is currently at 8.8% and therefore residential retail is facing an implied efficiency challenge of around 7.8% beyond the efficiency challenge

			applied at PR19. This calculation takes into account that some inflation is included from the 50% weighting of the forward-looking efficiency challenge as companies plans included inflationary pressures. It would appear unreasonable and without basis that companies should be expected to manage this level of inflationary pressure on their input costs as most of the increase in costs derives from general inflation in the wider economy with very limited scope for companies to mitigate their impact. We therefore propose that the residential retail price control should be indexed by inflation, in line with the wholesale control and the proposals in the Business Retail Exit code, with an appropriately derived efficiency challenge applied. This approach will also have the benefit of reducing the complexity of the price control framework, in particular the financial modelling. We do not accept the argument that the approach of reflecting a forecast of input price pressures in allowed revenues “provides appropriate incentives for retailers to manage input costs they are best placed to manage” (see section 3.5.1). Retailers have the same strong incentives to minimise costs whether they are seeking to beat a pre-fixed input cost assumption or an index that broadly tracks input costs on an ongoing basis. We would propose that Ofwat also adds a (symmetrical) true-up mechanism to adjust for any difference between the forecast input price pressures at the time of the Final Determination and the outturn level. This will protect both companies and customers for deviations in the forecast of input price pressures, which could be significant. This approach would be consistent with the wholesale approach to wage rate price pressures. **Retail cost models** The consultation considers removing the bottom-up cost models for retail as it outlines that the top-level models perform better. The use of bottom-up models are useful as a cross check and at this point we do not believe that they should be dropped. We believe that both bottom-up and top-down models should be utilised and

			the confidence of the models can be used to influence the weights applied in the model triangulation. We welcome Ofwat's intention to review how the impact of deprivation on bad debt costs is modelled, as there may be scope to adopt better measures than those used in the PR19 models. However, as deprivation is a major cost driver, especially for us and a group of other companies, we do think it would be preferable to include it as a cost driver in the retail modelling rather than to rely on the cost adjustment claim process. **Bioresources** A supplementary document for bioresources was published on 2 September 2022. We welcome the publication of this additional detail given the complex nature of the changes and will provide a detailed response in due course. We raise two points for consideration within this response. Firstly, it is important to note that the changes to bioresources cannot be made in isolation as they have impacts for the modelling for wastewater network+, in particular wastewater treatment. The bioresources 'back cast' information data request asked companies to make adjustments to their opex figures for the impact of both opex and capital recharges. It is important to ensure there is consistency in the methodology for calculating the recharges for cost assessment modelling. The introduction of the capital component for the recharge introduces capital recharges based on depreciation and cost of capital within the opex elements of the wastewater network+ price control. It is important that the impact of these recharges are considered within cost assessment. The introduction of capital recharges, the high degree of economies of scope between wastewater treatment and bioresources and the proposal to set separate efficiency challenges, reinforces the requirement to undertake modelling for wastewater treatment and bioresources together to ensure that appropriate and efficient allowances are set. Secondly, we raised a query with regards to the application of the frontier shift. Ofwat confirmed in their Q&A response that legacy assets will not be excluded from the application of the frontier shift. We disagree with this proposal. The proposed

			methodology removes the funding of historical investment through the typical building blocks approach of the RCV. The proposals state the pre-2020 RCV will be protected, the application of the frontier shift is inconsistent with this commitment. **Productivity and Efficiency** The draft methodology outlines that a frontier shift will be applied to the base cost assessment. Performance commitment levels on common PCs will be set for the period using (principally) historical performance information. The combination of these two steps, - applying a frontier shift to base costs and also setting PC levels representing improved performance that should be achieved from base – "double counts" the productivity factor. The productivity factor that is applied to the frontier shift element of base cost allowances should be adjusted to reflect the level of performance improvement included in the performance commitments levels. The draft methodology in Appendix 9 make a case that such a "double count" does not exist because in practice the available water sector productivity measure does not properly account for changes in quality. However, Ofwat's measures productivity with reference to comparator industries. An important factor, then, is the degree to which output quality is accounted for in the measure of TFP from these comparator sectors. If the quality of outputs is fully accounted for within the comparator sectors, then the resulting frontier shift can be applied to base costs allowances to represent the reduction in costs that can be achieved whilst improving outputs. But if then a subsequent performance improvement 'stretch' is applied to performance commitments then this should be reflected in a reduction to the cost function 'frontier shift'. In other words, in order to avoid the potential for double-counting (or under-stating) efficiency improvements, whether by means of cost reduction or quality improvements, we think the safest approach can be outlined as follows: The first step is to prepare an estimate of the aggregate scope for TFP improvement, i.e a combination of "catch-up" efficiency and "frontier shift", plus 'quality' or performance improvements. In the second step this TFP improvement can then be allocated between improvements in cost efficiency and improvements in

			performance levels. Whilst this may pose some estimation challenges, it is methodologically sound and takes a 'joined up' approach to cost improvement and service quality and avoids inconsistencies or "double counting" that can arise when separate methodologies are applied to each. **Modelling Period** The draft methodology proposes to use the full historical data series to develop cost models. The use of a long panel can be useful in cost assessment; however, the quality of the historical data should be taken into account. For example, companies submitted back cast data on Bioresources sludge liquor recharges that may not be of sufficiently good quality to use in cost modelling. The methodology outlines that companies' business plan forecast data may be used to help identify cost trends and future efficiency gains. We do not agree with the use of forecast data in the assessment of efficient costs to inform future cost trends and efficiency gains. This is due to the interaction with the business plan incentives. Companies are incentivised to put forward "ambitious" plans. Whilst it is appropriate for companies to challenge themselves on cost, an element of this may be 'unsubstantiated'. It is therefore inappropriate to set companies' baseline performance on a level of ambition that may not materialise. By way of illustration, at PR19 the efficiency level for residential retail was informed by a forward-looking upper quartile. For 2021-22 we note that 4 out of the 5 companies that informed the upper quartile level of cost efficiency for retail are currently over-spending their allowances, with one company over-spending by nearly 50% over the first two years of the AMP. **Transition** We welcome Ofwat's proposal to retain the transition funding mechanism, and would like to see this extended from one year to two years. We are anticipating a large NEP programme in AMP8, which will be challenging in terms of delivery. Allowing us to make a start on this programme of work in 2023-24 will help with the deliverability of

			the programme, ensure best value and manage the programme efficiently as well as delivering outcomes earlier than would otherwise be the case. **Uncertainty mechanisms for WINEP/NEP** Ofwat states (Appendix 13, page 16) that it is not convinced that a WINEP uncertainty mechanism is required for PR24. At this stage we are facing considerable uncertainty around the timelines for WINEP and NEP and do not agree that "the majority of the uncertainty around the programmes have reduced". We believe it is too early to say whether the PR19 uncertainty mechanism for WINEP and NEP should be dropped, and would propose that Ofwat keeps this possibility open for the time being.
6. Setting expenditure allowances	Q6.2	What are your views on how we can best align the treatment of third-party costs and revenues?	Third party rechargeable works in RAG 4.09 Appendix 1 are currently incorrectly categorised as income governed by the price control. The change from RAG 4.08 to 4.09 was raised as an error as part of the PR19 query process. The error was acknowledged, and it was agreed this would be corrected at PR24. Rechargeable works costs and revenues should therefore be outside the price control. This will require a change to the draft business plan tables as currently proposed. We also consider that the costs and revenues from supplies of non-potable water should also be excluded from the price control and cost-sharing. We acknowledge that non-potable supply costs can be entangled with the costs of providing potable supplies and may require some analysis to separate. However, a problem arises when a significant large potential non-potable customer seeks a new water supply. If non-potable costs and revenues are embedded within the price control and cost-sharing mechanisms the supplier receives none of the incremental revenue but bears a significant part of the incremental costs. If the incremental costs are excluded from cost-sharing then the company bears all the costs but receives none of the incremental revenue. Therefore, like the costs and revenues associated with bulk supplies, we think non-potable water supply costs and revenues would best be dealt with outside price controls and excluded from cost-sharing.

				Views are also sought on whether there should be any changes to the RFI in relation to third party costs and revenues. In line with the views expressed above, we think third party revenues should be excluded from the RFI altogether. We do not have any further concerns with the current approach with regards to the treatment of third-party cost and revenues.
6. Setting expenditure allowances	Q6.3	Do you agree that companies that submit the most stretching and well evidenced business plans should receive the most favourable cost sharing rates at PR24?	Disagree	As noted below (11.4) we would propose an approach in which all companies receive the same 50:50 cost sharing rate. Setting an asymmetric cost sharing rate introduces a skew into the balance of risk and return, which complicates and undermines the assessment of financeability. We believe that the cost sharing rate should be set for all companies at the rate deemed most appropriate to achieve the objective of incentivising efficiency and managing risk. This is then the most appropriate sharing rate for all companies, regardless of the quality of business plans. Using this regulatory tool as part of the business plan incentive framework undermines the primary objective of the tool, by amending it in order to pursue a secondary purpose (high quality business plan submissions). We would particularly oppose an approach by which a company's cost sharing rate is based on Ofwat's assessment of a company's plans fixed at a moment in time. Companies can submit additional supporting information and Ofwat can change its view on a company's plan, as happened at PR19.

6. Setting expenditure allowances	Q6.4	Do you agree that resilience enhancement should be used to fund companies to manage increasing risks to specific hazards that are beyond their control and not covered by base expenditure and other enhancement areas?	Neither agree nor disagree.	We agree that enhancement needs to be expanded to include resilience explicitly, but believe the scope is too limited. It is welcome that Ofwat acknowledges that resilience enhancement may be needed to manage increasing risks to specific hazards. But it may also be needed to: • reduce the risks of specific hazards that have grown over time, • where the risks were previously poorly understood, • or where the risk appetite of regulators /stakeholders /customers is lower than it was in the past. We also believe it may be in customer interests to invest to strengthen resilience without it being linked to a specific hazard – for example by linking supply zones, or increasing storage capacity for treated water, in order to be more resilient to a range of hazards that may otherwise threaten water supply interruptions.
6. Setting expenditure allowances	Q6.5	Do you agree with our proposed approach to setting performance commitment levels at PR24?	Agree	We broadly agree with the approach, but would add the following comments. 1. We reinforce the point above concerning the need for deadbands on CRI and wastewater treatment works discharge compliance. 2. Ofwat notes that some of the drivers of differences in performance across companies are captured in the base cost models. To the extent that this is the case, there needs to be a more joined up approach in setting the 'stretch' between costs and performance commitment levels. At PR19, costs allowances were derived through modelling and applied on an upper quartile basis. PC levels were derived separately, and then also applied as an upper quartile, without reference to the expectation that companies meet an upper quartile of cost efficiency. 3. Companies have natural areas of strengths and weaknesses when it comes to relative performance, for historic or geographic reasons. It is right to accept that companies will outperform their peers in some areas and underperform in others, with an assessment of the deliverability of the FD taken 'in the round', and this appears to be the approach that Ofwat is taking. Care should be taken, however, not to interpret 'underperformance' in a particular area as a failure of the company in the sense of poor management or poor practice.

6. Setting expenditure allowances	Q6.6	Do you agree with our view on what performance commitments should be set using common or company specific performance commitment levels?	Neither	Broadly we agree with the approach, but we do not agree that CSOs and river water quality measures should be set on a common basis across England and Wales. Measures with a common target need to be 'normalised' on an appropriate basis. For example, the pollution incidents measure was normalised simply on a 'km of sewer' basis, without taking into account that the number of other wastewater assets are also relevant to the number of pollution incidents. Our PR19 submission on this point, which remains wholly relevant, can be found here – from page 23 onwards. We agree that companies should be able to make a well-evidenced claim to Ofwat if they believe they have particular characteristics or operating circumstances that disadvantage the company relative to others on a particular performance measure. This is in reality difficult to do without access to the relevant data from other companies, though Ofwat's recent data requests may assist in this regard.
6. Setting expenditure allowances	Q6.7	Do you agree with our proposed approach to incentivising and funding efficient investment in reducing greenhouse gas emissions and reducing the use of storm overflows?	Neither agree nor disagree	On funding efficient investment in reducing greenhouse gas emissions, our view links to the proposal we have set out above on the definition of the measure. Our view is that the measure should be based on a percentage reduction in total GHG emissions relative to a base year, rather than a reduction in the quantity of emissions normalised by volume of water. For the purposes of determining the cost allowance (and indeed limiting the impact of climate change), the absolute reduction in emissions is the only relevant value ~~is~~ (expressed in the tonnes of GHG emissions removed). We offer the following comments: 1. "Common performance level for operational GHG emissions to be delivered through base expenditure." It is not clear whether Ofwat intends for this to be a common normalised level of emissions, for water and wastewater, or a common reduction in emissions. We would argue for a common percentage reduction in total emissions (compared to an appropriate baseline) to be delivered from base expenditure, on an average or some other basis. 2. "Standard enhancement reduction". We agree there may be scope to reduce emissions further through companies' enhancement investment programmes. This will likely vary across companies, depending on the nature of their programmes. There may be some scope for benchmarking the reductions

		available here, but it may not make sense to set a minimum level of reduction, given that some enhancement activities may increase emissions. Setting a minimum requirement runs the risk of distorting investment planning and optioneering intended to deliver overall best value. 3. "Net zero enhancement reduction." It is right that Ofwat should look across all proposed net zero specific investment proposals, and determine an efficient unit cost of carbon reduction. Companies should present schemes necessary to deliver on their long-term strategy for meeting net zero. it is unclear how Ofwat could set a standard 'additional' reduction in the performance commitment on this basis. As long as customers are only paying the efficient cost of carbon, companies should use a PCD to deliver the reduction necessary to meet their long-term net zero plan, taking into account the expected reduction from (1) and (2) above and aligning it with the rate of reduction that UK & Welsh Government are targeting between 2025 and 2030. 4. "Net zero challenge." According to the proposal a 'pot' of funding for additional GHG emissions reduction is being proposed, that companies will bid for in order to go further in meeting net zero than what is set out in their long-term strategy for net zero. It is unclear however how this would work. Bids will be assessed based on the unit rate of emission abatement per £. But companies will already be incentivised to deploy their most innovative technologies, at the lowest unit carbon abatement cost, in delivering the net zero enhancement reduction above. They would have no incentive to go beyond this, using an allowed unit rate that is lower than that allowed under (3) above. We believe this area requires further thought, with an industry working group perhaps offering a good way forward to take these ideas forward. On **CSO spill reductions** we agree that in Wales, companies should propose storm overflow investments where there is evidence that they will improve river water quality, that is not already funded, drawing on the DWMP work and the work of the Better Water Quality Taskforce.

6. Setting expenditure allowances	Q6.8	Do you agree with our proposed approach to implementing nutrient neutrality in the PR24 regulatory framework?		No comment (applies in England only).
6. Setting expenditure allowances	Q6.9	Do you agree with our proposed approach to encouraging companies to deliver best value through our cost assessment?	Agree	No comments.

6. Setting expenditure allowances	Q6.10	Do you agree with our proposed approach to removing the potential disadvantage that nature-based operating expenditure solutions may face in relation to the treatment of enhancement operating expenditure?		There is no single correct solution to the problem of the incentives around opex-based solutions. We support Ofwat's proposal as a pragmatic way of addressing the issue at PR24. A more comprehensive (and complicated) approach may be required in due course if opex-based solutions are common and significant. As noted by Ofwat, any company that has implemented opex-based solutions can submit cost adjustment claims at PR34 and beyond. It would be helpful if Ofwat could signal some support for this possibility. Finally, we note that if any company is embarking upon a major opex-based scheme or programme and wishes to eliminate uncertainty by "locking-in" the expected opex costs it has the option of applying for delivery by means of DPC.
7. Aligning risk and return	Q7.1	Do you have any comments on our approach to the overall balance of the PR24 incentive package, our proposed guidance on producing risk ranges, and our view of the balance of risk facing the notional company?	Disagree	We support the stated objective of providing companies and their investors with a "fair bet". However, a number of important components of the draft methodology skew the balance of risks and incentives to the downside. These include: • the proposal that companies bear all the inflation risk for the retail business. Notwithstanding that an assumption may be made for upward input price pressures as proposed, inflation can "surprise" to the upside far more than to the downside, so there is an asymmetry in the risks companies are required to bear. Inflation is currently at 8.8% and therefore residential retail is facing an implied efficiency challenge of 7.8% beyond the efficiency challenge intended at PR19. As a result, the industry is currently overspending its aggregate retail allowance by approximately 20% on average. There is no realistic possibility of a corresponding under-spend resulting from lower than expected inflation. • the removal of deadbands for ODIs where companies cannot realistically reach perfect performance, and where rewards cannot be earned; • the fact that the onus is based on companies to demonstrate company-specific factors that push up costs and/or inhibit service performance, with a very high evidential bar (in part because relevant data from the rest of the industry is not available);

				• the expectation that companies will share with customers outperformance relating to areas of the price control package that are not currently subject to sharing mechanisms, such as outperforming on the allowed cost of debt (see page 108). Since there is no mechanism by which customers bear a share of any corresponding underperformance, this requirement creates an asymmetry in companies' expected net returns; and • the lack of exemptions for extreme weather on a number of measures, where the downside risk is much greater than the upside from 'benign weather'. This is exacerbated by the removal of caps and collars.
7. Aligning risk and return	Q7.2	Do you agree with our proposals on the regulatory regime for managing companies' exposure to uncertainty over 2025-2030?	Agree	We broadly support the proposals on the regulatory regime for managing companies' exposure to uncertainty, with four caveats: • as noted by CEPA in its report for Ofwat ("*Allocation of Risk*" – 18th June 2021) the general IDOK provisions are "*…now somewhat out of line with the rest of the regime e.g. in how they categorise and consider costs*". Our analysis suggests that they may no longer provide companies (and customers) with the protection originally intended and could produce anomalous results. We think they need to be overhauled in order to ensure that they work as intended alongside Ofwat's methodology for price reviews; • we note the weight given to the cost-sharing framework in managing companies' exposure to uncertainty. Given its importance we would question whether modifying cost-sharing rates as part of the (entirely separate) business plan incentive proposals is appropriate. In other words, if the cost-sharing rates put forward are considered to be optimal for the purposes of managing uncertainty during 2025-30, it would be sub-optimal then to change them for reasons associated with the incentivisation of business plans; and

				• the proposal for retail is for no automatic indexation of allowed revenues and for input price pressures to be reflected in the revenue limit. Our views on indexation are outlined in question 6.1. If the price controls are not automatically indexed and input price pressures are reflected in revenue limits, we propose that a true-up adjustment is introduced to reflect changes between the forecast input price pressure and the outturn position. This would be similar to the current wholesale wage rate adjustment mechanism. • a significant portion of the embedded debt that companies will take into AMP8 is RPI-linked. Whatever assumption is made about the RPI-CPIH wedge at PR24, it is likely to be subject to a wide margin of uncertainty, given the current inflationary environment. We think there should be a symmetrical true-up mechanism at the end of AMP8 to account for such variance, otherwise there is a possibility that either customers or companies will be significantly disadvantaged. The presence of a true-up could also render the question of what wedge should be assumed in the first place less contentious.
7. Aligning risk and return	Q7.3	Is there value in introducing more prescriptive requirements and guidance for company-produced RoRE risk ranges? How might this be implemented for: a. Interactions between performance on cost and service? b. Interactions between performance on different ODIs?	Agree	We agree that there is value in providing more guidance on company-produced RoRE risk ranges. However, it is important to acknowledge that a considerable amount of judgement is involved, and that the subjective views of different Boards may legitimately vary.

7. Aligning risk and return	Q7.4	Do you agree with our proposed approach to setting the allowed return on equity?	Neither	We acknowledge that calculations based on the CAPM have an important role to play in forming judgements on the appropriate allowed rate of return. However, we would encourage a wider approach to the derivation of the allowed return on capital, including an "in the round" appraisal of the answer. The allowed WACC should be the rate of return that investors and creditors require in order to commit capital to the sector. There is no single calculation that provides "the right answer" to this question, and it is necessary to use all available evidence and exercise judgement. In particular, we do not see financeability as a separate issue: if analysis shows that financeability tests are not met on the basis of an assumed WACC then, by definition, that cannot be the return required by financial markets and should be re-visited. In addition, we do not agree with the view that asymmetric risk is better dealt with through recalibration of incentives rather than adjustments to the allowed return on equity. As we have noted in our answer to question 7.1 important sources of asymmetric risk are outwith the regulatory framework, and therefore cannot be addressed through the price review methodology. We have a general concern that is relevant to all components of the calculations of the WACC namely the role played by different price indices. At PR19 Ofwat relied on a number of relatively uncontroversial assumptions, e.g that the CPIH would broadly track the CPI that is targeted by the Bank of England's Monetary Policy Committee, and that the CPIH could be assumed to grow 1% slower than the RPI. These were necessary, for example, to derive a forward-looking estimate of the real (CPIH) risk-free rate on the basis of historical data on RPI-linked gilts. In the current inflationary environment these assumptions have broken down. The RPI-CPIH wedge is currently running at well over 3%, and even CPI and CPIH have diverged significantly. Navigating the conversions from one basis to another in deriving the components of the WACC is likely to involve methodological choices at a detailed level on which the draft methodology is largely silent. We think it would be helpful if Ofwat could consider its approach to the PR24 WACC in detail, in the light of the fact that established relationships have broken down in the current inflationary environment, ideally in a separate consultation/discussion paper in advance of the final methodology publication in December.

7. Aligning risk and return	Q7.5	Do you agree with our proposed approach to setting the allowed return on debt?	Disagree	We have a number of concerns/comments on the proposed approach to the return on debt. First, we have concerns regarding the use of company balance sheet information as this introduces endogeneity into the calculation of the cost of debt. We believe that this should be regarded as a second-best option and used as a cross-check, rather than as the primary source of evidence. Second, and in any event, in adopting a balance sheet approach it is proposed to exclude the use of both junior debt and interest rate swaps as well as all other 'non-pure' elements. In particular, we do not accept the argument that since junior debt is generally a feature of highly-geared structures it can be ignored. The essential point of having junior tranches in a debt structure such as ours is to improve the credit quality of senior debt and thereby reduce its cost. It would be perverse to include the cheaper senior tranches in the cost of debt calculation without including the more expensive junior debt that has created that benefit. Note that we recently issued junior debt even though our gearing is close to that of Ofwat's notional company. Third, for the purposes of the allowed cost of new debt, we note the proposal to 'discount' the benchmark index to adjust for historical sector out-performance and the options for making adjustments for out-turns at the end of AMP8. We think there is a general risk that such an approach could introduce endogeneity into the allowance which could impact the cost of debt going forwards. If this approach is to be adopted we do not think it would make sense to re-visit the cost of new debt at the end of AMP8 in respect of out-turn movements in the index but not in respect of out-turn movements in the relationship between the index and sector performance in issuing new debt. Consequently, we think any such adjustment should be subject to a symmetrical true-up at PR29. Finally, we have a general concern that is relevant to all components of the calculations of the WACC namely the role played by different price indices. At PR19 Ofwat relied on a number of relatively uncontroversial assumptions, e.g that the CPIH would broadly track the CPI that is targeted by the Bank of England's Monetary Policy Committee, and that the CPIH could be assumed to grow 1% slower than the RPI. These were necessary, for example, to derive a forward-looking estimate of the real

				(CPIH) cost of embedded debt. In the current inflationary environment these assumptions have broken down. The RPI-CPIH wedge is currently running at well over 3%, and even CPI and CPIH have diverged significantly. Navigating the conversions from one basis to another in deriving the components of the WACC is likely to involve methodological choices at a detailed level on which the draft methodology is largely silent. We think it would be helpful if Ofwat could consider its approach to the PR24 WACC in detail, in the light of the fact that established relationships have broken down in the current inflationary environment, ideally in a separate consultation/discussion paper in advance of the final methodology publication in December.
7. Aligning risk and return	Q7.6	What are your views on the options we have set out for estimating the RPI-CPIH wedge for converting RPI-linked yields to a CPIH basis?		For the purposes of calculating the risk-free rate, we agree with the approach of using official forecasts. However, there is a separate and wider issue relating to the basis risk companies bear on account of the significant proportion of RPI-linked debt in the industry. Ofwat suggests that this is offset *"to the extent that CPIH is a less volatile measure of inflation than RPI…"*. We do not think the question of volatility is relevant, as it is deviations in the wedge from forecast to which companies and customers are exposed. We think Ofwat should address this question in the final methodology.
7. Aligning risk and return	Q7.7	Do you agree with our proposed approach to the notional structure and setting allowances for corporation tax?	Neither Agree nor Disagree	We broadly agree with the proposals for setting allowances for corporation tax, but we have two concerns that we would like to raise. First, it is proposed that separate tax allowances are calculated for each wholesale control as if they represented distinct stand-alone entities but the rationale for this is not explained. We do not support this proposal: tax is calculated at a company level and the introduction of hypothetical tax calculations for each control introduces unnecessary complexity and is potentially arbitrary. This is evidenced in the draft business plan tables which presently require companies to postulate opening tax positions for each price control.

				Second, we agree with the proposals to allow companies revenues to cover forecast tax expenditures based on the gearing of the notional company. However, we note that a different approach has been used in calculating tax for the purposes of determining in-period ODI payments. We have raised our concerns about this in our '2021-22 in-period ODI submission'. Our ODI penalties are being inflated in line with an assumed tax saving of 19% that we do not make, because our marginal tax rate is zero. Clearly there needs to be consistency between the approach that underpins price reviews and that which is used in in-period ODI determinations. Our preference would be for the approach to ODI determinations to be brought into line with that used in price reviews, and for any inflated penalties applied during AMP7 to be corrected at PR24.
8. Aligning risk and return: Financeability	Q8.1	Do you agree with our approach to assessing financeability?	Neither	We agree with the broad framework for assessing financeability. However, we do not agree that it is a separate exercise to the derivation of the appropriate allowed rate of return. As noted in our answer to question 7.4 above, an estimate of the rate of return required by the markets cannot be correct if it means that financeability tests are not met. We have a particular concern regarding the approach to financeability in the context of the general proposals for bioresources and the fact that Ofwat no longer plans to allow a market rate of return on bioresources RCV. It is indicated that a 'post-2025 RCV' will be recorded. However, since this is not RCV in the conventional sense (i.e as a value on which a regulator allows a return) it cannot be treated for the purposes of financial ratio calculations as though it were equivalent to the actual RCV of the other wholesale controls. It is important for investor confidence in the sector that the definitions of the financial ratios are not inadvertently distorted. We think it is important that Ofwat address this issue with specific proposals as a matter of priority, and in any event in the final methodology in December.

8. Aligning risk and return: Financeability	Q8.2	Do you agree with the focus on the metrics outlined in section 8.4 for the assessment of financeability?	Agree	We agree with the focus on the metrics outlined in section 8.4. We believe that greatest focus should be given to the 'alternative' measures of adjusted cash interest cover and funds from operations to net debt which are closer approximations than the standard versions to the ratios used in practise by Moody's and S&P respectively. It is the ratios used by the rating agencies themselves that should be used to test financeability at a given credit rating level.
8. Aligning risk and return: Financeability	Q8.3	Do you agree with our proposed approach to cost recovery, in particular that we set a narrow range for RCV run-off rates within which companies will be required to evidence their choice of rate which best achieves a fair balance between current and future customers?	Neither Agree nor Disagree	We agree with the proposal of having a narrow range of RCV run-off rates in principle but will consider the calculation of the suggested rates when they are published by Ofwat. We note that for the bioresources control it is intended to apply a frontier shift adjustment to legacy RCV. This, in effect, limits cost recovery by imposing permanent restrictions on the return of capital. As we have stated in our answer to question 6.2 we do not think this is appropriate. It is important that those investing capital in an efficient company can be confident that it will be remunerated and returned.
8. Aligning risk and return: Financeability	Q8.4	Do you agree with our proposed approach to resolving a financeability constraint?	Neither Agree nor Disagree	As set out in our answer to question 7.4 the presence of an apparent financeability constraint may be evidence the that assumed WACC is incorrect and needs to be re-visited. Where a company is expected to engage in a large investment programme relative to the size of its RCV there may be a temporary financeability constraint, in which case we do not think it is unreasonable to assume an equity solution to address the issue.

9. Promoting financial resilience	Q9.1	Do you agree with the proposed standard set of scenarios for testing financial resilience?	Agree	We agree with the proposed standard set of scenarios.
9. Promoting financial resilience	Q9.2	Do you agree with our approach to how the Board of the company should approach its Board assurance statement?	Disagree	We remain concerned that the requirement for Boards to assure financeability based on notional company structures is not in line with the role that Boards should be expected to play. Financeability assessments against the notional structure may play part of the regulatory process, in particular for considering the appropriate level of WACC, but should not be an expectation in assurance of plans.
9. Promoting financial resilience	Q9.3	Do you agree with our proposed approach to dividend policies, performance related executive pay and voluntary sharing of financial outperformance?	Agree	No comments

10. Companies' PR24 submissions	Q10.1	Are the PR24 submission requirements clear and sufficiently specified?	Agree	No comments.
10. Companies' PR24 submissions	Q10.2	Is any data missing, or included but not required or areas we need to look at again?		We provide some detailed comments on specific tables in the relevant tab of this response. Our general comments are: - Many of the tables ask for separate information by price controls, where this disaggregation is unnecessary. We would recommend that Ofwat to aggregates to the appointee level wherever possible. As an example, we question the benefit of reporting our tax position by price control. The data tables do not currently indicate how that data could be derived and reported. - Many of the tables are copies of APR or Cost Assessment data request tables which were focused on actual data, but request forecasts of this data in a number of cases. It is unclear what is the benefit of providing such data, how companies can be expected to forecast the data, and how it could meaningfully be used. Examples include forecasts of C-Mex and D-Mex scores. - We would welcome an early updated release of the Business plan tables ahead of the publication of the Final Methodology, to help companies to prepare and understand the level of granularity of data (and in particular forecast data) required for the assessment of our plan. - The data collected in APP29 at PR19 which showed the breakdown of our fixed asset expenditure for capital allowance is missing from the current draft table set.

10. Companies' PR24 submissions	Q10.3	Are the limits on the number and size of documents workable? Should we be more prescriptive in terms of file and folder structures etc?	Agree	We believe that 25MB may be an unnecessarily low limit for file size, as some of the larger documents, particularly the main Business Plan document of up to 300 pages, could be larger than that. Ofwat could have 25MB as a guideline, with up to 50MB as a limit.
10. Companies' PR24 submissions	Q10.4	Do our expectations for company board's assurance and governance arrangements provide enough guidance to ensure that boards have sufficient level of 'ownership' and so ensure a high quality submission?	Agree	Overall we agree that the expectations are in line with the role that the Board will play in providing assurance and governance around our plan. We remain concerned that the requirement for Boards to assure financeability based on notional company structures is not in line with the role that Boards should be expected to play. Financeability assessments against the notional structure may play part of the regulatory process, in particular for considering the appropriate level of WACC, but should not be an expectation in assurance of plans. It is not sensible or meaningful for Boards to provide assurance of financeability based on a hypothetical company structure. We note that in some cases the expectations necessarily require subjective judgements and may be difficult for the Board to assure in absolute terms, for example the Board will be able to provide a statement of its view "that the expenditure proposals are affordable by customers" with regard to the general bill impact, but this could not be taken to apply to every customer we serve, and we offer support to those customers who find bills unaffordable.

10. Companies' PR24 submissions	Q10.5	Do you agree with our proposal to continue to apply revenue adjustments for past performance across all years of 2025-30, after the financeability assessment?	Neither Agree nor Disagree	The proposal is to apply revenue adjustments to the controls after financeability has been assessed. However, there is a distinction between the revenue adjustments that relate to company performance and the reconciliations that are more "technical". So, for example, we would agree that it would be wrong to assess financeability after the impact of end-of-period ODI penalties have been taken into account. However, it would be unfair on a company if it were judged to be just financeable before the reconciliation relating to the RPI-CPIH wedge were made, if the impact of that adjustment were then to render it un-financeable. In other words, if a company is holding cash that is due to be returned to customers for reasons other than performance that should be taken into account before financial ratios are calculated for the purpose of financeability tests (and *vice versa).*
10. Companies' PR24 submissions	Q10.6	Do you agree with our proposal for 2024-25 blind year adjustments? Should we treat in period ODI adjustments in the same as other blind year adjustments or retina the approach set out in the Rulebook?	Agree	We agree with the proposals for the 2024-25 blind year adjustments. We agree with the PR19 Reconciliation Rulebook approach that the 2024-25 blind year adjustments are adjusted through the in-period ODI model in late 2025, adjusting revenues in 2026-27.
10. Companies' PR24 submissions	Q10.7	Do you have any comments on how to best deal with the impact of shadow and non-shadow reporting in table BIO3 on other tables?		We propose for companies to submit Totex and Base cost submission tables that reflect the changes for the shadow reporting.

10. Companies' PR24 submissions	Q10.8	Do you have any comments on the data we should collect in table BIO5?		No comments.
11. Encouraging quality and ambitious business plans	Q11.1	Do you agree with the framework we propose to encourage the best business plans? Specifically, do you agree • that we should first assess 'quality' followed by 'ambition'? • with our proposed allocation of rewards and penalties for performance on each?	Agree	We agree with the proposed framework overall, and that the assessment is separated into two steps, the first looking at whether the plan meets a minimum set of requirements, and the second looking at the 'quality' of the plan. The current framing of the two steps as 'quality' and then 'ambition' is misleading and sub-optimal. The first step is not really an indication of the quality of the plan, just that it passes a number of tests. The second step isn't, or shouldn't be, just about 'ambition'. Framing it as 'ambition' suggests that, for example, companies with (over) ambitious plans, not supported by customers or stakeholders, and with large bill increases attached, would be rewarded. We don't believe this to be Ofwat's intention. With the first step set up as a pass/fail step based on compliance with the requirements, for the second step, Ofwat could reframe the assessment as a 'quality' assessment, with an emphasis on the degree of 'stretch' and 'challenge' in the plan, to include delivery of significant improvements, value for money, alignment with customer and stakeholder priorities, and so on. As an additional point, we welcome the opportunity to seek high level feedback from Ofwat on long term delivery strategies in early 2022. Concerning the suggestion that once company business plans have been put into one of the four categories, that companies should have to state their category "prominently" on direct communications with customers and stakeholders. This could lead to gaming by companies and debate between companies and customers as what constitutes "prominent" and appropriate display of this information. It could very easily be misunderstood by customers unless the context of the 'labelling' is properly explained to customers. We would argue that

				this is not something that should feature prominently in the limited 'bandwidth' available for companies to communicate key messages with customers. The proposals risk undermining confidence in the sector. Key stakeholders including other companies will be aware of the categorisation, and this is where the reputational element of the incentive can and will have an impact.
11. Encouraging quality and ambitious business plans	Q11.2	Do you agree with the proposed scope of our 'quality' assessment? Specifically, do you agree: • we should have minimum expectations in the six areas described above? • with the minimum expectations we specify in each of the six areas?	Agree	We agree with the proposed scope, the six areas and the minimum expectations, with the following reservations: 1. It is hard to see how a company could in any meaningful sense "demonstrate that it will deliver fairness for both existing and future customers". 2. We disagree with the requirement that company Boards assure that their plan is financeable on the basis of the notional capital structure. The notional structure is not real, and company Boards cannot be expected to provide assurance in relation to something which is hypothetical. Any such assurance provided would in any case be meaningless.
11. Encouraging quality and ambitious business plans	Q11.3	Do you agree with the proposed scope of our ambition assessment?	Neither agree nor disagree	For the reasons noted above, we disagree with the framing of the second step as an 'ambition' assessment. High quality plans that are in the best interests of customers and the environment may not be 'ambitious' in every sense. It would be better to reframe this as a 'quality' or 'quality and ambition' step, with specific qualities that Ofwat expects spelt out, perhaps including (but not limited to) stretching efficiency improvements where these are achievable, the same for performance improvements, a strong set of affordability measures for customers who struggle to pay their water bills, and a plan which has clearly articulated how it is the right first step to deliver on the ambitions for 2050. It is hard to comment further in this area as few details are provided.

11. Encouraging quality and ambitious business plans	Q11.4	Do agree with our proposed reputational, financial and procedural rewards and penalties, including the overall package of reward and penalty?		Concerning the financial incentives, we do not think it is appropriate to apply financial penalties for 'inadequate' or for a judgement of 'lacking ambition'. The WACC should reflect the rate of return on capital sufficient to finance the company, and nothing more. This raises the question therefore as to how Ofwat would ensure that companies facing 'up front' financial penalties of this nature would remain 'investable'. Regarding the cost sharing, we welcome the proposed simplification of the cost sharing approach in the business plan assessment. However, we would go further and suggest that the cost sharing rate plays a minor role in incentives, and that a 50:50 cost sharing rate for all companies would be a simpler approach.
11. Encouraging quality and ambitious business plans	Q11.5	Do you have any other comments regarding our proposed approach to business plan incentives at PR24?		We welcome the simplification of the assessment framework compared to PR19 when there were nine assessment areas. It will be important that there are opportunities for dialogue and feedback in the absence of an IAP stage, particularly for companies who are in danger of having their plans categorised as 'inadequate' for failing some of the more subjective criteria in the first stage of assessment.
Appendix 6 – Performance Commitments	QA6.1	Do you have further views on whether the proposals laid out for C-MeX are appropriate?	N/A	Yes. We welcome the continuation of C-Mex with only minor changes. On the proposal to remove the check and challenge process, we disagree with the proposal. The check and challenge process provides a valuable opportunity to ensure interviews are carried out and recorded correctly and accurately. Our challenges alone were upheld seven times last year. We would also note that the process should be extended to cover online survey responses, as all companies have indicated a significant number of inaccurate scores as a result of customer mis-types. These mistakes distort performance, and would

				undermine the legitimacy of C-Mex in the eyes of companies if the challenge process was removed. As at PR19, we strongly disagree with the requirement to be in the upper quartile of the UKCSI index in order to be eligible for enhanced C-Mex rewards. As set out in detail in our previous submissions on this topic, it is not appropriate to compare utility companies in general, and water companies in particular, with private sector product and service providers, when it comes to customer service scores. Customers do not generally choose their water companies, and have no choice as to whether to use the service or not. In addition, contact with water companies most often comes when things go wrong, which skews perceptions to the downside. No water company in England and Wales has so far met this threshold. Given this, the requirement to be in the upper quartile on UKCSI is too high – this weakens the intended incentive of the enhanced rewards as well as exacerbating asymmetry in the ODI framework.
Appendix 6 - Performance Commitments	QA6.2	Do you agree that C-MeX needs to adapt to provide better service to vulnerable and worse served customers?		No. We believe that providing good customer service to customers in general, and meeting the needs of vulnerable and worse served customers, are related but separate issues, and are best addressed through different mechanisms. It would not be feasible to adapt C-Mex to incentivise companies to provide better service to vulnerable and worse served customers without distorting or undermining the main purpose of C-Mex. Service to vulnerable customers in particular is multi-faceted and therefore hard to capture in a single measure.
Appendix 6 - Performance Commitments	QA6.3	What are your views on our proposal to introduce a single, combined common performance commitment ('BR-MeX') capturing the experience of both	N/A	No comments (does not apply in Wales).

		end business customers and retailers as intermediate customers?	
Appendix 6 – Performance Commitments	QA6.4	Do you consider evidence suggests that the current water supply interruptions performance commitment is inhibiting innovation? If so please provide it.	For us the key distinction is between planned and unplanned interruptions. The 3-hour 'window' is too short to use the most efficient and innovative techniques. These techniques often involve (where possible) rezoning to allow the section of mains to be taken out of service, refurbished, disinfected and returned to service. This could be done within a 12 hour window. However, in order to keep customers on supply, we have to resort to more 'traditional' methods for replacement of existing mains in urban areas, in most cases by opencutting a new mains alongside the existing and transferring all connected customer communication pipes on to the new main. In some cases it is possible to install a temporary overland bypass main, temporarily transferring the communication pipes on to the bypass, while the main is repaired, but this is often not possible in urban environments and can be as costly as open cut techniques. The opencutting technique means more excavations, with increased traffic management, more disruption and noise for customers, significantly increased cost and significantly increased carbon emissions. Our customers tell us consistently that they are happy to tolerate supply interruptions that are planned and communicated in advance. Such planned interruptions are of an entirely different nature as unplanned interruptions, from a customer perspective. It is our view therefore that it would be in customers interests to allow up to 12 hours for planned interruptions to allow for mains replacement or refurbishment. This would allow us to implement more efficient approaches, with less customer disruption and lower carbon

			emissions, for planned mains replacement schemes, and also to trial innovative new approaches. Our view, in summary, is that the current supply interruption does inhibit innovation, but it is right that for unplanned interruptions, the current measure is appropriate as the interruption to supply should be minimised in order to minimise the very real inconvenience for customers. However, planned interruptions should be dealt with separately, with a suggested 12 hour window. Separating out planned interruptions would not mean a change to the current performance level as the way we manage things currently means that we have virtually no planned interruptions contributing to our performance on supply interruptions. However, the change would allow us to repair more pipes, improving asset health and service to customers.
Appendix 6 – Performance Commitments	QA6.5	Do you agree with our proposed definition for the biodiversity performance commitment?	We support the proposal to have a performance commitment on biodiversity, but the proposed measure has been designed to work for companies in England. The Biodiversity Metric 3.1 is a tool used to measure biodiversity net gain within England – we currently have no officially endorsed tool for Wales. We are currently waiting to hear what tool will be proposed for Wales but this is still being developed by Welsh Government and NRW – there is no deadline or indication of when this will be available. However we do understand that that the tools will not be the same. We would not wish to have to use two different tools – one for NRW and one for Ofwat – as this would involve significant duplication of effort. We provide further detailed comments on the definition in Appendix A.
Appendix 6 – Performance Commitments	QA6.6	Do you agree with our proposal to have separate operational greenhouse gas emissions performance commitments for	We support the introduction of a common measure to track companies' progress in delivering reductions in operational GHG emissions, in the absence of a suitable and reliable measure at this stage to cover embedded emissions. Regarding the normalisation of the metrics, Ofwat proposes to use distribution input (for water), and volume of wastewater treated (for wastewater). We do not believe it is

		water and wastewater, which are based on a normalised measure?	appropriate to normalise the tonnes of emissions using the volume of water distributed (for water) or treated (for wastewater). This is because the volume of emissions is only partially related to the water volume – the majority of emissions are a 'baseload'. Normalising emissions based on water volume will complicate the comparisons across companies when there are (growing) variations in rainfall and other weather factors across the companies. What matters is the absolute reduction in GHG emissions, and only this absolute reduction will support the 'Journey to Zero'. Our preference would therefore to report on a percentage reduction in operational GHG emissions against a suitable base year. This approach would align with externally recognised accreditation standards (such as the Carbon Trust and Science Based Target Initiative). We would propose to use 2019-20 as the base year. The importance of being able to compare and share performance transparently with external stakeholders and demonstrate alignment with the objectives set out in legislation is acknowledged in Appendix 7. This solution would work equally for water and wastewater companies, and therefore there may not be a need to have separate measures or targets for water and wastewater. The relevant metric for water and sewerage companies will the total reduction in greenhouse gas emissions, so it would be sub-optimal to set separate targets for water and wastewater for WASCs.
Appendix 6 - Performance Commitments	QA6.7	Do you agree with our proposal that the performance commitment on serious pollution incidents should only apply to water and wastewater companies?	We agree that exclusion of the water-only companies from having to report this measure is a pragmatic solution, provided Ofwat is satisfied that alternative regulatory tools, including financial penalties if necessary, are available to deal with the possibility of a serious pollution incidence in a water-only company area.

Appendix 6 – Performance Commitments	QA6.8	Do you agree we should focus the bathing water performance commitment on the outcome that customers have received and should continue to develop an alternative definition to do this?	We believe that option 2 as proposed is the best solution for now, with a weighted classification-based approach. This option has the advantage of being easy for customers to understand. It is also plausible to be able to derive valuations of customers' perceptions of the benefits of the different classification levels from customer research, and then 'map' these to the measure to generate an appropriate and reasonably robust ODI rate. Regarding option 3, we welcome Ofwat's thinking in this area. It seems worth exploring whether a robust and clear methodology could be developed for a sample-based approach that is able to capture a more direct 'outcome' for customers. However, counterintuitively, this more direct 'outcome' as expressed in the measure is actually a great deal more complicated and more difficult for customers to understand. It would therefore be a lot more difficult to do robust customer research to derive the related valuation, and to map the results of such research to an applicable ODI rate. Regarding the details of the measure as set out in the Outcomes Working Group meeting on 1 September, we would also urge Ofwat to think carefully about what the appropriate thresholds for the percentage classifications would be. It would seem important to make reference to the thresholds used as part of the current bathing water quality classifications. It might be the concentrations of bacteria below a certain threshold are essentially meaningless and of no benefit. The calibration of the measure, using these thresholds, will be important to optimise the way in which the measure incentivises company to deliver actual benefits to customers. Subject to further work, our proposal would be to take the time to get this measure right and work on it further with a view to potentially introducing it for PR29. Whichever option is chosen, it is important to ensure that the PCL that is chosen is appropriate for each company's circumstances. As Ofwat acknowledges, companies will be starting at different points at 2025, reflecting their operating circumstances and previous investment. We have invested significantly in the past to get every designated bathing water to at least "sufficient". In our view, further improvements would need to come from action from other sectors in order to deliver best value – any

			further improvements to come from our investments would be disproportionately costly, and there are more important priorities elsewhere.
Appendix 6 – Performance Commitments	QA6.9	Do you agree with our proposal for the river water quality performance commitment to measure the reduction of phosphorus entering rivers?	We support this measure as the best current option (but see proposed amendment below). It is imperfect as a measure but overall is worthwhile and will help to incentivise and track improvements. This is a complex policy area and the targets should be set with reference to the separate approaches being taken in England and Wales. We offer the following observations and suggestions: • We note that Appendix 7 states that all detailed definitions, exclusions etc are to be confirmed, so there remains considerable uncertainty about the measure. • Overall we believe the measure applying to companies in Wales should be modified to target the agreed % of DCWW's "Fair Share" removal achieved from all interventions, not focusing only on treatment works discharges. The "Fair Share" level could be based on the recent modelling of SAC rivers in our region and in line with proposed policy for the Habitats Review of Permits that NRW plans to carry out in the coming months. This would provide a load removed expressed against the element of environmental need DCWW should deliver and would be in line with our legal obligations. It would also allow us to pursue partnership approaches in our area to establish the most beneficial approaches to reducing nutrients.

				• It is not clear how the 2020 baseline level will be determined. At 2020 sites did not have a P limit or driver so the levels will have to be reverse modelled. • The reporting period will need to be clarified. Following scheme completion a 12-month sampling programme is implemented according to the requirements with the permit conditions and reported in the APR the following year. Improvements made may not therefore be immediately reportable within the AMP for all schemes. • We would strongly support an approach which allows for P removed through nature based and partnership approaches. We believe that whatever final definition is agreed upon, the target should be aligned with government and regulator's approaches regarding P removal. Companies also had widely differing levels of investment in P removal prior to 2020. Therefore a common target across all companies will not be appropriate. It is not yet clear whether the 'technically achievable limit' (TAL) approach to be applied to WWTWs in nutrient neutrality areas will apply in Wales.
Appendix 13 – Data and modelling	QA13.1	Do you agree with our proposed approach to mechanisms at PR24?	Agree	We think there is a strong case for an additional mechanism to true-up the difference between the assumed cost of RPI-linked debt instruments expressed in CPIH terms and the out-turn. This is needed partly because the "natural hedge" of the RPI-linked portion of the RCV will be discontinued, and partly because Ofwat plans to increase the assumed portion of debt for the notional company accounted for by index-linked instruments, which in general are based on the RPI. It is required for embedded/legacy debt and potentially new debt as well, depending on whether the out-turn RPI-CPIH wedge is already reflected in the tracking index for the cost of new debt.