UUWR_50

PR24 Draft Determination: UUW Representation

Area of representation: Outcomes

August 2024

This document outlines our response for outcomes in the PR24 Draft Determination

Reference to draft determination documents:
'PR24 draft determinations: Delivering outcomes for customers and the environment'
'PR24 draft determinations: United Utilities Water – Outcomes appendix'
'PR24 draft determinations: Outcomes – Measure of experience performance commitments appendix'
'PR24 draft determinations: Outcomes – Measure of experience performance commitments appendix'

United Utilities

Water for the North West

Executive Summary

Ofwat represents that it has presented a balanced risk range for UUW's PR24 draft determinations outcomes package, at -2.06% to +2.00%. However, we do not consider that the range presented accurately reflects the risks embedded in the Draft Determination. These arise from Ofwat's broad removal of risk protections, the inclusion of significant exogenous factors on companies' measured performance, the significant increase in ODI rates disjointing them from customer research and historic rates, the inclusion of three penalty only PCs and one reputational only PC, and the changes to C-Mex from a well-functioning AMP7 metric to one which appears like to be de facto "penalty only" for the industry.

The PR24 Outcomes package is significantly downside skewed. We do not agree with Ofwat's estimation of the draft determination ODI risk range as being broadly symmetrical. We consider that it is significantly downside skewed at -3.4% to +1.7%. This is even after taking account of the application of the aggregated sharing mechanism which only takes effect at very severe levels of penalty. We propose targeted improvements to bring the package more into balance, more reasonable and more acceptable to UUW. Our draft determination response would produce a P10 to P90 range of -2.7% to +2.3% after application of the aggregated sharing mechanism. Our proposed improvements include:

- appropriate PCLs, a collar and ODI rates for the Internal Sewer Flooding performance commitment which are in line with our PR24 business plan submission;
- appropriate and effective caps and collars for storm overflows based on modelled performance data rather than a company's regulated equity which will afford different levels of risk protection based on companies' historic investment decisions rather than performance ranges related to the PCL; and,
- ODI rates for customer contacts about water quality which bring the rate per contact per issue more into line with customer valuations and more calibrated with the annual water services bill.

We consider that Ofwat should re-estimate plausible performance ranges to understand the true risk range of its Outcome package on companies. Ofwat should observe the impact of its PR24 DD Outcomes proposals on historic performance levels, including companies' most recent performance in the 2023/24 APRs. We note that the combined effect of Ofwat's PR24 draft determination ODI rates and PCLs on 2023/24 outcomes would be to significantly increase penalties – by an overall 500% - on those measures which carry over into 2025-30, especially on Wastewater PCs and C-Mex.

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1. Key points

- **We welcome Ofwat's approach at PR24 to rationalising the Outcomes package to 23 common performance commitments for all water and sewerage companies**: We consider that this should produce a core set of performance measures which is more easily understood by customers in AMP8.
- **Ofwat's draft determination proposals produce a further emphasised downwards skew in the Outcomes package:** The downside stretch on outcomes is too great, especially on wastewater and C-Mex. We do not consider that the draft determination reflects an effective calibration of ODI rates in particular and performance incentives more generally.
- **Ofwat's RoRE risk range is unrealistic:** Ofwat has removed risk protections, increased exogenous factors in PC measurement (such as extreme weather events), and increased ODI rates to levels that are up to eighteen times PR19 rates and more than three times Ofwat's PR24 final methodology indicative rates. In this context, and given actual past performance, it is difficult to understand how Ofwat can still consider that companies' P10 to P90 risk ranges from the outcomes package remain within its stated range, presenting UUW's at a balanced -2.06% to +2.00%, calculated as a percentage of regulated equity.
- **Ofwat's published RoRE risk range appears difficult to reconcile with the downside skew of PCs and ODIs:** We do not consider that Ofwat's analysis of company risk ranges is robust. We are particularly concerned about the removal of outliers and the broad application of industry-wide performance to company specific outcomes. Ofwat's balanced risk range for UUW of -2.06% to +2.00% is a surprising result, given that the package contains three explicitly penalty only PCs and a reformed C-Mex which is calibrated towards penalties for the majority, if not all, of the sector in AMP8. Our view is that the risk range is significantly downside skewed at -3.4% to +1.7%, even after the application of the aggregated sharing mechanism.
- **Caps and collars should act as effective controls:** Ofwat does not appear to have considered how to set effective and appropriate caps and collars beyond its initial proposals in its PR24 final methodology. We believe we presented strong evidence in our PR24 business plan submission on the appropriate use of caps and collars, particularly for internal sewer flooding, and for storm overflows where we propose a cap/collar at +/-30% of the PCL.
- **Ofwat should reassess its approach to the internal sewer flooding:** Ofwat should revisit how it has set the performance commitment for internal sewer flooding. When coupled with the significantly increased ODI rate and the absence of any risk protection mechanisms, this single performance commitment presents an unacceptably high expected penalty – £314m at our estimation of P10 performance, -0.95% RoRE. This is distortionary to the overall package.
- **We propose amendments to bring the package towards a more acceptable balance:** The changes we propose in this draft determination response, to performance commitments and incentive rates and structure, should deliver a reasonable balance between underperformance and outperformance and is in accordance with the framework for setting outcomes and incentives. Our draft determination response would produce a P10 to P90 range of -2.7% to +2.3% after application of the aggregated sharing mechanism, which we believe would be a more reasonable balance and bring the range within that set out in Ofwat's PR24 methodology.
- **We have provided clear signposting:** We respond to each aspect of Ofwat's DD relating to outcomes regulation in our draft determination response in section 2 of this document. The signposting table provides clear information as to which aspect of each PC these representations are made on and where these can be found in our suite of DD response documents. Section 3 provides our response to the common PCs, their PCLs and definitions. Section 4 provides our response to bespoke PCs considered suitable for progression to final determination by Ofwat. Section 5 contains our response to Ofwat's draft determination ODI rates and our limited proposals for alternative rates. Section 6 contains our assessment of the risk range produced by the outcomes package with proposed amendments to bring the package towards a more acceptable balance.

2. Signposting table – Performance commitments and ODIs

The table below signposts where UUW's responses to Ofwat's draft determination can be found on performance commitments and ODIs.

Ofwat ref	PC name	Definition	PCL	ODI rate[1]	Cap / collar[1]	Deadband	Key representation	Document ref
WSI	Water supply interruptions						None	
-	Severe water supply Interruptions						Response to Ofwat proposals made for this new proposed common PC.	UUWR_60
CRI	Compliance risk index						None	
WQC	Customer contacts about water quality			UUWR_58 OUT7			ODI rate – proposed as per PR24 business plan submission	UUWR_58
ISF	Internal sewer flooding		UUWR_12 OUT1	UUWR_12 OUT7	UUWR_12 UUWR_93		PCL, ODI rate and collar – proposed as per PR24 business plan submission	UUWR_12
ESF	External sewer flooding						None	
	C-MeX	UUWR_51		UUWR_51			Propose reversion to AMP7 definition and measurement for AMP8 Year 1, pending further revisions to C-MeX proposals	UUWR_51
	D-Mex						None	
	BR-Mex						None	
WGHG	Operational GHG emissions W	UUWR_53					Recalculation of baseline to take account of AMP7 WINEP investment	UUWR_53
WWGHG	Operational GHG emissions Ww	UUWR_53					Recalculation of baseline to take account of AMP7 WINEP investment.	UUWR_53
		UUWR_13					Biomethane facilities should be removed from baseline.	UUWR_13 Section 8
BIO	Biodiversity		UUWR_62 OUT1		UUWR_62 UUWR_93		PCL requires correction in line with Ofwat's response to companies 2 August 2024. Cap/collar proposed as per PR24 business plan submission	UUWR_62
LEA	Leakage						None	UUWR_44
PCC	Per capita consumption						None	
NHH	Business Demand	UUWR_64	UUWR_64 OUT1				Correction required to underlying PCL calculation and proposals made to improve definition of end of period PCL adjustment mechanism	UUWR_64

[1] Standard and enhanced

Ofwat ref	PC name	Definition	PCL	ODI rate[1]	Cap / collar[1]	Deadband	Key representation	Document ref
POL	Total pollution incidents	UUWR_56		UUWR_56	UUWR_56		Propose improvements to change control mechanism to take account of EA guidance updates, and a collar	UUWR_56
SPL	Serious pollution incidents						None	
DIS	Discharge permit compliance					UUWR_54 UUWR_93	Propose deadband in line with PR24 business plan submission and EPA	UUWR_54
BWQ	Bathing water quality	UUWR_55	UUWR_55 OUT1		UUWR_55 UUWR_93		Recalculated baseline and ambitious PCL in line with PR24 business plan submission	UUWR_55
RWQ	River water quality						None, although believe this should be a financial measure	
SOF	Storm overflows				UUWR_10 UUWR_93		Propose collar in line with PR24 business plan submission	UUWR_10
MRP	Mains repair[2]						See UUWR_44 for interaction with Leakage performance	
UNO	Unplanned outage	UUWR_63					Uplift in DD PCL for raw water quality outages noted	UUWR_63
SCO	Sewer collapses						None	
WW	Wonderful Windermere	UUWR_65 UUWR_66	UUWR_65 OUT1	UUWR_65 OUT7	UUWR_65 UUWR_93		We have addressed Ofwat's DD interventions as detailed in "PR24 draft determinations: United Utilities Water – Outcomes appendix"	UUWR_65 UUWR_66
EGG	Embodied GHG emissions	UUWR_67 UUWR_68	UUWR_67 OUT1	UUWR_67 OUT7	UUWR_67 UUWR_93		We have addressed Ofwat's DD interventions as detailed in "PR24 draft determinations: United Utilities Water – Outcomes appendix"	UUWR_67 UUWR_68
-	Improving bill affordability[3]						Removed following Ofwat rejection at DD	

[2] Ofwat has updated the name for this PC at draft determination to "Repairs to burst mains"

[3] Full name: "Improving water bill affordability for socially important non-household community groups"

3. Common performance commitments

3.1 Summary

In order to bring the risk range of the outcomes package more into an acceptable balance, we consider that there are a number of changes which should be made to particular performance commitments. Of paramount importance is that Ofwat should reassess the performance commitment approach for Internal sewer flooding. The use of a common target, when coupled with the significantly increased ODI rate and the absence of any risk protection mechanisms, means that the financial risk which this individual performance commitment presents to UUW's overall PR24 determination is unacceptable. We also urge Ofwat to reconsider its proposed reforms to C-Mex and consider that they would impair the current incentivisation of customer service, rather than improve it.

We welcome Ofwat's proposals for new mechanisms intended to account for uncertainties on both the Total Pollution and Business Demand PCs and make proposals in our accompanying response documents for how we consider these mechanisms could be made most effective. With effective mechanisms, we consider that the potential risks relating to these PCs can be managed.

The changes we propose to the performance commitments should enable a more balanced outcomes package for PR24, helping to enable the potential for a reasonable balance between underperformance and outperformance, in accordance with Ofwat's outcomes framework.

3.2 Internal sewer flooding

Ofwat's approach to setting a common PCL for this performance commitment fails to take account of local exogenous factors that are outside of management control. We do not agree that this is an appropriate approach. Ofwat's draft determination fails to account of the significant environmental differences between company regions and therefore creates an inequitable stretch across the industry with some companies facing PCLs that are easily met and others being presented with unachievable PCLs.

Critically, to prevent the outcomes package being significantly negatively skewed by exceptional weather events, Ofwat should re-instate a collar on this measure at a level equivalent to 0.5% of Ww RoRE: Companies cannot reasonably be expected to 'weatherproof' the network against such events without very material additional investment that would likely have an unacceptable impact on customer bills.

We recognise, and take extremely seriously, our statutory responsibility to effectually drain our area: However, this should not be conflated with an unrealistic suggestion that companies can or should upgrade networks to fully accommodate all flows associated with exceptional weather events.

Ofwat has excessively overpowered the ODI rate and divorced it from its own customer research valuations. Ofwat's draft determination ODI rate now values the avoidance of one internal sewer flooding incident at £62,922. Not only is this new rate 12 times in excess of Ofwat's own PR24 customer research results but it is also almost triple that of Ofwat's own PR19 final determination ODI rate (a rate that was, in turn, coupled with appropriate risk protections of caps and collars).

The combination of an excessively overpowered ODI rate, an inappropriately set PCL and the absence of an appropriately calibrated underperformance collar means that Ofwat's draft determination for this measure is unacceptable.

Ofwat has failed to recognise the financial risk that this measure now poses to UUW, in its significantly understated RoRE range for this measure of -0.19% to +0.05%[4]. This performance range is based on the application of an industry average performance range to UUW's P10/P90 for internal sewer flooding. As we explain further in UUWR_12, we consider that it is highly inappropriate to estimate UUW's performance range for this measure based on an industry average because, as a result of our unique operating circumstances, we have

[4] Values taken from Ofwat PR24 draft determination document 'PR24-DD-ODI-risk-5-Year-Additive-RoRE-Payments-model' tab '% RoRE Wastewater Summary'' cells M17 and M37

never been able to achieve an incident level that is concordant with the industry average. Indeed, our estimates indicate that under Ofwat's proposed incentive design, the P10 to P90 RoRE performance range for this measure against Ofwat's draft determination is -1.4% to -0.2%, presenting an unacceptable negative skew on the outcomes package. Given the PCL which Ofwat seeks to impose in its draft determination on UUW, historical performance data and UUW's compelling evidence in our PR24 business plan submission, Ofwat should recognise that this performance range is not statistically sound. Ofwat should therefore amend the PCL, risk protections and ODI rates for this PC.

We therefore propose what would be a highly stretching but nevertheless more acceptable package for this measure in this response, with the proposed PCL stated in OUT1.4, the ODI rate in OUT7.4 and the collar in UUWR_93 section 4.3 table 3. For our full response to Ofwat's draft determination for this outcome, please see "UUWR_12_Internal Sewer Flooding".

3.3 Total Pollution Incidents

Ofwat has set PCLs for this measure based on company performance against the Environmental Performance Assessment (EPA) methodologies set by the environmental regulators. We welcome Ofwat's recognition that the EPA methodologies may change during the 2025-30 period, and that Ofwat will consider the impact of those changes on the performance commitment. Ofwat states that it may propose corresponding changes (including PCLs, ODI rates and caps and collars) if it considers there is sufficient reason to do so.

Ofwat proposes to manage any such changes in accordance with the change control process set out in Section 7 of "PR24 draft determinations: Delivering outcomes for customers and the environment".

We support the proposal and reasons for a change control process; however, we remain concerned with the magnitude of uncertainty surrounding this measure given the potential significance of these potential changes and the current specificity of Ofwat's proposed change control process. Given the financial risk assigned to this PC through the significantly increased ODI rate – Ofwat has nearly tripled the ODI rate compared to its PR19 final determination ODI rate for the same performance area – we consider that it is vitally important that Ofwat appropriately specifies this new change control process to cope with the impact of these prospective changes to the EPA methodologies.

Ofwat does not propose a penalty collar on the basis that this is a well-established performance commitment. However, given the substantial potential scope and definitional changes that are likely to serve to increase the number of incidents counted by the metric, we also consider that a penalty collar may also be an appropriate means of managing the risk of what is likely to become a much less well established performance measure during AMP8.

In "UUWR_56_Total pollution incidents" we detail the prospective regulatory guidance changes and the material uncertainties about how performance against this PC will be assessed and calibrated. We also outline our reservations on the ability of any change control process to appropriately deal with such changes in PCLs, ODIs and risk protection mechanisms, when there is limited or no historical data available for these changes. Through our response, we endeavour to highlight to Ofwat recommended areas to target the development and capability of its change control process.

We strongly urge Ofwat to thoroughly consider the impact of these points and address these concerns when implementing adjustments as part of the change control process. For our full response to Ofwat's draft determination for this outcome, please see "UUWR_56_Total pollution incidents".

3.4 C-Mex

We have carefully reviewed the proposed changes to calculating incentive payments for C-MeX, supported by analysis from Frontier Economics. We believe Ofwat's proposed approach to C-MeX will demonstrably fail to achieve Ofwat's stated aim of improving incentives for companies to increase levels of customer service. We propose that Ofwat reconsiders its approach in light of the analysis presented and that the current AMP7 approach to C-MeX survey design and incentive allocation be largely retained for year one of AMP8.

Our view is that the proposed changes do not comply with the risk and reward guidelines set out in Ofwat's PR24 final methodology and, as Ofwat states itself in the draft determination, the overall incentive is substantially skewed towards penalty. There is clear evidence that top end rewards are unlikely to be achievable by any water company. This increases the downward skew of the overall ODI package, which includes three penalty-only PCs.

For our full response to Ofwat's draft determination for this outcome, please see "UUWR_51_Customer (C-Mex)".

3.5 Operational Greenhouse Gas Emissions (Water and Wastewater)

We support the principle that operational greenhouse gas emissions should be subject to AMP8 incentives. However, the baseline year chosen for the PCL by Ofwat in its draft determination for UUW prohibits a fair and comparable performance commitment across the sector. We therefore propose that Ofwat should update the baselines for both Operational GHG PCs to be consistent across the sector and across water and wastewater. We suggest a baseline of 2024/25 forecast should be used.

Ofwat's proposed PCLs for Operational GHG should be updated in line with UUW's robust and assured forecasts. Ofwat's PCLs do not include the operational GHG effects as a result of UUW's AMP7 WINEP becoming operational, 2023/24 actual reported carbon data, improved granularity on chemical consumption, benefits from unfunded net zero enhancements and scope changes resulting from the draft determination. We propose a PCL which reflects all of these changes and is calculated using Ofwat's methodology stated in its draft determination.

The net zero base uplift of £7m is not sufficient to support the associated 2.5% stretch on the PCL: heat and fleet emissions make up less than 8% of our PCL. We have made a representation in response to Ofwat's draft determination of our net zero enhancement cases, as we believe that enhancement expenditure is the appropriate classification for investment to meet the net zero obligation.

Ofwat's proposed caps and collars for the GHG PCs are ineffective and do not sufficiently protect customers or UUW from unforeseen external events. We encourage Ofwat to reevaluate the level at which these risk protections are set, in order to ensure their effectiveness for these PCs, cognisant of the actual levels of performance and ODI rates for these PCs. For example, Ofwat's proposed 0.5% RoRE level means that, for Wastewater, the collar would be set at a level which is twice the level of our entire operational carbon emissions. This does not appear to be a realistic level at which a company's performance should be limited at, as it is far in excess of the performance range extremes which we would consider appropriate.

For our full response to Ofwat's draft determination for these two outcomes, please see "UUWR_53 Operational GHG PCs for Water and Wastewater".

In our September 2023 submission, we also highlighted that the wastewater operational greenhouse gas emissions performance commitment tended to interact negatively with biomethane production and export. This appears to run counter to government policy to support biomethane production. We did not receive feedback on this point at the draft determination, but we are providing additional evidence on this issue for Ofwat's further consideration at DD. We consider there is a case for removal of biomethane facilities from the PC baseline by re-baselining carbon emissions associated with biogas use, thus aligning the PC incentives with the direction of government policy. This is provided in Section 8 of UUWR_13_Bioresources.

3.6 Bathing Water Quality

Having reviewed the approach taken by Ofwat in the draft determination, we propose a revised PCL and baseline for this measure, calculated in line with Ofwat's methodology. We have conducted a comprehensive reassessment of our baseline, on a site by site basis, in accordance with the rules provided by Ofwat at Draft Determination. We have applied Ofwat's methodological approach and have provided compelling site-specific evidence to demonstrate that the new baseline is appropriate. This is set out in detail in "UUWR_55 Bathing Water Quality" and the associated annexes. We believe that the evidence provided is consistent with Ofwat's approach to baseline assessment and that Ofwat should be confident in adopting the new baseline proposed.

There are no AMP8 enhancement drivers for existing UUW bathing waters that will result in an improvement in classification: Enhancement drivers for new bathing waters at Coniston and Edisford Bridge have been reflected in

the performance commitment level. We have allocated an "Excellent" baseline for two new bathing waters, even though this will be based on a provisional dataset. This demonstrates our commitment to stretch for this measure. Given that all improvements to existing bathing waters are from base expenditure, we consider that an improvement in one bathing water represents a reasonable overall PCL target. Our proposed approach is in line with the Ofwat approach taken to all companies in setting the PCL for this measure and is equivalent to a 1% overall improvement compared to the baseline. This can be seen in OUT1.15 2029-30.

For our full response to Ofwat's draft determination for this outcome, please see "UUWR_55 Bathing Water Quality".

3.7 Business Demand

We make representations on both Ofwat's PCL and risk protection mechanisms included within its draft determinations for UUW. We propose workable solutions which we consider should be acceptable to Ofwat, for inclusion in its final determination.

We proposed an 8.3% target reduction to the 3-year average Business Demand in our PR24 Business Plan submission. This was replicated in Ofwat's draft determination; however, the draft determination also included a Business Demand PCL in excess of our submission. We propose Ofwat should update rWRMP input values into the PCL model "PR24-DD-PCM-Business-demand-1.xlsx" to adjust for UUW's allocation of unmeasured household consumption to 'water unbilled' in the WRMPs, but to NHH demand in PR24 tables. As a result of this input update, UUW's proposed demand reduction target for 2029/30 will pass all intervention tests. This should result in a final determination PCL which matches our PR24 business plan submission.

We continue to believe the best approach to managing uncertainty and unpredictability within the Business Demand PC is to exclude customers that typically use more then 50Ml/yr of water from the measurement of the PC (as Ofwat itself proposed in the PR24 draft methodology for this PC definition). Absent this consideration in the PC definition, we beieve that Ofwat's PCL adjustment mechanism is a step in the right direction to help manage uncontrollable risks such as business growth and large water users. We consider that moderate changes should be made to improve it, including reducing the materiality threshold and making indicative adjustments annually to allow companies to understand their performance throughout the AMP.

For our full response to Ofwat's draft determination for this outcome, please see "UUWR_64_Business demand".

4. Bespoke performance commitments

4.1 Summary

We welcome Ofwat's view that two bespoke performance commitments are suitable for progression to FD. These measures seek to improve the water quality of Windermere and reduce our embodied greenhouse gas emissions. We have addressed Ofwat's interventions in the draft determination and include revised versions of these two bespoke PCs in our response.

4.2 Wonderful Windermere

Ofwat considers that our proposed bespoke performance commitment is suitable for progression as a bespoke performance commitment. We have addressed Ofwat's feedback and interventions as detailed in "PR24 draft determinations: United Utilities Water – Outcomes appendix" related to this bespoke PC. Our response to Ofwat's actions is set out in 'UUWR_65_Wonderful Windermere' and the definition for this PC is set out in "UUWR_66 Wonderful Windermere definition document".

We are pleased that Ofwat recognises the compelling local circumstances which we identified in our proposal, including that of Windermere being a nationally significant water body. We welcome Ofwat's acknowledgement that the majority of phosphorous in the lake is attributable to third party assets, not directly associated with United Utilities, such as agricultural runoff, private treatment works and private septic tanks.

We have addressed Ofwat's comments in the draft determination on this bespoke performance commitment and look forward to applying our expertise in this area to improve the health and quality of the lake and surrounding catchment in order to achieve a better outcome for customer and stakeholders for this nationally significant waterbody.

For our full response to Ofwat's draft determination for this proposed outcome, please see "UUWR_65_Wonderful Windermere".

4.3 Embodied greenhouse gas emissions

Ofwat considers that our proposed bespoke performance commitment is suitable for progression as a bespoke performance commitment. We have addressed Ofwat's feedback and interventions as detailed in "PR24 draft determinations: United Utilities Water – Outcomes appendix" related to this bespoke PC. Our response to Ofwat's actions is set out in "UUWR_67_Bespoke PC - Embodied GHG Emissions" and the definition for this PC is set out in "UUWR_68 Embodied GHG definition document".

We have addressed Ofwat's comments in the draft determination on this bespoke performance commitment and look forward to reporting on this measure in 2025-30, seeking to find the basis for a common PC at PR29.

For our full response to Ofwat's draft determination for this proposed outcome, please see "UUWR_67_Bespoke PC - Embodied GHG Emissions".

5. ODI rates

5.1 UUW's PR24 proposal

In our business plan submission (UUW05 section 5.6.1) we set out our approach to ODI rates and commented on Ofwat's approach to the valuation of indicative ODI rates for use in companies' PR24 business plans.

Ofwat significantly changed its approach to calculating ODI rates at a relatively late stage in the process and shortly before companies had to submit their PR24 business plans. This meant that we were unable to use them fully in shaping our investment proposals as we would have wished or otherwise conduct our own robust customer research to propose alternative rates.

We noted that when Ofwat set indicative rates, it did not calibrate these against likely future performance ranges for each individual performance commitment, nor against the overall risk that companies would face in their business plans. In part, this reflects the sequencing of these activities: Ofwat was setting indicative rates before plans were received. However, Ofwat still required companies to submit plans which had an ODI RORE range of +/- 1 to 3%. Ofwat's methodology aims for a balanced ODI risk profile within this range which is challenging given three penalty-only PCs, the broad removal of collars, deadbands and exclusions and penalty-only PCDs (which were outside of this range entirely). Whilst UUW submitted plans within this range (including well-evidenced proposals for bespoke PC ODI rates and rates for the three PCs which Ofwat did not propose), it was not without intense consideration of our likely risk ranges on what is a stretching set of PCLs that we proposed.

Ofwat's indicative rates included, for example, a "top down" ODI rate for internal sewer flooding which was double Ofwat's PR19 ODI rate and ten times more powerful than Ofwat's PR24 customer research indicated. We incorporated Ofwat's "top down" rate in our PR24 submission whilst also setting a PCL and deadband which reflects regional operating circumstances. We noted that if such an excessively powerful and uncalibrated ODI rate were coupled with unattainably high performance commitment levels – ignorant of regional operating circumstances – then this would lead to an excessively negative skew for the risk/reward framework.

From companies' October 2023 submissions and post-submission query responses, Ofwat has sought additional detail on performance ranges with which to appropriately calibrate ODI rates and PCLs. Set appropriately, they should incentivise companies to balance competing pressures in allocating cost and effort to different areas of customer service delivery.

5.2 UUW's understanding of the position in the draft determination

Ofwat has made a number of changes to its ODI rates. Sometimes this results in setting rates which are inconsistent between companies and are also inconsistent with its stated approach of placing its customer research results at the heart of the valuation of its ODIs. Ofwat has uplifted the value of over nine ODIs compared to indicative rates, without evidence that the resultant rates have been calibrated to its customer research, ODI rates determined at previous price reviews, or the resultant ODI RoRE range appropriately assessed as sitting within the expected +/- 1 to 3% RoRE range stated in its final methodology.

Ofwat has removed the ODI rate entirely for one of its new common PCs – River Water Quality – which now remains as a PC but is reputational only. This is a surprising decision given that it is open to Ofwat to place customer protection measures around ODI excesses which could arise if it sets the PCL at a level which ultimately results in significant under- or out-performance given that the measure is relatively new. The use of a reputational only PC also seems at odds with the final methodology and approaches to the AMP8 Outcomes regime.

Ofwat's DD reinforces the inherent downside skew of the Outcomes regime. Not only are all three of the penalty-only PCs (CRI, DPC, Serious Pollution) now subject to significantly increased ODI penalty rates (by 127% to 208% compared to Ofwat's indicative ODI rates) but the CRI deadband has been halved, C-Mex has been reformed to become significantly downside skewed for the industry and enhanced rewards removed which were previously available for PCC and Total Pollution Incidents PCs.

5.3 Significant increases to ODI rates

Ofwat has significantly increased the value of nine ODI rates compared to the indicative rates its published shortly before companies submitted their PR24 business plans. This creates a significant disjoint in the PR24 process and it is exceptionally difficult for companies to create coherent plans around such key moving targets. Inappropriate ODI rates and performance levels which are not calibrated to each other can lead to uneconomic decision-making by companies, chasing uneconomic performance levels to avoid or attract over-valued ODI rates that are not grounded in customer valuations. Such uncalibrated outcomes will lead to ineffectiveness of incentives and will incentivise inefficient allocation of resources and investment decisions, to the detriment of company, customers and the environment.

The combined effect of Ofwat's PR24 draft determination ODI rates and PCLs can be seen when applied to the most recent reported year of performance. UUW's AMP7 performance is measured on a package of PCs, around 12 of which will persist into PR24: from water and wastewater measures, to C-Mex. If we maintained 2023/24 performance but applied Ofwat's draft determination PR24 ODI rates and 2025/26 PCLs, the financial impact would be significantly worse on these pervasive measures. The negative skew of ODI's and ultimate drag on financials is excessively punitive on this like for like basis, with the downward skew on this basket of continuing performance incentives increased by 500%. This is most severe on wastewater PCs where we could expect to see a deterioration of nearly five times in the ODI penalty. Significant contributors to this worsening position are from: more than fourfold penalty increases to internal sewer flooding (increase to £(66.1)m), external sewer flooding (increase to £(28.2)m); and, more than fivefold increases to total pollution incidents (increase to £(27.2)m) and C-Mex (deterioration from a reward to an estimated penalty of £(21)m). This reflects the significant increase in the power of financial incentives and the further stretch of PCLs.

Ofwat's proposed reforms to C-Mex – published alongside the draft determinations for consultation – also result in effectively a significantly penalty-only PC. Ofwat states itself that the overall C-Mex incentive is substantially skewed towards penalty. There is clear evidence that top end rewards are highly unlikely to be achievable by any water company. For example, UUW would expect to earn a £(9.8)m penalty in 2025/26 if we had identical performance as that in 2023/24 where we earned a reward of £1.8m. This adds further to the significant downside skew of the outcomes package – a package which already contains three explicitly penalty-only PCs.

A further example of the extremes in the ODI package can be seen in some of the per incident ODI rates, which appear grossly disproportionate to the service failure experienced by the customer or Ofwat's own PR24 customer research valuations. The PR24 draft determination rates equate to financial penalty of £6,778 each time a customer contacts the company regarding water quality. This is around thirty times the annual water bill and is applied based on whether there was a contact from a customer – not on whether a material failure actually occurred. Likewise, penalty rates of £62,922 per internal sewer flooding incident and £23,373 per external sewer flooding incident appear very high, whether compared to historic levels, customer valuations or the wastewater bill.

Ofwat has made this significant increase to the ODI rates across its outcomes suite with limited reference to its own PR24 customer research results or regulatory precedent. Ofwat has an extensive repository of customer valuations for the performance areas which it is seeking to impose ODI rates on, ranging from AMP6 to its own customer research results as part of PR24. There appears to be very limited evidence of a clear thread between the PR24 draft determination ODI rates and past valuations – whether customer research or past ODI rates. For such significant changes in valuations from PR19, over the relatively short space of time to July 2024, it would be reasonable to expect that the revised ODI rates would be well justified. This would at least allow companies to plan and calibrate business plan proposals in a robust fashion. However, since making an abrupt change in approach in April 2023, to then adopt a top-down approach to valuing ODI rates, from the previous bottom-up approach, Ofwat's approach has been challenging to predict and volatile in practice.

At draft determination, Ofwat has supplemented its approach with a rule that its DD ODI rates should be no less powerful (in terms of monetary value per measured incident) than the PR19 FD ODI rates. This might be a reasonable approach, all other things being equal. However, PR19 and PR24 are not equal, with PR19 having far

more risk protections and far less of an inherent downside financial skew to the Outcomes package than PR24 currently has.

Ofwat could also have chosen to check that its PR24 draft determination ODI rates are in line with customer research. For example, the PR24 DD ODI rate for internal sewer flooding is 12 times in excess of the customer valuation which Ofwat calculated in 2021/22. For this area of performance customers were directly asked how much they would value the avoidance of a service failure, being an internal flooding of their property by sewage. Once weighted by household and non-household respondents, this valuation was a direct mapping to the common PC and ODI rate.

Ofwat does not appear to have performed this check in its resultant DD ODI rate (or the previous indicative ODI rate, or the April 2023 ODI rate before that). Such changes in ODI rates over a relatively short space of time have been very difficult for companies to address when formulating where their AMP8 investment programme should be weighted, in order to appropriately respond to Ofwat's incentive package. Compared to Ofwat's FD PR19 ODI rate for this service area, UUW's ODI rate has nearly tripled at PR24 DD. We accepted the PR19 FD package, of which the internal sewer flooding PC was a part of, included as it was with what we viewed to be a reasonable ODI rate and effective collar. These appropriate safeguards were a key element that supported that decision and made the package acceptable in the round.

Ofwat has chosen to apply an ODI rate calculated from an artificially narrow performance range, rather than its own PR24 customer research results. Ofwat's P10/90 performance range is artificially narrow due to Ofwat's exclusion outliers from the long historic dataset for this PC. We consider that this approach of excluding some performance from the ODI calculation is not in keeping with Ofwat's approach to defining and measuring company performance on this PC. Very little is removed from the assessment of company performance and with no cap or collar, outliers are included in financial incentivisation. The effect of Ofwat's understated RoRE range is then applied to create an overstated ODI rate in Ofwat's ODI calculations 'PR24-DD-ODI-Rates'.

Ofwat should use a realistic RoRE range and calibrate its ODI rate to past ODI rates and customer valuations. The table below summarises the movements in ODI rates at three key points: PR19 final determinations, PR24 business plans (where we included the indicative ODI rates which Ofwat published June 2023) and PR24 draft determinations. It highlights the significant changes in ODI rates since PR19 FDs for the pervasive measures, showing a lack of consistency and illustrating the difficulties companies have faced when attempting to put the financial incentive properties at the heart of business planning for PR24.

Table 1: ODI rates: PR19 final determinations (uplifted to a comparable price base), PR24 Ofwat indicative and PR24 draft determinations[5]

	ODI rates (£m)			Comparisons (%)		
	PR19 FD	PR24 Ofwat indicative	PR24 DD	PR24 Ofwat indicative vs PR19 FD	PR24 DD vs PR19 FD	PR24 DD vs PR24 Ofwat indicative
Water supply interruptions	1.10	2.06	1.48	187%	135%	72%
Compliance risk index	1.33	1.90	2.41	143%	181%	127%
Customer contacts about water quality	29.39	19.06	49.74	65%	169%	261%
Internal sewer flooding	7.97	15.10	21.74	189%	273%	144%
External sewer flooding	2.64	6.76	8.07	256%	306%	119%
Leakage	0.21	0.37	0.91	176%	433%	246%
Per capita consumption	0.47	2.57	1.35	547%	287%	53%
Business Demand	0.00	0.36	0.25	n/a	n/a	69%
Total pollution incidents	1.08	1.78	2.83	165%	262%	159%
Serious pollution incidents	n/a	1.14	1.75	n/a	n/a	154%
Discharge permit compliance	1.80	2.88	5.98	160%	332%	208%
Bathing water quality	n/a	1.64	1.91	n/a	n/a	116%
River water quality	n/a	0.000661	n/a	n/a	n/a	n/a
Storm overflows	n/a	1.29	1.78	n/a	n/a	138%
Mains repair	0.28	0.37	0.32	132%	114%	86%
Unplanned outage	3.19	4.06	10.91	127%	342%	269%
Sewer collapses	0.37	1.71	6.57	462%	1776%	384%

Source: UUW analysis

Table 1 shows that Ofwat has increased more than two thirds of the ODI rates at draft determination compared to its PR24 final methodology indicative rates, four of which have more than doubled, one has more than tripled. Compared to the PR19 final determination ODI rates which Ofwat set, the PR24 draft determination ODI rates have all increased, six by around 3x and one by 18x the PR19 FD valuation.

5.4 Risk ranges

Ofwat's risk ranges for the Outcomes package are not reflective of individual company performance risk and do not appear credible when set against UUW's PCLs, historical performance ranges, the absence of effective risk protections in the Outcomes package and the broad definition of performance commitments which encapsulates many more exogenous factors than in previous price controls. Ofwat appears to have assessed P10 and P90 performance ranges on an industry wide basis, rather than at a company level basis and also to have removed outliers from its dataset.

We do not think that Ofwat should exclude outliers from the historical data set. In Ofwat's DD document "PR24-DD-ODI-risk-Monte-Carlo-set-up.xlsx" tab "Cover" Ofwat states: "The normal distribution is informed by historical percentage difference between company performance and the performance commitment level (PCL) target using data from 2011 to present, where available. To form a normal distribution, we remove outliers that may skew the normal distribution values".

Over a long data set, such outliers are highly likely to represent statistical P10 and P90s and should not be excluded. Excluding data at either extreme will result in an understated risk range. The purpose of using the P10 and P90 values rather than the maximum and minimum is to prevent extreme outliers from skewing results but excluding them from the dataset will mean that the proposed P10 and P90 are understated and not true P10 and P90 values. This is inappropriate when modelling the statistical risk that companies are exposed to, based on

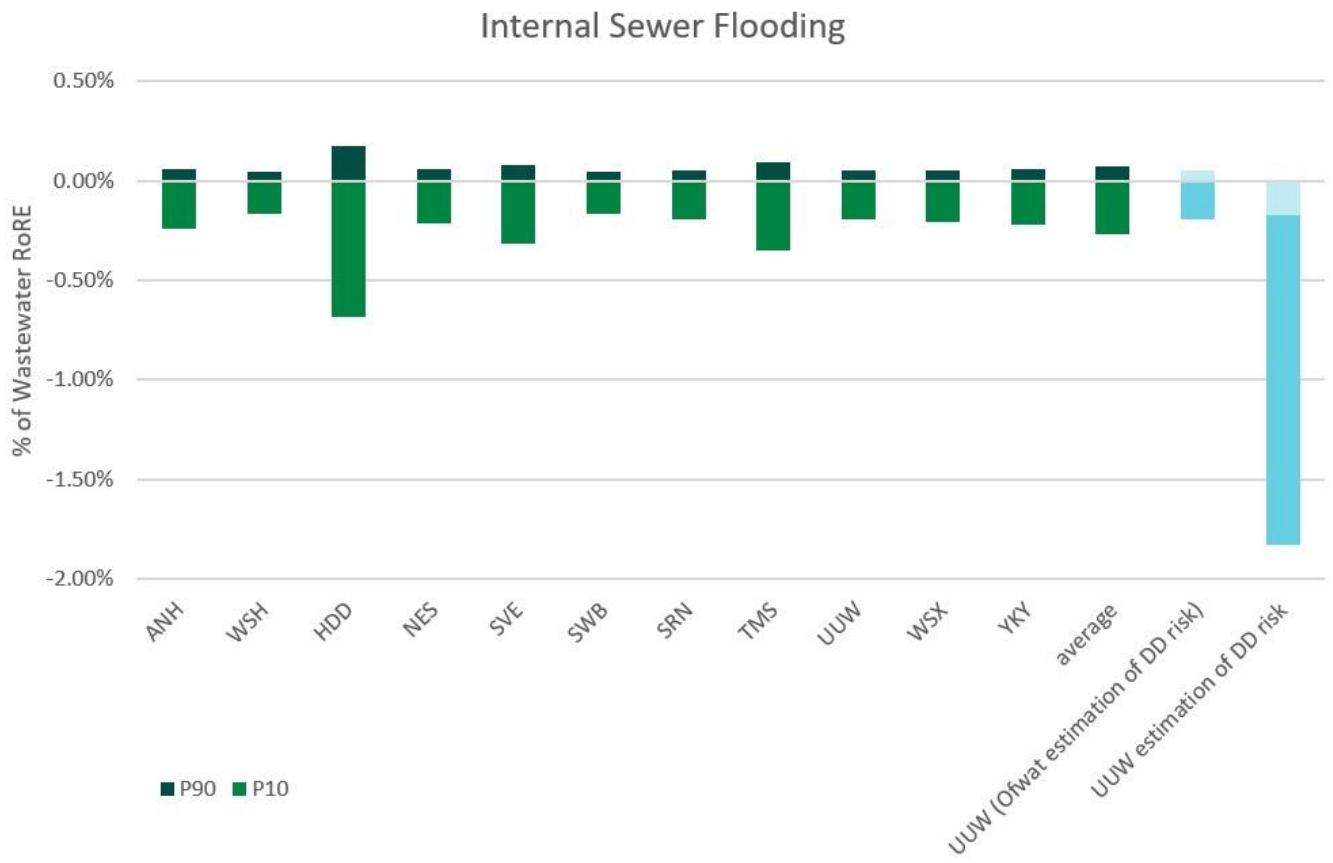
[5] Excluding PR24 PCs where Ofwat did not propose an indicative ODI rate. These are the three GHG emissions PCs, the bespoke PCs, and Biodiversity PC.

historical data sets. Including all observations within the historical data set is even more important when considering that 'extreme' events, particularly due to weather events, are becoming more common with the impacts of climate change. To present the correct risk ranges faced by companies and investors, Ofwat should use the entire dataset when assessing the P10 and P90.

Ofwat had limited data sets for the new common PCs and asked UUW to explain how it had calculated its risk ranges. We expansively responded to this query (OFW-OBQ-UUW-147) but it is evident from the resultant risk ranges - particularly in Wastewater - that company responses have not been taken into account when setting P10 and P90 risk ranges and therefore Ofwat's resultant ODI rates. Through this method of analysis, Ofwat has therefore been able to present in its draft determination very narrow risk ranges (see Figure 12 page 131 "PR24 draft determinations: Delivering outcomes for customers and the environment").

Ofwat's calculations imply that UUW's underperformance risk across Wastewater is the lowest of all companies at -1.22% of RoRE. The PR24 ODI risk range presented for Wastewater is particularly unintuitive for UUW given that this includes the risk for internal sewer flooding. This is an area where Ofwat proposes a common PCL at a similar performance level trajectory to AMP7, for a performance area in which UUW has never met the PCL and no enhancement allowance has been made (historically or in PR24) to enable UUW to make that step change in performance to bring it into line with the industry. Ofwat's individual PC risk ranges for internal sewer flooding calculates that UUW will perform, at a P10 level only -0.19% under the PCL (which is more favourable than the industry average P10 which Ofwat estimates of -0.27%) and at a P90 level, at 0.05% above the PCL during AMP8. We estimate that performance at the P10 level on the internal sewer flooding measure alone as defined in the draft determination would yield a c.£(314) million penalty over AMP8 and -1.4% of RoRE (using Ofwat's DD RoRE), implying an average of £(63)m per annum.

Figure 1: Internal Sewer Flooding draft determination performance ranges

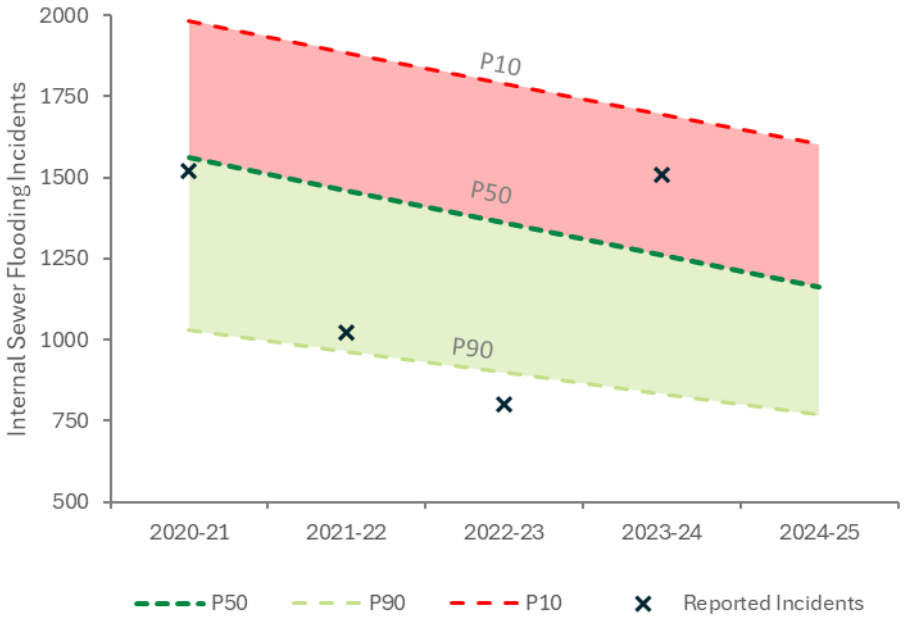


Source: UUWanalysis

We consider that our P10 estimation represents a reasonable worst-case scenario, with 2 of the 4 years of AMP7 to date experiencing total incident numbers that are in line with our calculated P10 for AMP8. Further, comparison of observed internal sewer flooding incident numbers in AMP7 to date with the P10/P50/P90 ranges

that we calculated at PR19 demonstrates that our forecasts are reasonable and broadly capture the range of potential internal sewer flooding scenarios we experience (Figure 2).

Figure 2: UUW's PR19 P10, P50 and P90 estimations for internal sewer flooding alongside observed AMP7 incident levels to date. Our method of estimation was therefore sensible and broadly able to capture the range of scenarios experienced



Three of the years fell within the P10-P90 range. The 2022/23 outturn was slightly above the P90 level, reflecting that this was our best ever performance and the results of the combined factors of the benefits from dynamic network management (DNM) being realised and the weather being particularly dry. Our 2023-24 outturn was within the P50-P10 range, demonstrating that our method for estimating P10s is robust and our AMP8 projections should be considered a suitable estimation of potential risk.

The risk range that Ofwat presents in its draft determination does not reflect the inherent downside skew which Ofwat has built into the outcomes package. Not only are there three penalty-only PCs, but there is also the impact of the revised C-Mex PC which statistically will be significantly downside skewed but has been represented in Ofwat's draft determinations (see Figure 5 page 15 "PR24 draft determinations: Aligning risk and return appendix") as having a balanced P10 to P90 range of 0.5% RoRE, the extremes available for this measure. All customer experience measures have been similarly represented in Ofwat's draft determination risk assessments. However, only C-Mex now carries this innate downside bias due to its revised calculation method.

In addition, there appear to be errors within Ofwat's ODI risk range models. For example, the Biodiversity P10 and P90 are both stated as positive values, relative to the PCL. This implies that there is assumed to be no underperformance possible on this PC, but it is clearly stated in the performance commitment definition document and Key-dataset-1 to have an associated underperformance ODI rate.

5.5 River Water Quality

We are disappointed that Ofwat has removed any positive financial incentivisation from companies to deliver early their environment commitments to reducing phosphorous outputs. It has done this through removing the ODI from the River Water Quality PC and instead regulating the delivery relating to companies' phosphorus permit allowances. Ofwat proposes that this is measured and incentivised through a PCD, the design of which does not allow for significant financial incentivisation for outperformance. By having a financial incentive attached to the River Water Quality PC, there existed a mechanism to encourage and reward companies for delivering environmental improvements in excess of their permits. The PCD which Ofwat proposes relating to phosphorus does not provide any meaningful incentive to make this environmental improvement over and above permits or

allowances. Our PR24 business plan submission proposed that PR24 determinations should have the capacity to incentivise this environmental improvement through the outcomes regime, rather than through PCDs. Ofwat has taken the opposite approach in its draft determinations which means that environmental improvements will likely be less incentivised and therefore slower.

6. Risk protections

6.1 Ofwat's approach to risk protections at PR24

Whilst Ofwat's common PC suite is far narrower at PR24, compared to previous price review, what performance is captured by these PCs is far broader. In many instances, the performance measured is so broadly defined that it is substantially exogenous to the regulated company itself. This creates an increased risk for companies which should be effectually managed by risk protection instruments in the outcomes package.

Ofwat's disapplication of deadbands and the setting of caps and collars at distant levels that are ineffective as mitigation means that these mechanisms do not offer appropriate or effective protections opposite these expanded risks.

Ofwat has not proposed caps and collars set with reference to the performance levels that they are also requiring of companies, but rather with reference to their regulated equity (i.e. their past historical investment). This means that not only are caps and collars divorced from performance levels, but that companies do not have common cap and collar levels for common areas of performance, not even for those PCs where the PCLs are set at a common level across companies. In some cases, this means that the caps and collars fail to provide any meaningful level of protection for either customers or companies. We note that this is a materially different application than was made by Ofwat at both PR19 draft and final determinations.

Ofwat's risk protection approach is out of step with its PR24 method of defining PCs and what is in or out of company control. It is also out of step with the financial risk which companies now face from significantly increased ODI rates, where UUW's PR24 DD rates have increased from PR19 FD by up to 18 times.

We are however pleased to see that Ofwat has now widened the caps for asset health measures and made them symmetrical with the collars. This is in line with our response to Ofwat's draft methodology consultation on the matter.

6.2 Using RCV to scale risk protection mechanisms (caps and collars)

We do not support the proposed approach for calculating risk protection mechanisms – caps and collars - based on the proportion of each companies' regulated equity. This approach suggests that the limits up to which performance is incentivised for each company should be set with reference to the scale of past capital investments. This would lead to the extremes of performance in some areas of England and Wales being valued over ten times higher than in other areas. In line with past determinations and our PR24 business plan submission we propose that caps and collars should be expressed and calculated with reference to performance levels. We provide caps and collars expressed with reference to performance levels in UUWR_93. A top-down calculation of financial risk which a company is exposed to – calibrated to its past capital investments – is not an appropriate way to limit the financial exposure of customers or companies or set the range above or below which companies are no longer incentivised to perform at.

We propose instead that caps and collars should be calculated based relative to PCLs. This is how we have proposed the appropriate cap / collar for the Storm Overflows PCL and provided compelling evidence to support the level at which we have proposed it. For more information, please refer to UUWR_10_Overflows.

We do not believe that Ofwat has provided justification for why it has set caps/collars at 0.5% (or 1.0% for WSI). In our PR24 business plan submission we provided compelling evidence on a PC by PC basis for the level of each cap and collar which we proposed, expressed in terms of performance (see the "summary, definition and parameters" tables for each PC in our PR24 submission PC technical appendix 'UUW30', for example table 7 for Water Supply Interruptions). We assumed that Ofwat would follow regulatory precedent and express the proposed RoRE % collars in terms of performance in the draft determinations. Ofwat has not done so and its definition in "Delivering outcomes for customers and the environment" of what RoRE would be used to determine caps and collars in AMP8 is open to ambiguity. Ofwat has used AMP8 draft determination average RoRE values to calculate ODI rates. However, because the caps and collars do not appear to be expressed in £m or

performance levels in the draft determination documentation, it is unclear what RoRE will be applied to calculate caps / collars in AMP8 itself. We consider that options could include basing RoRE on: actual or shadow RCVs; an aggregated "Large company" RCV (which has been used to calculate ODI rates for UUW); AMP8 average RCV or annual RCV (this would lead to growing caps/collars as investment in RCVs increased over the AMP). Equity injections would also impact RoRE. Such ambiguity should be resolved to enable Ofwat and companies to properly assess the risk of the outcomes package.

We urge Ofwat to consider our proposals and set appropriate risk protections with reference to performance rather than with reference to past capital investments. Ofwat considers it appropriate to take into account the size of companies' RCVs when setting ODI, so as not to over-power ODIs. However, it has not been consistent in also considering that using RCVs to set acceptable performance extremes means that companies' risk exposures are significantly different on the same PC (sometimes with a common PCL) for no other reason than past capital investment has produced significantly different RCVs.

By calibrating caps and collars to regulated equity, each company will face a very different – up to ten times – upper and lower extremes of performance on which it is incentivised. Customers do not value out or underperformance of an outcome based on past historical investment. Ofwat's approach to caps and collars means that customers of companies with relatively low RCVs - compared to those with higher RCVs – will find their WoC or WaSC has a relatively narrow range of performance over which it is incentivised to deliver, compared to a customer of a company with a much larger RCV. The risk of hitting caps or collars is therefore different for every company. If cap and collars are set on an annual – rather than an AMP8 average – RoRE, this will grow with investment. However, this growth is not forecast to be consistent between companies, therefore caps and collars will further diverge across the industry.

Setting caps/collars on divergent RoREs is an unreasonable position if all companies have common ODI rates, common PCLs and the P10/90 performance ranges have been assessed on a common-industry-wide basis. It would also be an inconsistent approach with how Ofwat has set ODI rates – where Ofwat has grouped "Large RCV" companies together in order to calculate a consistent ODI rate for these companies based on their averaged regulated equity. If caps/collars are then calculated on an individual company basis, it will be difficult to explain to investors why companies have different levels of risk exposure on these common PCs.

It does not seem appropriate that the value placed on a company's potential performance range is so directly limited by a financial mechanism such as regulated equity. Whilst it may be appropriate to set ODI rates top-down based on regulated equity, performance ranges should be set based on more suitable factors such as historical performance.

6.3 Internal Sewer Flooding – collar

Critically, to prevent the outcomes package being significantly negatively skewed by exceptional weather events, Ofwat should re-instate a collar on the Internal Sewer Flooding PC. Companies cannot reasonably be expected to 'weatherproof' the network against such events without very material additional investment that would likely have an unacceptable impact on customer bills. Over the last 10 years, 29% of UUW's total internal sewer flooding incidents occurred on just 1% of the days, illustrating the disproportionate impact that low frequency, high magnitude weather events can have on this performance commitment.

We recognise, and take extremely seriously, our statutory responsibility to effectually drain our area: However, this should not be conflated with an unrealistic suggestion that companies can or should upgrade networks to fully accommodate all flows associated with exceptional weather events.

Ofwat is understandably concerned that caps and collars limit incentives once the cap or collar level is reached. Whilst we understand this concern, the application of a collar on this measure in AMP7 has not disincentivised UUW from delivering performance improvements and additional investment in this area. In our PR24 submission we demonstrated that UUW has had by far the largest total expenditure of all companies on 'reducing flood risk for properties' per 10,000 sewer connections within AMP7 to date. As a result, we do not believe that the application of a collar discourages investment in resilience measures. The introduction of the customer-focused licence condition in February 2024 provides an additional layer of protection for customers such that if a company

hits a collar in a given year, it is still incentivised to drive performance improvements or receive a fine of up to 10% of company turnover. For a full discussion on the Internal Sewer Flooding PC, please see UUWR_12_Internal sewer flooding.

6.4 Storm overflows – collar

In our PR24 business plan submission and subsequent query responses such as query 147 part 2, we provided extensive and compelling evidence to justify the application of a collar at +/-30% of the PCL. The proposal was based on historic modelled data, presented in UUW64 and again identified though the query process in response to query 147 (part 2). We ran 10 years of time series rainfall through our hydraulic network models for 82 sites to identify the modelled annual spill frequency which was then compared to the ten-year average for each site. The annual variance was measured as a percentage of the ten-year average spill frequency; by using the percentage variance we were able to compare results from overflows that had varying annual spill frequencies.

Following our PR24 submission, UUW has continued to model storm overflows to further enhance our understanding of operation of storm overflows under different rainfall years. We have now modelled over half of our storm overflows to identify the range in spill frequencies as a result of rainfall. Following the same methodology as carried out previously, we ran hydraulic network models using 10 years of time series rainfall to identify the annual spill frequency from 1,179 storm overflows within the North West. The annual spill frequency was compared to the average spill frequency and presented as a percentage change from the average.

The expanded results show reasonable correlation between the variation in spill frequency from our initial sample of 82 sites and the much larger sample of over 1,179. For sites discharging an average 10 times or more, 80% of data points fell within the +/-30% variance, and 89% fell within a +/-40% variance. Thus indicating that, based on the evidence, it is reasonable to limit any under-performance and out-performance payments at +/-30% of the target. For further details of this evidence please see UUWR_10 section “Caps and collars”.

In its draft determination, Ofwat has not responded to UUW’s extensive evidence on the calibration of the cap/collar which we provided in our PR24 business plan submission nor provided evidence in support of its proposed -0.5% RoRE-based collar.

We consider that our analysis is robust and statistically sound and should form the basis of the cap/collar for this PC, set at +/-30% of the PCL. For a full discussion on the overflows PC, please see UUWR_10_Overflows.

6.5 Total Pollution incidents – collar

Given the substantial potential scope and definitional changes that are likely to serve to increase the number of incidents counted by the metric, we also consider that a penalty collar may also be an appropriate means of managing the risk of what is likely to become a much less well established performance measure during AMP8. For a full discussion on the Total Pollution Incidents PC, please see UUWR_56_Total pollution incidents.

6.6 Deadbands

Ofwat’s approach to deadbands at PR24 is out of line with previous regulatory precedent. For example, PR19 deadbands for DPC and CRI sought to provide for some fluctuation in performance for these performance commitments with full compliance, whilst providing a strong incentive to minimise compliance failures. We illustrate in the DPC response document (see Figure 1 in ‘UUWR_54’) that there is significant volatility in performance, and it supports our arguments for the need for a deadband on DPC for which Ofwat has not proposed one. This is at odds with Ofwat’s approach to another full compliance measure with significant volatility, Compliance Risk Index. We endorse Ofwat’s draft determination to set a deadband for this measure, which takes into consideration exogenous factors captured by its performance commitment measurement.

Ofwat has not applied a deadband to the Discharge permit compliance measure. This is a full compliance measure. By removing the deadband at PR24, Ofwat becomes out of step with the quality regulator and out of step with its’ own approach to the application of deadbands on full compliance measures at PR19. We consider that a 100% performance target with no deadband is an unrealistic expectation for performance; past

performance does not suggest that companies can reliably perform at this level on a consistent basis. We provide evidence that nearly all the examples relied upon by Ofwat for historic performance at the 100% level are unrepresentative of the challenges faced by the industry as a whole. Further, given the potential for additional changes to the assessment of permit compliance, 100% compliance is likely to become an even more challenging target during AMP8.

The Environment Agency and the CMA have each recognised that even the leading companies are unlikely to achieve a 100% perfect score. The EA fully recognises the importance of this measure as an EPA "core" gateway metric; however, it sets a "Green" threshold of 99% recognising that continuous perfection is unlikely to be attainable. Ofwat should apply a deadband of 99.0% to this PC, as we proposed in our PR24 business plan submission. Alternatively, if Ofwat does not wish to apply an industry-wide deadband then it could include a deadband specifically for WaSCs, reflecting the differing challenges between the operator types. If Ofwat does not wish to pursue either of these approaches then it may wish to apply a flexible deadband, one which is applicable twice within the AMP. Allowing a deadband for up to two of five years within the AMP would act as a mid-point position between a fixed deadband and the absence of a deadband. We discuss this proposal further in section 5 of 'UUWR_54'.

At final and draft determinations in PR19, Ofwat said in relation to CRI and Treatment Works Compliance (the PR19 version of DPC):

"We require full compliance with these measures. We also consider deadbands are appropriate for these performance commitments with full compliance to provide for some fluctuation in performance, whilst providing a strong incentive to minimise compliance failures. For these performance commitments, we consider deadbands should be the same across all companies. We consider company specific arguments and allow exceptions if well justified."[6]

The CMA also agreed this view in its PR19 redeterminations:

"We also agree that deadbands may be appropriate in certain circumstances. Deadbands may be appropriate where outcomes may not be fully within the control of management such as in the following circumstances:

(a) The measure itself allows very little tolerance: In these cases, a company might 'miss' the PC without necessarily having objectively failed in management of the commitment. Ofwat set deadbands for the two statutory PCs (the water quality index CRI, and Treatment works compliance), for which the PC level is full compliance (an index score of zero, or 100% treatment works compliance)." [7]

It reflected that deadbands should be applied for compliance related performance commitments such as CRI and Treatment Works Compliance (the pre-cursor to PR24's PC DPC) because the relevant regulatory bodies (DWI and Environment Agency) require 100% compliance (e.g. no quality related failures). At PR19, Ofwat consistently applied the deadband throughout the development of PR19 and that the deadband is to allow a "margin in performance, before an underperformance payment applies". To be consistent in its regulatory approach to TWC/DPC performance, Ofwat should therefore apply a deadband to DPC performance.

In its PR24 methodology Ofwat decided to align completely with the EA methodology with respect to reporting the percentage compliance to 1 decimal place, rather than the two decimal places required in AMP7. The variance in reporting was an inconsistency between regulators and the reporting of performance – for UUW it resulted in reporting of underperformance against Ofwat's performance commitment in some years whilst simultaneously achieving the EA's expectations. Such outcomes are contradictory and confusing to stakeholders – UUW welcomes the resolution of this discrepancy and considers that this approach of regulatory alignment

[6] "PR19 final determinations: Delivering outcomes for customers policy appendix", Ofwat, December 2019, https://www.ofwat.gov.uk/wp-content/uploads/2019/12/PR19-final-determinations-Delivering-outcomes-for-customers-policy-appendix.pdf, page 16 table 3.1

[7] "Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations - Final report", CMA Competition and Markets Authority, 17 March 2021, https://assets.publishing.service.gov.uk/media/60702370e90e076f5589bb8f/Final_Report_---_web_version_-_CMA.pdf, page 631 section 7.103

should also be applied to the deadband. This should be set in alignment with the green thresholds for EPA of 99.0% compliance.

The draft determination ODI rate for this PC is more than triple that PR19 final determination ODI rate, for a penalty-only measure which had the risk protection of a deadband at PR19. The absence of a deadband on this PR24 PC is therefore more egregious, adding significant downside skew to the overall RoRE range of the PR24 Outcomes package.

For our full response to Ofwat's draft determination for this proposed outcome, please see "UUWR_54_Discharge Permit Compliance".