

Introduction

United Utilities welcomes the opportunity to comment on Ofwat's consultation on the Annual Performance Report 2018-19.

We have responded to each of the questions set out in the consultation and have also set out a number of additional comments about the RAGs that are not covered in the responses to the specific questions.

As part of our response to question 3 all companies have come together, facilitated by Water UK, to share experiences of shadow reporting for 2017-18. The common feedback on three measures is included within our response to this question. We have also included two annexes to this response setting out the specific proposed changes to two of these measures.

Consultation questions

Q1. Transparency of financial flows - Appendix 1 contains our new table 1F;

- a. Do you agree with the scope of the proposed information items in the new table?**
- b. Is there any information missing from this table which you think should be included in order to achieve transparency and consistency for financial flows reporting?**

Do any of the line item definitions require further explanation?

- a) We agree with the scope of information with the exception of the points raised below:

Actual performance adjustment 2010-15 Adjustment Line 1F.2

The 'Actual performance adjustment 2010-15' Line 1F.2 relates to out/under performance generated in the previous AMP. The inclusion of this within financial flows is inconsistent with the rest of this metric, which calculates returns generated/accrued in the year and does not include returns when they are subsequently actually realised through the P&L (e.g. through revenue/RCV adjustments). This is demonstrated by Line 1F.12 re: ODIs which only includes out/under performance from ODIs as a result of current year performance (i.e. on an accruals basis) and does not adjust for when the subsequent payment is made/received through revenues/RCV (i.e. on a cash basis). This same accruals basis also applies for lines 11 totex and line 13 retail. We believe that, in order to generate a more meaningful measure, financial flows should represent actual returns generated in the year (i.e. purely on an accruals basis) and the current combination of accruals and cash basis distorts this measure, becoming misaligned to actual returns generated in the year. As such, we believe line 1F.3 should be removed.

ODI out / (under) performance Line 1F.12

The definition for line 1F.12 includes the statement "*The ODI out / under performance as reported in table 3A*". However, table 3A ODIs does not include any out/under performance in relation to SIM. This is inconsistent with the ODI component of the RORE metric, presented in Table 4H line 24, which includes "*ODI or SIM outperformance payment or underperformance payment*". We believe forecast SIM out/under performance payments should be included in financial flows either as an additional line or, in line with RORE, by amending the existing Line 1F.12 definition e.g. append the additional wording "Also includes the impact of SIM outperformance payment or underperformance payment earned in the year, as included in 4H.24"

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

- b) The only information missing, based on the current line definitions, is SIM as outlined in part a) above.

Line definitions requiring further explanation:

Cost of debt line 1F8

The Cost of Debt line definitions (1F.8a & 1F.8b) point f) both include “Adjusted for Corporation Tax (at standard rate)”, resulting in cost of debt being presented post-tax. However, the ‘Variance in Corporation Tax’ line (1F.6) uses the pre-tax position, including the deduction of finance expense, to calculate tax outperformance. As such, this line will already include the tax impact of any finance out/underperformance and therefore this tax component would be double-counted in the financial flows metric. To resolve this we believe that point f) on lines 1F.8a/b should simply be removed and a clarification, similar to lines 1F.11-13, could be included i.e. “(Note: no adjustment should be made for corporation tax)”.

This issue can be illustrated by this simple example below. Suppose Company A, geared in line with Ofwat’s notional gearing assumption (62.5%), earns a return on regulatory allowance equal to the FD allowance (5.63%) and has zero under/out performance on everything else. Its financial flow for total earnings (line 1F.15) would equal 5.63% or, say, £200m.

Instead suppose that there is a Company B, identical in every way to Company A with the one difference being that they managed to raise debt in the year at cheaper rates, with a resultant cost of debt/interest expense say £10m lower than company A. Under the current line definitions, this would result in a Line 1F.8 cost of debt, calculated post 19% corporation tax rate, equal to £10m * (1 - 0.19) = £8.1m. However, with £10m lower finance expense its taxation charge would also be £1.9m higher than for company A and this would also be fully reflected in Line 1F.6 ‘Variation in corporation tax’. This results in the 1F.15 Total earnings line of £206.2m (as shown in the table below), being £6.2m higher than the £200m returns from company A. However, with the only difference being £10m on cost of debt = £8.1m post-tax, the difference should only be £8.1m. If line 1F.8 Cost of debt was alternatively calculated pre-tax, as proposed, this would correct this erroneous difference arising from the double-counting of taxation on finance expense, which in this case would result in a correctly calculated total earnings of £208.1m (as shown in the table below).

APR Table 1F	Current & proposed 1F.8 line definition		Current 1F.8 line definition		Proposed 1F.8 line definition	
	Comp. A (% return)	Comp. A (£m return)	Comp. B (% return)	Comp. B (£m return)	Comp. B (% return)	Comp. B (£m return)
1F.1 Return on regulatory equity	5.63%	£200m	5.63%	£200.0m	5.63%	£200.0m
1F.6 Variation in corporation tax	0%	£0m	(0.05%)	£(1.9m)	(0.05%)	£(1.9m)
1F.8 Cost of debt	0%	£0m	0.23%	£8.1m	0.28%	£10.0m
All other lines	0%	£0m	0.00%	£0.0m	0.00%	£0.0m
1F.15 Total earnings	5.63%	£200m	5.81%	£206.2m	5.86%	£208.1m

Additional minor points

In addition to the cost of debt issue raised above, there are several cross references to lines which need to be updated to reflect the new table layout as detailed below:

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Line	Issue
1F.8	Reference to "Line 1F.7" needs to change to "Line 1F.9", reflecting the updated line numbering
1F.15	Total earnings omits the 'Adjusted Return on Regulatory Equity' shown on line 3 (currently only adding the financing (line 10) and operational (line 14) performance totals. Definition should change to also include this adjusted base return i.e. "The sum of lines <u>1F.3</u> , <u>1F.10</u> and <u>1F.14</u> "
1F.19	Definition is now "Line 1F.17 minus line <u>1F.17</u> ". The 2 nd "1F.17" should be changed to " <u>1F.18</u> ", reflecting the updated line numbering.

Q2. New connections - Appendix 1 contains our new table 2K;

- a. Do you agree with the scope of the proposed information items in the new table?
- b. Is there any information missing from this table which you think should be included in order to achieve transparency and consistency for new connections reporting?

Do any of the line item definitions require further explanation?

a) We concur with the addition of a table in Section 2 of the APR which aims to provide more transparency on the cumulative balance of network reinforcement costs and infrastructure charges.

We disagree, however, with the proposed line definition for Revenue within Table 2K (line 2K.5) which states that the revenue figure being compared against the network reinforcement costs (as reported in Tables 2B and 2J) should be gross of any discounts applied (as disclosed on Line 2K.1). Our 2018/19 and 2019/20 infrastructure charges have been set with the intention of recovering network reinforcement costs forecast over the relevant 5 year period after taking any discounted infrastructure charges into account. We are currently forecasting discounts of c.£3million per year - for both 2018/19 and 2019/20 the discounted charge is set at 10% of the value of the standard charge (i.e. a 90% discount). Discounts include those designed to incentivise developers to enhance water efficiency or, for example, where a developer does not require surface water drainage. It is important to note that the infrastructure discounts are (effectively) rebalanced across standard infrastructure charges (i.e. not by other customers), in order to meet the overall requirement to broadly maintain the balance of charges between developers and other customers.

Assuming we outturn in line with forecasts, the reporting approach outlined in Table 2K would result in the company's APR reflecting an excess of relevant revenues over costs of c£15million for the first 5 year period and a similar amount for subsequent periods. This could be misleading to customers. Note that our PR19 submission also assumes that the company's network reinforcement spend should be equal to infrastructure charges income net of discounts.

As such, if Ofwat wish to retain the existing format of this table, we believe the line definition 2K.5 for 'Revenue' should be changed so that it links to infrastructure charges net of discount (line 2K.1) instead of gross of discounts (line 2K.3) i.e. change to "Water: Value derived above in 2K.1 (column 1); Wastewater: derived above in column 2K.1 (column 2)"

b) We do not believe there is any information missing from this table

Line definitions requiring further explanation

See response a) for changes proposed to line 2K.5.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Q3. What are your views on the proposed changes to the existing tables in Appendix 1?

The table below sets out our views on the proposed changes to the tables in Appendix 1.

The first three comments have been jointly developed with other companies, facilitated by Water UK. The proposals for two of the measures (sewer collapses and unplanned outages) set out some additional clarifications to the guidance. If this clarification is endorsed by 22 March 2019 then we will report against both measures on this basis in an early APR submission by 15 May 2019 and resubmit business plan forecasts for 2019-20 to 2024-25 on this basis at the same time. We have also appended two Annex's to this response setting out the agreed clarifications to these two measures.

The feedback on the third measure, Risk of sewer flooding in a storm, was that there is still variability in the detailed approaches taken by companies and although some areas have been identified for improved consistency, the current focus should be on improving transparency to stakeholders. We will continue to work with other companies on this to improve the robustness and comparability of this measure.

Furthermore, we consider that there is an opportunity to demonstrate greater transparency and stimulate companies to drive for more consistent and uniform reporting by adding additional lines to APR table 3S to report and share information that is currently requested within the measure guidance. For example by using two separate lines to report type 1a and 1b approaches to assessing risk of flooding within Section J - Risk of sewer flooding in a storm, or by adding additional lines to Sections G and H sewer flooding to allow the different categories of incidents to be separately recorded and reported (e.g. neighbouring properties, severe weather etc.). Adding these additional lines would provide greater clarity and transparency to these metrics. It would also show how robustly companies have developed their reported numbers and provide an easy way to identify changes in the reported numbers due to potential subsequent changes in assessment methodologies.

We have also provided a number of additional comments within the table.

Table	Line(s)	Issue
3S	3S.07 Proportion of unplanned outage of the total company production capacity	<p>Unplanned outage common performance commitment</p> <p>All companies have come together, facilitated by Water UK, to share experiences of shadow reporting for 2017-18 of the new unplanned outage measure, and have identified opportunities to improve the consistency of reporting through clarifying and in some cases expanding the reporting guidance.</p> <p>As a result, our understanding is that the widely shared view across the industry is the proposal of a limited number of revisions to the reporting guidance. The rationale for these revisions is provided below, and the specific proposed changes are provided in Annex A (in track changes).</p> <p>Rationale for proposed revisions to reporting guidance</p> <p>The proposed changes relate to two areas, the definitions of 'Peak Week Production Capacity' (PWPC) and of the duration of an outage.</p>

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

		<p>Peak Week Production Capacity</p> <ul style="list-style-type: none"> • Making clearer (through reordering the first sentence, removing some unnecessary text and adding an additional sentence) that this measure is different from PWPC as defined in Water Resource Management Plans • To improve consistency, clarifying that PWPC should be at least the highest historic performance that has been sustained for any seven-day period in the last five years (unless a change to assets or processes can be evidenced), but could be higher • Expanding the section on how companies could evidence PWPC, including that the duration of any tests need not extend to seven days, to avoid unnecessary wastage of water and operational disruption <p>Duration</p> <ul style="list-style-type: none"> • Where an asset has been fixed and is ready to be put back into service, but there is not an immediate operational requirement for them to actually be put back into service, companies propose that to promote operational and water efficiency, the end time of the reportable unplanned outage should be when the asset is repaired, rather than when it is recommissioned, to avoid an unnecessary temporary recommissioning process • To maintain incentives for companies to ensure that the asset is genuinely ready to be put back into service when it is needed, in line with the spirit of this measure, companies propose that in this situation, if the asset failed when subsequently being recommissioned to put back into service, then the start time for the reported unplanned outage should be the start of the original outage • A minor amendment is also proposed to remove one sentence that could cause confusion between planned and unplanned outages <p>We, and other companies, would be happy to expand further on the rationale for these changes if that would be helpful. If the approach set out in this note was supported by Ofwat, and confirmation of this was provided by 22 March 2019 in line with the timeline set out in the consultation, we confirm that we would be able to report on this basis in the early APR submission by 15 May 2019, and resubmit business plan forecasts for 2019-20 to 2024-25 on this basis at the same time.</p>
35	3S.12 Sewer collapses	<p>All companies have come together, facilitated by Water UK, to share experiences of shadow reporting for 2017-18 of the new sewer collapse measure, and have identified opportunities to improve the consistency of reporting through clarifying and in some cases expanding the reporting guidance.</p> <p>As a result, our understanding is that the widely shared view across the industry is the proposal of a limited number of revisions to the</p>

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

		<p>reporting guidance aimed at providing clarity in reporting. The rationale for these revisions is provided below, and the specific proposed changes are provided in Annex B (in track changes).</p> <p>Rationale for proposed revisions to reporting guidance</p> <p>The proposed changes relate to clarifications in five areas: the scope of the measure, the definition of customer and environmental impact, which assets that should be included, report timing and exclusions covering proactive status and impact of root ingress.</p> <ul style="list-style-type: none"> <p>• Clarification of the scope of the measure</p> <p>Making clearer that the measure is for sewer collapses that have not been identified proactively by the company and cause an impact on service to customers or the environment</p> <p>• Clarification of the definition of customer and environmental impact</p> <p>Making clearer that ‘impact’ covers any contact with the company (i.e. an impact on service has caused someone to contact the company), or any unplanned escape of wastewater, that results in the need to replace or repair the pipe to reinstate normal service; this revision aims at providing clarity that an impact to customer and environment should not be limited to a flooding or pollution event.</p> <p>• Clarification of assets that should be included</p> <p>Making clearer that a reportable sewer collapse also applies to pipe bridges, and failures on the infrastructure network, including inputs into the inlet of treatment works and terminal pumping station rising mains (in accordance with RAG guidance 4.07).</p> <p>• Clarification of the report timing</p> <p>Making clearer that a sewer collapse should be reported in the reporting year when the service incident was reported to the company and not when the repair was completed.</p> <p>• Clarification of exclusions covering proactive status, impact of root ingress</p> <p>Making clearer, via an updated flow diagram, the distinction between the proactive and reactive sewer collapse. Additionally, removing two exclusions (fractured assets and minor pipe breaks), providing clarity on how root ingress and</p>
--	--	--

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

		<p>patch repairs should be treated, making the wording on exclusions less ambiguous</p> <p>We, and other companies, would be happy to expand further on the rationale for these changes if that would be helpful.</p> <p>If the approach set out in this note was supported by Ofwat, and confirmation of this was provided by 22 March 2019 in line with the timeline set out in the consultation, we confirm that we would be able to report on this basis in the early APR submission by 15 May 2019, and resubmit business plan forecasts for 2019-20 to 2024-25 on this basis at the same time.</p>
3S	3S.13 Risk of sewer flooding in a storm	<p>All companies have come together, facilitated by Water UK, to share experiences of shadow reporting for 2017-18 of the new wastewater resilience measure (risk of sewer flooding in a 1 in 50 storm). As a result, we understand that the widely held industry view is that there are opportunities to improve the consistency of reporting primarily through greater transparency.</p> <p>Context</p> <p>This measure is new and relatively complex, with a number of stages, some of which involve the use of judgement (for example in assigning grading the vulnerability of catchments or whether to use ‘buffer’ or ‘2D’ approaches to modelling). As would be expected for a newly introduced measure of this nature, there is some variability in the detailed approaches taken by companies; greater transparency would improve visibility of this and over time result in improved consistency through the identification of best practice.</p> <p>Enhancing commentaries to improve transparency</p> <p>To improve transparency to stakeholders, we propose that as a matter of routine, all companies provide in a commentary all the information set out in section 3.6 of Developing and Trialling Wastewater Resilience Metrics, Atkins, and specifically Tables 6-9.</p> <p>In addition, all companies should:</p> <ul style="list-style-type: none"> • Set out the parameters they have used in applying the catchment vulnerability assessment (Appendix A of Developing and Trialling Wastewater Resilience Metrics, Atkins) • Reporting the extent to which they use ‘2D’ modelling approaches or the simpler modelling approach of applying a buffer zone • Confirm whether they currently use FEH13 in their assessment, and if not, when they expect to do so <p>While we commit to providing this information, we suggest that it would be helpful for Ofwat to explicitly include a requirement to do so in the APR reporting requirements.</p>

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

		<p>Technical aspects where companies will improve consistency</p> <p>At a more technical level, we have identified more consistent approaches to applying some aspects of the methodology, set out below:</p> <ul style="list-style-type: none"> • Modelling properties at risk of flooding on the basis: <ul style="list-style-type: none"> ○ For the ‘buffer’ approach, including any residential property where flood water reaches the property address point centroid ○ For the ‘2D’ approach, including any residential property where flood water reaches the house boundary <p>Future development</p> <p>We recognise that over the next few years, there is further work to be done to improve understanding of this metric, for example more standardised parameters for the catchment vulnerability assessment and better understanding of the relative merits of using the two approaches to modelling (‘buffer’ or ‘2D’). We will continue to work with other companies on this to improve the robustness and comparability of this measure.</p>
4C	<p>4C.1 Cumulative totex over/underspend so far in the price control period</p> <p>4C.2 Customer share of cumulative totex over/underspend</p> <p>4C.3 RCV element of cumulative totex over/underspend</p>	<p>The guidance to lines 4C.1, 4C.2 and 4C.3 include the following formula to calculate over/underspend; “<i>menu baseline totex</i>’ – ‘<i>actual menu totex</i>’”.</p> <p>In the case of a totex underspend compared to allowed menu totex this calculation results in positive values for lines 1 to 3 in table 4C. The value in 4C.3 is included in the calculation of line 4C.6 ‘Projected Shadow RCV’. A positive value in line 4C.3 from an underspend will cause an increase in the shadow RCV using the calculations in the guidance, whereas it should result in a reduction in Shadow RCV.</p> <p>The formula in these three lines to needs to be reversed so the projected Shadow RCV calculated in line 4C.6 increases/(decreases) as expected from a totex over/(underspend).</p> <p>Furthermore, the definition calculations refer to “<i>Menu baseline totex</i>” despite the line definitions themselves referring to the difference between the “<i>allowed totex</i>” and actual totex. It is the allowed menu totex that is compared to the actual menu totex as per the PR14 reconciliation rulebook and not the menu baseline totex (as the RCV in line 5 already accounts for differences between the allowed menu and the menu baseline). As such, the calculation definition should also be amended so it refers specifically to the allowed menu totex to avoid any confusion.</p>
4W	Column (‘Incineration of digested sludge’)	Incineration of digested sludge has been included as a column in the Sludge Treatment block of Table 4W. This appears to be inconsistent with the boundary definitions in RAG4.08 (page 115) which states that

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

		<p><i>"If incineration of completely treated sludge takes place, then this should be included in 'sludge disposal'". We believe the 'Incineration of digested sludge' column should therefore be moved to the Sludge Disposal section of this table.</i></p> <p>Note that absent any changes to the RAGs our current intention is to include the incineration of treated sludge within 'Sludge disposal – Other' rather than 'Sludge Treatment – Incineration of digested sludge' to ensure aligned with RAG boundary definition and our PR19 submission.</p>
--	--	---

Minor corrections (e.g. typos, incorrect cross references)

Table	Line	Issue
4B	4B.1 Actual totex	Agree that 4B.1 should refer to " <u>2B.24</u> " not "2B.21" (as set-out in section 8.2 of consultation document). However, this proposed change has not been included in RAG 4.08 itself, which therefore needs to be updated to reflect this.
4G	4G.2 Operating expenditure	Agree that 4G.2 should refer to " <u>2B.11</u> " not "2B.9" (as set-out in section 8.2 of consultation document). However, this proposed change has not been included in RAG 4.08 itself, which therefore needs to be updated to reflect this.
4M	4M.14 NEP – Groundwater schemes	Cross reference has been incorrectly updated to "4M.151", should be " <u>4M.15</u> ".
4M	4M.15 NEP – Investigations	Cross reference has been incorrectly updated to "4M.129", should be " <u>4M.12</u> ".
4M	4M.24 New development and growth	Cross reference has been incorrectly updated to "4M.289", should be " <u>4M.28</u> ".
4N	4N.9 Estimated terminal pumping costs size band 6 works	Due to the reworking of this table, the end of the line 4N.9 definition " <i>included in the direct costs (Line 4N.7) above</i> ", is now incorrect (since Line 4N.7 no longer relates to direct costs for band 6 STWs). This definition ending should be deleted so that the complete definition is " <u><i>The sum of estimated costs of terminal pumping stations pumping to STWs in band 6.</i></u> "
4V	4V.7 Other operating expenditure excluding renewals - direct 4V.8 Other operating expenditure excluding renewals - indirect	The line definitions both refer to lines "4V.5 to 4V.6", but should both refer to lines " <u>4V.1 to 4V.6</u> "
4V/4W	Column definitions	It would be useful to include column definitions for Tables 4V and 4W. In particular, it is not clear for Table 4W which column(s) should include the costs of thickening, dewatering and the treated sludge transport pipeline. We are currently including the majority of these costs in 'Sludge Treatment – Other' but for the avoidance of doubt it would be useful to have definitions as to which activity is required to be classified in each column.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Q4. What are your views on the issues highlighted in section 3 'Future developments in performance reporting'? Are there any other issues which we should consider? We are particularly interested in your views on the impact of additional price control units (section 3.2).

New accounting standard; IFRS 16 - Leasing

IFRS 16, effective from 1 April 2019, will result in all leases (including existing leases) effectively being treated as finance leases. Under IFRS, there will be transitional 'opening balance sheet' adjustments on 1 April 2019 for Right of Use (ROU) assets associated with current operating leases. This will be reported as a fixed asset adjustment as opposed to an addition and thus be reported outside of capex/totex. Ongoing annual lease payments (c£4m per annum for U UW) will no longer flow through operating expenses/totex, being treated instead as finance charges and repayments of debt.

Ofwat has addressed the transitional issue of companies being recognised for future lease payments on existing leases, which will no longer flow through totex, through a midnight RCV adjustment, reflected in PR19 table App33 (c£55m for U UW). This is based on the forecast position as at March 2020.

However, this does not address the issue in relation to 2019/20 reporting. Ofwat is proposing that companies do not dis-apply this standard for regulatory reporting in 2019/20. This would result in operating expenditure of zero in relation to leases, which is inconsistent with the basis of totex assumed at the PR14 determination, resulting in companies reporting unearned outperformance in 2019/20 (c£4m expected for U UW), whilst still incurring the actual payments for that year. Ofwat expects that companies will be able to explain any differences so comparisons to business plan can still be made. However, as well as explaining differences, it is important that companies are fairly remunerated for these genuine costs.

To address this issue, our recommended solution would be to delay the implementation of IFRS16 in the regulatory accounts until 2020/21 reporting, maintaining consistency with the basis of the PR14 totex assumptions. This would result in statutory to regulatory adjustments in 2019/20 to show 2019/20 reported on the old IFRS basis. This approach would also be aligned to Ofwat's midnight RCV adjustment, which is applied as at March 2020 rather than March 2019 (as under IFRS).

Table 2A – Impact of additional price control units

Expansion of Table 2A revenues

We welcome the expansion of table 2A to include the revenues for all price control units, mirroring the binding price controls for the 2020-25 period. It is important for Ofwat to recognise the challenge faced by companies in reporting revenues for each price control, and commit that further work is undertaken with the industry to investigate this matter further. It is also important to recognise the key linkage between this APR proposal and Ofwat's wholesale charging rules for 2020/21, which we assume will also be consulted upon in the coming months.

The main issue is that customers are charged by reference to a total end user price for each of water/wastewater. Given the separation of the business retail market, and the relative simplicity of domestic retail prices (i.e. an annual charge per customer), separation of retail and wholesale revenues has, for AMP6, been more straightforward. However, separately reporting components of wholesale revenue (i.e. water resources & water network+, and bioresources & wastewater network plus) will be significantly more complex, potentially requiring the separation of wholesale charges between those components.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Revenue (by price control) reported for the first year of AMP7 will rely on 2020/21 charges which will be published (in indicative form) in 8 months time (early October 2019) and subject to final publication in less than 12 months from now. If charges are to be separated to inform reporting of income by price control in the APR, then this will require urgent revisions to charging rules, to ensure that this can be accommodated, and to provide clarity on publications requirements (e.g. do we need to publish a separate charges scheme for charges within each price control?). It will then also be determined whether or not there would be any impact on the retail market systems and process.

Alternatively, if Ofwat expects revenues by price controls to be reported without the supporting rigour of separate charges, then it should be clear what would be an acceptable (or unacceptable) basis on which to separate wholesale revenues into the four separate price controls.

Absent any such further guidance, we see a risk of high levels of opacity and inconsistency in how companies choose to report revenues by price controls, which will be to the detriment of transparency to customers. Therefore we strongly recommend further work is undertaken with the industry on this and on any associated changes required to Ofwat's wholesale charging rules.

Recording of principal use recharges

There is currently a mismatch between the way principal use recharges were reported in the PR19 tables and how they are reported under the current RAGs. In particular, the PR19 tables required such recharges to form part of totex, whereas the current RAGs place principal use recharges separate from totex. The RAGs therefore need to be amended for 2020/21 reporting to ensure costs are reported on a consistent basis with PR19 totex assumptions for AMP7.

For APR reporting, capex and associated depreciation is recorded in the price control unit of principal use. RAG 2.07 2.3.2 makes it clear that depreciation recharges should be reported as an operating cost in the line 'Recharges from other segments' in APR pro forma 2A (with offsetting income reported on the 'Recharges to other segments' line below). Importantly, this is a separate line to 'Operating expenditure' and thus depreciation recharges should not be within operating expenditure. We followed this RAG guidance for 2017/18 APR reporting.

However, in Ofwat guidance for the PR19 data tables it was clear that the depreciation recharges should be reported in 'Operating expenditure' (PR19 Queries No's 12, 250, 549 and 576) and therefore we completed the AMP7 totex values for our PR19 business plan submission on this basis.

To enhance the transparency and consistency of reporting and to be consistent with PR19 guidance we believe that, as a minimum, principal use recharges should be shown on a separate line in the APR tables (as it is already in Table 2A lines 8 and 9). Alongside this, the existing totex tables (i.e. 2B, 4D, 4E, 4J, 4K) and retail tables (2C and 4F) should be amended so that they also include two additional principal use recharge lines, with totals linked through to Table 2A. To ensure the 'operating expenditure' in these tables reconcile back through to Table 2A and is consistent with RAG 2.07 2.3.2, we would recommend these new lines are recorded outside of normal 'operating expenditure' within an additional section of the table. Note that if principal use recharges were alternatively to be included within 'operating expenditure' then RAG 2.07 2.3.2 and Table 2A would both need to be amended to reflect this.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Sludge liquor recharges

It is important that companies have clear guidance as to whether or not there should be a sludge liquor recharge between wastewater network plus (WWN+) and Bioresources and the basis of such a charge. This is to ensure consistency of reporting between the PR19 business plan and APR reporting as well as between water companies. This is particularly important given the different customer sharing mechanisms between WWN+ (c50% customer share) and Bioresources (no sharing) for totex in the next AMP.

PR19 final methodology (Appendix 6, section 3.2.3) states that *“when sludge liquors are returned to a wastewater treatment works, the activity of treating the liquors is a network plus wastewater activity. The cost of treating liquors should be paid for by the bioresources business”*. We completed our business plans on this basis, with recharges based on trade effluent charging arrangements and calculated in line with “Mogden”. However, Ofwat’s cost assessment published with its PR19 IAP assessment does not currently account for any such recharge and it is clear that many companies did not include a sludge liquor recharge within their PR19 business plan submissions. As such, companies first need clarity around whether or not there should be a recharge, whether this will form part of PR19 assumed totex and what the basis of that will be. This should be applicable to all WaSCs.

The current RAGs also provide for no such recharge, with sludge liquor activities and the associated expenditure all clearly sitting in WWN+. If companies final PR19 cost baselines contain no liquor recharges then the current RAGs should not change.

If the companies’ cost baselines are adjusted for liquor recharges (as was expected in the PR19 final methodology), then the 2020/21 RAGs would need to be amended to also allow this, i.e. on a consistent basis. In this case, the calculation basis of the recharge also needs to be clearly defined as the PR19 methodology guidance is open to interpretation. We consider the liquor recharge operating costs are variable, as they are directly proportional to sludge volumes. We propose that charges should be based on the relevant “Mogden” components of water companies’ Trade Effluent charges (usually excluding the conveyancing component), to ensure that the recharges are cost-reflective, transparent and provide a level playing field with third parties. We would also recommend a requirement for companies to provide supporting information on the volumes of sludge liquors treated.

Other recharges between Bioresources and Wastewater network plus

As per RAG2, costs should be attributed/allocated between price controls in relation to the way in which resources are consumed. A key cost allocation principal is "No cross subsidy between price controls". RAG 4.07, section 2, sets out the boundary definitions of which upstream service costs should sit.

Whilst the RAG boundary definitions generally fairly apportion costs under ‘normal operations’, when there is an incident the most efficient operational alternative is chosen which may result in costs being recorded in a way no longer aligned to where costs would sit commercially as demonstrated by the two below examples:

Example 1 – Asset failure in Wastewater network plus - Requirement for temporary kit

In normal operations wastewater network plus (WWN+) operate thickening assets to thicken sludge to <10% dry solids on a standalone WWN+ facility (not co-located with Bioresources). An asset failure

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

causes a temporary asset to be hired by WWN+ - usually a mobile centrifuge which thickens sludge to >10% - with the asset and costs then recorded within Bioresources in line with the RAGs.

In this example the RAGs result in additional costs being assigned to the Bioresources business, whereas in a normal commercial environment, such costs would normally be expected to sit where the issue arose (i.e. with WWN+). This could result in incorrect signals being sent to the market as it will be perceived (mistakenly) as inefficiency, and thus encourage inefficient entry from the market. However, in a truly competitive market a Bioresources business would not incur these additional costs without charging the WWN+ business for the additional activity undertaken.

Example 2 – Asset failure in Bioresources – Requirement for change in transport/treatment

In normal operations sludge would be transported from a WWN+ facility to a Bioresources asset on a co-located facility, with costs recorded within the Sludge Transport upstream service within Bioresources. However, an asset failure of a sludge screen in Bioresources would mean that sludge would need to be transported to the inlet of the wastewater treatment works to enable screening. The transport of sludge from a WWN+ facility to the inlet of another WWN+ facility would be a transport cost within WWN+.

In this example the RAGs result in additional costs being assigned to WWN+. In this instance, the price signals that should have been sent to the market (those of inefficient/ineffective operations by the Bioresources business) are avoided, as the costs are assigned to WWN+. Again, under a competitive market, this scenario would result in additional costs being incurred within the Bioresources business as it would be their responsibility to transport the waste to a different facility if one of their assets had failed rather than the WWN+ business.

Sludge quality

There is also an issue that, in a commercial sludge trade, the quality of sludge will be described and payments for sludge service are likely to vary based on the quality of sludge provided. This commercial situation is in stark contrast to the RAGs, which crystallise all costs (or benefits) of variations in sludge quality within the Bioresources business. These variations could be significant given the difference in income available (e.g. from CHP generation) from different qualities of sludge. The differences could be large enough to influence sludge trading outcomes between companies.

We therefore recommend that the RAGs are amended to allow specific charging schemes depending on the quality of the sludge in line with the rest of the competitive market, and that further work be undertaken with the industry to also specify sludge quality (as well as % dry solids) at the boundary between WWN+ and Bioresources.

Bioresources trading

We support the reporting of a breakdown of non-appointed revenues, including imported sludge, in line with current APR Table 1A. We believe that this could be further supported through a new data line in the APR capturing imported raw sludge treated by the incumbent (ttds/year). There may also be benefit in splitting revenues and volumes between long-term and short-term trades.

However, we do have reservations with regards to the potential disclosure of associated costs and profits for imported sludges. We have concerns as to the potential commercial sensitivity of such

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

disclosures, particularly where companies may only have one or two contracts in any year. We also believe this could distort the competitive market by placing all the information in the hands of one party to a potential trade (the exporter). Disclosing costs would help the potential exporter of sludge since they would have visibility of the importer's costs of treating this. However, the potential importer does not have visibility of the exporter's sludge treatment costs per site and so this asymmetrical disclosure would place all the information in the hands of the exporter.

This proposal would likely erode the potential profit margins of the importer to the detriment of its customers (through the non-appointed customer share, as set out in RAG5.07, sections 10 & 11). Finally, given the highly localised cost per site of treating sludge, this additional disclosure may not present a very insightful view of the overall market.

If this information was to be collected, we would propose, alternatively, that this information is collected from companies outside of the APR process and not released into the public domain. Given the potential subjectivity in the measurement of costs, we would suggest splitting imported sludge into short-term and long-term contracts, which should be completed in line with RAG 5 guidance.

Impact of Retail non-household exit

There are certain activities which, under the existing RAGs, we will continue to report as part of our non-household retail activities through to 2019/20, inline with the 2014 determination. This is despite UUW having exited the non-household retail market. Ofwat confirmed this as the correct approach at their February 2018 RAWG meeting.

The main area we expect to continue to incur costs in AMP7 is 'providing developer information and administration for new connections' (under RAG2.08 table 2.4.1) which did not migrate to our Water Plus joint venture (c£250k in 2017/18). This should be offset by non-household revenue for application fee income, so the net profit in non-household retail re: developer services should be broadly nil.

We have submitted our PR19 tables on the basis that these costs and associated revenues will move to non-appointed activities from 2020/21 as we no longer hold a non-household retail licence. We propose that the 2020/21 RAGs should be amended so non-household retail no longer includes the administration of developer services and it be moved to either wholesale (where activity logically sits) or non-appointed activities (matching our business plan submission).

Other retail/wholesale cost classifications

As well as the above point we would also suggest some of the ambiguity surrounding the allocation of costs between the wholesale and retail price controls in general should also be addressed as detailed below:

Customer side leaks

The RAG2.07 section 2.4 classification of customer side leaks between wholesale and retail currently states that that "*all expenditure should sit within retail except where there is expenditure to meet wholesale outcomes*". This definition is very subjective and, as demonstrated in water companies' 4F APR tables, results in opposing retail and wholesale classifications between companies, with a resultant inconsistency of reporting. We would recommend the classification be replaced with "*wholly in wholesale*" (*i.e. so all costs sit in wholesale*) on the basis that all water companies have significant programmes of work within their wholesale business required to reduce leakage by at least 15% in AMP7.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Demand-side water efficiency initiatives

The RAG2.07 section 2.4 classification of demand-side water efficiency initiatives between wholesale and retail currently states that that “*all expenditure should sit within retail except where there is expenditure to meet wholesale outcomes*”. This definition is very subjective and, as demonstrated in water companies’ 4F APR tables, results in opposing retail and wholesale classifications between companies, with a resultant inconsistency of reporting. We would recommend the classification be replaced with “*wholly in wholesale*” on the basis that water efficiency measures are designed to the meet the goals of our water resources management plan and protect both the short and long term resource requirements of our water resources.

Income from ‘diversions’ activity

Income from diversions can be broadly broken down into three distinct categories:

- 1) Developer driven diversions under s185 of the Water Industry Act – Moving our existing water/wastewater infrastructure at the request of developers - c£9m projected spend in AMP7, 100% of which is expected to be recovered from developers.
- 2) New Roads and Street Works Act 1991 (NRSWA) diversion schemes - Moving our existing water/wastewater infrastructure at the request of a third party under NRSWA, due to the construction of new road or rail infrastructure authority in accordance with NRSWA 1991 - c£42m projected spend in AMP7, a proportion of which (82% for road and 92.5% for rail) is expected to be recovered from developers.
- 3) One off significant infrastructure diversions, not related to connection activity (e.g. HS2) – Moving our existing water/wastewater infrastructure to enable the new road/rail infrastructure to be installed outside of NRSWA arrangements at the requested of HS2 Limited - c£60m projected spend in AMP7, 100% of which is expected to be recovered from HS2 Limited.

We recognise that developer driven diversions (category 1) can, but not always, help in the provision of new water connections and, as such, it could be argued that this effectively should form part of the wholesale price control services (along with other new connection related activities). As such, we can see why this could potentially be included as part of price control income, aligned with existing grants and contributions (G&Cs) from developers.

However, for diversions under NRSWA and other infrastructure (categories 2 & 3), which forms the vast majority of our forecast diversions income, these activities are not being completed as part of developer services related to any new connection activity. They are solely being carried out to enable the new road/rail infrastructure to be installed, at the 3rd party’s request, with the 3rd party recognising the requirement for it to pay for that work to be undertaken. The requirement for these types of diversions are outside of the control of the incumbent water company, vary significantly from year to year (and hence are difficult to forecast). The level of volatility is even more pronounced in future with regards to HS2 related diversions due to the material size of the project and uncertainty of timing.

Therefore, we strongly believe these types of diversions income fit into the rechargeable works category (presented in RAG 4.08 appendix 2), with this income similar in principal to existing rechargeable works such as ‘Charging for building over company assets’. If Ofwat includes these categories of diversion income as price control, and hence subject to the AMP7 WRFIM mechanism, this would introduce a significant degree of unnecessary volatility into price control revenues and hence customer bills. This seems wholly inappropriate and unnecessary given that the 3rd parties requiring the work to be undertaken acknowledge their liability to pay for the work, which is (predominantly) to recharge the cost of the work.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Whilst the PR19 guidance classifies diversion income as price control, it is of great importance that this incorporates only developer driven diversions (category 1), whilst the far larger category of other diversions (category 2 and 3) continue to be classified as non-price control. The current RAGs classify all diversion income as non-price control. If diversion income is to be included as price control for AMP7, the 2020/21 RAGs would need to be updated to reflect this.

The PR19 App28 definition specifically excludes contributions from local authority schemes under NRSWA (i.e. category 2 above) from the diversion income line, which are treated as 'Other contributions (non-price control)', whereas there is no such exclusion in the current RAG definitions. The diversion income line definitions in table 2E (lines 2E.5 and 2E.12) would also need to change to be consistent with the PR19 App 28 diversion income line definitions (lines 11 and 27). This would ensure category 2) diversions are correctly excluded from price control income, in line with PR19 guidance.

Furthermore, consistent with our PR19 submission, we would also propose to update the line definitions to make it clear that other infrastructure diversions, notably HS2-related G&Cs (or any other diversions resulting from major infrastructure projects, not related to new connections activity), should also be classified as 'Other contributions (non-price control)' (as per category 3 explained above).

Incorporating the points raised above, to ensure NRSWA and HS2 G&Cs are excluded from price control income, we propose the 2E line definitions for diversion income (lines 5/12) be amended, from 2020/21 onwards, as per below, with the underlined section appended:

"Contributions received from local authorities, highway authorities and private companies to divert sewers (Water Industry Act s185). Contributions from local and highway authority schemes under the New Roads and Street Works Act 1991, as well as HS2-related contributions, should be excluded and reported in line [6/13] below."

Q5. What are your views on our preference to require all costs associated with the 'Traffic management act' to be reported (section 6)?

In 2017/18, we reported only the actual direct cost of permits within table 4V and 4W of the APR, as well as within the PR19 submission, and have not included any implementation or administration costs, as we believe this was in the spirit of the guidance.

The direct permit costs is likely to be the only clearly identifiable element of a cost increase associated with permit schemes, as previously companies would have incurred the associated costs of adhering to a notification scheme. Therefore the increase associated with the introduction of permit schemes opens up to a degree of ambiguity around what costs a company was incurring previously. We also operate a number of network partnerships schemes where our partner operates the administration of the permitting process, with this cost being passed to UUW in the form of an overhead. As such, identifying the specific cost in relation to this set-up is open to error as we would be reliant on a third party specifically itemising these permit administration costs. We suspect a number of other companies operate in a similar manner.

As such, we would suggest that if it is Ofwat's intention to capture all associated costs of permit schemes that they split the data capture into at least 2 lines, one which captures the direct cost of permits, a second that captures any associated costs and potentially a third that captures the number of permits. This would allow Ofwat to assess the efficiency that each company is meeting in adhering to the permit scheme.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Q6. What are your views on our additional asset type descriptions for Water resources which recognise 'desalination' and 'effluent reuse' abstraction assets (section 7)?

These proposals seem reasonable and recognise the range of abstraction options that many water companies are pursuing.

Additional comments re: RAGs not covered in above consultation responses

We have separated our additional comments re: RAGs not covered in the above consultation responses into two sections; those we consider to be of most importance and other issues. Our comments include concerns identified during previous years' reporting processes that we feel have not been reflected in the latest version of the regulatory accounting guidelines and of which we continue to hold these views:

Key issues

Direct procurement

There is a general expectation that DPC assets and liabilities will not flow through totex. However, under IFRS16 it is likely that most DPC assets will be categorised as finance leases and capitalised on water companies' balance sheets - classification dependent on whether the company has the right to substantially all the economic benefits of the asset and the right to direct its use. We believe that our proposed DPC in AMP7 re: Manchester & Pennines Resilience is likely to meet the finance lease classification criteria.

In line with Ofwat guidance, we completed our business plan tables excluding the construction costs from totex of our proposed DPC project (i.e. excluding the costs that would be incurred by the competitively appointed provider). However, under the current RAGs (following IFRS 16), this would result in DPC assets being reported in the company's capex/totex with the associated lease liabilities reported in net debt on lease inception. Whilst subsequent revenue collected from customers will be treated as revenue, payments to the DPC provider will be treated as a balance sheet reduction in a financial creditor rather than a totex cost.

It is important that careful consideration is given as to how DPC assets and liabilities and associated revenues and costs are treated in the Regulated Accounts to both ensure that: (i) the regulatory mechanisms work as intended; and (ii) to avoid asymmetric information being presented resulting in potentially adverse perceptions of companies' credit metrics leading to adverse outcomes for credit ratings.

In this regard it is important to also note that the credit rating agencies have their own definitions of net debt which are likely to include lease liabilities regardless of whether they are excluded from regulatory net debt. This may mean, for example, that it is desirable to identify and report the regulatory support for the future DPC obligations in some way.

Pro forma Tables

Table 1C – Net Debt

At present, Table 1C only has a distinct line for preference share capital within non-current liabilities (line 28). We report preference share capital as current borrowings in the company's statutory accounts due to the nature of the preference shares in issue. To ensure net debt in Table 1E is

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

correctly reported, as suggested by Ofwat for 2017/18 reporting, we made a statutory to regulatory adjustment to reclassify our preference share capital from current to non-current liabilities. If we did not make this adjustment, preference share capital reported in Table 1E Line 2 would be nil and thus omitted from our regulatory net debt, since this value is automatically populated from Table 1C line 28. This would understate net debt by £130m and would also have implications on the financial metrics calculated in Table 4H.

To avoid having to make this adjustment, which incorrectly presents our preference share capital as non-current in the regulatory accounts, we propose that Table 1C includes an additional 'Preference share capital' line within the 'Current liabilities' section. The definition within the preference share capital line in Table 1E Line 2 should also be amended so that it also includes the value from this new line (as well as the existing non-current preference share capital line 28 as currently stated). Alternatively, Table 1E line 2 could be manually populated and not explicitly linked to Table 1C line 28 to allow flexibility in how preference share capital is reported for statutory purposes.

Also see additional comments raised on 1E within other issues later in this document.

Other issues

Pro forma Tables

Table 1C Statement of financial position

Bank overdraft

The 1C.11 line definition for 'Cash & Cash equivalents' states that the overdraft should be reported within 'Trade & other payables' line 1C.13 (although not specifically referenced in 1C.13 itself). However, this is different to IFRS classification and is also inconsistent with the equivalent PR19 table App12 where the overdraft is included within its 'Cash and cash equivalents' line 11. For consistency with IFRS reporting and the PR19 tables, we believe the existing 1C.11 definition should replace the wording "*Overdraft balances should not be netted off as it should be included separately in Trade & other payables*" with "*Overdraft balances should be included as a negative figure*".

Current deferred income – grants & contributions (G&Cs) and adopted assets

Consistent with the presentation of non-current liabilities (lines 1C.26 & 1C.27), within current liabilities we believe two distinct lines for deferred income G&Cs and deferred income adopted assets should be added. This will improve transparency and ensure that total capitalised G&Cs and adopted assets can be reconciled to Table 2E line 19 (carried forward G&Cs)

Table 1D Cash flow

Other Income

Currently 'Other income' line 2 is only be populated with "*the cash impact of other income*". This is not aligned with 'Operating profit' line 1 which is populated from Table 1A.4 and includes non-cash items. This results in a mismatch of regulatory to statutory adjustments – for example the amortisation of deferred income is removed from 'Operating profit' 1D.1 but can't be reclassified to 'Other income' in 1D.2 as it is a non-cash item. We propose the 1D.2 line definition to be amended to "*Other Income. Equal to 1A.5*".

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Non-cash items

We propose to include an additional line within Section A of the table for 'Other non-cash items' so that the working capital and provision lines reflects true movements in working capital and provisions only.

Table 1E Net debt analysis (in addition to point raised within key issues above)

There is an inconsistency within this table at present in the way 'Borrowings' line 1 are categorised between fixed rate and floating rate and the way interest costs, interest rates and average years to maturity are categorised on lines 9-13. The borrowings in line 1 are currently categorised based upon the terms of the debt instrument only and do not reflect the synthetic (post-hedge) position created as a result of our financial derivatives, whereas lines 9-13 reflect the synthetic (post-hedge) position. We would recommend that the guidance be amended to state that the borrowings in line 1 be categorised based on the synthetic (post-hedge) position which would result in all the information in the table then being on a consistent basis.

In addition, the borrowing valuations used in line 1 represent a 'notional value' basis which we believe is more appropriate than book value and is in line with the guidance. In our opinion, the guidance could be more explicit in stating that 'notional values' should be used (as has been done in the guidance for 'Preference share capital' in line 2) rather than book values and recognising that this could create a reconciling difference to borrowings in Table 1C. We are currently inferring the use of notional values from the guidance which states: *"The following should not be included: fair value accounting adjustments which do not impact on the principal sum outstanding on the debt or the total interest paid. For example when financial instruments, such as interest rate swap agreements are presented at fair value."*

Table 2D – Tangible Fixed Assets

Table 2D 'Historic cost analysis of tangible fixed assets - wholesale & retail' does not, by its nature, include 'intangible assets' and we completed the table on this basis for 2017/18 reporting. Under the IFRS accounting definition 'Intangible assets' consist both of depreciating assets, mainly software, and non-depreciating assets (e.g. goodwill) although it should be noted that U UW only has amortising intangible assets.

We believe that this fixed asset table should include all depreciating assets to provide a more complete overview. This would also be consistent with PR19 query 341 relating to App16 (the equivalent fixed assets table for PR19) where Ofwat allowed companies to include intangible assets if they were depreciated. To ensure full transparency and for consistency with the PR19 tables, we believe the RAGs should be amended so Table 2D includes both tangible assets and depreciating intangible assets. This could be achieved for example by including a clarification line at the start of this table e.g. *"For clarity this table should include all depreciating intangible assets (e.g. software)"*

Table 4G Wholesale current cost financial performance

We continue to support the simplified assumption that all interest costs are allocated to wholesale. However, there are additional items within 'Other income' (line 6) that should not be attributed to the wholesale business as they are genuine retail costs or income. An example of this is other income derived from the use of central systems by other group entities. This includes shared central systems that span all price controls not just the wholesale business for which income is received.

Our proposed approach would be to append the current line 4G.6 definition with the underlined section as shown here: *"Equal to 1A.5, less any other income attributable to the retail business"*.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Table 4H Financial metrics

Credit rating

In respect of 'Credit rating' (line 9) we believe that the requirement should be to list all solicited long-term ratings for the appointed business (along with the outlook / watch status). We would recommend that only solicited ratings are reported as only solicited rating agencies receive additional non-public information on which to make their assessments and so are likely to be more accurate than unsolicited ratings.

FFO / Debt

We expect 'FFO / Debt' (line 15) is likely to be interpreted by users as mirroring the ratings agencies' calculations. Whilst we recognise that Ofwat has stated that its approach will differ to the credit rating agencies, we still consider it would be more appropriate that this ratio is calculated based on Standard & Poor's methodology to ensure consistency in the calculation of this metric. The key difference is that FFO should be calculated after deducting all underlying interest, not just cash interest as per the 'Funds from operations (FFO)' (line 12) definition. Net debt should also include any reported pension deficit. An additional sentence could be added to the existing line definition so it reads:

"Ratio of FFO to net debt. FFO as per line 12 less interest charge for the accretion of index-linked debt. Net debt as per line 1 plus any reported pension deficit (as per Table 1C, line 24). We acknowledge that our approach to calculating this differs from some of the methodologies applied by the credit rating agencies."

Table 4I Financial derivatives

We faced a couple of limitations with the table for 2017/18 reporting. Firstly, line 23 requires 'Other financial derivatives' to be included as one line to reconcile the total (line 24) mark-to-market value through to table 1C. We have two types of derivatives which feed into this line, being electricity swaps and forward dated floating to fixed interest rate swaps. In relation to the electricity swaps the nominal value by maturity would have been GWh rather than a financial amount and there is no weighted average interest rate to disclose only a fixed price per GWh. In relation to the forward dated floating to fixed interest rate swaps, the nominal value by maturity assumes the swaps have reached their value date which they have not due to them being forward starting. As such we only disclosed a combined Mark-to-Market value for the two types of swaps in line 23 and left the other fields blank, providing additional analysis instead within the narrative. One potential solution to this issue might be to specifically exclude commodity swaps from the table and require a reconciliation instead to table 1C. Line 23 could then be used purely for forward starting swaps, we could provide a weighted average interest rate, but with these swaps we would remain unable to provide a maturity analysis due to them not having reached their value dates.

The second issue we faced was the inclusion of two different currencies in 'Currency interest rate swaps Other' (line 16). One of our swaps was HKD/ GBP and the other was reverse dual currency, swapping USD principal and JPY interest into GBP. As a result, the interest receivable disclosed in the table was a blend of HKD and JPY interest rates. One solution to this issue might be to allow for more currency lines within the table.

Table 4T Non-financial data – Sludge treatment

Similar to the point raised in question 3) re: Table 4W, '% Sludge treatment process - incineration of digested sludge' (line 6) has been included within the Sludge Treatment block of Table 4T. This appears to be inconsistent with the boundary definitions in RAG4.08 (page 115) which states that "If incineration of completely treated sludge takes place, then this should be included in 'sludge disposal'". We believe this line should therefore be moved to the Sludge Disposal section of this table.

United Utilities response to the Ofwat consultation: Annual Performance Report Consultation 2018-19

Note that absent any changes to the RAGs our current intention, in line with our agreed approach with Ofwat for 2017/18 reporting, is to include the incineration of treated sludge within Line 14 '*Sludge disposal route – other*' rather than '*% Sludge treatment process – incineration of digested sludge*'.

Table 4W Operating cost analysis – sludge transport, treatment and disposal

There is a large % of costs which sit within the 'Other' column, for example in our 2017/18 APR 49% of sludge treatment opex was reporting in 'Other'. To provide improved disclosure we would recommend further splitting this out between 'Thickening', 'Dewatering' and 'Other'.

Annex A: Proposed revisions unplanned outages

This annex sets out, in track changes from the published guidance, the proposed changes.

Reporting guidance – Unplanned outage

Objective

The guidance seeks to enable all companies to report on outages for the defined year with confidence and at a reasonable level of accuracy and with a common approach. Companies shall apply consistent and robust methods and common assumptions. This will facilitate the comparison of performance across companies by customers, regulators and other companies with reasonable confidence.

Key Principles

There are several key principles applied in the compilation of the guidance:

- Reporting of annual outage forms part of each company's assurance process applied to all measures reported annually by companies;
- A company needs to have a written methodology or procedure in place for reporting outage. This procedure is reviewed annually and updated as required;
- The reporting guidance for annual outage reporting is set out as a consistent good practice baseline for the industry which companies should achieve now or in the short and medium term; and
- Where a company is not able to meet any part of the good practice methods then it is required to explain any shortfalls and its plans to address this.

Measure Definition

This measure is to be used as a means of assessing asset health (primarily for non-infrastructure – above ground assets), for water abstraction and water treatment activities. It is defined as the annualised unavailable flow, based on the peak week production capacity. or PWPC), for each company. This measure is proportionate to both the frequency of asset failure as well as the criticality and scale of the assets that are causing an outage.

It is important to understand planned and unplanned outage as they both reflect on asset health. The actual unplanned outage should be reported as the temporary loss of peak week production capacity in the reporting year weighted by the duration of the loss

(in days). Outages arising from planned works should be recorded separately to outages arising from unplanned causes, such as asset failure.

The proposed calculation for both figures is

$$\frac{\text{Reduction in peak week production capacity} \times \text{Duration in days}}{365}$$

Unplanned outage for each water production site is calculated separately and then summed over the reporting year to give a total actual unplanned outage for the water resource zone.

The company water resource zone weighted outage can then be summed (MI/d) and normalised based on overall company peak week production capacity to be reported as a percentage.

A calculation example is as follows:

For a single source works:

A source works has a peak week production capacity of 30 MI/d
For 15 days the maximum production capacity is reduced to 15MI/d due to a temporary unplanned outage (pump failure). This is a loss of peak week production capacity of 15 MI/d for 15 days.

The weighted unplanned outage for this source works = $15 \times (15 / 365) = 0.62$ MI/d
Each weighted unplanned outage is then summed over the reporting year to give a total unplanned outage for the water resource zone.

For a water resource zone:

First source works in zone –weighted unplanned outage = 0.62 MI/d
Second source works in zone –weighted unplanned outage = 2.58 MI/d
Third source works in zone –weighted unplanned outage = 3.67 MI/d
Zonal weighted outage = 6.87 MI/d

The company water resource zone weighted unplanned outage can then be summed and normalised based on overall company peak week production capacity.

Company normalising:

Zone 1 weighted unplanned outage = 6.87 MI/d
Zone 2 weighted unplanned outage = 7.95 MI/d
Company weighted unplanned outage = 14.82 MI/d
Company peak week production capacity = 120 MI/d
Unplanned outage proportion = 12.4%

Exclusions for managing raw water quality and other matters are permitted and described in Section 5.6. Exclusions should be reported alongside the planned and unplanned outage figures.

Reporting Process

The guidance is structured in the way that outage is normally estimated and components of outage are described in Section 5.

The process for deriving planned and unplanned outage is shown in the following diagram.

A company is required to report against this definition and:

- Disclose where its methodology does not comply with this guidance using the checklist in Annex A;
- Explain the reasons for any non-compliance;
- Set out its plans and programme to comply with the guidance; and
- Disclose any other factors which have an impact on the methodology for reporting outage.

Components of Unplanned Outage Calculation

Peak Week Production Capacity

A company should define its peak week production capacity (PWPC) for each water production site or source works included in its water resources management plan (WRMP) a company should define its peak week production capacity (normally an input for modelling purposes). PWPC for this measure is not expected to be the same number as reported for dry year peak week production capacity (although it is possible that it may be the same).

For this measure, PWPC This is equivalent to the maximum volume of water which can be put into supply and sustained over a period of one week measured in Ml/d. This should be at least as great as the highest historic performance that has been sustained for any seven-day period in the last five years (unless a change to assets or process can be evidenced) but could be higher. This should be supported by physical tests to demonstrate capability undertaken at least once every five years. It is expected that this value should be reviewed annually and as modifications to assets and processes are completed which impact capacity.

It is expected that PWPC would be a fixed value for each production site each year unless a change to assets or process can be evidenced.

Peak week production capacity does not account for seasonal changes in yield (most commonly observed at groundwater sources) and allowed abstraction volumes (most commonly observed at river sources) which are weather dependent and not an indicator of asset health.

A company is expected to:

- Define PWPC for each water production site.
- Review PWPC annually.
- Support PWPC with evidence of [actual output or of](#) capacity tests undertaken on a rolling programme each five years. [This should be based on a risk-based approach for each works and the duration of testing does not need to extend to seven days.](#)
- Support revisions to PWPC with evidence of changes to assets or processes.

Asset Failure / Unplanned Outage

The failure or deterioration of any asset which impacts on the ability to produce the peak week production capacity should be recorded as an unplanned outage. This may be a failure which impacts part or all of the production plant which contributes to peak week production capacity.

This can include:

- source abstraction assets (e.g. abstraction pumps, screens, boreholes);
- raw water transport assets (e.g. pumping plant and mains);
- raw water storage assets (e.g. balancing reservoirs);
- water treatment assets;
- treated water storage assets (e.g. contact tanks, pre-distribution storage); and
- treated water distribution assets before distribution input meter (e.g. treated water pumping).

In some circumstances the failure of assets upstream of the treated water distribution assets may not impact on the peak week production capacity. For example, where a river abstraction is pumped to bankside storage and then stored water is pumped onto treatment works, the failure of an abstraction pump may not impact peak week production capacity as water onto the treatment works can be maintained from the raw water storage. The length of time that this asset is unavailable will determine whether the peak week production capacity is reduced and therefore contributes to unplanned outage.

Where asset failures occur at water production sites with standby assets this may also not impact peak week production capacity. For example, a groundwater site with a peak week production capacity of 10MI/d may have three boreholes on site, all with capacity of 5MI/d. Under normal circumstances boreholes 1 and 2 may be operated to provide the site output of 10MI/d. If the pump in borehole 1 fails then borehole 3 is switched on to replace the lost capacity. Providing borehole 3 is switched on within 24 hours to replace the failed asset in borehole 1 there would be no unplanned outage recorded. There may need to be an outage at a later stage to repair or replace the failed pump. Whilst this can be scheduled and planned for a convenient time the reason for the need to make the repair is an unforeseen failure of an asset and therefore the outage for the scheduled repair or replacement should also be classified as unplanned.

Planned Outages

Where assets are taken out of supply or made unavailable for supply to enable planned maintenance or capital works to be completed then these should be recorded as planned outages. The same principles for work on standby assets apply here as for unplanned outages.

It is expected that a company will have a process whereby planned works on production assets are approved and scheduled. This may be the basis of evidence to demonstrate that the outage is planned.

Where planned work results from an asset failure any resulting outage should also be recorded as unplanned.

Duration

Only outage events which exceed 24 hours in duration should be included in this measure. Outage duration should be recorded to the nearest whole day with normal rounding rules applied. For the avoidance of doubt, all outages below 24 hours are excluded and rounding does not apply. The duration may span a calendar day

By way of an example of rounding, an unplanned outage of 79 hours would be 3 days whereas an unplanned outage of 115 hours would be 5 days.

A company should identify the start of an outage period using telemetry data wherever possible. ~~This is likely to relate to an alarm, the unexpected loss of water into supply or a planned switch off.~~ If a company uses another source of data to indicate the start of an outage period it should specify the data source and demonstrate auditable record keeping.

The end of the unplanned outage period should be recorded as the time when the asset was returned to a state meaning the availability of peak week production capacity is restored. For the avoidance of doubt this should not be when the individual asset is repaired or planned work completed but when the recommissioning process is

completed, except when there is no immediate requirement to put an asset back into service.

In this case the repair time is taken as the end of the unplanned outage period. If when the asset is next required to be put into service, it operates in a way that would count as an unplanned outage, the start time for the reported unplanned outage should be that of the original outage.

For example, if a borehole pump is replaced due to an unexpected failure or planned works the end of the unplanned outage is not when the pump replacement is completed but when any subsequent pumping to waste and water quality testing is finished and full peak week production capacity is restored, if the pump is required in service immediately.

If the pump is not required in service immediately, then repair or replacement time is taken as the end of the unplanned outage. When the pump is next required to be put into service, should it operate in a way that would count as an unplanned outage, the start time for the reported unplanned outage should be that of the original outage.

Where planned work exceeds the duration of the scheduled outage any extension is to be included within the planned outage figure.

Where a company chooses not to respond immediately to an unplanned outage such as a failure at the weekend for which alternative water can be deployed the duration may be longer than it might otherwise have been. A company should make no adjustment for this in the measurement of the duration of the unplanned outage. This may result in reporting higher unplanned outage figures but given that alternative sources are available it is unlikely that the unplanned outage in this example would be contributing a large amount to the overall company peak week production capacity and so would therefore have a relatively small impact on the overall measure. This is something that could be reviewed as the definition of this measure is further developed.

Repeated unplanned outages at the same water production site should be treated as separate events with independent start and finish times unless the initial outage repair and recommissioning was not concluded and there was not full restoration of available peak week production capacity.

A company is expected to:

- Record unplanned outages over 24 hours in duration.
- Record unplanned outages as unplanned even if they result in a programmed outage later.
- Measure duration to the nearest whole day.
- Record the start and end time of an outage using telemetry data.
- Record the end of an unplanned outage as when recommissioning is completed and peak week production capacity is fully restored except when there is no

immediate requirement to put an asset back into supply. In this instance the repair time is taken as the end of the unplanned outage and when the asset is next required to be put into service, if it operates in a way that would count as an unplanned outage, the start time for the reported unplanned outage should be that of the original outage.

- Make no adjustment for over-running planned outages.
- Make no adjustment for unplanned outages which are not responded to immediately.
- Justify use of data sources other than telemetry.

Reduction in Peak Week Production Capacity

For each unplanned outage the impact of the outage is recorded as the reduction in peak week production capacity. For asset failures or programmed work resulting in the total loss of water production from the site then the impact of the outage is recorded as the total peak week production capacity for the site. Some asset failures or programmed work may result in a reduction of peak week production capacity. For example, a groundwater source with a peak week production capacity of 10MI/d may have three boreholes on site, all with capacity of 5MI/d. Under normal circumstances boreholes 1 and 2 may be operated to provide the site output of 10MI/d. If the pumps in boreholes 1 and 2 fail then borehole 3 is switched on but can only replace half the lost capacity. The lost peak week production capacity in this instance would be 5MI/d. The replacement of the failed pumps may require the whole output to cease for the period of the works. From the point at which the output is zero the lost capacity would increase to 10MI/d and would have a separate duration to the initial partial reduction in capacity.

Exclusions

Unplanned outage arising from changes in raw water quality beyond the normal water quality operating band shall be excluded as this is not a measure of asset health. Exclusions must be evidence based including evidence to show what the normal water quality operating band for that production site is. This exclusion applies to transient changes to raw water quality such as turbidity, algae, pollution, spikes in nitrate and pesticide. If a company chooses to manage variable raw water quality by proactively temporarily restricting water production then this should also be classed as an exclusion.

Long-term trend based changes in raw water quality which result in unplanned outages are not permitted as exclusions as a company should have the data to recognise a rising trend and foresee the need to plan for treatment etc.

Extreme weather can result in raw water quality events as described above. In addition to this they may present constraints on ability to resolve the unplanned outage e.g. a storm event may increase turbidity and cause a site failure and flooding of the immediate area. It may be difficult for operational staff to attend site to rectify the problem. In an example such as this the health and safety constraint on access should

be allowed as a further exclusion, but would need to be well justified and assured. Extreme weather may also include heavy snowfall when access to remote sites can be difficult.

A company is expected to:

- Demonstrate based on evidence normal water quality operating bands for each water production site.
- Record raw water quality events outside of these bands and provide evidence of the exceedance.
- Provide evidence of extreme weather events such as storms and snowfalls which have presented hazards preventing access to sites.

Glossary

PWPC	Peak week production capacity
WRMP	Water resources management plan
MI/d	Mega litres per day

Annex B: Proposed revisions sewer collapses

This annex sets out, in track changes from the published guidance, the proposed changes.

Reporting guidance – Sewer collapses per 1,000km

Objective

This guidance seeks to enable all companies to report on sewer collapses for the defined year with confidence and at a reasonable level of accuracy and with a common approach. Companies shall apply consistent and robust methods and common assumptions. This will facilitate the comparison of performance across companies by customers, regulators and other companies with reasonable confidence.

Key Principles

There are several key assumptions made in the compilation of the guidance:

- Reporting on number of sewer collapses shall be subject to each company's assurance process which is applied to all measures reported annually.
- Companies have a methodology or procedure in place for reporting on sewer collapses
- There is an assumption that there will be continued improvement by all companies in the short and medium term through innovation, new technology, data quality improvements and staff training;
- The measure assumes a clear and simple approach that can be understood by customers and regulators;
- The essential reporting requirements for reporting on sewer collapses are set out in the guidance;
- The focus of the guidance is on annual reporting of number of sewer collapses. It is not intended as a definitive guide to managing the risk of sewer collapses;
- Exclusions are to be kept to a minimum and shall be consistent with the reasonable expectations of an affected customer.

Applying this guidance is likely to mean that comparisons of historical performance between companies, and of individual companies' previous performance, may not necessarily be valid. However, it is anticipated that future individual company year on year trends in performance will be possible.

Measure Definition

Number of sewer collapses per thousand kilometres of all sewers that have not been identified proactively by the company and causing an impact on service to customers or the environment.

This measure seeks to reflect failures, ~~due to structural weakness~~ in the asset, causing any impact on service to customers or the environment that requires replacement or repair to reinstate service, while maintaining incentives for companies to proactively investigate asset quality.

A reportable sewer collapse is considered to be where a ~~structural~~ failure has occurred to the pipe that results in either any contact with the company (i.e. an impact on service has caused someone to contact the company) or any unplanned escape of wastewater and any loss of flow has occurred that results in a service impact to a customer or the environment results in the need to replace or ~~restore~~ repair the pipe to reinstate normal service (as set out in the flow diagram below). The measure intentionally does not refer to the magnitude of the collapse.

This measure includes rising mains, pipe bridges, and failures on the infrastructure network, including inputs into the inlet of treatment works and terminal pumping station rising mains (in accordance with RAG guidance 4.07).

Note this measure should include all public sewer and lateral collapses recorded by the company inclusive of those incidents that have been reported as flooding or pollution failures, if the primary cause of the flooding or pollution was a sewer collapse.

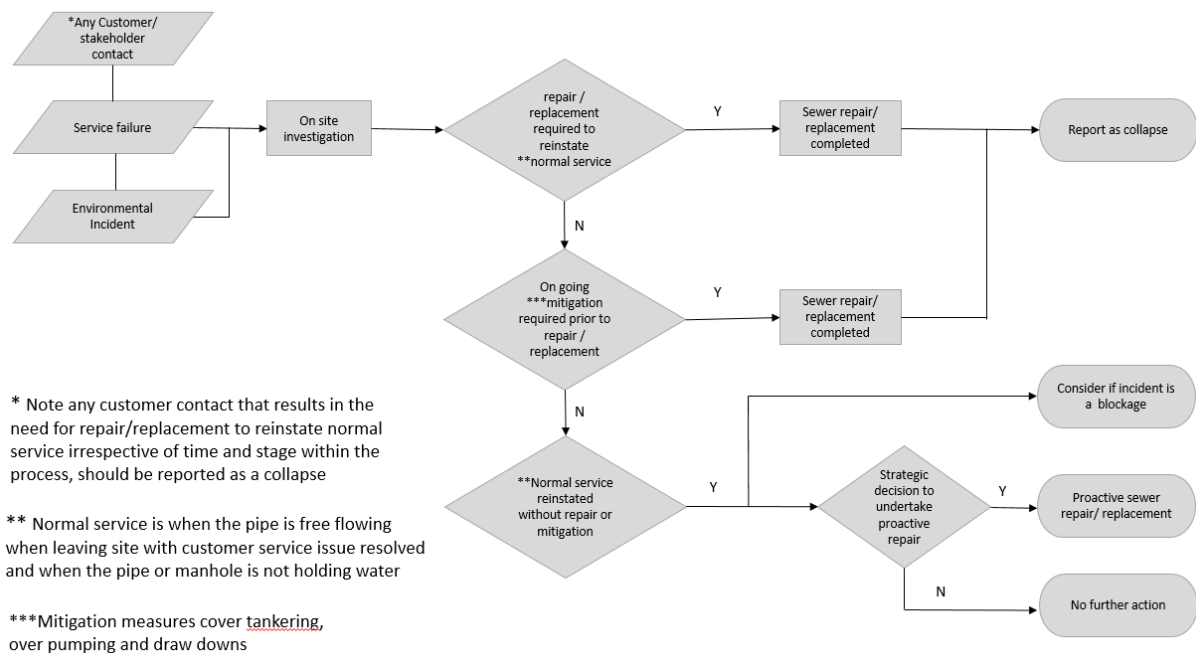
Note multiple incidents on the same length of sewer (manhole to manhole/ valve to valve) will count as a single incident if all work is carried out as part of the same remedial job. This assumes that the locations are in close proximity. This would not be the case if separate locations were more than 25m apart.

For clarity if jetting enables restoration of flow without the need for pipe replacement or repair then the incident is not to be reported as a sewer collapse.

However, if pipe replacement or repair is needed to resolve an issue that has been identified as a result of either a contact with a company or any unplanned escape of wastewater, then it is to be reported as a sewer collapse in the reporting year in which the service impact was reported to the company, not when the replacement or repair took place.

Reporting Process

The process for deriving the number of sewer collapses is given in the diagram below:



A sewer collapse should be reported in the reporting year when the service incident was reported to the company, not when the replacement or repair took place.

A company is required to report against this definition and:

- Disclose where its methodology does not comply with this guidance using the checklist in Annex A;
- Explain the reasons for any non-compliance;
- Set out its plans and programme to comply with the guidance; and
- Disclose any other factors which have an impact on the methodology for reporting outage.

Components

Sewer Length

Companies should separately record the length of sewer that was transferred to their responsibility under the Transfer of Public Sewers Regs 2011.

Exclusions

The following exclusions ~~could~~ apply to the sewer collapse measure definition:

- Proactively identified collapses – Should ~~a collapse~~ the need to replace or repair a pipe ~~pipe that has structurally failed~~ be found as a result of proactive activity (survey or proactive sewer maintenance work) on the network ~~unrelated to the reported reactive activity to restore service~~ then it ~~could~~ should be excluded (see flow diagram above).
- Third party damage – Third party structural damage (including water utility damage) of the sewer is not an indicator of asset health and hence ~~could~~ should be excluded.
- Manhole damage and internal backdrops ~~could~~ should be excluded
- Displaced joints, cracked ~~or fractured~~ pipes, open joints, intruding connections, ~~minor pipe breaks~~ and hard blockages, patch repairs and sewer lining do not reflect sufficiently significant structural failure hence ~~could~~ should be excluded from the measure.
- Root ingress is excluded unless it has resulted in a need for pipe replacement