

Green Recovery Draft Decisions - UUW Representations

9 June 2021

1. Executive Summary

United Utilities Water is pleased to have the opportunity to respond to Ofwat's Draft Decisions on its Green Recovery proposals.

As set out in our initial submission, the substantial majority of spend that United Utilities is intending to advance during AMP 7 is not subject to the Green Recovery process, requires no specific regulatory permissions and will be subject to standard PR19 rules governing totex. However, UUW made specific proposals in relation to four potential areas where we considered there were opportunities to either advance AMP8 expenditure or deliver new and innovative schemes ahead of PR24. These were:

- Accelerating partnerships to deliver natural solutions;
- Environmental improvements to the Manchester Ship Canal;
- Tackling storm overflows; and,
- Emissions regulations and the journey to zero carbon.

This document responds to Ofwat's draft decisions in respect of each of these areas.

In addition, we provide:

- comments regarding Ofwat's proposed approach to tax impacts as published by Ofwat on 28 May 2021;
- comments in response to Ofwat's email request of 26 May 2021 in relation to accounting for Green Recovery projects through the APR framework; and,
- a revised copy of data tables WS2 and WWS2, reflecting correction of an allocation error in our previous submission.

United Utilities Water is excited to be playing its part in the Green Recovery for customers and communities in the North West of England and we look forward to Ofwat's final decisions in the summer.

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1. Accelerating partnerships to deliver natural solutions (GR0002)

1.1. Overview

- 1.1.1 We are pleased to see support for many of our Green Recovery natural solutions proposals in Ofwat’s draft decision. We do however have some specific concerns around the details included in the draft decisions document. In particular, we are surprised that nature based solutions have been singled out for a 10% reduction in cost allowances. This is concerning both in terms of the impact on deliverability of our proposals and also the signal it sends more broadly about how these schemes are judged relative to “hard engineering” or “traditional” solutions.
- 1.1.2 The draft decision refers to a lack of clarity over the benefits to customers. Whilst natural solutions benefits can be more challenging to specifically identify and be more varied based on the natural conditions, we consider that evidence has been provided of both actual and modelled benefit from natural solutions which are similar to those proposed. We have also provided information on how the cost of delivering through these solutions represents efficient spend and aligns to meeting core objectives which would have to be delivered through other means without these catchment measures
- 1.1.3 Additionally we note that there was a query on why we have chosen specific catchments. We made these decisions based on experience and analysis to identify the locations that we believe have the greatest need and will deliver the greatest customer benefit. This has been assessed across owned catchment, non-owned catchment and non-catchment land. We have focused on areas where we have partners with clearly aligned objectives.
- 1.1.4 The importance of delivering more nature based solutions was a clear theme recognised in Ofwat’s strategy “Time to Act Together” published in 2019 and through the current cross governmental review of the WINEP. United Utilities Water is fully supportive of the need for this approach which is why we developed and submitted proposals for the efficient delivery of nature based solutions. However, in reviewing both our submission and those of other companies, the delivery of traditional hard engineered solutions seems to have been better received than the catchment and partnership approaches put forward. For example, our proposals for Bury WWTW and Severn Trent Water’s phosphorus management investment have both been provided the full allowance, whilst nature based solutions have all been subjected to a 10% reduction in allowed costs. This approach does not seem consistent with the direction being targeted by Ofwat in PR24 and Beyond – Creating Tomorrow Together:
- “At PR24, we want to see companies deliver even more environmental and social value by exploring different approaches to their core activities. We want to encourage companies to routinely consider the wider, long-term benefits to communities and the environment when putting forward solutions, using a systems-oriented approach. For example, nature-based solutions can not only deliver direct benefits like better water quality, but can also improve biodiversity, reduce flooding, reduce emissions, and help to eliminate harm from storm overflows.”*
- 1.1.5 A key barrier to the uptake of nature based solutions is that they are judged against the same criteria as hard engineered solutions. Taking this approach disincentivises the development and delivery of natural solutions now and moving forward into AMP8. It is harder to definitively prove the benefits of many nature based solutions as they can rarely be ring fenced from the wider ecosystems in which they operate and their benefits are likely to vary with environmental conditions. Nevertheless the government’s 25 year plan recognises the importance of restoring natural capital and the water industry are repeatedly recognised as one of the key players in this arena due to our dependence on nature to

deliver our services. To unlock these benefits for PR24 and beyond, then all parties need to have confidence in how to achieve this objective.

- 1.1.6 The cost allowances requested in GR0002 were based on experience of delivery where available. Where they were not, we worked with leading organisations to understand efficient costs. Application of a flat 10% reduction does not reflect delivery costs and reduces our ability to secure additional partnership funding and deliver the identified significant customer benefits. We recognise that not all the benefits we can deliver accrue directly to the water bill payer and thus we set out in our Green Recovery submission ambitious plans to secure significant partnership funding to deliver the programme of measures we put forward. We also intend to use our proposal for the Eden catchment to further drive forward work to develop natural capital markets which are key to unlocking wider co-funding of interventions in nature. Reducing the cost allowance by 10% reduces our ability to deliver these goals and will slow the understanding and development of these methods prior to PR24.
- 1.1.7 Through this response we will address the points raised in Green Economic Recovery: Draft Decisions Document and demonstrate the benefits that delivering through natural solutions has for customers. We will highlight the evidence presented on efficiency and review the cost calculations that have been made. In order to do this effectively we have structured this section in 3 sections as below:
- Section 1.2: Evidence to support customer benefit and the locations and interventions selected
 - Section 1.3: Assessment of the SuDS proposal and amendments that could better protect customers
 - Section 1.4: Assessment of the financial calculations completed through the draft determination and the impact to the allocation of funding across our proposed interventions

1.2. Evidence to support customer benefit and the locations and interventions selected

1.2.1 Peatland Restoration

- 1.2.2 The submission in GR0002 focused on 5 key locations for peatland restoration; Haweswater, Barnacre/Grizedale, Winter Hill, Longdendale and the Goyt Valley. In these areas there is clear evidence of the challenge that degraded peat is posing and the forecast benefits that could be achieved by its effective restoration. In combination these catchment areas are the source of drinking water for 3 million people, which represents 41% of customers. We believe this is a significant number of customers who will benefit from an increase in the resilience of the catchments through peatland restoration which secures long term improvements in water quality, biodiversity, natural flood management and carbon sequestration.
- 1.2.3 Through leveraging external funding from partner organisations we are seeking to ensure that the cost of the additional benefits to customers (above statutory commitments on water quality and biodiversity) are funded from other sources, such as the Government's recently announced Nature for Climate peatland grant scheme¹. The funding accompanies the government's recently published England Peat Action Plan, which sets out ambitious plans to restore upland peat in England and recognises that one of the benefits of doing so is to provide a sustainable supply of high quality drinking water.² Additionally, the document recognises that peatland restoration boosts resilience to wildfire risk which can have a significant and immediate impact on raw water quality.
- 1.2.4 UU has experienced increasing prevalence of wildfires in recent years including an area of the Goyt Valley in 2018 and most notably the extensive fires at Stalybridge and the West Pennine Moors in 2018.

¹ <https://www.gov.uk/guidance/nature-for-climate-peatland-grant-scheme>

² UK Government, England Peat Action Plan, May 2021

These areas were under wildfire again in 2019, when one in Longdendale also broke out. This follows an increasing trend nationally which is referenced in academic literature³.

- 1.2.5 To increase the resilience of the catchment to wildfire UU is taking a multi-pronged approach to addressing this having worked closely with Natural England and the Fire Services to develop our plans. Peatland restoration is one of the elements of this approach and it will particularly benefit several of our land holdings around Greater Manchester which are particularly vulnerable to wildfire due to their high visitors numbers which give rise to potential sources of ignition (discarded cigarettes, disposable barbeques etc.) and the long term history of air pollution which has contributed to their degradation.
- 1.2.6 The England Peat Action Plan also recognises that it can take 20-50 years to fully restore the hydrological and ecological function of a blanket bog. This means that it is very difficult to show tangible benefits to water quality in the short term but also highlights the importance of taking a precautionary approach and acting now.
- 1.2.7 United Utilities has a long history of delivering peatland restoration through SCAMP in order to protect raw water quality. We have invested significant sums to build up a 16 year monitoring record of how the peatland is responding to the restoration in recognition of the long term nature of restoration processes. A report by Penny Anderson Consultant Ecologists, independent experts in the field concludes that *“SCaMP-related land management and interventions have been observed to have had significant, although sometimes time-limited effects on water quality in key locations, and these effects have been positive⁴”*. It goes on to note that *“A review of the trends in SCaMP-related raw water colour data, when compared with those observed elsewhere in UU reservoirs and watercourses now strongly suggest that the increasing trends in colour production observed over past decades may be stabilising across many sites, albeit at a higher level of colour and colour variability”*.
- 1.2.8 We recently identified that an area of non-owned peatland catchment in the Barnacre/Grizedale area was showing a significant deterioration in raw water quality which goes against the trend for most UU raw water sources. This is an area of catchment that has never been part of UU’s SCAMP programme and potentially provides an example of where we might have been without SCAMP across much of our catchment. Part of our proposals in GR0002 involve working in this area as we believe it is essential to treat the catchment as a system and deliver relevant improvements on both owned and non-owned catchment.
- 1.2.9 To provide some assurance around delivery of peatland restoration our proposal committed to assuring our delivery of peatland restoration through use of the Peatland Code⁵. Whilst this code is aimed at assuring carbon benefits there are many synergies with raw water quality because the issue is related to the release of carbon from degraded peat into the water as particulate or dissolved organic carbon.
- 1.2.10 The Peatland carbon code is an independent certification of the work completed on site and will help to demonstrate and provide assurance on the additionality of the work funded by Green Recovery. A baseline assessment prior to starting work will be taken followed by an assessment of the work delivered and the carbon benefit (and therefore assurance for the other benefits e.g. water quality and biodiversity).
- 1.2.11 Based on our long history of delivering peatland restoration activity and monitoring this since 2005 and the fact that Defra is incentivising the delivery of peatland restoration through schemes such as the nature for climate peatland grant scheme, it is not clear to us what further evidence of benefit to customers and communities could reasonably be required by Ofwat in order to confirm the required cost allowance in full.

³ <https://iopscience.iop.org/article/10.1088/1748-9326/abd9f2>

⁴ Sustainable Catchment Management Programme Final Report-Executive Summary Oct 2020, Penny Anderson Ltd Consultant Ecologists

⁵ <https://www.iucn-uk-peatlandprogramme.org/peatland-code-0>

- 1.2.12 The description of the peatland restoration activity in table A1.33 appears to restrict the application of the cost allowance solely to UU’s own land holding. Our proposal had included one area of non-owned catchment which is Barnace/Grizedale. We do not believe our ownership of the land is relevant in terms of whether it is in customers’ best interests to deliver the scheme as protection of raw water quality is the driver. As a result we propose the wording is changed to refer to “raw water catchment area” in order to avoid excluding the Barnace/Grizedale element of our proposal.

Proposed actions:

- Remove the 10% reduction and reinstate the requested cost allowance and unit rates for peatland restoration to allow full delivery of the benefit this approach has for customers
- Change the description in table A1.33 to say raw water catchment areas rather than United Utilities land holding

1.2.13 Catchment Raw Water Quality Management

- 1.2.14 The submission in GR0002 focused on the catchment area for Franklaw Water Treatment Works in the Fylde, Lancashire. There is clear evidence of the challenge that deteriorating raw water quality is posing to the cost of water treatment and the potential benefits that could be achieved by its improvement through catchment management as a long term measure. The Green Recovery cost allowance will provide additional capacity for the Lune Rivers Trust and Wyre Rivers Trusts to work with us to influence the practices and activities of farmers and land managers in these river catchments upstream of the abstraction point. The catchment areas are vast, totalling 109,345 hectares. They are the source of drinking water for 500,000 people living and working in Lancashire. We believe this is a significant number of customers who will stand to benefit from an increase in the resilience of the catchments through engagement and partnership which secures long term improvements in water quality and other associated ecosystem services such as biodiversity, natural flood management and carbon sequestration.
- 1.2.15 The Drinking Water Inspectorate⁶ requires companies to take a “twin track” approach to managing risk to raw water quality. This is to ensure that we can mitigate risks to treatment in the immediate term while establishing catchment solutions to mitigate the risk in the longer term. In the case of reducing pesticides in raw water we have several examples of AMP6 NEP schemes (Huntington, Sutton Hall, Hurleston, Wayoh and Franklaw drinking water safeguard zones) where engagement and interventions in the catchment have been successful at reducing the levels of pesticides detected in the raw water. This approach protects the customer by avoiding the cost of additional water treatment to remove pesticides that would otherwise be required.

⁶ DWI Guidance Note: Long term planning for the quality of drinking water supplies – Water Resources and Sufficiency of Supplies (2000) <https://cdn.dwi.gov.uk/wp-content/uploads/2020/11/03135404/Long-term-planning-guidance-Water-Resources-and-Sufficiency-of-Supplies.pdf>

- 1.2.16 Our proposal was to take a similar approach in the Wyre and Lune catchments to address other raw water risks including ammonia, bacteria and nutrients. As these issues are from a huge number of diffuse sources it requires additional capacity for the partner organisations to engage with the farmers and landowners; building on their existing relationships and successes through initiatives such as Natural England's Catchment Sensitive Farming⁷.

Proposed action:

- Remove the 10% reduction and reinstate the requested cost allowance unit rates for catchment raw water quality interventions to allow full delivery of the benefit this approach has for customers

1.2.17 Catchment Phosphorus Management

- 1.2.18 The submission in GR0002 focused on 2 key geographical areas; the Eden and the Irwell and in both of these areas there is clear evidence of the challenge that phosphorus is posing and the benefits that could be achieved by its effective removal through catchment interventions. In the former there is an impact on the protected habitats in the Special Area of Conservation and in the latter there are significant upwards pressures in phosphorus concentrations due to the growing population in Greater Manchester.
- 1.2.19 We are concerned to see the draft decision has made the cost allowance for the Eden phosphorus interventions conditional on Natural England agreeing the target for the River Eden Special Area of Conservation. We will of course work with Natural England but we are concerned that written agreement from Natural England is likely to be conditional on a ministerial decision which may take time to happen. This risks taking the pace out of delivering a really innovative element of our Green Recovery proposals.
- 1.2.20 We are undertaking extensive investigations this AMP into the condition of the Eden in line with the habitats regulations and the initial results from these are that reductions in phosphorus emissions are technically achievable and therefore it is reasonable to assume we will be required to meet the regulations. This provides a clear indication that we would expect to receive drivers to reduce the phosphorus load entering the Eden in AMP 8. These results are summarised in Section 5, Table 6 of GR0002.
- 1.2.21 Whilst we are awaiting sign off from Natural England as to what the targets associated to these interventions will be it is extremely likely that these will be agreed due to the Special Area of Conservation status of this river which means it requires this significant level of protection.
- 1.2.22 In the event that the drivers were not signed off we would still emphasise that the results of the catchment investigations remain valid and there would be a clear environmental need to act in this catchment in line with our proposals. Our proposals represent an opportunity to intervene in the catchment in an efficient way and improve the environmental performance which would reduce any further future action under the habitats regulations or WFD drivers. The benefits of working in this way now would also align to the already extensive work we have done in the catchment to establish natural capital markets through our work in the Petteril so now is the opportune time to intervene to deliver efficient and sustainable nutrient reductions.
- 1.2.23 In order to assess the efficiency of the proposals we have also undertaken engineering reviews to assess all of the required phosphorus reductions that have been identified. This has assessed the likely impact to any future capital solution that would be delivered by undertaking catchment offsets now and we have only proposed solutions where we believe there would be a material difference to the onsite solution that would be delivered in AMP 8. Section 5 Table 6 of GR0002 also demonstrates the results of

⁷ <https://www.gov.uk/guidance/catchment-sensitive-farming-reduce-agricultural-water-pollution>

these investigation and shows the sites where we believe there is a clear opportunity. Working in this way has clear benefits for customers in United Utilities meeting our core objectives in a far more efficient way as evidenced by previous work in the Petteril. This is included in GR0002 Section 7.3.8 which details some of the additional benefits modelled and the cost reductions realised through a catchment approach.

- 1.2.24 Through our submission we have demonstrated evidence of the cost of delivering interventions in the Petteril, which is within the Eden catchment. Based on actual tendered cost to deliver similar interventions a unit cost of P removal was established to be £1,100/kg (Section 7.3.10 – 7.3.11 of GR0002) with additional costs of £100k (both based on outturn costs) to engage with catchment partners to facilitate this market and ensure this low unit cost can be realised. These costs were demonstrated to be efficient in comparison to onsite investment as mentioned above but also compared with costs from across the industry as confirmed by Dan Sokell of the Cambridge Institute for Sustainability Leadership who leads on the Catchment Leadership Network. We therefore believe these costs represent efficient delivery which achieves clear customer benefit.
- 1.2.25 In the case of the Irwell the need to tackle phosphorus in the river is demonstrated through Section 5 Figure 6 of GR0002 which shows a chain plot demonstrating the phosphorus performance of the waterbody. In order to move towards the requirements of the Water Framework Directive in this catchment it is important that all sources of pollution are tackled and whilst the proportion of phosphorus coming from agriculture is lower here than in the Eden the scale of the catchment still means there is a significant load that needs to be addressed to allow the river to move towards its quality requirements. As the population of the Irwell catchment continues to grow a catchment approach to tackling diffuse pollutions sources will be a key part of meeting the environmental standards in the river and efficient nutrient management across the catchment
- 1.2.26 The urban element of these proposals is more innovative and as such does not have the same cost base drawn from previous delivery experience associated to it. However as stated in GR0002 Section 7.3.13-7.3.14 we have engaged with an NGO that specialise in managing urban runoff through green infrastructure and they have provided us with expected costs for delivery in the urban environment.
- 1.2.27 Whilst these costs are less certain based on less delivery experience we had already applied a 50% reduction to our proposed cost allowances to ensure customers are protected from this uncertainty so an additional 10% reduction will represent a significant risk that nothing can be delivered in this area. We have already undertaken work to identify how we can promote markets and engage partners to secure the required partnership funding to deliver these schemes and have partnered with Finance Earth in a Natural Environment Investment Readiness bid targeting how other beneficiaries could contribute to this work. Key to the success of this however will be United Utilities being in a position to pay for the benefits we are procuring and therefore reducing the unit rate for these interventions will reduce our ability to deliver for customers and miss an opportunity to develop an urban catchment market that could provide additional delivery options in the future.
- 1.2.28 The benefits of intervening in these catchments align to those expressed in the Eden but with additional factors such as the ability to also tackle other pollutants found in urban runoff and the creation of urban green infrastructure and the broader benefits that can have to biodiversity and air quality etc. in an urban environment.

Proposed action:

- Remove the 10% reduction and reinstate the requested cost allowance unit rates for catchment phosphorus management interventions to allow full delivery of the benefit this approach has for customers

1.2.29 Invasive Non-Native Species Management

- 1.2.30 Our proposals in GR0002 around Invasive Non-Native Species (INNS) management in the Irwell are specifically targeted at a significant problem in the catchment that affects customers, communities, river users and United Utilities. Through Section GR0002 5.5.8 - 5.5.17 we have demonstrated the spread of these species throughout the catchment and the impact that they have on customers through both their presence on our land and across the catchment. We have also shown how quickly they spread meaning that our base position of managing these on our own land does not deliver sustained reduction and is becoming harder to maintain.
- 1.2.31 As a result we propose to tackle these at a catchment level, working with partners, and securing significant partnership funding, to eradicate these across the catchment and prevent their re-establishment, and through GR0002 Section 6.7 we demonstrated how this approach represents the most effective long term solution to this challenge and would allow us to engage others in the catchment in INNS management.
- 1.2.32 We believed that our proposals demonstrated clear benefit to customers through this activity and currently there is no mechanism to effectively deliver these benefits. As a water company which is dependent on the water environment and with suitable experience of delivering these interventions we believe we are well placed to lead in this activity. Not tackling this in a coordinated way now, as proposed in our Green Recovery submission, will lead to far greater spread of these and the problem will become harder to manage. This will eventually require coordinated action to tackle this but it will be a far bigger problem at that time.

Proposed action:

- Reinstate the requested cost allowance and unit rates for INNS management interventions to allow full delivery of the benefit this approach has for customers

1.3. Sustainable Drainage Solutions (SuDS) assessments

- 1.3.1 The proposals put forward to deliver SuDS worked differently to the rest of our proposed interventions in that we are not targeting specific schemes for a specific cost but instead established an assessment of the cost benefit of identified schemes. We proposed to complete any schemes with a cost benefit ratio greater than 1:1 up to a maximum cost allowance of £10m (See GR0002 Sections 11.3.3 – 11.3.10). Reducing the overall cost allowance for SuDS – as envisaged in the draft decision - would simply reduce the number of schemes that we were able to deliver and not serve to increase the benefit that investment in any individual scheme would achieve for customers.
- 1.3.2 As a result of this we propose that the original maximum cost allowance for SuDS is restored to the £10m requested (at outturn costs) but that the cost benefit assessment is adjusted to increase the required cost benefit ratio by 10%. We would keep the methodology as discussed in GR0002 but instead of requiring a cost benefit ratio of 1:1 projects would have to deliver at least a 1:1.1 ratio to be completed. This would promote efficient investments, provide additional customer protection to ensure they were getting appropriate benefits from the investments and also allow us to deliver benefits more in line with our original forecast. Customers are protected as our proposal made it clear that if there were insufficient projects that deliver the required benefits then we would not spend the money and there would be no cost passed onto customers.
- 1.3.3 In table A1.34 Condition of Allowance it states that “*Customers pay for the marginal difference in costs between conventional and SuDS or NFM solutions.*” This represents Option A as described in the decision tree included in Section 6 Figure 17 of our submission. This would seem to exclude delivering SuDS that

are shown to be cost beneficial based on Option B as there would be no means to fund the element of the cost equivalent to a conventional solution. There will be significant opportunity to deliver SuDS under Option B and given the enhanced protection for customers proposed earlier in this section we would like to continue to deliver SuDS that are shown to be beneficial even if traditional solutions do not show a cost benefit. This is important in increasing the delivery of SuDS and allowing us to engage partners to help promote and fund this delivery. If the delivery is constrained to only solutions where a traditional solution would have been cost beneficial it will prevent customers from obtaining the added benefits SuDS can deliver and not allow us to drive the increased delivery of SuDS which is needed to provide resilient long term drainage infrastructure into the future.

Proposed actions:

- Reinstate the requested cost allowance for SuDS to allow full delivery of the benefit this approach has for customers
- Allow the delivery of SuDS solutions where the conventional solution was deemed to be non-cost beneficial but the SuDS solution is cost beneficial when considering the added natural capital value (Option B in Section 6 Figure 17 of GR0002)

1.4. Calculation of allowances

- 1.4.1 For the reasons set out above we believe the costs and benefits delivered by our proposed interventions represent efficient cost that deliver good value for customers and would therefore seek to remove the 10% reduction to cost allowances across all of our natural solutions. In reviewing the draft decisions document however we have also found that some of the original planned allocations have been amended in a way that does not appear to be consistent with the changes that we interpret Ofwat may have intended to apply.
- 1.4.2 In the draft decision it seems some of the cost allowances proposed by United Utilities have been deflated to a FY18 price base and then efficiencies applied to these. Footnote 65 explains a simplification used by Ofwat to arrive at the cost breakdown. This simplification has had the effect of increasing the funding allocated to catchment phosphorus management to a level greater than that requested but in turn reducing the maximum funding for SuDS by more than the stated 10%.
- 1.4.3 This amendment could result in us delivering a greater amount of catchment phosphorus reduction than we have targeted and could lead to inefficiencies and overlapping delivery with what would need to be achieved at treatment works in AMP 8. This would also reduce the amount we could achieve with our SuDS programme. As a result we have re-stated the numbers we submitted based on the steps laid out below and what we believe Ofwat intended to do. The results of these assessments are included in Table 1 and 2 below and presented with the numbers set out in the draft decision document for comparison.
- 1.4.4 Column 1 represents the amounts originally requested in our Green Recovery proposal and in line with our predicted spend profile, deflated to a FY18 price base. Column 2 removes the proposed schemes for Invasive Non-Native Species management and applies a 10% reduction to all maximum allowances and unit costs which reflects what we understand to reflect Ofwat’s key interventions in the draft decision. Column 3 shows the (different) values actually specified in the draft decision.

Table 1: Comparison between United Utilities calculated maximum allowances and Ofwat figures included in the draft decisions document

	1. UU Requested allowance GR0002 in FY18 price base	2. UU calculated allowance (based on above methodology reductions)	3. Ofwat calculated allowance in GR Draft Determination
Catchment Phosphorus Management (Irwell)	£1.819m	£1.637m	£1.626m
Catchment Phosphorus Management (Eden)	£1.091m	£0.982m	£1.626m
Invasive Non Native Species	£0.458m	£0	£0
Catchment Raw Water Quality	£0.723m	£0.651m	£0.650m
Peatland Restoration	£2.253m	£2.028m	£2.032m
SuDS	£9.057m	£8.151m	£7.478m
Total	£15.401m	£13.449m	£13.412

Table 2: Comparison between United Utilities calculated unit rates and Ofwat figures included in the draft decisions document

	UU unit cost requested GR0002 in FY18 price base	UU calculated unit cost (based on above methodology reductions)	Ofwat calculated allowance in GR Draft Determination
Catchment Phosphorus Management (Irwell)	£10,494/kg Urban £1,000/kg Rural £136k Catchment Support	£9,445/kg Urban £900/kg Rural £123k Catchment support	£9,906/kg
Catchment Phosphorus Management (Eden)	£1,000/kg £91k Catchment Support	£900/kg £82k Catchment support	£946/kg
Invasive Non Native Species	£4,578/km (in catchment) £6.05/m ² (on UU land)	N/A	N/A
Catchment Raw Water Quality	£2,411 per farm	£2,170/farm	£2,287/farm
Peatland Restoration	£901/ha	£811/ha	£860/ha
SuDS	N/A	N/A	N/A

1.4.5 As can be seen from the above based on Table 1 columns 2 and 3 the figures included in the draft decision document move c£650k of funding from SuDS to catchment phosphorus management. In the final determination we would request full reinstatement of the proposed cost allowances as represented in Table 1 column 1. However if this is not done we would look for the reallocation of allowances as shown above to be corrected in line with the numbers in Table 1 column 2.

Proposed actions:

- Reinststate the requested cost allowance and unit rates for all interventions to allow full delivery of the benefit these approaches have for customers
- If the full cost allowances are not provided in line with our GR0002 proposal, then at least return to the balance of activity in line with Table 1 column 2.

1.5. Summary

- 1.5.1 In our submission for the Green Recovery we included efficiently costed proposals with identified benefits based on our long experience of delivering natural solutions and work completed with partners who were expert in their respective areas. Additionally, we set out ambitious plans to attract partnership funding, some of which is already secured. The efficiency that was already included in this programme means that to apply a flat 10% reduction across all of our proposals will compromise our ability to deliver interventions and ultimately reduce the benefits we can achieve for customers
- 1.5.2 We believe the water industry does have an important role to play in increasing the uptake of nature based solutions. In order to deliver this innovation, it will be necessary to recognise that straight comparisons of nature based solutions with traditional solutions are unlikely to support rapid adoption of the former and are more likely to favour the latter. Such a bias will be based on the comfort derived from certainty and familiarity with tried and tested approaches. However, given the strong encouragement provided by all regulators for the development of natural solutions, we believe that proposals put forward which seek to deliver such innovations should be given slightly more permissive treatment under the assessment regime and – certainly – that blanket reductions in the allowances are not appropriate. This is particularly the case for those which – as in U UW’s case – have been carefully designed to already confer a margin of safety and customer protection in estimation and are supported either by mechanisms which prevent recovery of non-cost beneficial approaches or by rich evidence that forecast benefits are likely to be achieved.
- 1.5.3 We also believe that these points warrant further consideration if such approaches are to be encouraged for PR24. We are committed to ongoing engagement with regulators to drive a different approach to regulating these solutions. This will be needed if we are to collectively ensure that their uptake can be scaled up significantly in AMP8 and beyond.

2. Environmental improvements to the Manchester Ship Canal (GR0003)

- 2.1.1 We are pleased that Ofwat's draft decision is in line with our proposed cost allowance to deliver investment at Bury WwTW Storm Tanks and the Nuttall Hall Road CSO – as set out in business case GR0003.
- 2.1.2 As per our response to Ofwat's query UUW-GR-RFI-008, the project milestones for the delivery of these schemes will be defined as part of the project tender process and confirmed upon awarding the contract. Based on our current projections, we anticipate this to be in summer 2022 (August 2022). Once the delivery profile has been confirmed we will be able to provide a cost associated with individual stages of the project delivery and therefore a mechanism for recovering cost based on milestones or stages of the project delivered. This project will be recognised as complete once it has been signed-off by the Environment Agency and we therefore proposed that we should provide interim milestones to Ofwat once the delivery profile has been confirmed. Milestones then achieved can be reflected at PR24. Having not received an explicit response to this submission from Ofwat, we are assuming that this approach is acceptable.
- 2.1.3 In the event that it is not acceptable then we will utilise a single milestone for completion which is the sign-off by the Environment agency. If this falls beyond AMP7 then it should be reflected in full in the RCV during the year in AMP8 where it is fully complete and provision for this would be made as part of the PR24 final determination. We note that such an approach would be equivalent to the action of the WINEP cost adjustment mechanism applied in AMP7 in that it similarly only adjusts for total project impacts, and takes no account of partial delivery.

3. Tackling storm overflows (GR0004)

- 3.1.1 We are pleased that Ofwat's draft decision is in line with our proposed cost allowance to deliver investment for the majority of the activity included in GR0004. However, we note that Ofwat refers to overlaps with statements previously made about our intention to install overflow monitors and that on this basis Ofwat has declined the proposed cost allowance for this activity.
- 3.1.2 Throughout AMP6 we have delivered an effective programme of EDMs which has given us a greater awareness of how our wastewater system is operating. This was an efficient and targeted programme delivering EDMs to high priority overflows. Lower priority overflows were risk assessed out of the agreed AMP6 programme with the Environment Agency, which was an appropriate and an efficient assessment made at the time.
- 3.1.3 Achieving 100% coverage for monitoring of our overflows is a priority for AMP8 plans. Our commitment to achieve 100% coverage was made via WaterUK whilst we were refining our Green Recovery submission in 2020. Declaring an intent to deliver investment in an activity does not mean that companies should then be denied the prospect of recovering the relevant costs which clearly fall within the definition of delivering our responsibilities as a water undertaker. Our intention has always been to secure funding for this additional monitoring through the Green Recovery process. Achieving 100% monitoring is a level of activity over and above our AMP7 commitments and we note that we were not alone in taking this view in making our green recovery submission. We consider that investment to achieve 100% monitoring is a valid use of customer funds and that an additional cost allowance for EDM installation should be approved.

4. Emissions regulations and the journey to zero carbon (GR0005)

4.1. Investment in IED compliance

- 4.1.1. We are disappointed with the Draft Decision to exclude our Emissions regulations and the journey to net zero proposal from the Green Recovery programme. Progression of this proposal within Green Recovery would have ensured timely compliance with the Industrial Emissions Directive (IED).
- 4.1.2. The draft decision acknowledges the statutory requirement for UUW to be compliant with the IED and that there will be a significant scope of works and cost in order to achieve compliance. However, the rejection of our Green Recovery proposal appears to leave no avenue to obtain the cost allowance to deliver compliance.
- 4.1.3. The scale of investment required is too great to be considered immaterial, and moreover, is outside of any cost sharing arrangements. If the draft decision on this matter is confirmed, then in this instance the regulatory framework has failed to provide the company with the financial resources to deliver its statutory obligations.
- 4.1.4. The draft decision rests on the assumption that the delivery of improvement conditions within IED permits will be required by the end of 2024 and that very few, if any, water company sites would meet the criteria to have completion dates extend beyond 1st April 2025, into the 2025-2030 period. It therefore concludes that any IED investment is excluded from the 2025-2030 period, and as a result "United Utilities' investment proposals do not meet any of the green recovery criteria. [Ofwat] therefore cannot make a green recovery cost allowance." As such, the decision appears to confirm that the investment need is accepted but that it is the timing of that investment which acts as the deciding factor when assessing whether a green recovery cost allowance can be made.
- 4.1.5. UUW considers that it is premature to state that compliance dates will not be extended beyond 1st April 2025, as the permitting process has not yet defined the investment requirements or timescales for delivery. Based on the permitting timescales agreed with the EA, we expect to submit IED permit applications between April 2021 and July 2022. We therefore do not expect to have all permits issued to us until July 2022 at the earliest.
- 4.1.6. Once permits are finalised there is further work to scope and define the appropriate solutions for improvement conditions, e.g. management controls through to investment. This will take significant time and needs to be integrated into our overall delivery programmes. We stated in our proposal that we would undertake operational actions as soon as possible but it is unreasonable to expect that IED capital enhancement improvements confirmed as late as July 2022 should be fully delivered in a 2.5 year period (i.e. by the end of 2024).
- 4.1.7. In this context, the Environment Agency letter dated 5th January 2021 (submitted as an appendix to our proposal) states that, "Four years is sufficient time to achieve BAT compliance."

- 4.1.8. While waste operators with existing IED permits have had four years to implement the 2018 BAT conclusions, we have not. This is because the EA only confirmed that IED permits would be required for the biological treatment of sewage sludge in July 2019 and have set out a schedule to obtain permits that runs to July 2022. We ask for an equivalent period of time to deliver IED improvements as waste sector operators. It is also worth noting that during that period waste operators have had the opportunity to recover the cost of meeting their IED obligations through price changes to customers. Ofwat's draft decision implies that some appointees (of which UUW is one) will not be able to recover such costs from customers. However, it is not unreasonable for us to have a mechanism to recover costs to meet our IED obligations so as to enable a level playing field for our future participation in the Bioresources market both opposite other appointed companies and other waste operators.
- 4.1.9. On the basis that four years is a reasonable period to deliver BAT improvements and on the basis that the start of the period is from the time permits are issued. The earliest permits we could receive will be in July 2021 and the final permits will be received in July 2022. Four years for improvements to be completed would therefore run to between July 2025 and July 2026.
- 4.1.10. Whilst the EA may not have initially anticipated this process and the delivery of IED improvements extending into AMP8, it is not unreasonable to conclude that capital investment required to meet our IED obligations will fall into AMP8. Acceleration of that investment into AMP7 would satisfy the Green Recovery criteria and therefore a green recovery cost allowance should be made. Not providing such an allowance unjustifiably obstructs us from recovering the resources necessary to meet the IED obligations being imposed.

4.2. Future Regulatory Changes Impacting Bioresources

- 4.2.1. Future changes in environmental regulation are likely to significantly impact the Bioresources Market. We are keen to support the development of a pragmatic approach to setting timescales for regulatory compliance to enable us to secure the resources for all investment related to our environmental obligations.
- 4.2.2. As stated in our proposal, we consider the best way to do this is to include IED and any further bioresources obligations (for example, in relation to the Farming Rules for Water or the EA sludge strategy) in the next Water Industry Strategic Environmental Requirements (WISER) publication. The WISER sets out the actions the EA would like to see from the water companies over the next planning cycle, and is the appropriate way of communicating these expectations to the water industry. This would provide a mechanism by which the water industry could plan to meet existing and future requirements.
- 4.2.3. Any resulting investment requirements will then be submitted into the next available price control process, to ensure companies have sufficient resources to meet the requirements. In this case, that would mean PR24, for investment to be delivered during AMP8. We would anticipate that any such requirements could also form part of AMP8 transitional investment, recognised at PR24.

5. Treatment of tax impacts

5.1. Introduction

- 5.1.1 Under the normal regulatory building block approach, tax is a key component to the allowed revenues that companies recover from customers. We believe that the approach for additional spending sanctioned through the Green Recovery process should be consistent with this and we note that in this case the tax adjustment is negative rather than positive. Green Recovery determinations are being set after the change in tax rules announced in the recent March 2021 Chancellors Budget (“The Budget”) so should reflect the most up to date information, for that spend only. Not to make any adjustment for tax for the Green Recovery determinations would in effect be ignoring current tax laws as well as deviating from the ‘building block’ approach that Ofwat uses to set company allowed revenues. This is also, as we understand it, consistent with the IDoK model, which just reflects tax impacts of the changes in investment requirements and does not re-model the base position or account for actual company performance on the underlying programme.
- 5.1.2 As Ofwat highlights, companies will benefit in AMP7 from reductions to taxable profit due to;
- (1) additional capital allowances,
 - (2) increased opex (if applicable) and
 - (3) higher interest charges from raising additional debt.
- 5.1.3 Each of the factors above will reduce the amount of taxable profit and this should be reflected in respect of determinations for additional spend sanctioned as part of the green recovery process.
- 5.1.4 Companies taking revenue impacts in AMP7 will also see a tax impact of that revenue, although that will naturally be allowed for via the proposed ODI mechanism.

5.2. Do you agree our proposed approach?

- 5.2.1 Ofwat has proposed “to adjust the value of the RCV for the incremental value of tax saved during the 2020-21 to 2024-25 period due to the green recovery investment”; in effect only adding the ‘net cost’ that the company faces in AMP7. We agree that deducting the tax benefit from the amount added to the RCV at PR24 is the most practical and transparent way to account for this. We do not think that it would be appropriate to attempt to use any of the existing PR19 reconciliation mechanisms, such as the tax reconciliation mechanism, to try to account for the additional tax impacts and changes in tax rules.
- 5.2.2 The calculation of tax savings (resulting from higher capex, opex and interest) is the same for all companies, regardless of whether they are deferring all revenues to future periods (such as UJW) or seeking some revenue adjustments in AMP7. However, the same is not true for the tax impact of subsequent revenues. For companies that are seeking additional revenues in AMP7, the tax impact of that revenue uplift will automatically be allowed for via the ‘in period adjustment model’ that Ofwat proposes to use, which will uplift the additional revenues for the forecast rate of corporation tax in that year⁸. Therefore, at AMP8 Ofwat should exclude consideration of the tax impact of AMP7 revenues (as that will already have been allowed through the ‘in period adjustment model’), and therefore only need to “true up” the tax impact of the higher capex, opex and interest costs for those companies.

5.3. Ex ante or ex post adjustment

- 5.3.1 In a price review, Ofwat sets an ex ante tax assumption against which companies are then incentivised to manage tax more efficiently (to outperform) but the benefit of this is that it results in longer term reductions for customers as the capital allowance pools are updated at the next price control. Companies get a short-term profit incentive and customers receive a longer-term bill reduction. Whilst for a price review, we believe that this incentive is effective and so we fully support the continued use of an ex ante assumption against which the company is then incentivised to outperform, we believe that, in the very different circumstances of Green Recovery, where Ofwat is making an additional regulatory determination, an ex ante assumption is not appropriate.
- 5.3.2 Ex ante allowances work in price reviews in part because of the significant amount of solution development and regulatory challenge that can occur over a longer period. Companies have had the time to undertake more detailed solution development to receive better insight into the amount and the profile of the required expenditure, whilst Ofwat has independent benchmarks and additional information with which to challenge company views. Companies have no doubt tried to make cost estimates as robust as possible in the time available but it should not be ignored that these plans were developed in a much shorter timescale than would be the case under a price review submission. This may mean that the allowances are not as heavily scrutinised (through both company and Ofwat scrutiny) as they would have been under normal business plan development.
- 5.3.3 Because of the 2021 Budget changes, there are two aspects that are of significant importance when assessing the impact of the new tax rules; the *amount* of and the *profiling* of expenditure over time. Obviously, the amount of expenditure also dictates how much expenditure is applicable to the different capital allowance pools but it is the total, not the allocation to capital allowance pool, which Ofwat has sought to benchmark. Additionally, what is of equal importance and something that is typically less heavily scrutinised is the profiling of expenditure. The profile will dictate whether the expenditure is able to receive the enhanced capital allowances in 2021/2022 and 2022/2023 and what the impact of the increase in the rate of corporation tax in the latter years of the AMP will be.

⁸ Assuming that the incentive rate are set at the required revenue excluding tax allowances so not to double count tax revenues

- 5.3.4 There might be high(er) levels of certainty over the total amount of expenditure required e.g. through using PR19 cost assessment models, but this does not provide any certainty over the profiling. Indeed, given that Ofwat has applied asymmetric cost sharing rates it would suggest that there is also less certainty over the total allowance than was the case under price review assessments. Given the increased uncertainty and the significance of the tax incentive in the first two years (as designed) then we accept that it is not appropriate to set an ex ante allowance as there is likely too much uncertainty over the profile to not result in undue winners and losers. Therefore, we accept that an ex post adjustment to account for the actual tax benefits incurred will prevent any risk of customer or company loss resulting from uncertainty in the allowances. We assume that this will be a forecast adjustment in PR24, which is subsequently trued up as part of the blind year reconciliations for 2024-25, with any variance in the blind year adjusted as part of PR29.

5.4. Incentives

- 5.4.1 The use of incentives is a strong tool for Ofwat to use to push the industry towards delivering (and revealing) more efficiency. As already mentioned, the incentive on tax outperformance against an ex ante allowance for a company can be strong and ultimately leads to lower bills for customers – we support this in the wider price control. Incentives can be adjusted to account for the lack of certainty in the initial estimate, typically through the sharing of out/underperformance between customers and companies. Sharing rates are most effective when set in relation to an ex ante assumption. If setting that ex ante assumption is too uncertain (as we believe will be the case with Green Recovery) then calibrating an appropriate sharing rate may prove difficult, especially if the amount of uncertainty cannot be quantified – it just becomes an arbitrary number, which is equally at risk of causing winners and losers. We would not support the use of an incentive that permitted companies to keep a percentage of tax savings that is not relative to an ex ante assumption e.g. 10% of *total* tax savings, because this is a one-sided adjustment and would only stand to profit the company at the expense of customers. Because of this and the factors in the previous section, we agree with Ofwat that it is most practical to have no sharing rates on tax impacts and that all tax benefits associated with the additional allowances approved through the green recovery process are passed to customers.
- 5.4.2 For the avoidance of doubt, we support an ex post reconciliation of tax without sharing for the Green Recovery additional investments only. Actual differences in tax paid relative to the allowances set in PR19 that are due to management decisions i.e. those not due to legislative changes, on the AMP7 programme should remain outside of the scope of both the PR19 reconciliation mechanism and the Green Recovery ex post reconciliation. This maintains the incentives for companies to outperform, which is ultimately in the long-term interest of customers.

5.5. Forecast impact of green recovery expenditure

- 5.5.1 We have calculated the tax benefits from our proposed expenditure (Table 3) and estimated the impact that Ofwat's draft decisions will have (Table 4). These tables show the expected impacts on capital allowances, opex and interest as well as how the different impacts are profiled over time. Given the uncertainty in the current forecasts for both the total and the profiling of the additional expenditure, the actual tax impact however might be substantially different, which further reinforces the justification for an ex post adjustment.
- 5.5.2 **Table 3** shows the forecasted tax benefits resulting from the expenditures proposed in UUW's submission. In order to derive this forecast, we allocate capital expenditure to capital allowance pools based on the assets and the profile of expenditure within the submission. We then calculate interest payments using the PR19 cost of new debt assumption. This results in a forecast of c£13.2m of tax benefits in AMP7.

Table 3: Forecast tax impacts of UUW proposed green recovery expenditure £m (nominal)

	31 Mar 21	31 Mar 22	31 Mar 23	31 Mar 24	31 Mar 25
Change to capital allowances	0.000	2.762	22.168	5.810	11.019
Total deduction to taxable profit	0.000	0.464	3.868	0.000	0.000
Interest payment	0.000	0.064	0.561	1.639	2.998
Opex	0.000	0.350	2.221	3.568	3.031
(Profit)/loss chargeable to tax	0.000	3.640	28.817	11.017	17.048
Corporation tax rate	19.0%	19.0%	19.0%	25.0%	25.0%
Tax charge/(credit)	0.000	(0.692)	(5.475)	(2.754)	(4.262)

- 5.5.3 **Table 4** reflects the impacts of Ofwat's draft decisions on all lines with the reduction in expenditure allowances resulting in a significant reduction to the potential tax benefits. To derive this forecast we have simply pro-rated any gaps in allowances across all lines and years. This results in a forecast of c£4.7m of tax benefits in AMP7.

Table 4: Forecast tax impacts of Ofwat's draft allowances for green recovery expenditure £m (nominal)

	31 Mar 21	31 Mar 22	31 Mar 23	31 Mar 24	31 Mar 25
Change to capital allowances	0.000	2.711	4.640	2.663	5.468
Total deduction to taxable profit	0.000	0.464	0.544	0.000	0.000
Interest payment	0.000	0.061	0.231	0.681	1.396
Opex	0.000	0.305	0.480	0.868	0.353
(Profit)/loss chargeable to tax	0.000	3.540	5.894	4.211	7.217
Corporation tax rate	19.0%	19.0%	19.0%	25.0%	25.0%
Tax charge/(credit)	0.000	(0.673)	(1.120)	(1.053)	(1.804)

6. APR tables

6.1.1 In an email dated 26 May 2021 Ofwat requested that we set out which tables we expected would be impacted by potential overlaps between PR19/AMP7 reporting and reporting of schemes allowed under the green recovery decisions. We have identified the following overlaps, as set out in table 5 below.

Table 5: Overlaps between PR19/AMP7 reporting

Green recovery project	Project component	Cost / Deliverables	Main APR tables	Green recovery element tables
Accelerate partnerships to deliver natural solutions	Protect habitats	Cost	4M	Expenditure would be covered in the relevant wastewater table in innovative catchment solutions (free form line)
		Deliverables	-	Project deliverables not currently monitored in APR tables
	Enhance raw water quality	Cost	4M	Expenditure would be covered in the relevant wastewater table in innovative catchment solutions (free form line)
		Deliverables	-	Project deliverables not currently monitored in APR tables
	Improve drainage (SUDS type projects)	Cost	4M	Expenditure would be covered in the relevant wastewater table in innovative catchment solutions (free form line)
		Deliverables	3B.5	Insert name of the bespoke PC (overall <i>HIFFR performance</i>)
			3B.6	Insert name of the bespoke PC (overall <i>HEFFR performance</i>)
	Reduce Phosphorus	Cost	4M	Expenditure would be covered in the relevant wastewater table in innovative catchment solutions (free form line)
		Deliverables	7F	WINEP phosphate removal projects
	AMP8 WINEP at Bury	Bury scheme	Cost	4M 25-27
Deliverables			7D.25	Additional volume of network storage at CSOs etc. to reduce spill frequency
Tacking storm overflows	SOAF	Cost	4M.37-39	Investigations (expenditure)
		Deliverables	-	Project deliverables not currently monitored in APR tables
	ICM	Cost	-	Not currently monitored in APR tables
		Deliverables	-	Project deliverables not currently monitored in APR tables

7. Revised data tables WS2 and WWS2

- 7.1.1 Subsequent to our submission, we have identified that a small amount of costs associated with catchment based approaches were allocated to wastewater when they should more appropriately have been allocated to water resources. We are therefore submitting revised tables WS2 and WWS2 which correct this error. This is provided alongside this submission as spreadsheet “UWGR WS2 WWS2 Proposal Costs V1.0”.