

Outcomes Working Group

October 2021



Draft Agenda: 14 October

Aim: To understand if there is a consensus on what the common performance commitments should be in future price reviews. To decide on actions required to progress.

10:00 Introductions and background

10:05 Presentations on Carbon: Anglian Water and Ofwat

10.25 Breakout session 1: Carbon

10.45 Feedback

11.00 Presentations on: Abstraction/leakage/demand Wessex Water and Ofwat

11:15 Breakout session 2: Abstraction

11.30 Feedback

11.40 Plenary including discussion on proposed working groups

11.55 Conclusions and look ahead

12:00 Close



Thoughts on emerging PC package

We have provided some draft thoughts to stimulate debate on the potential package. It does not necessarily represent the views of Ofwat of what the common PCs should be.

Potential performance commitments	Annual Reporting
Water supply interruptions	
Internal AND External sewer flooding incidents (possibly combined using consequence data)	
CRI PLUS possibly Water quality contacts AND/OR ERI	
	Affordability/Vulnerability
	Water pressure
Biodiversity	
[Pollution incidents AND Treatment Works Compliance AND Storm overflows] AND/OR EPA	
Possibly Bathing water quality AND/OR River water quality	
[Leakage and PCC] OR Distribution Input AND/OR possibly Sustainable Abstraction	
Operational Carbon PLUS possibly Embedded Carbon	
Possible PC on monetarising wider environmental benefits	
<p>Satisfaction metrics such as CMEX and DMEX to be considered as part of draft methodology. Asset health and operational resilience metrics to be considered after customer and environment PCs, when we would be able to consider findings of UKWIRs Future Assets project.</p>	

Dark blue text – propose to use existing definition such as that used at PR19



Criteria

Drawing from Creating Tomorrow, Together and the responses we have had we are considering the following criteria.

Does it measure an important outcome of enduring interest to customers?

- Companies will have more confidence to invest for the long term, if they have greater regulatory **certainty over the long term**. Outcomes should be **stable** from one price control to the next, reflecting **enduring interests of customers**, although exact metrics may change.

Does it require and is it suitable for financial incentives?

- In some cases, a financial incentive may be limited in what it can achieve. This can be because it is hard to capture an outcome in a metric or set an appropriate expected level. **We also need to consider the control and/or influence companies have over affecting metrics. A metric must be expected to change over time if company behaviour is aligned with customer's interests.**
- Not all important outcomes require financial incentives. These may not be required where: limited additional funding is required to improve; there are other financial impacts; or high reputational pressure is sufficient to provide incentives.

What would it add to the coverage of the overall package?

- PCs that add little to the overall **"coverage"** by the package of long term outcomes may not justify the additional resource by companies and Ofwat. The high number of PCs per company could dilute companies focus. The coverage of the package also needs to be balanced for both water and wastewater customers.

Can it be used to communicate with customers?

- The intent of PCs should be **clear to customers**, even if the metric is complicated. For example, CMEX is a relatively complex PC that few stakeholders understand how to calculate. But it (and SIM before it) provides clear information on the performance of water companies.



Anglian Water's carbon PCs



David Riley

Head of Carbon Neutrality
Anglian Water

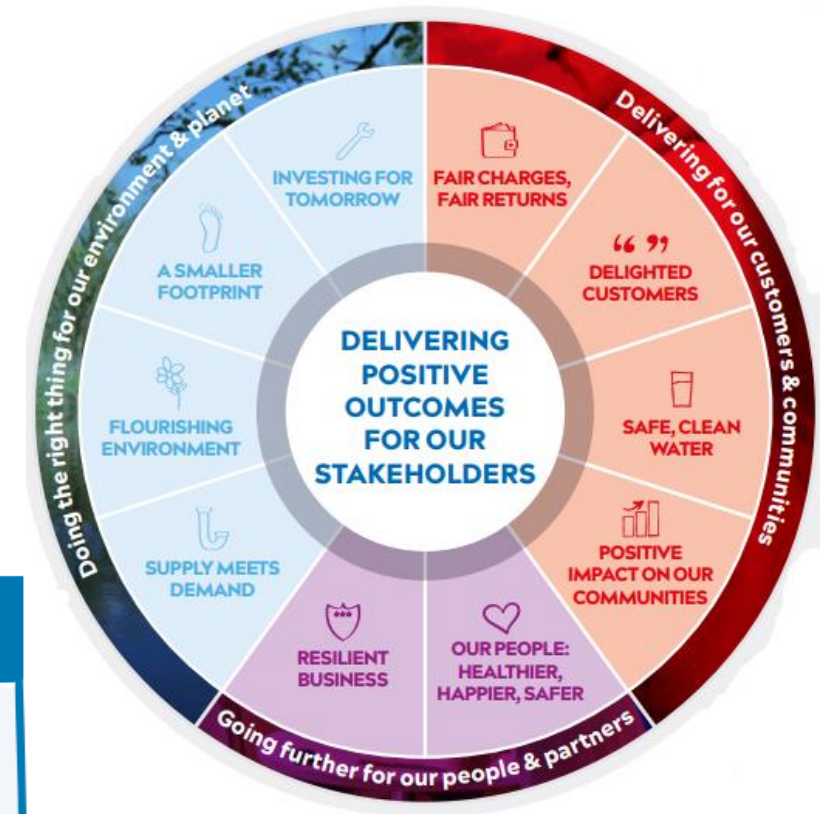
14 October 2021




Our AMP7 carbon PCs

Operational & capital carbon

- We have two reputational performance commitments, operation and capital carbon.
- These contribute to one of our ten outcomes, to achieve ‘a smaller footprint’.
- Introduced in AMP5, partly in response to guidance for PR09 and maintained since.
- Committed to a 10% reduction in operational carbon and a 65% reduction in capital carbon by 2025 (from a 2010 baseline).



 A smaller footprint				
What are we measuring?	How are we measuring it?	2020/21 performance	2020/21 target	Eligible for reward or penalty?
Operational carbon	Percentage reduction in carbon emissions from day-to-day operations compared to a 2019/20 baseline.	5.1%	2%	No
Capital carbon	Percentage reduction in carbon emissions from construction activity measured in tonnes of CO ₂ equivalent compared to a 2010 baseline.	61.2%	61%	No

Capital carbon...

...in detail

- We have been measuring the embodied greenhouse gas emissions for many years, and in 2010 set a target to reduce capital carbon by 50% by 2015 and 60% by 2020, 65% by 2025 from a 2010 baseline.
- So far we have achieved this by including whole-life carbon within the appraisal of investment options, and project governance, so project leads and engineers are challenged to bring forward low carbon, maximum whole-life benefit options.
- In many cases this has led us to modify and extend the life of existing assets rather than replace them, and to adopt low carbon natural capital approaches. Focusing on carbon has reduced cost.
- We believe the best way to measure and assess the environmental credentials of infrastructure is through the Publicly Available Specification (PAS) 2080. PAS was introduced following the 2013 Infrastructure Carbon Review and is administered by BSI. E.g. HS2, Environment Agency, Skanska, Aggregate Industries, Mott MacDonald taking the mantle forward through their PAS2080 verification.

bsi.

PAS 2080

Carbon Management in
Infrastructure Verification

CAPITAL CARBON

Reduction from
2010 baseline

61.2%

(Target by 2025: 65%)

love every drop
anglianwater 

Carbon PCs

Considerations for PR24

- Given the climate emergency, it is appropriate to reflect on whether the industry should be incentivised to reduce carbon through the outcomes framework.
- There may be wider benefits in introducing a common PC or PCs for carbon, such as driving supply chain innovation and contribution to the UN sustainable development goals.
- However there are questions that need to be considered for PR24:
 - Is there **customer support and/or societal need** for incentives? (capital and operational)
 - How to align carbon performance commitments to an evolving **cost assessment** approach? (capital and operational)
 - **Definitions and reporting consistency**, aligned to international and UK Government reporting and measurement requirements, with appropriate accreditation, to ensure credibility. (capital and operational)
 - How could we balance reputational and financial incentives to incentivise transformation of the sector to **achieve net zero**? Incentives have been reputational to date. If exploring financial incentives should we use customer valuation, carbon pricing, both, something else?



**Thank you
for listening**



Why we are focusing on the Reporting of GHG emissions

- UK is legally required to reduce net emissions of greenhouse gases (GHGs) to zero by 2050
- Committee on Climate Change (CCC) has recommended we seek to accurately measure the industry's GHG emissions
- Driving change and improving performance requires targets (HMT, 2013)
- TCFD hopes that better disclosures will enhance the assessment, management and pricing of climate-related risks

- Differences exist in how individual companies report on their operational and embedded emissions
- Investment needs to be supported by robust reporting

There is need for clear, consistent, standardised, transparent and accessible data; and for more detailed reporting



Reporting approach

- Our approach recognises differences in reporting, allowing time for companies to evolve their reporting approaches (voluntary to mandatory)
- Aims to deliver data and reporting that is gradually more detailed and standardised
- Approach will allow for greater understanding and a clearer demonstration of progress and performance, including where performance can be accelerated.
- It will also allow for greater scrutiny from both Ofwat and other stakeholders.

Operational emissions:

- Anchoring our approach to the latest version of CAW
 - clear focus on Scope 1,2, and 3 emissions
- Focused on enabling key data to be clearly and consistently extracted
- Voluntary standardised reporting for 2020-21 moving to mandatory standardised for 2021-22 onwards

Embedded emissions:

- Companies are not reporting in a comprehensive or consistent manner
- We have consulted on how reporting could be focused and standardised
- Voluntary open reporting for 2020-21, voluntary standardised for 2021-22, mandatory standardised for 2022-23

Our regulatory reporting response GHG emissions (2021-22) will be published towards the end of October 2021



Carbon

- Do you support a common PC on operational carbon?
- Should operational carbon cover all relevant scope 1,2 and 3 emissions?
- Do you support aiming to have a common PC on embedded carbon at PR24? If not, what approach should we take?



Sustainable abstraction outcome

Wessex Water
YTL GROUP



Why outcome-based regulation?

- The 25YEP is an ambitious policy framework for improving the environment
- The water sector will need to play an important role in addressing these environmental challenges
- However, alongside other pressures, this will create significant upward pressure on bills at a time of stress on cost of living
- We can deliver these improvements more efficiently with two changes to the regulatory framework

1. Set targets at an outcome level on a catchment scale

2. Ensure the incentive package sets a level playing field for all delivery options

- Started at “improved environment” / “natural capital”
 - But, too broad and allows trade-offs
 - So, Environment Bill – water quality, water abstraction, carbon, biodiversity
- Sustainable water abstraction is the outcome – the thing that really matters
 - Leakage, PCC, distribution input, etc. are all things we can control to one extent or another to influence how much we abstract but they don’t “matter” in and of themselves
i.e. we could reduce PCC to 90l/h/d and still over-abtract, or increase it to 150l/h/d and still sustainably abstract
- The metric could be set as compliance with abstraction licences

Why not the inputs / outputs?

- Incentivising inputs and outputs often drives perverse behaviours
 - PCC – Covid-19 showed that PCC is a bad measure to incentivise: people spent more time at home, in some areas driving PCC up by >10% whilst overall abstraction remained flat.
 - Leakage – should companies be incentivised to spend hundreds of millions of pounds, emit tonnes of carbon, and dig up roads to reduce leakage if they are meeting abstraction licences? Does that add environmental or social value?
 - Distribution input – similarly to leakage, incentivising reductions in DI will lead to perverse behaviours that might not solve unsustainable abstraction.

Does this work and what are the risks?

- Every catchment has an abstraction licence
- The measurement process exists and is robust
- The focus will all be in the right place
- Risk - there is a public focus on leakage which will need careful communication to explain why it is not being incentivised
 - Mitigation - we should still measure the inputs / outputs and share best practice in delivering the outcome
- Risk – we do it too late at high environmental and social cost
 - Mitigation – implement this change at PR24

Sustainable abstraction

Sustainable abstraction in England and Wales includes water being used as efficiently as possible.

The current [Welsh Government's SPS](#) sets out encourage and incentivise the sustainable and efficient use of water resources, including by encouraging companies to reduce leakage and consumption where it is cost effective to do so.

[Defra's draft SPS](#) sets out

- Challenge water companies to halve leakage by 2050
- Hold companies to account for their contribution towards reducing personal water consumption to 110 litres of water per head per day (l/h/d) by 2050.
- Work with the water retailers, incumbent water companies and other stakeholders to contribute to the delivery of the Industry Action Plan to improve water efficiency in the business sector.

Business sector

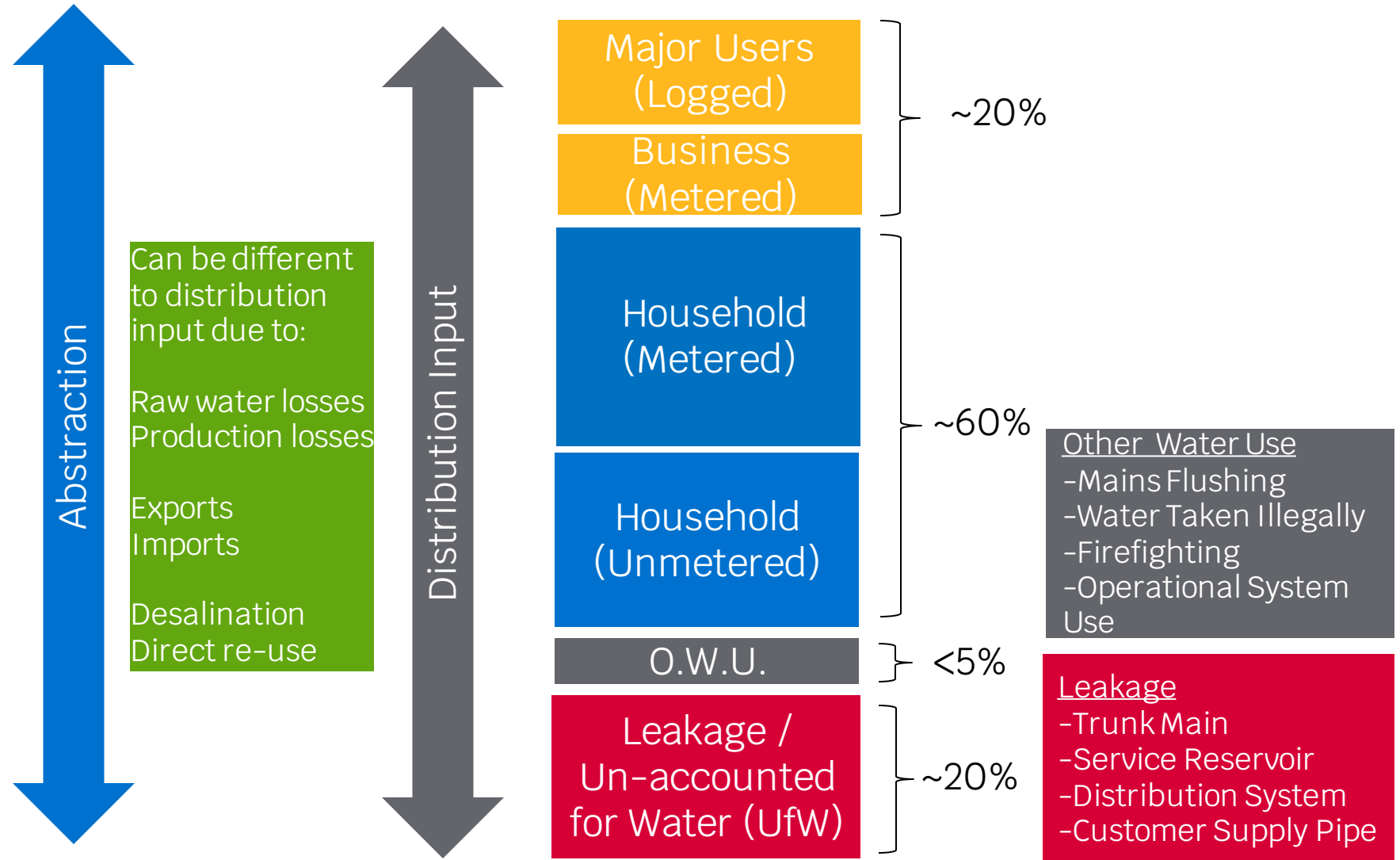
- The business retail market was expected to bring a benefit of increased water efficiency for non-households. This has not occurred in the way it was expected.
- NAO have noted the lack of progress in its [report](#) in 2020
- In March 2020 Ofwat and the Environment Agency wrote a joint letter for sector to take action.
- An action plan has been put together by the [Retail Wholesalers Group](#), which is [supported](#) by Ofwat and the Environment Agency.



Abstraction and distribution input

Currently we do not receive comprehensive information about the water balance, although companies have to collect and audit this information. For instance we do not receive estimates on unmetered non-households.

We may need to collect more complete information to be able to understand company performance.



	Option 1	Option 2	Option 3	Option 4	Option 5
PC 1	Sustainable abstraction PC	Leakage PC	Leakage PC	Distributional Input PC	Leakage PC
PC 2		PCC PC	PCC PC		Water efficiency PC
PC 3			Business demand PC		
Pro	<ul style="list-style-type: none"> Incentivises end outcome 	<ul style="list-style-type: none"> Metrics are those focused on by government to date with clear expectations 	<ul style="list-style-type: none"> Creates an incentive for business water efficiency. Potential to target the incentive for business water. For example, excluding major users to reduce volatility and to increase the focus on organisations that need more help (eg schools). 	<ul style="list-style-type: none"> Mitigates the risk of the “new normal” having a different balance between household and non-household demand Allows flexibility to reduce abstraction in most appropriate way (reducing leakage more in dry weather if demand increases) 	<ul style="list-style-type: none"> Companies less exposed to factors they have only have partial control over.
Con	<ul style="list-style-type: none"> Metric that provides clear evidence that abstraction is at a level that is sustainable in the long term does not exist. 	<ul style="list-style-type: none"> No incentive on business demand 	<ul style="list-style-type: none"> Constrains companies if new information emerges after WRMP. If we equalised ODIs for the 3 PCs it would add little to option 4. Unclear impact on overall incentives for the retail business market in England. 	<ul style="list-style-type: none"> Normalisation is difficult. Normalising by population, household or length of mains will impact companies differently. Unclear impact on overall incentives for the retail business market in England. 	<ul style="list-style-type: none"> Companies have no incentive to improve the influence that they have on customers beyond activities that can be quantified.



Sustainable abstraction

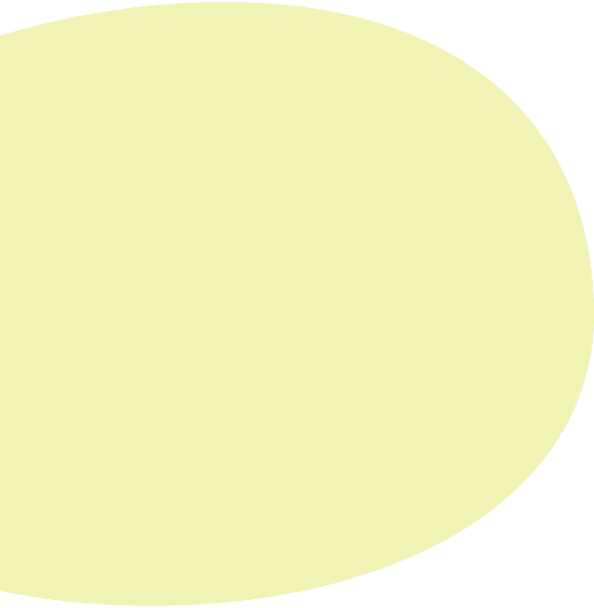
- What approaches should we consider to incentivise sustainable abstraction?
- Do you support extending the incentives within the common PC package to support greater water efficiency for business, charity and public sector organisations?
- Do you support Ofwat collecting more information on the water balance to better understand the issues?



Discussion

What are the key points of consensus?

What actions should we take forwards?



Task and finish groups - aims

Biodiversity

Develop options for performance commitments that would best demonstrate progress on how water companies are maintaining and enhancing biodiversity. Options should consider the scenario that the biodiversity PC is only applied to land that the company owns and how this could be extended beyond this. The group should consider using the Biodiversity Metric 3.0 as a basecase, at least in England, and compare other options against this. The aim should be to have a definition that water companies could report against for 2022-23.

River Water Quality

Develop options for performance commitments or other information that companies could report publicly, that would best demonstrate progress on how water companies are limiting adverse impacts on the water environment and how they are contributing to tangible progress towards good ecological status of water bodies as part of their statutory functions. The group should consider a wide range of approaches to measure water quality that best reflect how water companies can impact rivers. These options should include both those that can be implemented in time for 2025-30 period and those that could only be implemented at a later date.



Look ahead

We suggest the following draft dates and subjects, although this is subject to change.

14 October	Carbon and Sustainable Abstraction
November	ODIs – marginal costs and
December	Response to November Ofwat Paper
January	ODIs
February	Measuring outcome risk – options
March	Caps and collars