

Outcomes Working Group

July 2021

ofwat

Agenda

Aim: To understand views of what benefits related to the environment should have financial incentives and the options of how PR24 (or future price reviews) provide them.

- 13:00 Introductions
- 13:05 Presentation by Ofwat
- 13.15 Breakout session 1: What benefits should have financial incentives?
- 13.35 Presentations by Yorkshire Water and United Utilities
- 14:05 Breakout session 2: How do we provide incentives?
- 14.35 Feedback
- 14.55 Conclusions and Look ahead
- 15:00 Close



Recap

At the meeting in March we discussed how do we promote investment that delivers multiple benefits over the long term, while improving compliance with statutory standards?

The summary of the discussion was

- Should be evolution and will take time to get it right;
- Need to be able to discuss risks and consider flexibility and a tolerance for failure in order to innovate;
- Most systems are set up for single agencies and need to evolve to allow multiple agency models;
- What should be done within the water company regulated business? There needs to be a clear line of sight from what customers want companies to deliver as part of their statutory duties to how CBA is conducted and how incentives are specified;
- Should focus on outcomes not outputs;
- Agreement we need better metrics to incentivise natural and possibly social capital improvements;
- Metrics are difficult to specify including that benefits may accrue over time; and
- Should metrics attempt to measure absolute levels across companies or differences made by projects?



Multiple Benefits – Example London Strategic SuDS Pilot Study

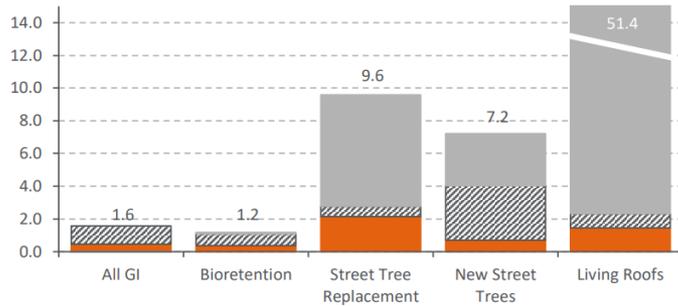


Figure 34 – benefit-cost Ratios, Full Realisation of SuDS Opportunities

Note: y-axis capped at £15

Key:

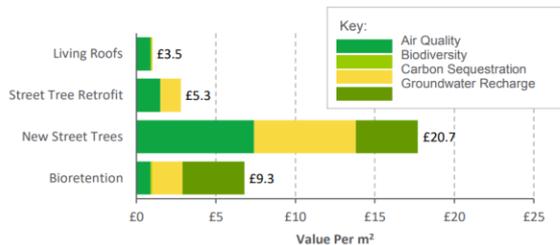
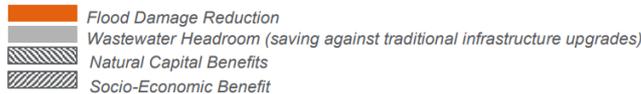


Figure 18 – Natural Capital, Environmental Value of SuDS Features per m²

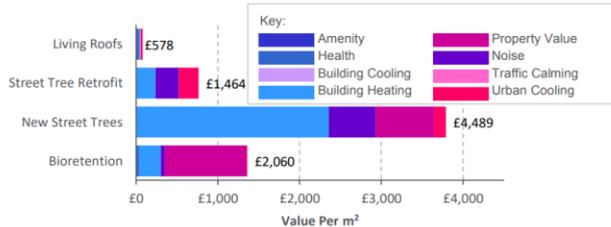


Figure 19 – Natural Capital, Socio-economic Value of SuDS Features per m²

5% of Most Optimal SuDS Features Represent...



£35 Million Capital Investment in SuDS

(On Average per London Borough)

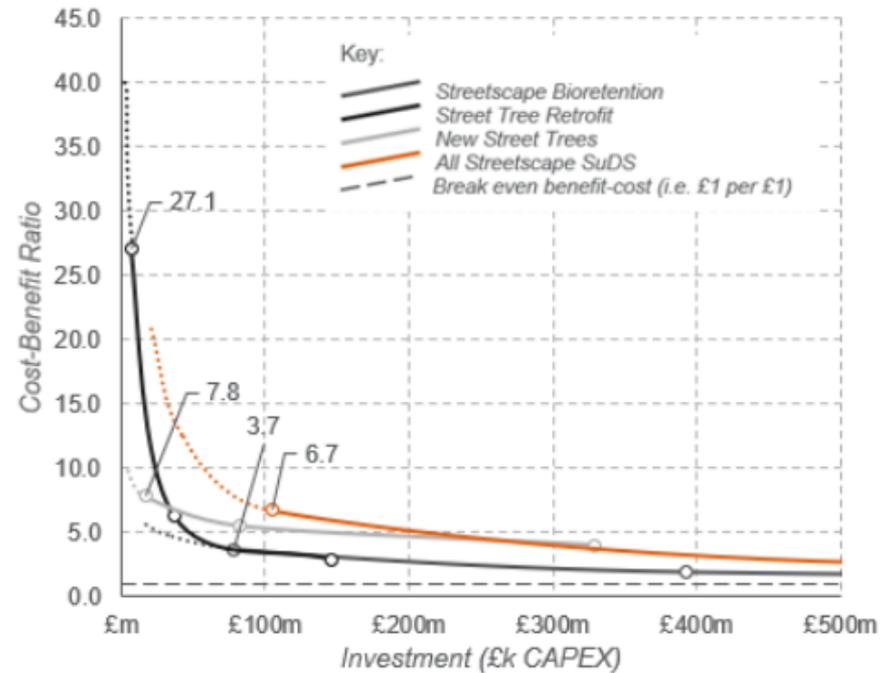
Could generate...

£190 Million in Flood Damage Reduction

£40 Million in Natural Capital Value



What should be financially incentivised in order to support long term decision making?



Principles for public value

Some of the recently published principles have particular relevance:

Principle 2: The mechanisms used to guide activity and drive decision-making should facilitate the delivery of social and environmental benefits that are measurable, lasting and important to customers and communities.

Principle 4: Delivery of public value outcomes should not come at greater cost to customers without customer support.

Principle 5: Companies should consider where and how they can collaborate with others to optimise solutions and maximise benefits, seeking to align stakeholder interests where possible, and leveraging a fair share of third-party contributions where needed.

Issues	How we might address
Lack of confidence regarding that PCs do accurately measure benefits that customer's value.	Put restrictions on the level of incentive AND/OR Regulators have more involvement in the measurement of benefits.
Lack of clarity of how costs and benefits are shared/attributed across partner organisations	
Benefits may not be sustained.	Pay the incentive as the benefit occurs (and have a mechanism for periodic review of the benefits), rather than when the scheme is completed.
Risk that the world moves on	Have a process to update guidance outside the price review



Possible approach

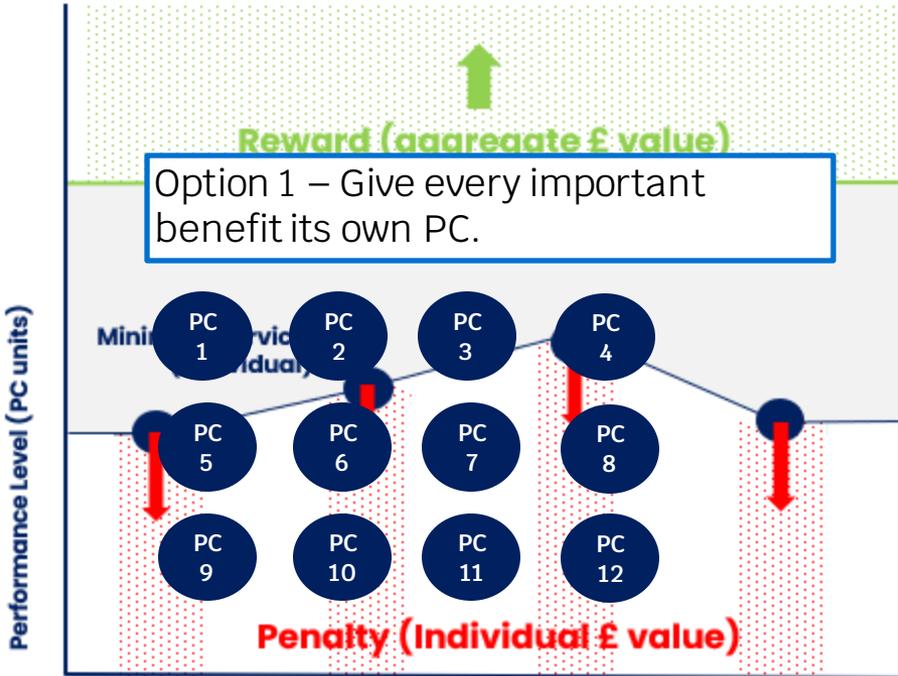
There are a range of approaches that we could ask companies to take in reporting environmental PCs

	Absolute measurement across the company	Incremental improvement (could be modelled or measured)	Benefit of improvement (ie monetarised net benefit)
When it may be most suitable	Where measures are robust and the costs of the measurement are justified.	Where it may not be cost effective to measure the factor across the company area, but it is of sufficient importance to have an individual measure that can be applied on a more targeted basis.	Where measurement of the individual factors is not justified and/or providing companies with greater flexibility to target the most appropriate benefits to provide.
Examples of where it could be used	<ul style="list-style-type: none"> - Bathing waters - Operational GHG emissions 	<ul style="list-style-type: none"> - Biodiversity - Phosphorus 	<ul style="list-style-type: none"> -Recreation and amenity -Health and well being -Air pollution / heat / noise -Wider flood risk



- River water quality
- Bathing water quality
- Greenhouse gas emissions
- Biodiversity
- Recreation and amenity
- Health and well being
- Air pollution
- Wider flood risk (ie not sewer flooding)
- Urban heat
- Noise
- Which of these and anything else?

**What should have
financial
incentives in the
outcomes
framework?**



Value Target (aggregated)

Option 3 – PCs act as minimum standards, but positive incentives are based on overall value



Option 4 – Incentives are based on overall value.



Potential example: Options for PCs related to river water quality

Option 1 (Option 3)	Option 2	Option 1	Option 1	Option 1	Option 4 (Option 3)
Pollution incidents	Pollution incidents	% water bodies failing good ecological status - phosphorus	% water bodies failing good ecological status for reasons where water company has a significant role (eg ammonia, oxygen levels, BOD, total phosphorus)	% water bodies good ecological status	Natural capital (£m)
	Treatment works compliance	% water bodies failing good ecological status - Ammonia			
Treatment works compliance	Average number of storm overflow spills	% water bodies failing good ecological status - Oxygen levels			
	Monetarisaton of improvements beyond normal delivery (£m)	% water bodies failing good ecological status - BOD			
Package A	Package B	Package C	Package D	Package E	Package F



Breakout session 2

1. What should have PCs that directly measure improvements?
2. How should PCs measure performance (absolute or increment)?
3. Should we have a PC for which the measurement is to monetarise a number of benefits? If so what and how?

**How do we
provide financial
incentives?**

The background features a large, solid orange-red shape on the left side, which is partially obscured by a large, light blue circle on the right. The light blue circle overlaps the orange-red shape and extends towards the top right corner. The overall design is minimalist and modern.

Yorkshire Water

The background features a large, solid orange-red shape on the left side, which is a semi-circle or quarter-circle. To the right, there are several overlapping light blue circles of varying sizes, creating a layered, abstract effect. The overall composition is clean and modern.

United Utilities

Breakout session 2

1. What should have PCs that directly measure improvements?
2. How should PCs measure performance (absolute or increment)?
3. Should we have a PC for which the measurement is to monetarise a number of benefits? If so what and how?

**How do we
provide financial
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Look ahead

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

w/c 13 September	Package of common PCs
w/c 11 October	TBC – Follow on from September
November	ODIs and innovation
December	TBC
January	Setting ODI rates
February	Measuring outcome risk – options
March	Caps and collars