Wessex Water
Draft methodology response

This document contains our summary responses to the draft methodology consultation, excluding questions relating to bioresources.

Chapter 2 - Regulating through the price review

2.1 Do you agree with the challenges facing the sector and the ambitions for PR24 we have identified?

Strongly disagree

Key messages

- The draft methodology significantly underestimates the scale of the challenges facing the sector. Whilst the identification of the areas of importance are correct, the quantification of the size of these issues appears underweighted in the methodology.
- Whilst we support the stated ambitions so far as they go, we believe these need to go considerably further and be backed up by significantly improved detailed proposals in some areas in order to be effective.

Additional points

- We believe that the industry can go further in terms of aligning with net zero targets but this is not reflected in the draft methodology.
- The methodology should provide for approaches that: both adapt to and mitigate climate change, focus on sustainable abstraction, address nutrient neutrality, and use appropriate measures for affordability, anything less than this will not allow for the development and maintenance of an efficient and economical system of water supply.
- Some of the proposed performance commitments will drive perverse behaviours that undermine the protection and enhancement of the environment.

2.2. Do you agree that continuing to use our three building blocks helps push companies to meet our ambitions for PR24? (Please provide detailed comments on specific building blocks to the relevant chapters.)

Disagree

Key messages

- The outcomes regime, cost assessment process, and risk and return framework could be an appropriate basis for effective regulation. However, these elements are underdeveloped and are unlikely to be effective in their current form.

Additional points

- Outcomes - review is needed because the draft methodology focuses on inputs and outputs that will not deliver the right outcomes as regards the development and maintenance of an efficient and economical system of water supply and sewerage services.
- Cost Assessment - the approach in appendix 9 falls short of what is needed for Ofwat to meet its own objectives and to act in accordance with the UK Government SDS.

- Risk and return - proposed changes are not in the long-term interests of customers and are likely to reduce the attractiveness of the sector to new investment and risks companies not being able to finance their functions.

2.3 Do you agree that we have struck the right balance between what's in and what's outside of the price control?

Agree

Key messages

• We broadly agree with balance of the scope of price control.

• Please refer to questions 3.4 and 3.5 for our additional comments about how developer services should best be accounted for and how DPC is applied.

2.4 Do you have any comments on our approach to evaluating progress? What specific evaluation questions (based within the four key ambitions) do you think an evaluation should look to answer?

N/A – Neither agree nor disagree

Key messages

- We encourage Ofwat to consider all counterfactuals in its evaluation rather than relying solely on a comparison of PR24 and PR19.
- The key question in evaluating progress should be whether the outcomes for customers, society and the environment have been delivered in the most efficient and economical way.

Chapter 3 - Design and implementation of price controls

3.1 Do you agree that in our final methodology we should commit to introducing either an adapted water trading incentive or a new water trading incentive at PR29? If you have a preferred approach, please provide reasons, including any thoughts on how the options we set out in Appendix 2 could be improved.

Agree

Key messages

- We agree that a long-term commitment to the water trading incentive is in the best interest of all stakeholders. Providing this certainty will enable companies to better commit to these, often long term, solutions ensuring that the most efficient solutions are taken overall.
- Overall, we favour option 1 - the evolution of the current approach. This gives long term certainty on the type of incentive, rather than risk creating any perverse incentives around the timing of new trades. We also support the proposal to move the incentive payments in period, as this will more closely align business decision making with its impact.
- Although we see some merits with option 2, we cannot see the benefit that the increased regulatory burden would have over option 1.

3.2 Do you agree with our proposals to:

a) **Continue to include network reinforcement in the network plus price controls?**
b) **Remove wastewater site-specific developer services from the wholesale wastewater network plus price control?**

Agree

Key messages

- Our preference is that both (a) and (b) should be excluded from the price controls. This will:
    - ensure that those responsible for triggering the investment pay their share;
    - provide end users with additional protection from any potential under recovery of revenue; and
    - provide companies a greater incentive to set cost reflective charges.
- However, retaining network reinforcement within the price control is currently a measured and practical approach. But only if cost allocation can be resolved, because network reinforcement is driven entirely by third parties, it could be excluded from the price control or at least assessed separately from the general wholesale controls.

3.3 Do you agree that the inclusion of network reinforcement in cost sharing would be enough to manage uncertainty around the volume and mix of network reinforcement work to be delivered?

Agree

Key messages

- This question cannot be answered fully before Information about the final cost allowances is provided.
- In principle, we agree that that cost sharing is sufficient to manage the uncertainty around network reinforcement expenditure.
- Note that if a coarser approach to cost sharing is taken, provision may be needed for additional risk sharing (e.g. to include local factors).

3.4 For water site-specific developer services:

a) **Do you agree with our proposal to exclude new developments of more than 25 properties from the wholesale water network plus price control at PR24, but with transitional arrangements for companies with low levels of competition?**
b) **Do you think that new developments of 25 properties and fewer should remain in the wholesale water network plus control or be removed? If they were removed from the price control, what alternative protections could we introduce to protect new connection customers from monopoly power?**

a) **Agree**
b) **N/A**

Key messages

- We agree with (a) and believe that for (b) that new developments of 25 properties and fewer should also be removed in the price control. We expand on this in our longer answer.
- Moving these activities outside the price control doesn't prevent Ofwat from setting charging rules and retaining dispute power. Charging rules should require companies to set competitive and cost reflective charges on a level playing field with self lay providers. This should provide the protection needed and would not require transition arrangements.
- A critical backstop protection for users can be provided through the continuation and evolution of the current charging rules for new connection services.

Additional points

- Leaving plots with 25 or fewer properties in the price control will cause challenges e.g. in relation to accounting, administration and logistics, duplication and inefficiency of services, and the creation of perverse incentives for developers to split plots.
- Moving these developments outside price control provides the potential for better service including options to scale inspection and adoption resources and increase flexibility.
- We are opposed to the use of any coarse measure, such as price increases linked to CPIH because this will quickly lead to charges that do not reflect cost. Maintaining charges that are cost reflective is critical.
- We want to flag that strong inspection and adoption powers must be retained in order to create and adopt assets of appropriate quality and service life into the public asset base and that the accreditation market is not yet mature and we continue to work closely with 3rd party service providers to promote high delivery standards.

3.5 Do you agree with our proposals:

a) **To raise the size threshold above which companies should deliver schemes through DPC to around £200m lifetime totex?**
b) **For companies to deliver schemes through DPC by default above this threshold?**

Strongly disagree

Key messages

- The £200m threshold is the minimum at which DPC could be considered, but it should not be the default option as it may still not be in the customers' interest, particularly for smaller sized projects.
- There is insufficient information provided by Ofwat to support this specific threshold level.
- It is not possible to give a complete answer on the application of DPC at this stage, prior to the further guidance on DPC becoming available later this year.

Additional points

- We believe that the benefits through perceived efficiencies in design and build and in financing and operation are likely to be lower than currently thought.

3.6 Do you have any views on any other aspect of our proposals in relation to:

a) **The design of price controls**
b) **Water resources**
c) **Developer services**
d) **Retail activities**
e) **Bioresources**
f) **Other controls**
g) **The revenue forecasting incentive mechanism; or**
h) **Direct procurement for customers?**

Neither agree nor disagree – N/A

Key messages

- Price control structure:
    - We do not fundamentally object to the single till price control structure proposed but questions the omission of its benefits through the review of PR14 [should this be PR19?] and this document.
- Key building blocks:
    - We fully support the continued use of the key building blocks outlined on page 25. Coupled with the long term guarantees such as the RCV and appropriate uncertainty / risk sharing mechanisms, these underpin the strong investor confidence in the sector. However, these mechanisms need to be correctly calibrated and should incentivise innovation and efficiency.
- Water resources:
    - We remain fully supportive of the continued use of regional solutions and thinks that ultimately the RAPID programme will deliver responses to these challenges in the most efficient way. In light of this we are supportive of removing the bilateral entry.
    - Our view is that the boundary of water resources and water networks plus should be revised and refer to our response to "PR24 and beyond" in July 2021.
- Developer services:
    - Our responses on the key issues proposed to developer services are set out at questions 3.2 to 3.4. We support removing this from the price control and does not see the need for a separate price control to govern it. However, there is value in the continued evolution of charging rules to provide protection for customers.
    - We support removal of the income offset because this will mean that developers pay the full network costs of the investment that they trigger.
    - We think care needs to be taken on the inclusion of the NAV market.
- Water trading incentives:
    - Please see our response to question 3.1. We fully support the proposal to remove the requirement for utilisation risk sharing on large water resource investment.
- Retail Price Control:
    - We do not believe that it is appropriate not to have automatic indexation of revenues and there are no other retail sectors that take the inflation risk for five years as proposed. The current high inflation scenario highlights this risk.
    - If indexation is included, we remain broadly supportive of the five-year control and revenue reconciliation mechanism.
- Bioresource price control:

  - We are nervous about the proposed implementation because the removal of a long-term guarantee on fundamental regulatory building blocks such as the RCV proposes a material increase in risk for an asset intensive business. We will comment on this further when we submit our response for bioresources on the 16th September.
- RFI:
  - We are supportive of the RFI continuing and agrees with Ofwat's assessment of its benefits and technical proposals for implementation. With developer services moving out of the price control, we support also removing it from the RFI.
  - With more focus in third party revenue and costs, there are compelling arguments for excluding the revenue from the RFI.

Chapter 4 - Reflecting an understanding of customers and communities

4.1 Do you agree with our approach to making sure that companies' price review submissions and our determinations reflect an understanding of customers', communities' and environmental concerns?

Disagree

Key messages
- We are supportive of the collaborative national research but have concerns about the way it is used and whether that will "make sure submissions and determinations reflect customers' concerns".
- There are contradictory statements in the draft methodology about how and when the research is to be used.
- We have significant concerns about affordability and the scale of the requirements being set out in policy and regulation. We are concerned that Ofwat's position on this is not strong enough and encourage Ofwat to engage more fully with respective government departments and quality regulators about the scale of these requirements, Ofwat's ambitions, and its obligations to deliver a plan that meets its statutory duties.

Additional points
- We are concerned that if the research must be used, some of the timelines are unworkable e.g. the estimated January publication of ODI rates.
- We question the appropriateness of the use of the research in some contexts because the peer review undertaken by eftec found the research to be unsuitable for use in Cost Benefit Analysis.
- We are concerned about the risk of relying on one piece of research for setting ODI rates because this research is based on a single point in time which may be skewed by circumstances at that time e.g. the cost of living crisis.
- We are concerned about the approach to local research and the weight and value it is given.

4.2 Do you agree with our proposal to conduct open challenge sessions?

Strongly disagree

Key messages
- Our plan is being informed by a range of robust research projects that comply with best practice and high-quality research principles, stakeholder engagement and a variety of public consultation initiatives.
- There is already provision for robust and expert challenge through our Customer Challenge Group and the open challenge sessions we have planned across our region for next year, to which Ofwat will be invited.
- It is not clear that the additional open challenge sessions proposed by Ofwat will add value above that which will be gained through our planned approach.

4.3 Do you have views on open challenge sessions can align with the collaborative approach in Wales?

We will not be commenting on this question.

4.4 Do you have views on how the outcome of collaborative customer research can contribute in the context of the collaborative approach in Wales?

We will not be commenting on this question.

Chapter 5 - Delivering outcomes for customers

5.1 Do you agree with our proposed package of common performance commitments? Is water demand best incentivised through separate performance commitments on household and domestic consumption and leakage or through a performance commitment measuring total demand?

Strongly disagree

Key messages
- We support the move towards a more streamlined, outcomes-based approach to setting performance commitments. This approach is partially aligned with our own Strategic Direction Statement.
- Ofwat's Draft Methodology is a step in the right direction, but it falls short of a full outcomes-based framework.
- We would like to take a more outcomes focused approach and could take the lead in this area at PR24.
- We support an approach to setting performance commitments at the level of total water demand (preferably a net approach, accounting for example, for water returned to the catchment through stream support mechanisms focusing on sustainable abstraction); we strongly disagree with leakage, PCC and business demand as individual performance commitments as they are all output focused measures.
- We disagree with a number of the proposals at a more detailed level as set out in the response below.

5.2 Do you agree with our proposed guidance for bespoke performance commitments?

Agree

Key messages

- Provided that outcome-focused common PCs are retained, we support the move to setting fewer bespoke PCs to the extent that this is consistent with adopting an outcomes framework with bespoke measures that reflect outcomes that matter to customers and the environment.
- We are concerned that if outcome-focused common PCs are not retained, bespoke PCs could be used by companies to introduce appropriate incentives to support their ambitions.
- It is important that aspects of the bespoke measures are carefully balanced. This includes commonality of bespoke measures across companies and criteria for bespoke measures.

5.3 Do you agree with our proposed approach to setting standard rates?

Disagree

Key messages

- Our view is that the proposed approach creates a disconnect between the cost and service link between ODI levels and delivery methods.
- We have identified several issues with the approach proposed by Ofwat.
    - We are concerned about removing marginal costs altogether.
    - Removing marginal costs from the formula means that there is a strong likelihood that customers will receive more than their valuation of each unit of service, or will pay more than their valuation for each unit of service.
    - The formula is dependent on the MB estimation and therefore requires robust inputs from high quality customer research and as it is intended to use the collaborative research as the primary input (without a process of explicit triangulation with the substantial body of customer research), this is a high risk approach to ODI calibration.

Additional points

- We support an approach that can simplify this complex area.
- In principle, we support the use of symmetrical incentive rates that are based on a simplified formula because this removes some of the complexity and provides a better balance of incentives.
- We support an increase in the incentive rates because it will manage the risk of out- and underperformance.
- So that Ofwat can achieve its ambition of setting a symmetrical approach, it is important that Ofwat considers the standard incentive rate approach not just on its own but in the context of the overall risk and reward package.

5.4 Do you agree with our proposed approach to the measures of experience performance commitments, including to increase the size of C-MeX?

Agree

Key messages

- Much of the detail of the measure for BR-MeX is still to be determined and is therefore difficult to provide meaningful commentaries on without it. However, we have provided comments on ways it could be implemented such as more quantitative scoring measures alongside qualitative scoring
- We generally agree with Ofwat's proposed approach to the measure of performance commitments.
- C-MeX should remain a broad measure of customer experience. Service to customers in vulnerable circumstances or those considered worst-served is best incentivised through other means such as the proposed Customer Licence Condition.
- There is little information provided on BR-MeX, but we believe that it needs to have an objective element as well as a qualitative aspect.

5.5 Do you agree with our proposed approach to estimating marginal benefits for common and bespoke performance commitments?

Strongly disagree

Key messages

- It is not appropriate to use a single research project (the collaborative research) for the most common ODIs because there is a risk with this approach that the developed ODIs may not be defensible against stakeholder scrutiny.
- The previous two price controls have taught us that a full understanding of customer preferences comes from a body of research that uses a mix of high quality methods.
- Ofwat needs to include a process of triangulating the results of the collaborative research with the body of evidence developed by companies. This would ensure that there is full transparency and that appropriate checks and balances are in place without over-emphasising a single piece of research.
- Our view is that for bespoke measures, we should be encouraged to use the full wealth of customer engagement and opinions at our disposal and using a comprehensive set of valuations from multiple sources and methodologies correctly triangulated can help mitigate weaknesses.

Additional points

- The timing of the research and business planning means that companies will have to develop their business plans and their investment optimisation processes based on their own customer valuations because the results of the collaborative research will not be available at that time. As a result, plans will be optimised against one set of data while the incentives for delivery within the AMP will be calibrated based on another. This disconnect could be remedied through the use of triangulation.
- On greenhouse gas emissions and biodiversity, we suggest looking at market-based values where these are available as they are more likely to represent the true valuation of improvements than publicly available societal values.

5.6 Do you agree with our proposed approach to incentivising asset health performance?

Strongly disagree

Key messages

- We do not agree with including asset health measures as ODIs as they are not outcomes. Please also refer to our response to question 5.1.
- We agree that asset health should be measured but the PCs should be customer-focused outcomes only.
- Our view is that the way to address the long-term impact of asset health deterioration is to create more certainty over the long-term incentives instead of measuring an output that is not customer-facing. A long term approach can be achieved by including penalties as RCV adjustments. See question 5.14 for more detail.
- If Ofwat persists with incentivising outputs, we suggest that a top-down approach is used as this is pragmatic and can be calibrated against other ODIs.

Additional points

- If asset health is included in ODIs, an inferred benefits approach is unlikely to work in practice as it will require too many arbitrary assumptions and will lead to double counting because the impacts are already captured by other PCs and ODIs.

5.7 Do you agree with our proposal to retain, expand and streamline enhanced incentives?

Agree

Key messages

- In principle, we support the continued use of enhanced incentives if these are applied appropriately to provide companies with incentives to innovate and drive service improvements to customers and the environment.
- The most important issue is the implementation of enhanced incentives and the overall impact on the risk and reward balance. There is currently a lack of clarity on the implementation of enhanced incentives.
- We support the adoption of an expanded and streamlined approach to setting enhanced incentives for PR24.

Additional points

- To achieve their stated aim, the target levels for enhanced incentives need to be stretching but they must also be consistently achievable by companies.
- Enhanced incentives may assist Ofwat in making the ODI incentives symmetrical in PR24.
- The efficacy of the application of enhanced incentives is dependent on what aggregate thresholds are applied and these need to be set at a level that provides the right balance of achievable levels for companies and the additional cost burden to customers.

5.8 Do you agree with our proposed approach to selecting performance commitments for enhanced incentives?

Disagree

Key messages

- The criteria used to select performance commitments for enhanced incentives can go further, which is important to provide incentives for truly stretching performance. We suggest widening the number of commitments by doing the following:
    - adjust the principles set out in the draft methodology to better reflect and allow for environmental and community benefits (as well as for customers);
    - extend the application of enhanced to apply to river water quality in addition to the four measures that Ofwat has set out; and
    - If a common PC is set on an outcomes basis for total water demand, this should also have enhanced incentives applied. However, this should not be applied to separate output-based PCs for leakage and PCC.

5.9 Do you agree with our proposed approach to setting enhanced thresholds, rates and caps?

Disagree

Key messages

- There is a need to ensure that the thresholds for enhanced incentives are set at a consistent level and at these are set at the correct level in order to be effective and to balance the levels that companies are required to achieve and the additional cost burden on customers.
- Our view is that the enhanced rewards should not be used to balance out the RORE ranges for the PCs that only have a penalty attached to them.
- It is not possible at this stage to give a view on the simplified approach to setting rates that Ofwat has proposed and more clarity is required from Ofwat.
- Caps should not be necessary if outcome-based measures are focused on the things that matter to customers, communities and the environment, where these are well-defined and where the delivery of the outcomes is within the companies' control.

5.10 Do you agree with our proposed approach to knowledge sharing?

Agree

Key messages

- We agree with Ofwat's proposal that companies that achieve enhanced performance will be required to share the knowledge behind their success with the sector.

5.11 Do you agree with our proposal to set caps and collars on a targeted basis, and apply a two-sided aggregate sharing mechanism to all companies?

Disagree

Key messages

- We do not support the application of caps and collars because:
    - caps and collars will blunt incentives rather than protect customers;
    - targets such as bathing water quality must be set taking into account the company's ability to control the outcome but the draft methodology proposals to not achieve this; and
    - some PCs already have well-established measures.

- We do not agree that caps and collars are only needed if there are inadequacies in other aspects of the ODI framework.
- caps, collars and aggregated sharing mechanisms should not be necessary if:
    - outcome-based measures are focused on things that matter to customers, communities and the environment;
    - they are well defined; and
    - where the delivery of these outcomes is sufficiently in the control of companies.

Additional points

- Setting a symmetrical aggregate RORE sharing mechanism is a pragmatic way to recognise that companies are not able to manage all risks around PC performance - we support this as a general approach.
- Ofwat could consider a wider threshold before risk is shared with customers and could consider putting more risk on companies on both the upside and downside and in all cases, the final threshold needs to be consistent with the overall balance of risk and reward in the determination.
- The approach to risk needs to be accompanied by a more pragmatic approach to updating PC definitions within the AMP where this is in the customers' interests.

5.12 Do you agree with our proposal to not set deadbands on any performance commitment?

Agree

Key messages

- We support the removal of deadbands if targets are set appropriately e.g. per our comments on setting caps and collars in response to question 5.11.
- 100% compliance is not an appropriate PC target given the current evidence. We recommend that Ofwat more rigorously assesses the point at which outcomes remain achievable and equitable before setting the target on compliance measures for PR24.

Additional points

- Under the draft methodology, there is a high probability that every company will be perceived to have been "fined" through receiving an ODI penalty. This creates a reputational risk for companies and regulators.
- Left unchanged, the draft methodology proposals would skew company ODI risks to the downside. The final methodology must explain how the ODI proposals achieve symmetry in the ODI risk overall.

5.13 Do you agree with our proposed approach to estimating ODI risk?

Strongly disagree

Key messages

- The proposed methodology will not provide a true assessment of risk at the company level.

- The proposed methodology is likely to treat future risks in the same way as past risks although future risks (such as climate change) are changing and does not take account of correlations between risks.
- It is important that Ofwat considers risk in the round rather than in isolation. This is particularly because the direction of travel in PR24 seems to be that companies will bear more risk before this is shared with customers.
- It is very important that companies undertake their own risk analysis in addition to Ofwat's analysis and that the final methodology explains how Ofwat will engage with and take account of a well-evidenced company risk analysis in making its decisions on business plan incentives.

Additional points

- The draft methodology is not clear about Ofwat's requirements for a good quality and ambitious plan e.g. whether this means a wider range of risk and reward, use of Ofwat assumptions or simply applying the appropriate incentive rates. This needs to be set out clearly in the methodology to assist companies to develop high-quality plans that meet Ofwat's requirements.
- We are concerned about the limited opportunities within the methodology to engage on ODI risk in advance of Ofwat's Draft Determinations.
- The removal of the IAP stage places additional risk on companies because it reduces the ability to respond to challenges arising from uncertain PCLs. The reduced "check-in" points increases the risk that the final allowances and PCLs will be misaligned.
- In order for Ofwat to achieve its ambition of setting a symmetrical approach and because many aspects are interrelated, standard incentive rates must be considered alongside the calibration of the risk and reward package and not in isolation.

5.14 Are there instances where providing greater clarity over our intended approach to incentive rates in PR29 would clearly be in the interests of customers? Please explain why and provide supporting evidence.

Neither agree nor disagree – N/A

Key messages

- The current approach is not sufficient because the treatment of and any advantage of outperformance is not clear, especially for innovative solutions and companies therefore have some delivery risk.
- If an opex solution is used, base costs would be higher but it is not clear whether this would be offset by the penalty avoided.
- A lack of long-term certainty impedes innovative solutions that would drive service quality forward. It is in customers' interests to fix the incentive imbalance so that companies can invest with greater certainty.

Additional points

- Our view is that RCV ODI adjustments could be considered further as these can be calibrated to give short term revenue impact and also give long term certainty.
- Committing to ODI payments for longer time periods can also reduce certainty and Ofwat should consider this because it has a significant impact on the long-term focus of companies' performance.

5.15 Do you have any comments on our proposed approach to implementing and streamlining payments at PR24?

Neither agree nor disagree – N/A

Key messages

- We support the use of continued annual adjustments with payments being adjusted for time value of money, inflation and tax but believes the in-period determination process could be streamlined.
- Our view is that the use of a model more similar to the RFI would be appropriate.
- The continued focus on in-period incentives to the exclusion of end of AMP RCV does not align with taking a longer-term approach and measure are needed to ensure that the additional costs of maintaining higher standards is not mistaken for inefficiency. See our response to question 5.14 for further explanation.

5.16 Do you have any wider comments about the ODI framework at PR24?

Neither agree nor disagree – N/A

Key messages

- A framework that calibrates ODIs without taking companies' customer evidence is high-risk and may not lead to defensible results.
- Basing 2024 ODIs on 2022 research may not be appropriate because the macroeconomic situation may evolve in that time.
- We recommend the use of triangulation with the body of evidence developed by companies to ensure that a clear understanding of customer preferences informs the ODIs and so that the ODI is not based on a single piece of research conducted at a point in time.
- We comment further on PCDs in our report in question 6.1 (section 5.7) but believe they need further review to ensure they promote an outcomes based approach and do not lead to more input/output based measure in place of performance commitments.
- We request that all ODI rates are shared in the final methodology, not just those derived from the collaborative customer research, as this is fundamental to a companies understanding of their risk and reward balances.

Chapter 6 - Setting expenditure allowances

6.1 Do you agree with our proposed approach to setting efficient expenditure allowances at PR24?

Strongly disagree

Key messages - please refer to section 1 of our separate report for our full response

- We have significant concerns about the proposed approach to setting efficient expenditure allowances for PR24. Key concerns are listed below but please refer to our separate report for our full response.

- The approach set out in appendix 9 of the draft methodology falls short of what is needed if Ofwat is to meet its own objectives and act in accordance with the UK Government SDS.
- Although Ofwat has presented ambitions to adopt a more outcomes-based regulatory approach, there is only limited progress towards this in PR24.
- Although we welcome Ofwat's recognition of the risk of an inefficient capex bias for enhancements and its openness to adapting its regulatory approach in PR24 to address this, we strongly reject both options set out in the draft methodology. This is because these options do not recognise the disparity in incentives for the investor.
- Our view is that the current approach to funding water companies' base expenditure needs further adjustment because it is unlikely to provide a reasonable basis on which to set allowances for the 2025-2030 period and that this has not been sufficiently addressed in the draft methodology. Given Ofwat's financing duty, we consider that Ofwat must satisfy itself that its largely backward-looking approach is appropriate for setting allowances in AMP8 and if not, enable suitable adjustments to be made. However, this is not necessarily done by just including forecast costs in the models.
- We would like to engage further with Ofwat in relation to the levels of performance funded by totex allowances. Our view is that more thinking is needed in this area and that this should draw on engagement between Ofwat and water companies and careful and detailed analysis. We has commissioned research in this area which provides insight and guidance and would be a valuable input as Ofwat takes its work forwards.
- Our view is that Ofwat and companies should engage with the questions about what considerations, metrics and tests should be taken into account in deciding which model specifications, and which suites of models, are most appropriate to use to set allowances.
- There is an important gap in the draft methodology in relation to the application of benchmarking analysis to enhancement initiatives. This is a major concern given the shortcomings at PR19 and Ofwat's aspirations for PR24.

6.2 What are your views on how we can best align the treatment of third-party costs and revenues?

Neither agree nor disagree – N/A

Key messages

- There are risks with trying to incorporate an assessment of third-party solution funding in the benchmarking, this is discussed in section 6.3 of the attached report.
- We are very supportive of giving companies the flexibility to secure revenue from the most appropriate source. To achieve this, it is important to be very clear how this revenue and totex is allowed and how it flows through reconciliation models. Solutions allowed within the price cap need to be clearly defined and the revenue and totex streams need to be run through the reconciliation models.

6.3 Do you agree that companies that submit the most stretching and well evidenced business plans should receive the most favourable cost sharing rates at PR24?

Disagree

Key messages

- We welcome the further consideration that Ofwat has given to the cost sharing mechanism since PR19 however we still think the proposed approach to be worse than the simple alternative of setting symmetric rates for all companies. Please see section 2.12 of our separate report for our full response.

6.4 Do you agree that resilience enhancement should be used to fund companies to manage increasing risks to specific hazards that are beyond their control and not covered by base expenditure and other enhancement areas?

Disagree

Key messages

- We disagree that the only resilience enhancement should relate to funding companies to manage increasing risk for specific hazards beyond their control, although this should clearly be a subset of resilience enhancement totex. Please see sections 3 and 4 of our separate report for our full response.

6.5 Do you agree with our proposed approach to setting performance commitment levels at PR24?

Strongly disagree

Key messages

- We have serious concerns about the proposals in the draft methodology. It is not clear that base allowances fund increased service. This conflates the impact of historic enhancement allowances and productivity efficiency improvements over time. We welcome further discussion on this.
- Please see section 4 of our separate report for our full response.

6.6 Do you agree with our view on what performance commitments should be set using common or company specific performance commitment levels?

Strongly disagree

Key messages

- This question is intrinsically linked to question 6.5 above and we have serious concerns about the proposals in the draft methodology. Please see section 4 of our separate report for our full response.

6.7 Do you agree with our proposed approach to incentivising and funding efficient investment in reducing greenhouse gas emissions and reducing the use of storm overflows?

Strongly disagree

Key messages

- We have significant concerns with the proposals on funding greenhouse gas emission reductions. The proposals will not enable the industry to achieve its stretching 2030 operational net zero target and create a potential perverse incentive on operational emissions at the expense of embodied emissions. Please see section 5.2 of our separate report for our full response.
- We have significant concerns with the proposal on funding the reduction of storm overflow operation. We can see no way in which this expenditure is captured in the data used to inform the econometric assessment. Please see section 5.3 of our separate report for our full response.

6.8 Do you agree with our proposed approach to implementing nutrient neutrality in the PR24 regulatory framework?

Strongly disagree

Key messages

- We strongly disagree with the proposed approach, as currently expressed, to implementing nutrient neutrality in PR24. However, we also fundamentally disagree with the requirements detailed in Defra's announcement and currently being incorporated in the Levelling Up and Regeneration Bill as these are not in the best interests of customers or the environment.
- Defra's announcement on nutrient neutrality dated 20 July 2022 appears to supersede and contradict the guidance set out in Appendix 9 of the draft methodology and in the section 5.5 entitled: Nutrient Neutrality in England.
- The methodology suggests a nutrient credit approach for developers to contribute towards the capital costs of asset upgrades. This fails to take account of the several considerations including:
    - a practicable mechanism to recognise contribution towards the ongoing operation and maintenance of these long term assets;
    - failure to recognise the additional embodied or operational carbon burden resulting from chemically and energy intensive treatment systems;
    - failure to recognise that water companies will be required to deliver biodiversity net gain where these schemes require planning permission, requiring additional upfront costs and maintenance requirements over a 30-year period;
    - failure to recognise that there are far more beneficial ways of achieving nutrient neutrality than fundamentally unsustainable asset improvements.
- We are concerned about potentially excluding nutrient neutrality from cost sharing.

6.9 Do you agree with our proposed approach to encouraging companies to deliver best value through our cost assessment?

Disagree

Key messages

- We are concerned that Ofwat's approach may not work well in practice and that it is not yet sufficiently well developed. However, we welcome the attention that Ofwat gives to wider economic benefits in the draft methodology.

6.10 Do you agree with our proposed approach to removing the potential disadvantage that nature-based operating expenditure solutions may face in relation to the treatment of enhancement operating expenditure?

Disagree

Key messages

- This is a key issue for the final methodology. We do not support either of the proposals outlined in the draft methodology as neither addresses the key issue that there is no renumeration for risk for non-capex based solutions.
- Explicitly, the proposed approaches do not remove the disadvantage that nature-based operating expenditure solutions face. Please see section 1.3 of our separate report for our full response.

Chapter 7 – Aligning risk and return

Q7.1. Do you have any comments on our approach to the overall balance of the PR24 incentive package, our proposed guidance on producing risk ranges, and our view of the balance of risk facing the notional company?

Strongly disagree

Key messages

- The proposed approach risks a mismatch between risk exposure and the level of returns at PR24 because of the following factors:
  - the use of sector-wide notional RoRE risk ranges do not take into account company specific characteristics and risks;
  - backward-looking data may not represent a robust proxy for forward looking risk;
  - the proposed approach omits long term risks such as risks relating to embedded debt and more generally is constrained to the next price control only;
  - current risk analysis does not accurately consider or reflect all potential drivers of asymmetry; and
  - it is not clear how risk analysis will translate into changes to risk allocation or returns.
- Risk asymmetry is not appropriately priced.

Q7.2. Do you agree with our proposals on the regulatory regime for managing companies' exposure to uncertainty over 2025-30?

Disagree

Key messages

- We support companies taking on risks that they are best placed to manage and which they can control.
- Key areas of increased risk going into PR24 are not within management control e.g. increasing energy costs and high inflation.

- We suggest the use of Retail Price Effects (RPEs) at 2024 with a true up at the end of the price control. There is extensive regulatory precedent for the use of RPEs.

Q7.3. Is there value in introducing more prescriptive requirements and guidance for company produced RoRE risk ranges?

Neither agree nor disagree – N/A

Key messages

- More detailed guidance on RoRE ranges would improve the comparability of risk analysis and quantification across the sector. The guidance for company-produced RoRE ranges should be primarily principles-based, with potentially more prescriptive requirements for parameters that are common across companies.
- We suggest that guidance on risk analysis at PR24 should be based on a set of principles for assessing risk rather than prescriptive guidance. This approach will underpin a robust understanding of the underlying risks faced by companies, including company specific characteristics and implications for risk, this could differ by company across the sector. We set out below a framework for considering risk at PR24:
    - First, consider actual risk exposure over PR19 considering operational performance, including totex and ODIs, and macroeconomic risk and how these risks translate to financial exposure;
    - Second, consider how this risk exposure translates to financial exposure based on the PR24 methodology compared to the PR19 methodology including totex allowances, the allowed return and calibration of ODIs.
    - Third, we would consider risk drivers which are new or increasing over PR24 both for the sector overall and for Wessex specifically due to our company's characteristics.
- Regarding implementation:
    - It will necessary to consider the relationship between cost and service in part on a company specific basis;
    - It will be necessary to map risk drivers for each ODI and understand the interaction between these risk drivers across the incentive package as a whole; and
    - The starting point should be a conceptual mapping of the relationships between risk drivers and how risk drivers link to different incentives and costs to build a map of key interrelationships between risks and incentives. Each significant interrelationship will need to be translated into specific measures of correlation based on either past performance data or tools which can capture expert evidence from the business on relationships between risks.
- Our view is that at this stage, it is more appropriate to focus on individual scenarios which could create exposure rather than stochastic modelling to map the interactions between all ODIs. This could be based on common principles and guidance around evidence which could be used to corroborate and quantify exposure.

Q7.4. Do you agree with our proposed approach to setting the allowed return on equity?

Strongly disagree

Key messages

- The proposed approach to setting the cost of equity at PR24 is based on a number of significant changes from the methodologies employed by the CMA in PR19. The

methods selected appear to introduce a downward bias to the cost of equity estimate.
- The proposed changes imply a reduction in the cost of equity which does not seem to be supported by market evidence and is driven primarily by methodological changes.
- We provide further details on our concerns with RFR, TMR, the beta, and our support of Ofwat's approach with regards to inflation.

Q7.5. Do you agree with our proposed approach to setting the allowed return on debt?

Strongly disagree

Key messages
- We do not agree with Ofwat's approach to exclude index-linked swaps and junior debt from the sector average methodology, the lack of clarity around how the sector average will be calculated (including averaging methodology and the companies which will be included) and the inclusion of an outperformance wedge.
    - Although at a high level Ofwat's approach is consistent with the CMA's approach to setting the cost of debt in PR19, differences in the detail could result in the omission of relevant costs and a material reduction in the cost of debt allowance.

  We make further comments on our concerns over the treatment of the cost of embedded debt, the cost of new debt and insurance and liquidity costs, and agree with the approach on new debt proportion.

Q7.6. What are your views on the options we have set out for estimating the RPI-CPIH wedge for converting RPI-linked yields to a CPIH basis?

Neither agree nor disagree

Key comments
- Our concerns are highlighted in the work co-ordinate by WaterUK and published on the Ofwat Future Ideas Lab.

Q7.7. Do you agree with our proposed approach to the notional structure and setting allowances for corporation tax?

Strongly disagree

Key messages
- The notional company should be set based on appropriate industry benchmarks and corporate finance theory.
- CPIH indexation - we agree with Ofwat's approach to fully transition to CPIH at the beginning of AMP8.
- Notional gearing – we do not agree with Ofwat's proposed reduction in notional gearing. The notional gearing should be set based on market evidence, and sector gearing is approximately 66 per cent.
- Proportion of ILD - the approach for setting parameters for the notional company should be internally consistent.

- Mix of RPI and CPIH ILD for the notional company - Ofwat has indicated that the notional company will be assumed to have a mix of RPI and CPIH linked debt. This approach results in a fundamental mismatch between CPIH linked assets and RPI linked liabilities for the notional company, with no pricing of this risk in the cost of debt allowance.
- Corporation tax – we agree with Ofwat's approach to calculating tax allowances and welcomes the introduction of the geometric uplift methodology. However, we await further clarification of the methodology for the PR19 tax reconciliation mechanism and the approach to capital allowances at PR24.

Chapter 8 – Aligning risk and return: Financeability

Q 8.1. Do you agree with our approach to assessing financeability?

Strongly disagree

Key messages

- Our view is that Ofwat's proposed changes to the notional structure - including a reduction in notional gearing, increase in the proportion of index linked debt, retention of RPI linked debt within the notional structure alongside a full transition to CPIH - undermine financeability as a robust and meaningful cross check.
- We disagree with the following changes to the principles:
  1. Reduction in notional gearing (departing from the sector average position)
  2. Increase in the proportion of index linked debt
  3. Mismatch between RPI linked debt assumed for the notional company and CPIH linked assets
  4. No pricing for hedging of RPI / CPIH basis risk arising from full transition to CPIH
- In our view, it is important to evaluate financeability based on the PR19 notional structure to isolate impacts of a reduction in the allowed return on financeability.

Q 8.2. Do you agree with the focus on the metrics outlined in section 8.4 for the assessment of financeability?

Strongly disagree

Key messages

- We strongly disagree: financeability should be a wider assessment than purely looking at limited credit rating agency metrics – this focuses financeability purely on debt finance whereas it should be a much more holistic assessment.
- We also note the importance of recognising the difference between financeability and financial resilience, which we discuss in detail in section 9.
- We agree that the metrics outlined in section 8.4 could be used as part of the assessment of financeability. The metrics should be calculated on a basis which is consistent with the relevant rating agency methodologies. The following equity metrics should also be included:
  - dividend yield
  - payout ratios
  - hedge ratios
  - equity buffer vs risk exposure

- Ofwat should target some headroom for the notional company above the minimum thresholds to ensure there is appropriate headroom for the management of downside risk.
- The thresholds for individual metrics and the scorecard approach should both be considered when assessing financeability based on these credit metrics. Each rating agency has a primary metric (e.g. Moody's AICR), the thresholds for these metrics should be considered as well as the average metrics as rating agencies consider certain metrics to be binding and could downgrade a company based on the primary metric.

Q 8.3. Do you agree with our proposed approach to cost recovery, in particular that we set a narrow range for RCV run-off rates within which companies will be required to evidence their choice of rate which best achieves a fair balance between current and future customers?

Strongly disagree

Key messages

- We do not agree with Ofwat's approach to introduce a range for run-off rates and a higher bar of evidence to change PAYG rates at PR24.
- Run-off
    - There are multiple methodologies that can be used for calculating run-off rates. Ofwat has emphasised the use of remaining asset lives which does not appropriately reflect the other methodologies and may result in the distortion of natural run-off rates.
    - Within the draft methodology, Ofwat compares the allowances for renewals and maintaining the asset base with the level of cost recovery over PR19. However, this analysis does not accurately reflect the actual renewals and maintenance costs incurred by companies. To align cost recovery and renewals and maintenance expenditure more closely Ofwat should look to the cost allowances to appropriately remunerate companies for the costs incurred rather than seeking to artificially reduce run-off rates.
    - Our view is that Ofwat has proposed an overly prescriptive approach to run-off rates in contrast to its preference to fund opex based solutions through RCV. Ofwat states in the draft methodology that it "wants to incentivise less capital-intensive solutions, where they are the best value approach" . However, companies will not seek these types of solutions if we are unable to recover the costs through adjusting run-off rates.
- PAYG
    - Ofwat's proposals to introduce a higher bar for changes to PAYG rates between price controls does not reflect the evolution of the actual costs we face as a business. There are multiple drivers of the mix between operating and capital expenditure which evolve over time.
- To deliver under the OBER framework, there needs to be flexibility over the type of solutions delivered (opex/capex) and how returns are set.

8.4 Do you agree with our proposed approach to resolving a financeability constraint?

Disagree

Key messages

- It is Ofwat's duty set a price control in which an efficient company can earn a fair return. If the notional company is needing to restrict dividends or inject equity, earning a lower return, to ensure financeability then we think this is a sign of broader problems within the settlement.

Chapter 9 – Promoting financial resilience

Q9.1. Do you agree with the proposed standard set of scenarios for testing financial resilience?

Agree

Key messages

- We are responding separately to the overall approach to financial resilience and ring fencing. Our responses to that consultation should be assumed to take precedence over this consultation as our work is ongoing. However, we discuss some areas below.
- The proposed set of scenarios for testing financial resilience appear to represent a good starting point for our analysis however it has significant limitations as it does not capture Wessex specific risks. We will also include Wessex specific scenarios linked to our principle risks.
- There is a risk that the analysis of the financial resilience scenarios performed across the sector is inconsistent because Ofwat has not included actual financing structure functionality within the PR24 model published alongside the draft methodology. We would welcome development of the PR24 model to incorporate actual financing structure functionality.

Q9.2. Do you agree with our approach to how the board of the company should approach its board assurance statement?

Disagree

Key messages

- We are responding separately to the overall approach to financial resilience and ring fencing. Our responses to that consultation should be assumed to take precedence over this consultation as our work is ongoing. However, we discuss some areas below.
- We agree in principle that company boards should consider and provide assurance on financial resilience. However, the assessment is dependent on Ofwat's price control calibration and crucially the level at which the allowed return is set – as this is the primary driver of financial resilience.

Q9.3. Do you agree with our proposed approach to dividend policies, performance related executive pay and voluntary sharing of financial outperformance?

Strongly disagree

Key messages

- We are responding separately to the overall approach to financial resilience and ring fencing. Our responses to that consultation should be assumed to take precedence over this consultation as our work is ongoing. However, we discuss some areas below.
- We do not think it is necessary or appropriate to provide more prescriptive guidance as to which and when dividends should be paid.
- Additional requirements would duplicate our dividend policy and autonomy over the level and frequency of dividend payments attracts equity investment in the sector.
- Our remuneration policy for executive directors and senior managers takes into consideration the long-term performance of the business and is based on areas including Customer service delivery and business costs, environment performance, employee alignment and financial performance. The policy is reviewed regularly to take into account actual company performance in these areas.
- There is a high bar for the introduction of new regulation and any proposed new mechanisms would need to address a specific market failure. We have not identified a clear market failure which could be addressed through the introduction of a voluntary sharing mechanism.

Chapter 10 - Companies' PR24 submissions

10.1 Are the PR24 submission requirements clear and sufficiently specified?

Disagree

Key messages

- It is hard to have a fully formed view on whether the requirements are clear and specified because there are still several documents to be issued over the coming months (guidance on DPC for example).
- We agree with the premise of board assurance, but believes the requirements are overly specific and take autonomy away from companies. Please see our further comments in response to question 10.4.
- We support Ofwat's desire to reduce the size of plan's submissions as commented on in question 10.3. However, there may be instances where large files of data are needed to support any proposals to changes in Ofwat's requirements that we believe should be excluded from this limit. These should be limited in number.
- We do not agree that redactions should be agreed with wider stakeholders – it should be down to our boards to decide what is appropriate to redact based on security and commerciality. Our redactions in PR19 were limited, and we would continue the principle of as open as possible. Adding further stakeholders into the process creates needless additional stages.
- We agree to the removal of the IAP stage if there was enough clarity in the draft methodology to understand what would be a compliant and expected plan. At the moment this clarity is not here, and so we feel the lack of IAP is a high risk for those submitting ambitious or alternative plans (e.g. an OBER focus). Please also see our comments on question 11.1.
- We would like to highlight the current uncertainty over the implementation of the single social tariff (SST). It feels increasingly unlikely that a tariff will be implemented

by 1st April 2025, and indeed what level of certainty of tariff design we will have in time to incorporate this into our plans.

- We note Ofwat's comments on early data submissions and that these would be detailed in the final methodology. Any earlier sight of these would always be appreciated in order to alleviate the burden on companies when the 2023 APR is taking place.
- The guidance is particularly unclear regarding taking into account the impact of Covid-19 and the impact on the Per Capita Consumption performance commitment. We request further clarity on this.
- Section 4.2 of appendix 9 contains an inconsistency in that it states that Ofwat expects 'efficient companies will deliver their PCLs on average', and separately where targets are not achieved companies should be penalised.
- Very specific guidance is needed in relation to Per Capita Consumption. This is currently not clear and the final methodology needs to be clear on whether it is accepted that the 2024-25 PCL will not be met, how associated PR19 penalties will be addressed, whether Ofwat is planning to deal with PCC as a deviation and if so, how a revised PR24 year '0' PCL and future glidepath will be determined.

10.2 Is any data missing, or included but not required or areas we need to look at again?

Neither agree nor disagree – N/A

Key messages

- The tables are significantly larger than for PR19 and are concerned they may set a precent for future APRs which is not sustainable
- We request Ofwat consider the level of detail required across the tables and take a proportionate approach in the final tables published in the final methodology

10.3 Are the limits on the number and size of documents workable? Should we be more prescriptive in terms of file and folder structures etc?

Agree

Key messages

- With some exceptions, we support the limit on file size and document numbers and that redactions should remain at the board's discretion. Further guidance on file and folder structure is not needed.
- We note that there may be instances where a significant amount of data may need to be provided - these should be considered separately to the business plan submission and should fall outside the final size limit.
- Although an open and transparent approach was taken in PR19, it was necessary to redact some areas due to security concerns or commerciality and we believe this should remain at the board's discretion.

10.4 Do our expectations for company board's assurance and governance arrangements provide enough guidance to ensure that boards have sufficient level of 'ownership' and so ensure a high quality submission?

Strongly disagree

Key messages

- Our view is that the assurance and governance arrangements go too far in that they are too prescriptive and take the autonomy away from companies and their boards.
- The Board fully embraces Ofwat's Board Leadership Transparency and Governance principles and the Wates Corporate Governance Principles for Large Private Companies. Wessex Water's Board is accountable for the accuracy and completeness of the information we report and publish. Board ownership is key to providing a strong assurance process. The five areas proposed for specific board assurance have guidance that is overly prescriptive, albeit the broad areas proposed are sensible.

10.5 Do you agree with our proposal to continue to apply revenue adjustments for past performance across all years of 2025-30, after the financeability assessment?

Strongly agree

Key messages

- We agree with the proposal although with the additional bill smoothing flexibility, it is unclear why to distinguish the two.

Q10.6 Do you agree with our proposal for 2024-25 blind year adjustments? Should we treat in period ODI adjustments in the same way as other blind year adjustments or retina the approach set out in the Rulebook?

Strongly agree

Key messages

- We agree with the proposals for the blind year adjustments.
- For ODIs, we agree with the proposal for the added flexibility given to the blind year adjustment.

10.7 Do you have any comments on how to best deal with the impact of shadow and non-shadow reporting in table BIO3 on other tables?

Neither agree nor disagree

Key messages

We will provide comments on this with our wider bioresources answers by the 16th September. However, we will not state whether we agree or disagree as this question is asking for comments.

10.8 Do you have any comments on the data we should collect in table BIO5?

Neither agree nor disagree

We will provide comments on this with our wider bioresources answers by the 16 September. However, we will not state whether we agree or disagree as this question is asking for comments.

Chapter 11 - Encouraging quality and ambitious business plans

11.1 Do you agree with the framework we propose to encourage the best business plans? Specifically, do you agree

- **that we should first assess 'quality' followed by 'ambition'?**
- **with our proposed allocation of rewards and penalties for performance on each?**

Strongly disagree

Key messages

- We are concerned about the lack of clarity around the definitions of quality and ambition. However, at the same time, the few examples that are given seem to be extraordinarily constraining.
- We agree that quality should be assessed first, before ambition but more clarity about the meaning of these terms is needed.
- Past performance should be included in an assessment of quality to avoid assuming an implausibly significant departure from historical performance.
- There appear to be contradictions within some of the proposed timelines e.g. the short turnaround for cost assessment and models that are planned for publication in Spring/Summer 2023 and the expectation that LTDS will use the ODI customer research values but these will not be published until December.
- It would be expected that rewards and penalties would be more prevalent in the regulatory framework that focuses on quality and ambition.
- We would be happy for the IAP stage to be removed provided that there was enough clarity in the draft methodology to understand what would be considered a compliant, quality and ambitions plan. Currently, this clarity is not present and the lack of an IAP is a high risk for those submitting truly ambitious or alternative plans.

11.2 Do you agree with the proposed scope of our 'quality' assessment? Specifically, do you agree:

- **we should have minimum expectations in the six areas described above?**
- **with the minimum expectations we specify in each of the six areas?**

Strongly disagree

Key messages

- We refer to our response to question 11.1 above.
- We would like to submit a high quality plan and for this to be based on the principles of OBER. However, it is not clear whether this would be seen as high-quality or not. The draft methodology does not give sufficient confidence to our board that they should bear that risk and we hope for and expect more clarity on this well in advance of the final methodology.
- The minimum expectations are severely limiting – particularly those around a “plan that uses our assumptions”. We’d expect Ofwat to be considering a range of assumptions for different companies, rather than assuming a one-size-fits-all approach. It does not seem

appropriate, ambitious, or high-quality for Ofwat to limit companies to a single approach or set of assumptions in all areas.
- We are concerned, after experience at PR19 that the bar for evidence to be compelling will be set subjectively and very rarely met. This could operate to bring all companies back into a one-size-fits-all approach on the basis that Ofwat does not find the evidence compelling.

11.3 Do you agree with the proposed scope of our ambition assessment?

Strongly disagree

Key messages
- Our view is that a key element has been omitted from the scope of Ofwat's ambition assessment in that companies with very ambitious plans e.g. to maximise the use of outcome-based regulation, are likely to be taking more risk. There should be an associated reward for that risk and we would suggest that some of this could be appropriated through the business plan incentives.
- We encourage Ofwat to consider a differential category for both quality and ambition that incentivises a non-traditional plan for those companies that truly want to go beyond the minimum requirements. This would recognise the additional risk of both submitting such a plan, as well as the risk associated with delivering it. It would do so by creating incentives throughout the price review process.
- Please refer to our response in relation to question 11.1 above.

11.4 Do [you] agree with our proposed reputational, financial and procedural rewards and penalties, including the overall package of reward and penalty?

Strongly disagree

Key messages
- We believe that incentives could be significantly stronger in encouraging an outcomes-based plan that delivers genuine efficiency in delivery of outcomes for customers, society, and the environment. Please refer to our response in relation to question 11.3 above.

11.5 Do you have any other comments regarding our proposed approach to business plan incentives at PR24?

We have no further comments.

Appendix 6 - Performance Commitments

6.1 Do you have further views on whether the proposals laid out for C-MeX are appropriate?

Neither agree nor disagree

Key messages

- We welcome the retention of C-Mex at PR24 and comments on the following areas on the proposed amendments:
    - We prefer to retain the check and challenge process because there is still a need for this because the challenge process is still in use. If check and challenge is removed, we would require more assurance and visibility of the quality checks in place at Accent and improvements being made.
    - We appreciate the difficulty in meeting quotas for the CESs and are comfortable with the use of alternative approaches although some adjustment may be needed. We note that if incentives are offered, this will increase the cost of the survey.
    - On communication channels, our view is that if the minimum requirement is increased, we would need early sight and discussion around the communication channels to be included to give time to implement. We must ensure that C-MeX is not incentivising companies to add channels that customers don't want.
    - We are concerned about the proposed timing for finalising the design of C-MeX. We believe this should be published in the Final Methodology so companies can factor any implications into their Business Plans.
    - We are supportive of the intention to increase the size of C-Mex as it provides an important measure of customer experience and we refer to our response to question 5.4.
    - We would like postcodes, even if truncated, to be included in the data set so we can evaluate if local/community initiatives are having an impact. This will make it easier to use the outputs of CES by providing a link between the survey response and geographical area.
    - We believe the CES element of C-MeX should be removed; it is providing perverse incentives by driving companies to spend money on marketing and building awareness rather than fundamental improvements to service. This is reflected in the scores, where there are companies who perform well on CES but perform poorly on customer service. Unless improvements in CES can demonstrably lead to improvements in customer service scores, it is inappropriate to incentivise expenditure for no service improvement.
    - If CES is retained, we argue that it needs to be refreshed because the responses suggest customers are not understanding the key satisfaction question and answering about their water supply as opposed to water services as a whole.

6.2 Do you agree that C-MeX needs to adapt to provide better service to vulnerable and worst served customers?

Strongly disagree

Key messages

- Companies should be offering a fully inclusive and accessible service to all customers and every customer, regardless of their needs, should have an excellent experience.

- Our view is that C-MeX should remain a general measure of customer experience. It is already complex and to try and incorporate these other areas would only increase that complexity.
- Improved service for vulnerable and worst served customers should be driven by other incentives or mechanisms which could include:
    - Proposed customer licence condition
    - Achievement of the British Standard for Inclusive Service Provision BS18477 (soon to be replaced by ISO 22458)
    - Implementation of all recommendations of CCW's affordability review
    - Delivery of company complaint action plans
    - Compliance with best practice and broader policy guidance
    - Wider best practice sharing.

6.3 What are your views on our proposal to introduce a single, combined common performance commitment ('BR-MeX') capturing the experience of both end business customers and retailers as intermediate customers?

Neither agree nor disagree

Key messages

- We have reservations about the measures being suggested and whether they will provide a truly accurate assessment of that performance but we agree in principle that wholesale performance should be measured.
- Our view is that both R-Mex and B-Mex are important measures but because they highlight subjective measures, they should be combined with a third, more objective performance measure which captures underlying performance such as the existing OPS. This would align it with the approach taken for D-Mex.
- We make the following comments and suggestions for improvements.
    - R-Mex: Our primary concern is that R-Mex is heavily influenced by a retailer's perception of wholesale performance rather than the actual strength of underlying performance and that there are several other factors that could inappropriately influence scores.
    - B-Mex: Our primary concern is whether when being surveyed, a customer can differentiate between the retail and wholesale functions and between supply and waste side providers for those who sit within a WOC area. Customers may also be influenced in their responses by a poor relationship with their retailer. This can be addressed through the approach of the surveying entity and in distinguishing between experiences related to the wholesaler and those that relate to the retailer. This should in theory be a C-Mex type assessment which we would support.

6.4 Do you consider evidence suggests that the current water supply interruptions performance commitment is inhibiting innovation? If so please provide it.

Strongly agree

Key messages

- Our view is that the current performance commitment definition continues to disincentivise best value to customers. If this definition continues, we are unlikely to

champion further innovation in no-dig technology because it will have a material negative impact on our performance.
    - Before the stretching PR19 performance commitment on supply interruptions, we achieved 80% of repairs using no-dig technology. This has reduced to 45% to enable us to meet the supply interruptions target.
- We note that innovative no-dig technology provides best value to customers for planned outages because it typically has less impact on the environment, reduces the need for and duration of traffic management/road closures and has less overall cost. However, it can often negatively impact the supply interruptions performance commitment.

6.5 Do you agree with our proposed definition for the biodiversity performance commitment?

Agree

Key messages
- We agree with the need for a biodiversity performance commitment which reflects the need to enable nature's recovery and with the approach set out by this performance commitment. However, we have some reservations and requires clarification in some areas, and makes the following comments:
    - the Defra Biodiversity Metric 3.0 is the most appropriate current tool to use for assessment purposes but it should be recognised that this tool is evolving and will change and improve over the course of PR24.
    - we recommend a five-year assessment period, once per AMP, rather than every four years. This is because only small changes, which may not be possible to significantly demonstrate or quantify, would be recorded in a four-year period. However, we recognise the need to report change in each AMP period and so suggest a 5-year assessment period to enable this.
    - there is currently limited detail on how water companies' efforts with third parties, such as landowners and charities, will contribute towards the metric to be used for this PC (e.g. biodiversity units per hectare of land owned by the company – when clearly this land is in third party ownership). Further clarity is required on this.

6.6 Do you agree with our proposal to have separate operational greenhouse gas emissions performance commitments for water and wastewater, which are based on a normalised measure?

Agree

Key messages
- We agree that there should be separate measures for water and wastewater, which are based on a normalised measure. However, clarification is needed in relation to:
    - the definition for scope 3 emissions
    - sector-wide agreement is needed for WASCs for either conversion factors or retention of an option to recalibrate base year emissions.
- We agree that there is a need for absolute emissions reporting alongside as stipulated on page 67 of Appendix 7 – Performance commitment definitions
- Offsetting must included as part of the suite of measures to meet net zero.

6.7 Do you agree with our proposal that the performance commitment on serious pollution incidents should only apply to water and wastewater companies?

Strongly disagree

Key messages

- We disagree with this proposal because it is fundamentally unfair to give one company an underperformance payment and not another for the same environmental impact. This is not in the best interests of customers.
- We also disagree with the premise of this underperformance only performance commitment because each company already receives a direct financial impact from prosecutions when a serious pollution incident occurs. We propose that this measure is removed to prevent companies being penalised twice, if not a third time through the performance commitment, Total Pollution Incidents.
- If this performance commitment remains, we propose that it is applicable to water only companies as well.

6.8 Do you agree we should focus the bathing water performance commitment on the outcome that customers have received and should continue to develop an alternative definition to do this?

Strongly disagree

Key messages

- We do not agree that Bathing Water status is a good or fair Performance Commitment for water companies due to the many locations where standards are influenced by other parties.
- Bathing Water status is not a good measure for a reduction in public health risk because it provides no real-time indication of water quality to enable customers to consider water quality issues in their decision making. We are proposing to address this through its real-time bacteriological monitoring using AI tools successfully developed for Warleigh Weir near Bath. We are proposing to roll this out to popular bathing locations around the Wessex Water area as part of our AMP7 outputs.
- We do not consider that any of the three options presented in the draft methodology are sensible nor fair Performance Commitments.
- By holding water companies to account for Bathing Water status, this perpetuates the incorrect information that the only sources of bacteriological pollution in rivers and sea are from water company assets.

6.9 Do you agree with our proposal for the river water quality performance commitment to measure the reduction of phosphorus entering rivers?

Agree

Key messages

- We agree with an outcomes-based approach to delivering improved water quality and its intention to include asset, catchment management and nature-based solutions enabling phosphorus reductions. However, the preferred approach must include the opportunity to reduce phosphorus contributions to watercourses from water company application or incentivisation of nature-based solutions and catchment management with third parties on a catchment scale. (We note that this is set out in this way in 4.7.1 but that 4.7.2 states “loads discharged from wastewater treatment works (our preferred option”)

Appendix 13 - Data and modelling

We have not reviewed the proposed financial model in detail. We believe there are substantial changes, specifically around bioresources still to come and so have no specific comments on it at this time.

13.1 Do you agree with our proposed approach to mechanisms at PR24?

Agree

Key messages

- We agree with the overall direction of simplifying the reconciliation process. Specifically, the proposed removal of a number of mechanisms. We think those mechanisms under consideration should ultimately also be removed.