United Utilities

Response to the Ofwat consultation on Regulatory Reporting 2022/23

March 2023

United Utilities

Water for the North West

Introduction

United Utilities welcomes the opportunity to comment on Ofwat's consultation on the Annual Performance Report 2022-23.

We have responded to each of the questions set out in the consultation. We'd like to draw your attention to two fundamental issues relating to table 4C 'Impact of price control performance to date on RCV', as raised in our response to question 1. To ensure alignment to Ofwat's PR19 cost reconciliation model, it is important that the shadow RCV build takes account of the timing of totex (derived using the total over/underspend variance, not the variance due to efficiency only) and the allowed totex is adjusted for changes to company's totex baselines resulting from the output of the WINEP adjustment mechanism – see page 5 for the proposed adjustments. In addition, we have concerns regarding the cost classification of leakage enhancement expenditure which should not be influenced based on allowances in the PR19 final determination, as set out on page 26.

We have also raised a number of additional comments not covered by the questions, including key considerations for PR24 and beyond, set out on pages 26-30.

Consultation question 1

What are your views on the proposed changes to the APR tables listed in appendix A3 and set out in full in RAG 4?

We have structured our response into two sections; key issues on the proposed changes to the APR tables and also the existing RAG definitions (further details provided following our response to question 14), and other administrative items.

1.1 Key issues on the proposed changes

Table	Line	Issue	Page ref.
4C, 4U	4C.32, 4U.11	**Shadow RCV - Treatment of timing differences** Impact to shadow RCV should be based on the total variance, not the variance due to efficiency only, consistent with the PR19 cost reconciliation model which takes account of the timing of totex.	5
4C	New lines	**Shadow RCV - WINEP adjustments mechanism** Final determination allowed totex should adjust for changes to company's totex baselines resulting from the output of the WINEP adjustment mechanism.	5
4L	26 – 28	**Leakage enhancement expenditure** We disagree with the definition that 'This line should only be completed by companies who were allocated leakage enhancement expenditure in the PR19 final determinations'. Although an enhancement allowance for leakage has not been allocated in our PR19 final determination, we have still incurred leakage expenditure which meets the definition of enhancement expenditure.	26
1A – 1D RAG 1.09		**Direct Procurement for Customers (DPC)** The primary statements could be expanded to include a new separate adjustments column to separately report the DPC impacts.	26

1F	10	**Financial flows - Innovation fund expenditure** The RAGs should be updated to clarify that innovation fund spend should be excluded from totex performance, since there was no expenditure allowance assumed at PR19 (being separately funded through customer revenues).	6
2I		**Reporting of revenues** To ensure consistency across companies, clarification of Ofwat's expectations on how it expects companies to split revenues into the four wholesale price controls would be helpful.	27
RAG 4 Appendix 1		**Rechargeable works** Rechargeable works should be reclassified as 'Third party services, Income not governed by price control' in line with the PR19 final determination.	27
4B	All lines	**Reporting of financial instruments** Table 4B has moved away from presenting financial instruments on a 'net exposure' basis to presenting individual legs of instruments, and would welcome further understanding as to how the information is used.	7
4H	17	**FFO / Debt** We expect 'FFO / Debt' (4H.17) is likely interpreted by users as mirroring the ratings agencies' calculations, and as such it would be more appropriate that this ratio is calculated on a consistent basis to Standard & Poor's methodology	27
4F, 4G, 4S, 4T	All lines	**Cumulative expenditure - Major projects and green recovery** Please clarify whether cumulative expenditure in tables 4F, 4G, 4S, 4T should be a straightforward summation of costs for the price control period to date.	7
4W RAG 3.14		**Pension deficit reporting** Whilst we welcome the introduction of this table, companies should also be required to disclose their key assumptions, in particular the mortality assumptions, without which it would be difficult to draw any meaningful comparatives across the sector.	7
9A RAG 1.09	New lines	**Innovation fund reporting** The reversal of the provision and reclassification of intra-company transfers in relation to the innovation competition fund should be listed in RAG 1.09 as a principal difference to the statutory accounts. Table 9A should include two additional lines to report contributions to and from other water companies as part of the 10% partnership contribution.	8
6A	29	**Peak week production capacity having enhancement expenditure for grey solution improvements to address raw water quality deterioration** Further clarification of the line definition required. See commentary below.	8
6A	30	**Peak week production capacity having enhancement expenditure for green solutions improvements to address raw water quality deterioration** Further clarification of the line definition required. See commentary below.	8
6C	26	**Average time properties are below the reference level** Challenge requirement to report/ability to report. Refer to response to questions 2-4.	10
6D	11-14	Additional lines are required within the table to capture when companies replace an exisiting meter with the same type of meter. For example, replace an existing AMR meter with a new AMR meter. Without this, Ofwat will be missing a key element of companies meter replacement programmes.	
7F	All lines	**Multiple WINEP IDs under the same scheme** When populating the 'Scheme name and WINEPID reference' column, there are occasionally instances where a named scheme has multiple WINEP references. For example, our scheme at Waverton WwTW represents two	

		phosphorus drivers - 7UU300131 with a P consent of 5.4mg/l and 7UU200756 with a P consent of 0.4mg/l. In this instance, our intention would be to insert a single row in the table for the Waverton scheme, but to identify both IDs in the 'Scheme name and WINEPID reference' cell. As such, this scheme would be titled 'Waverton WwTW - WFD P Removal AMP7 (7UU300131 and 7UU200756)'. Please could Ofwat confirm if this approach is acceptable? In this particuar example, we would also insert the more stringent of the two permit levels into the table	
7F	All lines	**Population equivalent units** Please could Ofwat specify the units for the 'Scheme design population equivalent' column? Our working assumption is that this information should be reported in actual PE, as opposed to thousands (000's), in line with guidance in RAG 4.11. We only wish to clarify this unit as we resubmitted our table in the thousands (000's) format following a query from Ofwat in 2021/22.	
7F	All lines	**Transferred flows** For transfer schemes our assumption is that the population equivalent, historic permit and enhance permit will be populated for the site that is being transferred from and not the that of the receiving treatment works and that the Transferred flows (cu.m/d) are the average flows being transferred. Please could Ofwat confirm if this assumption is acceptable?	
11A	1	**Burning of fossil fuels (location-based)** This information is not relevant for scope one emissions. Refer to response to questions 7-9.	14
11A	2	**Burning of fossil fuels (market-based)** This information is not relevant for scope one emissions. Refer to response to questions 7-9.	14
11A	5	**Emissions for land** Suggested amendments to line description. Refer to response to questions 7-9.	14
11A	7	**Total scope one emissions (market-based)** This information is not relevant for scope one emissions. Refer to response to questions 7-9.	14
11A	25	**Purchased electricity; extraction, production, transmission and distribution (location-based) emissions** Further clarification of the line definition required. Refer to response to questions 7-9.	14
11A	26	**Purchased electricity; extraction, production, transmission and distribution (market-based) emissions** Further clarification of the line definition required. Refer to response to questions 7-9.	14
11A	27	**Purchased heat; extraction, production, transmission and distribution emissions** Further clarification of the line definition required Refer to response to questions 7-9.	14
11A	28	**Use of chemicals emissions** Unable to report for 2022/23 but can report in future years. Refer to response to questions 7-9.	14

11A	29	**Disposal and treatment of waste emissions** Suggested amendments to line description. Refer to response to questions 7-9.	14
11A	30	**Total scope three emissions (location-based) emissions** This information is not relevant for scope three emissions. Refer to response to questions 7-9.	14
11A	31	**Total scope three emissions (market-based)** This information is not relevant for scope three emissions. Refer to response to questions 7-9.	14
11A	40	**Emissions reductions from use of insets** Further clarification of the line definition required. Refer to response to questions 7-9.	14
11A	46	**Sewage treatment GHG emissions** Further clarification of the line definition required/suggested amendments to definition. Refer to response to questions 7-9.	14
11A	48-55	**Capital project emissions** Challenge requirement to report, definition and ability to report. Refer to response to questions 7-9.	14

Impact of price control performance to date on RCV (tables 4C and 4U)

The shadow RCV build is not aligned with the Ofwat's PR19 cost reconciliation model, due to two fundamental issues – shadow RCV should take account of the timing of totex and be derived using the total totex over/underspend variance (not the variance due to efficiency only) and the final determination allowed totex should adjust for changes to company's totex baselines resulting from the output of the WINEP adjustment mechanism. Further details of how this could be presented are shown below, along with some additional points.

Line	Issue
4C.1 Final determination allowed totex	This line does not adjust for changes to company's totex baselines resulting from the output of the WINEP adjustment mechanism. We recommend adding two additional lines to this table. The first line would report the adjustments to totex baseline and the second line would show the adjusted baseline position, which would then be compared actual totex to derive the variances in existing lines 4C.7-4C.8. This first line showing the totex baseline adjustments would also need to be separately added to the shadow RCV (existing line 4C.32) to account for the underlying adjustment that will be made as part of PR24. We are currently reporting this as a timing difference in line 4C.7, as per 'RAG query log 2020/21' reference 21.
4C.11 – 4C.14 Customer and company share of totex over / underspend	Shadow RCV should reflect accelerated/deferred spend in any given year in line with the PR19 cost reconciliation model (both the RCV itself as well as the consequential allowed returns on RCV) which takes account of the timing of totex. UUW accelerated over £350m of its AMP7 investment programme in the first 2 years of the AMP to deliver benefits – including improved customer service and environmental benefits. This accelerated spend is reflected in our reported net debt and should also be recognised within the shadow RCV. These lines take the totex over/underspend due to efficiency (i.e. line 4C.8) and multiply by the relevant customer sharing rate. However, the whole total

	overspend (i.e. 4C.6), including any timing differences, should be reflected in shadow RCV. All 4 line definitions should therefore be amended by replacing '4C.8' with '4C.6'.
4U.8 – 4U.11 Green recovery customer and company share of totex over / under spend	The excel proforma has been changed so that these lines take the variance due to efficiency (i.e. line 4U.5) and multiply by the relevant sharing rate. However, the RAG line definitions correctly states that the whole variance (i.e. 4U.3), including timing differences, should be used to derive the impact of Green Recovery on the shadow RCV. The excel table should be aligned to the RAG 4.11 line definition.
4C.23 Actual totex - not subject to cost sharing	The line definition should be amended to include disallowable costs as reported in line 4C.4.
New line: Net proceeds from Land Sales	For completeness and consistency to the final determination, shadow RCV should also include an additional line which reports 50% of 'Land sales – proceeds from disposals of protected land' (as reported in table 2L.1). This total would then feed into shadow RCV under existing line 4C.32.

Financial flows (table 1F)

We recognise the clarifications made to this table, but we believe there is one further adjustment required to ensure that spend in relation to the PR19 innovation is correctly reflected for better alignment to actual shareholder's return.

Line	Issue
1F.10 Totex out / (under) performance	Innovation fund spend should be excluded from totex performance, since there was no expenditure allowance assumed at PR19 (being separately funded through customer revenues). We have already adopted this treatment for 2020/21 and 2021/22 reporting in line with 'RAG query log 2020/21' reference 209 and believe the RAGs should also be updated to reflect this. This could be achieved by adding an extra bullet to the line definition e.g. *'The difference between the actual totex performance versus the amount allowed in the published Final Determination, for the reporting period, adjusted for the following:* • *Timing differences* • *Company sharing ratio with customers* • *Expenditure directly relating to the PR19 innovation fund….'*
1F.11 ODI out / (under) performance	RAG query log 2021/22 clarified the meaning of notional outperformance/underperformance payments as an 'estimate of end of period incentives which may be accrued to date, which should continue to include PCC'. To ensure consistency of reporting, the line definition could be expanded to include PCC as an example of a notional incentive payment.

Reporting of financial instruments (Table 4B)

We appreciated the early engagement on the draft guidance setting out the proposed changes to the reporting of swaps. We are comfortable with the new requirements i.e. splitting out by swap categories in tables 4B and 4I and reporting the maturity split on the fair value of derivatives in table 4V.

However, as outlined in our response to the draft guidance, we do have some concerns regarding the presentation of table 4B, which has moved away from presenting financial instruments on a 'net exposure' basis to presenting individual legs of instruments. The debt and derivatives portfolio is not usually viewed in this way, and we believe this makes it more difficult for users to understand what each instrument is doing and how it is used to manage financial risk within the portfolio.

There is also an inconsistency of reporting, as cross currency instruments are reported on a net basis, in accordance with the guidance which states that these should be 'reported post currency swap characteristics, without splitting out the currency swap lines'.

We would welcome further understanding as to how the information is being used in order to ensure the information provided fully meets the requirements.

Cumulative expenditure - major projects and green recovery (Tables 4F, 4G, 4S, 4T)

Please clarify whether cumulative expenditure in tables 4F, 4G, 4S, 4T should be a straightforward summation of costs for the price control period to date (i.e. in year 2 it would be the sum of 2020/21 and 2021/22 costs), consistent with query UUW-APR-DP-001. If so, remove 'on schemes completed in the report year' from the column header in the excel proforma tables, as this suggest that costs should only be reported when the schemes are completed and come into beneficial use.

Pension deficit reporting (Table 4W)

We strongly endorse improving the transparency of companies' pension deficit reporting and believe the introduction of this new table is an important step towards achieving this. However, to ensure meaningful comparison across the sector, we propose disclosure of four additional assumptions – mortality, inflation, pay and pension increases – along with discount rate assumptions already incorporated in the table. The key assumption being mortality without which it would be difficult to draw any meaningful comparatives across the sector. These assumptions are challenging to incorporate as a single % number in a standard excel format, and as such we would advocate asking for these important assumptions as part of a required narrative disclosure instead.

We would also recommend that the financial assumptions (discount rate, inflation, pay increases) be disclosed in respect of the scheme valuation on an IAS 19 accounting basis given the sensitivity of the valuation of scheme liabilities on an accounting basis to the assumptions used.

Separate to this we would also continue to advocate that pension deficits on an accounting basis should be included in any debt/RCV gearing, FFO to debt, and debt to EBITDA calculations going forward.

Mortality assumptions:

We recommend that mortality assumptions be provided on a quantified basis consistent with what schemes are required to provide in their returns to The Pension Regulator:

	Cohort	Period
Life expectancy for a male aged 65 now	87.00	85.60
Life expectancy at 65 for a male member aged 45 now	88.80	
Life expectancy for a female aged 65 now	88.70	87.10
Life expectancy at 65 for a female member aged 45 now	91.10	

We consider that the 'Cohort' life expectancy is the most appropriate number to disclose as it incorporates a view of long-term improvement of life expectancy, and at a minimum we would recommend that life expectancy for a male and female aged 65 now be included. We believe that presenting information in this way will allow for meaningful comparison between companies.

In addition to this, companies could disclose more detailed post retirement mortality assumptions (including future improvements in mortality assumptions) as part of a narrative commentary accompanying the table e.g. for one of UUW's schemes we would disclose the below:

'Base table: S3PA year of birth tables ("middle" for females) with a weighting of 105%

Future improvements: CMI 2020 with a long term rate of improvement of 1.75% p.a., a smoothing parameter of 7.0, w_2020=0 and A=0.25%'

Innovation fund reporting

For statutory reporting, costs are accrued on receipt of revenue from customers or income from other water companies in relation to the innovation fund. This is to provide for costs that will be incurred on future projects for which we are successful bidders, or for which we will be required to transfer funds to other successful companies.

In accordance with the information notice "IN 22/01 Expectations for monopoly company annual performance reporting 2021-22", we are required to reverse this provision in the regulatory accounts. Only costs incurred on actual innovation projects (as reported in line 9A.22) should be reported in totex within tables 4D and 4E. As such, there is also reclassification of intra-company payment and receipts (facilitated by MOSL) and the administration charge from operating costs to other income. This ensures that the intra-company payments remain within the Income Statement and offset with the revenue collected from customers.

We propose that innovation fund reporting (i.e. the provision reversal and reclassification of intra-company transfers) is listed in RAG 1.09 section 4 as a principal difference to the statutory accounts, to ensure consistency of reporting across companies.

In addition, for completeness and to improve transparency, we propose that two new lines are added to Table 9A, to report the 10% partnership contributions to and from other water companies for leading projects. To ensure consistency with Ofwat guidance that partnership contributions should not be included in totex, these additional lines should follow 9A.24 - which currently feeds through to table 4C (and which exclude the 10% partnership contributions).

Peak week production capacity having enhancement expenditure for grey/green solution improvements to address raw water quality deterioration (Table 6A lines 29 and 30)

Further clarification is required of the line definition.

a. Should we report the total PWPC for WTWs with enhancement expenditure for grey/green solution improvements expenditure to address raw water quality or;
b. the increase in PWPC associated with the enhancement expenditure for grey/green solution improvements expenditure to address raw water quality.

If the latter is required it is not always possible to determine the increase in PWPC associated with the enhancement expenditure. In some instances expenditure is to address deterioration in raw water quality to reduce the risk of PWPC reductions. Some of the AMP7 expenditure to address raw water quality deterioration is to address water quality contacts rather than reductions in PWPC.

1.2 Other administrative issues identified

Table	Line	Issue
1D	6	Line definition should reference line 2B.14
1E	2	The formula in the excel proforma is currently linking to the line description (cell C43) and not the 'Total appointed activities' column (cell J43) of line 1C.28.
2B 4D 4E	2B.13, 2B.20 4D.5, 4D.12 4E.5, 4E.12	Definitions for the 'third party services' lines should be updated to clarify that developer services third party expenditure is excluded, to avoid a double count, as already reported within the developer services expenditure lines (e.g. 2B.11).
4C	2, 23	Line references to costs excluded from cost sharing should be updated to reflect the revised tables. E.g. Non-section 185 diversions should refer to 4P.12 (not 4P.4), innovation fund spend should refer 9A.24 (not 9A.20).
4C	24	The calculation 4C.23 less 4C.22 in the excel proforma is correct (to ensure overspend is presented as a positive value). Minor correction to the line definition which states 4C.22 less 4C.23.
4D	2	Line definition should reference line 4L.115
4D	10	Line definition should say 'Total developer services capital ~~operating~~ expenditure including third party capex. This line should equal line 4N.6 (capex) plus 4P.4 (water resources and water network+).'
4D	9	Line definition should reference line 4L.114
4H	7, 8	The formula in the proforma is 2I.20 - 2C.18 - 2C.19 divided by 2C.18 + 2C.19 + 2I.16, whereas the line definition states 2I.20 - 2C.18 - 2C.19 divided by 2I.16 + 2I.20. The same applies to 4H.8.
4H	15	The line definition should be updated to reference the cash interest paid element of 1D.10, consistent with the calculation of adjusted interest cover (line 4H.16).
4L	66	Total metering expenditure does not include new additional lines (4L.56, 4L.59, 4L.62) in the excel proforma.
5A	18	The consultation says the line definition has been updated for clarity however it does not appear to have changed except 'Sum of lines 5A.9 and 5A.10' has been deleted. Please confirm this is the only change. The description still reads as though it is a sum of 5A.9 and 5A.10.
6A	28	Our understandiung is that this would be the same as PWPC reported in 3F.20. If this is the case, then confirmation of this would be helpful; if not, then it would be helpful to identify the difference.
6B	30	This should be a calculated cell
6B	38	This should be a calculated cell
6B	58-67	Line descriptions in RAG 4.11 for 6B.58-67 reference incorrect lines.
6B	59	Line description is '87' this should be 'Distribution main losses' to align with RAG 4.11.
6D	23	RAG 4.11 definition includes reference to 6D.16 this needs to be updated to 6D.22 to align to the latest tables.

Consultation question 2

Is reporting the average time of low pressure feasible for the 2022-23?

We assume the average time of low pressure relates to the average time properties receive low pressure within the reporting year rather than the average time the properties reported at risk of low pressure at year end received low pressure.

We are able to identify incidents of low pressure that last 15 minutes or more and the number of properties affected therefore could calculate an average time of low pressure. We assume that exclusions are consistent with the PR19 common definition for properties at risk of receiving low pressure.

Consultation question 3

What resource is required to report this information initially and on an ongoing basis?

We are able to abstract the information from our system however manual intervention is required to calculate the average time of low pressure. If this was an ongoing reporting requirements we would look to systemise this which would have an associated cost. Further guidance on the definition is required to establish the resource implications of reporting this line. Additional resource would be required for data validation but the scale is difficult to estimate without further clarification on the definition.

Consultation question 4

Do you think that reporting both
• the number of properties below the minimum standard of pressure; and
• the average time of low pressure
provides useful information?

It may be useful for some companies with poor pressure performance to report the average time of low pressure. However we feel additional effort on measurement should be focused on key outcomes for customers and the environment where performance improvements are most required. On this basis, from a UUW perspective, the benefits of reporting average time of low pressure would not warrant the extra resources required. We consider it would be more proportionate and better targeted to apply measurement efforts elsewhere.

Maintaining the existing high standards of water pressure remains important to us and we continue to steadily address this issue. To enable the analysis of operational resilience at the same time we support inclusion of the number of properties below the minimum standard of pressure in the Annual Report. Companies report this performance on the Discover Water website later in the year and it is information that companies have reported historically and therefore is likely to be reported consistently.

The vast majority of companies are delivering high levels of compliance with the statutory standard. Most companies therefore only have a small number of properties that are at risk which will reduce further by 2025 if the current performance trend continues. There are already GSS payments for customers that receive poor service and, to some extent, companies have incentives to provide good service through other PR19 PCs such as C-MeX.

The number of properties at risk of poor pressure is a better measure of poor pressure than the average time customers experience poor pressure. The time most properties fail pressure standards is at peak demand in the morning, often only for a short period of time therefore the average time receiving low pressure could be misinterpreted as insignificant. In our view, the peak demand time is when customers require water to get ready for work, school etc. is important, so even short durations of poor pressure at this time can represent a significant service issue for customers. This is not picked up by an “average duration” measure.

In some circumstances (under section 65 of the 1991 Water Industry Act), companies do not have a duty to provide customers with a constant supply of water under pressure (usually because the properties cannot be supplied by gravity, from an existing Service Reservoir). In 2021/22 we had 176 properties at risk of receiving poor pressure and 50 of these properties fall under section 65 of the Water Industry Act. These properties are included in the number of properties at risk of receiving poor pressure. However, if they were included then they would distort the “average time” measurement of low pressure. Therefore, if an “average time” measure is to be used, then this should be defined and calculated in a way which makes clear that properties covered by s65 of the Water Industry Act should be excluded.

Consultation question 5

Do you have any comments on our approach to continue to align the GHG reporting requirements to the latest version of the Carbon Accounting Workbook?

We welcome ongoing alignment between annual regulatory reporting of GHG emissions and the sector's Carbon Accounting Workbook (CAW). There is a lead time to raise and effectively implement potential needs of the next update to the CAW.

The industry continues to collaborate through UK Water Industry Research (UKWIR) to maintain a cutting edge CAW that supports effective and consistent GHG reporting. The CAW has historically been updated annually with latest emissions factors and any agreed methodology changes. The update is a substantial and technically precise process led by an industry carbon working group with expert consultancy support. The typical timeline for the update is for change requests to be agreed no later than December, to allow an updated CAW ready for user testing around early March, and finalisation ready for use in annual reporting in April and May. This means that the changes requested in this consultation cannot practically be delivered in the current update to the CAW and will need to be considered in the next round. Therefore, for annual reporting this year, companies will be able to use the functionality in the latest version of the CAW (v17), see also our response to question 7 below. We do not recommend fast paced workarounds outside the CAW by individual companies because they cannot be as robust or consistent.

For AMP8, the water industry has discussed the need to develop a new reporting tool alongside the CAW to support reporting for the new common operational GHG Performance Commitments (PCs). We expect the new tool will be aligned with the version of the CAW in place at the Final Determination. To evaluate the impact of management interventions in PC reporting, the new tool will use a static set of methodologies and emissions factors. Separately, to support up to date annual performance reporting of GHG emissions, the CAW will continue to be revised each year with latest emissions factors and agreed changes to accounting methodologies. Please see further details in our parallel response to the GHG PC definition consultation.

Consultation question 6

Do you have any comments on our reporting guidance for GHG intensity ratios?

As referenced in our PR24 draft methodology response in September 2022, as an industry we have reported for many years using the normalising units of emissions per megalitre (Ml) of treated water, and per Ml of sewage treated. We agree that a similar unit is appropriate for ongoing sector reporting.

We suggest that the terms for “treated water” and “sewage treated” should use the relevant APR table references for the water and wastewater volumes to ensure that there is no ambiguity. We interpret Ofwat’s intention is that Distribution input (water) is the value captured in cell reference 6B.4 and Volume of wastewater received at treatment site is as captured in cell reference 7C.13.

To avoid unfairly benefitting or penalising companies when setting GHG PC targets, we recommend that it will be necessary to recognise regional factors that will be material to performance, such as the operational emissions impact of a different size Water Industry National Environment Programmes (WINEP) and differing geographies, such as those companies serving a large proportion of rural areas. For instance, where water is sourced from surface waters this needs more distribution and treatment inputs and transport for maintenance and operations.

Consultation question 7

Do you have any comments on the proposal to expand the scope of mandatory reporting for operational GHG emissions?

We support the intention to expand the scope of operational GHG emissions reporting in the APR, and thus what might be in scope for the common operational GHG emissions PCs, but we have concerns with the speed of mandatory reporting and of the some details in the proposal. More clarity is required and we set out below a suite of considerations and recommendations to help ensure an effective approach.

We have summarised our concerns in the below table, and provide more detailed explanations underneath.

Topic area	Consultation proposal APR table 11 reference	United Utilities response summary
Chemicals	Line 11A.28 Use of chemicals	The functionality in v17 of the CAW is not sufficiently defined or accurate to support consistent and reliable reporting of chemical emissions between companies this year. UU can report an estimate of chemicals emission from our annual spend-based scope 3 assessment, but for sector consistency we propose that mandatory reporting is postponed until 2023-24 when an updated CAW and guidance documentation is available. We also suggest the line should be retitled 'Line 11A.28 Chemical products' to remove the implication that it is the use of chemicals that causes GHG emissions rather than their production. Please see further explanation in **'Chemicals'** section below.
Waste generated in operations	11A.3 Process & fugitive emissions (existing line) 11A.4 Vehicle Transport (existing line) 11A.5 Emissions from land (new line) 11A.24 Outsourced activities (existing line, no change) 11A.29 Waste generated in operations (new line)	Our interpretation is that we are required to report emissions relating to the transportation, treatment and disposal of sludge by United Utilities or a third party. We will continue to do this using the appropriate GHG Protocol scopes. For further explanation and mapping of the activities to GHG Protocol categories, please see '**Waste generated in operations'** section below.
Fuel and energy-related activities	11A.25 Purchased electricity; extraction, production, transmission and distribution 11A.27 Purchased heat; extraction, production, transmission and distribution	We propose that the relevant lines in Table 11 are renamed to: 11A.25 Purchased electricity; Well to tank and Transmission & distribution 11A.27 Purchased heat; Well to tank and Transmission and distribution Please see further explanation in **'Fuel and energy related activities'** section below.

Chemicals

We support Ofwat's aspiration to improve the reporting of chemicals emissions but further work is required by water companies and the chemicals supply chain to enable consistent and meaningful reporting suitable for a mandated approach. We recommend that the reporting of emissions associated with chemicals is incentivised voluntarily for 2022-23,accepting a greater level of uncertainty. We also propose that Ofwat and the sector collaborate as a priority to develop the necessary detail and supporting tools, starting with a standardised list of chemicals that should be accounted for and capturing best available information.

In 2020, United Utilities introduced a new capability to annually estimate the emissions from the chemicals used in our operations, recognising this was an area of our carbon accounting that needed more attention. This is part of the scope 3 assessment we disclose in our annual report and financial statements, and in our APR. Whilst amongst leaders in this area of carbon reporting, our estimate of chemicals emissions is currently low confidence and it relies on a spend based, rather than volume based, methodology with various assumptions and estimates.

In addition, the sector has established rudimentary functionality on chemicals in the CAW. This functionality of the CAW is also currently low confidence, primarily because there is limited availability and quality of emissions factors for chemical products. Further work is therefore needed to adequately define effective and consistent approaches to support industry comparison in the APR and/or the operational GHG PCs.

In recent months we have been engaging with our chemicals suppliers and distributors to develop our shared understanding of chemical emissions. What has become apparent is the complex nature of supply chains for both raw materials and pre-prepared products, and therefore the challenge in developing emissions factors. We want to transition from a spend based calculation to a volume based approach using published generic emission factors as a minimum, and bespoke formulation specific emission factors where possible. However we recognise this is a substantial task that will take time and collaboration to progress. We are now focusing on key chemicals like ferric sulphate and sodium hydroxide, and will engage with the water industry towards a transparent and reliable approach that includes common principles and assumptions.

The boundaries of "*emissions associated with the production of chemicals used in water and wastewater processes*" require detailed definition to achieve consistent reporting by companies. As part of our ongoing collaboration, companies should, in agreement with Ofwat, determine a consistent approach including definitions for:

- What is included within the definition of chemicals e.g. in liquid, solid or gas form.
- A standard list of chemicals to be included, and a mechanism to deal with any chemicals that may be missed or become relevant.
- The emissions factors for each chemical, recognising variation in volumes, concentrations and formulations.
- Which emissions are included within the emission factor. We propose alignment with the Corporate Value Chain (scope 3) Accounting and Reporting Standard which requires a minimum of cradle-to-gate emissions for scope 3 category 1 products and services such as chemicals. Cradle-to-gate would include raw materials, production and transportation emissions of the raw materials and product.

National government actions could also help improve the availability of emissions factors for chemicals, for example with the introduction of frameworks, standards and requirements for chemicals suppliers and their supply chains to develop and make available consistent and robust emissions estimates of chemical products. This would be beneficial beyond the water sector.

Waste generated in operations

We support reporting emissions from the treatment and disposal of waste generated in their operation, focused on bioresources, as set out in section 13.15 of this consultation. However, further clarity is required to ensure consistent reporting between companies.

In our annual reporting, United Utilities reports emissions from all waste generated in operations as per the GHG Protocol, ISO 14064 and guidance from the Science Based Targets initiative (SBTi). This has a broad definition and includes office waste, hazardous waste and construction waste, as well as sludge disposal. Based on the activities mentioned in the consultation, our interpretation is that "waste generated in operations" refers only to sewage sludge waste. We also interpret the consultation to mean that companies will be required to report all the emissions relating to the transportation, treatment and disposal of sludge, regardless of whether it is carried out by the appointed business of United Utilities Water, or a third party.

United Utilities already publishes the emissions from sludge transportation, treatment and disposal in its annual report, in line with the definitions in the GHG Protocol. Sludge treatment and transport is reported as scope 1 if carried out by United Utilities and as a scope 3 emission if by a third party. Sludge disposal is always a scope 3 emission regardless of the party doing the disposal, and in the case of recycling to land, who owns the land.

For the avoidance of doubt we have set out in the table below the six sludge related activities, the GHG categorisation that applies, and suggested clarifications to where these emissions should be reported in Table 11.

Table 1 Sludge transport, treatment and disposal activities aligned to GHG protocol scopes and categories

Activity	Party	GHG Protocol Scope and Sub-category	APR Table reference (as per consultation)	Suggestion to align to GHG Protocol and CAW
Sludge transport	Company	Scope 1 Transport: Company owned and leased vehicles	11A.4 Vehicle Transport	11A.4 Transport: Company owned and leased vehicles
	3rd party	Scope 3 Category 4 Upstream transportation and distribution	11A.24 Outsourced activities	11A.24 Outsourced activities *
Sludge treatment	Company	Scope 1 Process & fugitive emissions	11A.3 Process & fugitive emissions	11A.3 Process & fugitive emissions *
	3rd party	Scope 3 Category 1 Products and services	11A.24 Outsourced activities	11A.24 Outsourced activities *
Sludge disposal (to land or otherwise)	Company	Scope 3 Category 5 Waste generated in operations	11A.5 Emissions from land **	11A.29 Emissions from biosolids disposal *
	3rd party	Scope 3 Category 5 - Waste generated in operations	11A.29 Disposal and treatment of waste	11A.29 Emissions from biosolids disposal **

* These values cannot be reported separately, consistently and directly using CAW v17 for the FY22/23 year because further work will be required following the outcome of this consultation. For example, to report sludge treatment emissions separately from other process emissions, or to distinguish sludge related outsourced activities from others, would require additional calculations to populate the additional lines in the APR table. The

functionality to do this could be delivered in the next version of the CAW for reporting on the year 2023/24. The consistent population of this data would require companies to capture relevant source data from their third parties from April 2023.

**This could be better defined as 'Emissions from biosolids disposal' which if disposed to land is a scope 3 not scope 1 emission, regardless of the owner of the land.

Fuel and energy related activities

We agree with Ofwat's proposal to include emissions on fuel and energy related emissions within the operational GHG PC but we would like to ensure that our interpretation of this proposal is consistent with Ofwat's intentions.

Our interpretation is that "*purchased electricity and heat: extraction, production, transmission and distribution*" refers only to "*transmission & distribution*" and "*well to tank*" emissions for electricity and heat respectively and that it excludes "*well to tank*" emissions relating to liquid fuels such as diesel. We would propose that the lines in consultation section A3 (section 11A) are renamed as set out below:

Relevant Emissions Proposal	Suggested Alternative
11A.25 Purchased electricity: extraction, production, transmission and distribution (location-based)	Purchased electricity: well to tank & transmission and distribution.
11A.26 Purchased electricity: extraction, production, transmission and distribution (market-based)	Remove line – not needed as scope 3 emissions do not distinguish between market or location based methods.
11A.27 Purchased heat: extraction, production, transmission and distribution	Purchased heat: well to tank & transmission and distribution.

Other – emissions reductions

We support the inclusion of reductions achieved through the export of renewable energy, subject to retention and retirement of energy attribute certificates, and the inclusion of insets linked to the implementation of nature-based solutions. We do not support the inclusion of a limit on recognition for insetting in AMP8, although this could be appropriate in the longer term.

Please see further details in our response to the consultation on operational GHG PCs.

Other – changes to reporting methodologies

More detail on the definitions and reporting methodologies for the different relevant operational GHG emission categories would aid consistent and transparent reporting.

Please see further details in our response to the consultation on operational GHG PCs.

Consultation question 8

Do you have any comments on the introduction of our mandatory framework for the reporting of embedded emissions?

We have been improving our capability in the estimation of the GHG emissions associated with our capital programme to ensure we are in a strong position for PR24 and AMP8. We support the aim for the sector to have consistent and mature reporting on 'embedded' emissions to shape more effective and sustainable decision making. However, we do not believe the proposed approach will effectively support this aim, or that effective and comparable sector reporting can be achieved for the upcoming APR. We explain our concerns and provide recommendations below.

To secure a consistent and meaningful report of 'embedded' emissions, we recommend that Ofwat and the sector work together to clarify and align their position on two distinct approaches that serve different purposes:

1. The annual assessment and reporting of all relevant scope 3 emissions in line with the GHG Protocol, as an expansion of the sector's long standing reporting of 'operational' emissions. United Utilities has done this annually since 2020, and openly discloses the results in the annual reports.
2. The reporting and management of 'embedded' emissions in asset and infrastructure programmes to further mature decision making for sustainable long term goals, using Publically Available Specification 2080 (PAS 2080). United Utilities also does this, with details disclosed in our recently published plans for water resources, drainage and wastewater, and in our Water Industry National Environment Programme (WINEP). We will also include more details in our upcoming PR24 submission and Long Term Delivery Strategy (LTDS).

Both of the above activities are relatively new and evolving areas of reporting for any organisation and we are working to continually improvement over time.

To achieve an effective approach on the reporting and management of embedded emissions in asset and infrastructure programmes, we suggest the sector, including Ofwat, the Environment Agency and the Tier 1 supply chain collaborate to:

- Consistently measure and report whole life GHG emissions associated with delivery programmes, not an arbitrary annual snapshot.
- Mature a consistent approach to whole life carbon assessment throughout the sector's infrastructure planning regime, underpinned by PAS 2080.
- Implement the water industry vision described in the Framework - Whole Life Carbon management in the Water Sector[1], in time to shape and support PR29 (i.e. ready in the first half of AMP8).

For this year's APR we recommend that Ofwat incentivise companies to voluntarily:

1. Report on their scope 3 emissions as far as each company is able, including a break down by the categories of the GHG Protocol that would therefore include Purchased goods and services, and Capital goods.
2. Use the SWOT narrative to summarise their approach to measuring scope 3 emissions and integrating consideration for whole life GHG assessment within infrastructure planning.

[1] UKWIR, Calculating Whole Life/Totex Carbon, 2022.

Application of frameworks and terminology

Alignment with best practice definitions, standards and frameworks is needed to ensure consistent and credible reporting on embedded and scope 3 emissions. The frameworks and terms below underpin our approach as an organisation and a sector. We therefore recommend Ofwat's proposed approach for the sector is closely aligned to these frameworks and terms, with a clear distinction between the purposes of each element.

These two frameworks serve different purposes and are parallel but distinct activities:

> **Publically Available Specification 2080 (PAS 2080)** is a global standard for managing infrastructure GHG emissions. It provides a method and guidance to estimate GHG emissions for an asset or infrastructure component for a defined lifetime (e.g. 60 years). PAS 2080 refers to lifecycle stages and modules rather than time periods. It describes how carbon assessments are ideally undertaken early in the investment lifecycle to help promote lower carbon solutions.
>
> **The GHG Protocol Corporate Standard** is the global standard for estimating and reporting annual emissions by an organisation or a geographic area. Emissions from purchased goods and services and capital goods are two of the fifteen specified scope 3 categories in the Protocol.

When Ofwat refers to 'embedded emissions', we think it is important to distinguish the following two definitions from PAS2080 to support clarity and consistency. The UKWIR report Calculating Whole Life / Totex Carbon 2022[2] describes:

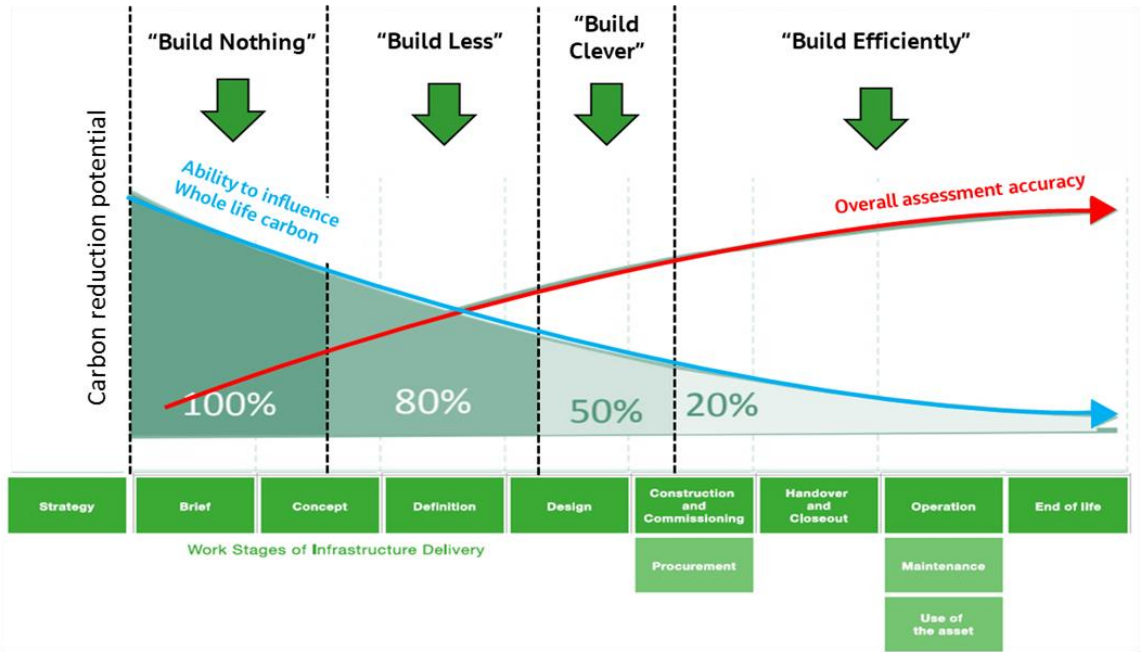
> **Capital carbon** - the GHG emissions associated with the creation, refurbishment and end-of-life treatment of an asset. Note: The term capital carbon is being adopted in the infrastructure sector as it accords with the concept of capital cost. The related term 'embodied carbon' will continue to be used at a product or material level whereas capital carbon will have greater relevance at an asset level.
>
> **Embodied carbon** - the GHG emissions associated with the extraction and production of materials and products, including the energy use in production.

Proposed annual reporting

Annual reporting of scope 3 emissions aligned to the GHG Protocol is a valuable exercise that we support and already undertake. But we do not believe annual reporting is appropriate or practical for embedded emissions in asset and infrastructure programmes as the consultation proposes. These emissions are associated with the delivery of capital projects and programmes, which typically runs over several years from design to completion. Therefore, an annual disclosure would give an unrepresentative view of an arbitrary snap shot of a project lifecycle. We recommend that embedded emissions are most usefully reported and compared, as part of whole life emissions, to a counterfactual e.g. a notional project or the design vs the delivered impact. In this way, it becomes possible to influence decisions based on whole-life GHG emissions and long term sustainability. This aligns closely with the sectors existing Price Review and strategic planning processes.

[2] UKWIR, Calculating Whole Life/Totex Carbon, 2022.

Figure 1 below illustrates how the earlier in the investment lifecycle carbon assessments are included the greater the carbon reduction potential. We observe substantial value in escalated consideration for the GHG emissions in the sectors infrastructure programmes and choices, especially at the early stages of planning.



We have found the need to improve data capture and reporting processes across the supply chain and also that these emissions will fluctuate markedly year on year because of the cyclical nature of investment programmes in the water industry. Normalisation with expenditure or scope of service, is therefore likely to be appropriate and valuable to stakeholders. We would welcome the opportunity to explore this further with Ofwat and share the learning from our studies.

Consultation question 9

Do you have any comments on distinguishing between construction and maintenance activities for the reporting of capital project emissions?

To support consistent and effective reporting, we recommend Ofwat and the sector work together to create a detailed reporting definition to clearly delineate the lifecycle stages of construction and maintenance activities and capital project emissions.

A consistent methodology is required to quantify all stages of whole life carbon across the infrastructure delivery programme so that carbon reductions can be made across the entire value chain. We set out in our answer to question 8 the need to follow best practice frameworks and terminology. We recommend PAS 2080 for estimating and reporting capital carbon where capital carbon is the GHG emissions associated with the creation, refurbishment and end-of-life treatment of an asset.

Figure 2, below, outlines the PAS 2080 carbon management lifecycle stages and modules, with the construction process stage as modules A4 and A5, and including emissions from transportation (including intermediate storage and distribution of products/materials and construction equipment) and the construction installation site. Maintenance is just one part of the use stage (B1 – B5) which comprises as emissions arising from works activities and new materials for the maintenance, repair, replacement and refurbishment of the infrastructure during the use stage / operation of infrastructure.

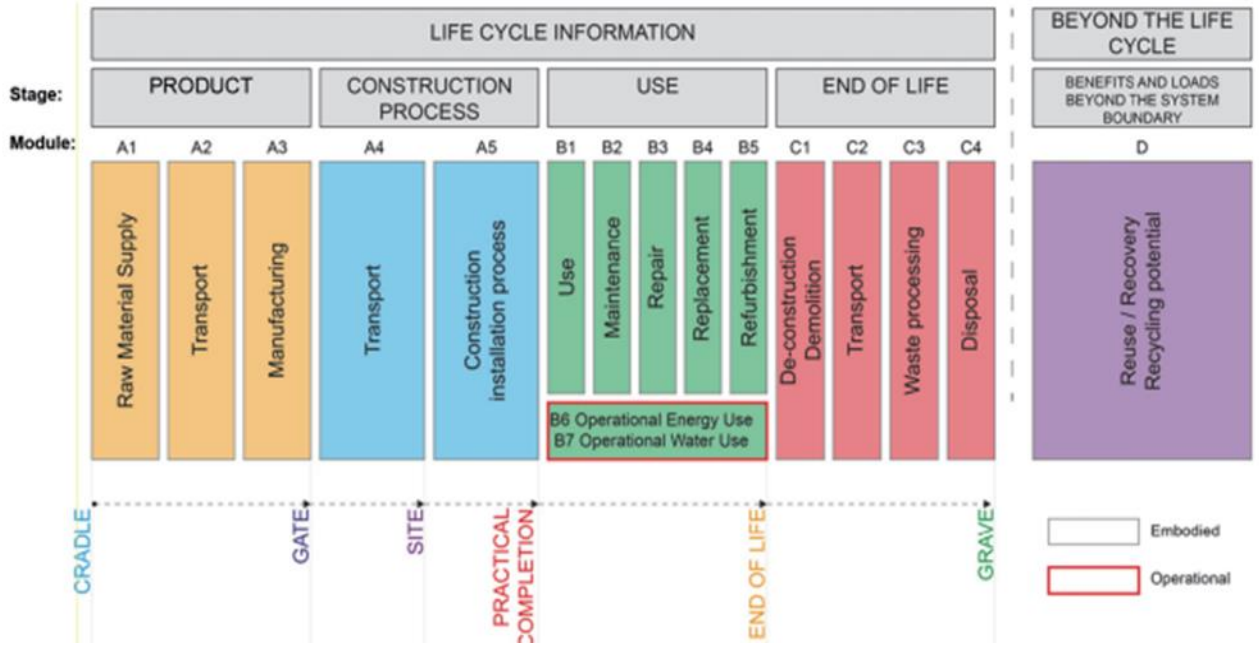


Figure 2 – PAS 2080 carbon management lifecycle

The consultation references:

- cradle to gate (PAS 2080 modules A1, A2 & A3),
- cradle to build or up to commissioned (modules A1, A2, A3, A4 & A5), and
- maintenance (module B2).

We recommend Ofwat and the sector work together to create a detailed reporting definition to clearly define and delineate the lifecycle stages of construction and maintenance activities and capital project emissions.

If what is required is to report emissions up to the "point it is commissioned" (para 13.21 bullet 1) then this excludes GHG emissions associated with refurbishment and end-of-life treatment of an asset and thus maintenance activities. Please confirm if our interpretation is correct that the intent is to include reportable

emissions in only construction modules A4-A5 and exclude maintenance module B2 for as the maintenance of infrastructure assets occur during the operational life of a project, once the construction stage has completed and after the asset has been commissioned.

We also note the intention for companies to break down GHG emissions from capital project construction activities into base and enhancement expenditure. Our interpretation of Ofwat's intention here, is for emissions from the construction process (defined as modules A4 and A4 in PAS 2080) to be reported for capital projects funded by either base or enhancement spend. This would be possible on an annual basis using a spend based approach but for the reasons stated in our response to Question 8 above we do not believe a distinction in this way would be useful.

Consultation question 10

What are the key challenges that need to be considered and addressed in introducing a rating system designed to facilitate increased standardisation and continual improvement in the reporting of embedded emissions?

We support this idea but think it unrealistic to complete in the APR in 22-23. Below, we include questions about how this approach might work and we make recommendations for matters that need consideration and resolution in advance of implementing a rating systems. It will be important to define a common framework, including definitions, standards and terminology.

Questions and considerations

1. Is this rating system only related to the reporting of "embedded" GHG emissions, rather than also operational GHG emissions? *Our recommendation is that the rating system covers all emissions to be more reflective of company's net zero position.*

2. Is the aim of the system to assess the maturity of accounting and reporting practices, rather than performance in managing those emissions? *Our recommendation is that the system only reflects maturity, with performance separately covered by the new PCs.*

3. Who will be doing the categorisation stated in 13.25: "companies reporting practices will be categorised as green, amber or red depending on certain core criteria."? Will it be a self-assessment by companies, or by Ofwat, or an independent third party? *Our recommendation is that this is completed by companies, similar to the approach taken for AMP6 RAG assessments against common ODIs.*

4. What evidence will be required to enable the assessor to decide the appropriate category for each company? Will companies would have to provide justification of how they are not fully compliant with the new rating system and then steps on how this will be addressed, as done for the AMP7 common ODI's. Would this be within the APR or in a separate report? *Our recommendation is that companies provide high level evidence to support their proposed position.*

5. Will there be any incentives or consequences for higher and/or lower performing companies? *Our recommendation is that this is for information only and penalty and reward remains linked to AMP8 performance commitments.*

6. Please can Ofwat clarify their expectation that the rating system and reporting requirements will evolve over time? *We consider that in order to aid the objective for "the emergence of standardised and consistent reporting on embedded emissions by PR29" it would be beneficial to define the vision for the accounting and reporting practices by a set date, and then rate the levels of progress towards achieving that vision.*

Recommendation

A successful rating system will use and encourage established and emerging best practice, including unambiguous terminology. For example, if the vision is to have comprehensive, consistent and verified annual GHG accounts related to regulatory activities, then the GHG Protocol is the recommended standard around which the rating system could be designed. We would recommend that the rating system mirrored the terminology and methods used, and introduces a hierarchy of expectations with supporting evidentiary requirements.

Consultation question 11

Are there are any particular frameworks or approaches our traffic light system should consider in determining differing levels of progress and what expected progress should look like?

We suggest that the primary framework should be the UKWIR Framework for Wholelife Carbon Management in the Water Sector[3]. This builds on the UKWIR framework for accounting for embodied carbon in water industry assets (2012)[4]. We would also recommend, as referenced in our previous answers, that PAS 2080:2016[5] carbon management in infrastructure should also be considered for wholelife carbon assessment.

The UKWIR framework is designed to maximise the potential for minimising the carbon emissions associated with the water industry's investments and activities, allowing organisations to apply it effectively whatever their current level of maturity in carbon management. Determining levels of progress can then be directly assessed using the four objectives and the 12 principles set out on page 30 of UKWIR's calculating whole life/totex carbon (2022) document, "W*hole life carbon accounting 'framework-on-a-page*". This is summarised in Figure 3, below.

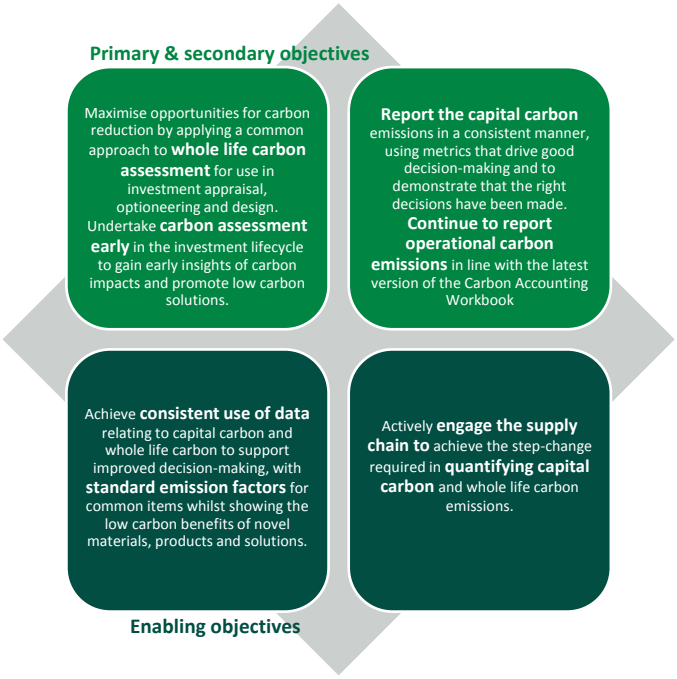


Figure 3 – Whole life carbon accounting objectives

[3] UKWIR, Calculating Whole Life/Totex Carbon, 2022.

[4] UKWIR (2012) A Framework for Accounting for Embodied Carbon in Water Industry Assets

[5] PAS 2080:2016 Carbon Management in Infrastructure.

Consultation question 12

Do you have any comments on requesting a SWOT analysis that covers both operational and embedded emissions?

We voluntarily completed the SWOT for the last two years' and find this provides companies the opportunity to summarise progress and challenges in their carbon accounting and reporting.

Consultation question 13

Do you have any comments on our proposed changes to disclosures in the Statement on dividend policy and explanation of dividends paid set out in RAG 3?

We support improving the transparency of dividends disclosures and consider that we already satisfy these requirements. We clearly set out our dividend policy approach and conditions for when we would pay dividends, including a number of additional considerations across a broad range of stakeholders (including customers and employees) who have interests in the performance of the company.

Consultation question 14

Do you have any comments on our proposed changes to disclosures in the Statement on executive pay and performance set out in RAG 3?

We have no comments about the amended requirements contained in RAG 3 on the disclosures to be provided as part of the statement on executive pay and performance. We already provide extensive and transparent disclosures in this area and are supportive of moves to improve reporting standards overall.

Additional comments not covered in the above questions

We have separated our additional comments into three sections:

- Key issues with 2022-23 regulatory reporting which have been raised in prior consultations, that we feel have not been reflected in the latest version of the regulatory accounting guidelines and of which we continue to hold these views;
- Key considerations for PR24 and beyond; and
- Other issues with the proforma tables

Key issues with 2022-23 regulatory reporting:

Leakage enhancement expenditure (Table 4L)

Consistent with the principles outlined in our consultation on 'Impact of historical enhancement allowances on performance trends', we disagree with the definition that leakage enhancement expenditure should only be recorded in table 4L by companies who were allocated leakage enhancement expenditure in the PR19 final determinations.

Although an enhancement allowance for leakage has not been allocated in our PR19 final determination, we have still incurred leakage expenditure which meets the definition of enhancement expenditure 'Enhancement expenditure is generally where there is a permanent increase or step change in the current level of service to a new "base" level and/or the provision to new customers of the current service level.'

This expenditure does not meet the definition of base expenditure which refers to 'maintaining the current level of service'. At PR19, we also claimed that meeting stretching leakage targets in AMP7 would require enhancement expenditure – the fact that Ofwat did not allow UUW to recover those costs as (additional) enhancement expenditure does not lessen the validity of these costs being enhancement expenditure. Our approach is also consistent with CMA's position on leakage enhancement expenditure.

Direct Procurement for Customers (DPC)

Whilst RAG 1.09 section 4.19 sets out that lease accounting is to be excluded from the regulatory accounts, we believe it would be beneficial to expand this to be more explicit in stating how companies should exclude the DPC impacts i.e. excluded from all APR tables via an adjustment to the primary statements.

To ensure adjustments are made on a consistent basis and are transparent, the primary statements (i.e. tables 1A-1D) could be expanded to include a new separate adjustments column (next to the statutory to regulatory adjustments column) called 'Direct Procurement for Customers' to separately report the DPC impacts which could then be deducted from the 'Total appointed activities' column. This would ensure all intended DPC impacts are excluded from the reported regulatory numbers in the section 2-4 APR tables

RAG 3.14 could also be amended to require companies to include a brief narrative in the APR explaining the adjustments for DPC (particularly if there is no separate column for DPC impacts in tables 1A-1D).

<u>Advance purchases classified as non-appointed</u>

As part of the Haweswater Aqueduct Resilience Programme (DPC project) UUW is purchasing land and other assets in advance to support this project. UUW will be reimbursed for these items by the CAP (once appointed) and this will ultimately be funded by customers through the unitary charge mechanism. As such, in order to ensure this spend is not inadvertently also captured within appointee totex, which feeds the cost sharing mechanism, it was agreed with Ofwat that this spend would be classified as non-appointed within the regulatory accounts. To ensure consistency of reporting across the industry, we would propose the income categorisation table in RAG 4.11 appendix 1 is expanded to list within non-appointed activities 'Advance purchases in relation to Direct Procurement for Customers which are separately funded through unitary charge mechanism'.

Reporting of revenues – Table 2I

Companies are now required to report actual revenues against the four wholesale price controls within table 2I. It would be helpful if Ofwat would clarify its expectations on how it expects companies to split revenues. For example, this could be done:

- by allocating simply based on PR19 allowances (very quick and easy to do); or
- based on a separation of charges between price controls which may be expected to reflect the separate build-up of charges (i.e. recognising the cost of providing the separate services and the consumption of those services by customers), particularly with the evolution of competition in Bioresources. This would require changes to the charges guidance, as Ofwat does not currently require companies to establish separate charging arrangements for the four wholesale price controls.

We do not have a strong preference about which approach should be taken, but we do believe that clarity is important to ensure consistency of reporting across companies. Current ambiguity could also lead to unnecessary time spent setting and monitoring charges to report the resultant revenue allocations down to a more granular price control level.

Rechargeable works

We appreciate your response to our query raised as part of the '2020-21 RAG query log', reference 24, regarding the classification of rechargeable works, however we do not agree that rechargeable works should be classified as 'Third party services, Income governed by price control'.

At PR19, revenue from rechargeable works was classified as sitting outside of the price control (consistent with PR14), and subsequent financeability assessments underpinning the Final Determination were made on that basis. This in-AMP change to the classification of revenue was not specifically highlighted or justified in the 2020-21 RAGs consultation.

Classifying rechargeable works' revenue to be inside the price control removes a company's incentive to recharge the responsible party (e.g. in the instance of a third party damaging a company's asset). Whilst the incumbent could recharge the costs of the damage to the party responsible, being now inside the price control would mean that this action would not result in additional revenue overall, but instead other customers would simply pay less by a commensurate amount to ensure no over-recovery of price control revenue.

We do not believe this is the correct treatment for costs of this nature, and therefore suggest rechargeable works are reclassified back to 'Third party services, Income not governed by price control', aligned to the PR19 final determination classification.

FFO / Debt (Table 4H)

We expect 'FFO / Debt' (line 17) within Financial Metrics (table 4H) is likely to be interpreted by users as mirroring the ratings agencies' calculations. Whilst we recognise that Ofwat has stated that its approach will differ to the credit rating agencies, we still consider it would be more appropriate that this ratio is calculated based on Standard & Poor's methodology to ensure consistency in the calculation of this metric. The key difference is that FFO should be calculated after deducting all underlying interest, not just cash interest as per the 'Funds from operations (FFO)' (line 14) definition. Net debt should also include any reported pension deficit. An additional sentence could be added to the existing line definition so it reads:

"Ratio of FFO to net debt. FFO as per line 14 less interest charge for the accretion of index-linked debt. Net debt as per line 1 plus any reported pension deficit (as per table 1C, line 24). We acknowledge that our approach to calculating this differs from some of the methodologies applied by the credit rating agencies."

External sewer flooding – company reactively identified incidents

External sewer flooding is scheduled to become a common performance commitment in AMP8. With regard to correctly identifying all customer properties that have flooded externally, Ofwat state in the external sewer flooding PC definition document (Final methodology, December 2022):

'*The company is expected to be able to demonstrate that the processes that it has in place are applied consistently in relation to similar flooding events in similar locations, including where different personnel attend. Properties in the vicinity identified by the company, rather than by the customer, shall should be flagged as such and the percentage found in this way reported.*'

In order to fulfil this condition, we would request that this new reporting requirement is added into Table 3G with immediate effect as a shadow reporting activity. This would bring reporting for external sewer flooding in line with the existing reporting line for 'company reactively identified' internal sewer flooding. This will enable a standardised continuity of reporting across both metrics, whilst also promoting a greater understanding of comparative external flooding performance across companies. We note that during AMP7 Ofwat has, in fact, used the disaggregated reporting on internal sewer flooding to follow up queries with companies; we believe that equivalent transparency on external flooding would also be of benefit.

Key considerations for PR24 and beyond:

Below we have outlined a number of questions on the PR24 final methodology. We are also raising these concurrently through the PR24 query process. However, we consider that it is important that Ofwat's annual reporting team also consider these points.

Bioresources enhancement obligations

We would like Ofwat to reconsider using the RAG5 transfer pricing framework to enable Bioresources to recover the cost of enhancements from Wastewater Network Plus (WwNP) in circumstances where obligations sit in WwNP (outside of Bioresources), but where solutions are most efficiently delivered within Bioresources. Dependent on the particular circumstances of each water company the most effective solution may sit in either WwNP or Bioresources, this can have the effect of distorting any comparison between companies. This distortion becomes particularly impactful as the treatment of investment diverges between controls creating a disparity. Compliance with phosphorus (P) standards provides a good example:

- The nutrient exists in effluent, and the standard will be measured and monitored at the point of discharge to the water course from the wastewater treatment works (i.e. within the WwNP business).
- However, most of the P flows through into Bioresources processes, and back into wastewater treatment via return liquors.
- Therefore, the ideal intervention point would be to remove the P from the return liquors within Bioresources (and therefore the most efficient intervention may be to invest in Bioresources assets).

Given that the obligation applies to Appointees as a whole (with no distinction made between Wastewater Network plus and Bioresources within the environmental obligations), the enhancement requirement will (without Ofwat intervention on how this should be accounted for) be deemed part of the Bioresources price control. In contrast, in a competitive (fully separated) Bioresources market, if a WwNP company sought to ask an independent Bioresources provider to construct and operate assets to remove P, the Bioresources business would expect to be fully remunerated by the WwNP business, as it is not a direct obligation on the Bioresources provider. Given this, it would seem unreasonable to expect incumbent Bioresources businesses to fund such investment, as that would act to skew their prices relative to related competitive markets.

At PR24 (and beyond) that would then mean that the cost of those enhancements would be assessed and remunerated as part of the WwNP price control, with transfer pricing arrangements acting in parallel to transfer funding from WwNP to Bioresources. This would be the right course of action to prepare Bioresources for operating and trading within a wider competitive market.

In addition, consideration needs to be given to how the relationship between WwNP and Bioresources is managed. While it is correct that some activities are beneficial to both WwNP and Bioresources, such as screening, some are not. In a sludge trade the parties need to enter into an agreement specifying the characteristics of the sludge that is to be treated with penalties and rewards associated with particular traits. We believe that in an environment where market pressures apply and there is competition the relationship between WwNP and Bioresources needs to mirror that between WwNP and another provider of Bioresources services. This would include use of intracompany transactions to incentivise behaviours and optimise service provision. Without this the differences in treatment of the appointed Bioresources business and potential competitors could skew the market.

Equity issuance costs

The PR24 final methodology proposes to provide companies with an allowance of 2% for equity issuance costs as an adjustment to base allowed totex. In the statutory accounts, costs directly related to equity transactions are recorded outside of the income statement (included in other comprehensive income and the statement of changes in equity), and as such equity issuance costs will not automatically flow through to totex in the regulatory accounts. Therefore, in the absence of any changes to the PR24 allowance for equity issuance costs or the RAGs, this would result in a mismatch between allowed totex and reported totex, resulting in companies potentially reporting unearned outperformance.

Non-section 185 diversions

We note that the PR24 Final Methodology has discussed the AMP8 treatment of non-s185 diversions for both cost and revenues. We would like Ofwat to provide clarity on the intended approach to reporting all s185 and non-s185 diversions at PR24 and whether non-s185 diversions are proposed to be within (as per Appendix 9) or outside (as per table guidance and RAG 4.09) of the price control. However this is ultimately set, it is important that the 2025/26 RAGs (notably RAG 4.09 appendix 1) are amended to ensure reporting is consistent with PR24 methodology.

Other issues regarding proforma tables:

Table	Line	Issue
Table 1C Statement of financial position	New line	**Current deferred income – grants & contributions (G&Cs) and adopted assets** Consistent with the presentation of non-current liabilities (lines 1C.26 & 1C.27), within current liabilities we believe two distinct lines for deferred income G&Cs and deferred income adopted assets should be added. This will improve transparency and ensure that total capitalised G&Cs and adopted assets can be reconciled to table 2E line 37 (carried forward G&Cs).
Table 1D Cash flow	1D.2	**Other Income** Currently 'Other income' line 2 is only be populated with *"the cash impact of other income in line 1A.5"*. This is not aligned with 'Operating profit' line 1 which is populated from table 1A.4 and includes non-cash items. This results in a mismatch of regulatory to statutory adjustments – for example the amortisation of deferred income is removed from 'Operating profit' 1D.1 but can't be reclassified to 'Other income' in 1D.2 as it is a non-cash item. We propose the 1D.2 line definition to be amended to remove the reference to cash impact and say "*Other Income. Equal to 1A.5*".
Table 1D Cash flow	New line	**Non-cash items** We propose to include an additional line within the top section of the table for 'Other non-cash items' so that the working capital and provision lines reflects true movements in working capital and provisions only.

Table 1E Net debt analysis	1E.1	**Table 1E Net debt analysis** The borrowing valuations used in line 1 represent a 'notional value' basis which we believe is more appropriate than book value and is in line with the guidance. In our opinion, the guidance could be more explicit in stating that 'notional values' should be used (as has been done in the guidance for 'Preference share capital' in line 2) rather than book values and recognising that this could create a reconciling difference to borrowings in table 1C. We are currently inferring the use of notional values from the guidance which states: *"The following should not be included: fair value accounting adjustments which do not impact on the principal sum outstanding on the debt or the total interest paid. For example when financial instruments, such as interest rate swap agreements are presented at fair value."*
Table 4I Financial derivatives	4I.26	Line 26 requires 'Other financial derivatives' to be included as one line to reconcile the total (line 27) mark-to-market value through to table 1C. We have two types of derivatives which feed into this line, being electricity swaps, and the forward dated floating to fixed interest rate swap. In relation to the electricity swaps the nominal value by maturity would have been GWh rather than a financial amount and there is no weighted average interest rate to disclose only a fixed price per GWh. In relation to the forward dated floating to fixed interest rate swaps, the nominal value by maturity assumes the swaps have reached their value date which they have not due to them being forward starting. As such we have disclosed a combined Mark-to-Market value for the two types of swaps in line 26. We have provided additional analysis within the narrative regarding this. One potential solution to this issue might be to specifically exclude commodity swaps from the table, and require a reconciliation instead to table 1C. Line 26 could then be used purely for forward starting swaps, we could provide a weighted average interest rate, but with these swaps we would remain unable to provide a maturity analysis due to them not having reached their value dates.
Table 4I Financial derivatives	4I.3-4I.5	No definition has been given for the accretion column. We would suggest "*Total accretion is equal to the inflation-uplift on the nominal amount of index-linked swap, which will be paid/received on maturity*".
Table 4I Financial derivatives	4I.11	We have a number of HKD currency interest rate swaps, but there is no row to accommodate these and they need to be input with other currencies in this line, skewing the weighted average interest rates. One solution to this issue might be to allow for more currency lines within the table, i.e. similar to Lines 21-23 for forward currency swaps which include CAD, AUD and HKD.
Table 8B Operating cost analysis for Bioresources		There is a large % of costs which sit within the 'Other' column, for example in our 2021/22 APR table 8B 92% of sludge treatment opex was reporting in 'Other'. To provide improved disclosure we would recommend further splitting this out between 'Thickening', 'Dewatering' and 'Other'.

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