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# Summary of discussion at May 2023 Outcomes Working Group

Thursday 18 May 2023
10.00 am to 12.00 pm

## Introduction

Ofwat introduced the session by thanking participants for joining.

Ofwat fed back that they are carefully considering the concerns companies raised at the April meeting in relation to using the revised Batch 1 marginal benefit rates. Ofwat will set out a response shortly including what this means for the Quality and Ambition Assessment (QAA) at PR24.

Ofwat updated that work was progressing to produce the Batch 3 rates and these were on track to be shared in early June, alongside any revisions to the Batch 1 rates.

## ODI rates – Batch 3 approach

Ofwat explained their reasons for moving to a "top-down" approach to set the ODI rates for the Batch 3 performance commitments (PCs).

For the demand PCs, it had been challenging to link the incidents customers valued, eg hosepipe bans, to the PC definitions for leakage and consumption. There was an incomplete data set across companies and a wide range in the potential impact across the industry. Ofwat had tested alternative approaches including using a national or regional average that could apply across companies. However, this had not produced ODI rates that were sufficiently robust. The ODI rates for demand PCs are therefore being progressed using a top-down approach.

For the discharge permit compliance PC, there was not a measurable relationship between the incidents customers valued and a discharge permit breach. For the river water quality PC, Ofwat have not received the necessary data to complete the mapping for this PC. The ODI rates are therefore being progressed using a top-down approach.

For the storm overflow and pollution incident PCs, the initial marginal benefit rates derived from customer valuations were significantly out of line with expectations which raised concerns the rates may not be robust. Ofwat undertook further qualitative research to better understand the valuations, however this did not provide a basis for adjusting the valuations or mapping approach. The ODI rates are therefore being progressed using a top-down approach.

## ODI rates – Using customer preferences

Ofwat explained that when applying the top-down approach they will assign a different allocation of regulated equity based on whether a PC is considered by customers to be of higher, medium or lower importance.

A participant asked how the proposed ranking had been derived from customer research. Ofwat offered to provide a follow up note to explain this in more detail.

Someone asked if this approach would produce the same ODI rate for each company. Ofwat confirmed it would set the same unit rate ie per pollution incident across companies, but that the final ODI rate would differ where it is normalised to match the PC definition.

## ODI rates - Issues raised

- **Timescales:** Companies stressed the importance of having clarity as soon as possible on whether the Batch 1 rates will be revised. Ofwat confirmed they would set out a response shortly.
- **Alternative rates and QAA:** Companies asked whether they could deviate from the indicative rates if they resulted in a skewed risk profile, and whether they would be marked down in the QAA for doing so. Ofwat responded that companies could propose alternative rates in their business plans. To meet the minimum expectations as part of the QAA, companies must provide compelling evidence for any alternatives.
- **Top-down approach:** Attendees said they would appreciate more detail the on top-down approach given it is now being used to set a larger number of ODI rates. Ofwat agreed to follow up with an explanatory note.
- **ODI vs marginal benefit rates:** A participant asked if rates derived using a top-down approach were ODI rates or marginal benefit rates. Ofwat confirmed they were ODI rates and assumed a benefit sharing factor of 0.7 as set out in the final methodology.

## Note of discussion on River Water Quality (Phosphorus) Performance Commitment

There was general agreement to change the presentation of the PC to a percentage reduction. Ofwat updated the group that there is an issue with calculating percentages based on the existing definition as the number of works included in the PC is not constant.

There needs to be a constant baseline for the percentage calculation to lead to the same phosphorus reduction between years to lead to the same percentage change. We proposed to use the same baseline in 2020 to calculate the percentage change (cf Environment Act Target). To simplify the PC we propose to also use 2020 as the base year to calculate the reduction at each site.

There was general agreement with the proposed change. Members asked for further clarification on how the baseline would be calculated in 2020 including:

- the timeframe of the baseline is in the Environment Act Target;

[Post meeting note: Regulation 13 of the The Environmental Targets (Water) (England) Regulations 2023 states '"the baseline" means the load of total phosphorus discharged into freshwaters from relevant discharges in the year from 1st January 2020 to 31st December 2020]

- whether the Environment Act Target baseline is based on permit levels or actuals; and
- how discharges for which permits included phosphorus limits for the first time within 2020 (eg March 2020) will be handled.

Ofway agreed to consider these points in finalising the definition.

A question was asked about how to deal with small works that do not have measured flow. Ofwat's response was that where works have a dry weather permit then the company should assume the annual flow is equal to this multiplied by 1.2. Ofwat will consider what assumption to make if there is no dry weather flow.

A question was asked what to do if a treatment works was abnormal in 2020. Ofwat responded that there should be no adjustment. The value in 2020 is known and so if material we can take this into account in how we set performance commitment levels.

It was also noted that companies may outperform expectations up to 2025 that could lead to outperformance in the 2025-30 period. Ofwat noted that this could be the case for this performance commitment as it is with other performance commitments and provides incentives for water companies to improve outcomes as soon as possible. Ofwat will carefully consider improvements that have already been paid for by customers both before 2025 and after 2025 in setting performance commitment levels so that customers do not pay twice.

Members were also concerned that the contribution by partnership working may be limited and not be a major factor within the performance commitment. Ofwat noted that this may be the case but considered that the performance commitment equally valued the reduction in phosphorus whether at treatment works or by third parties. In addition working with third parties should help to limit green house gas emissions and increase biodiversity. These benefits are incentivised by other performance commitments.

Comments were also reiterated by companies already made in writing. Responses to these comments are available here.

Ofwat noted that they would talk with environmental NGOs and would then update the definition at the same time as the Storm Overflows performance commitment definition in June 2023.

Ofwat informed the group that we had now received the final dataset of historical phosphorus discharges from Jacobs. This will circulate the dataset and instructions by 26 May and expect companies to provide any updates by 30 June. We will be clear in our instructions if we expect to share any further data with companies to validate, such as for bathing water quality.

## Next steps

Ofwat thanked participants for their time and closed the meeting.