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23 May 2023

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Principal Economist
Ofwat
Centre City Tower,
7 Hill Street, Birmingham.
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Updating the storm overflows performance commitment definition for the 2024 price review (PR24)

Dear [Redacted],

We welcome the opportunity to comment on Ofwat's consultation on updating the storm overflows performance commitment definition for the 2024 price review.

We are broadly supportive of the proposals in the consultation, however we have number of potential additions that we believe would further improve the proposals. Our suggestions seek to better align storm overflow performance with actions and improvements made by companies rather than factors outside of their control. In particular, we are very keen to limit the effect that unusually dry or wet weather will have on reported performance and the associated rewards and penalties.

We are not clear whether Ofwat intend to set a common PC target for all companies in AMP8 beyond the initial expected starting point. We are strongly of the view that performance targets should be set on an individual company level to reflect local circumstances and other exogenous factors.

If you have any questions, please feel free to contact me.

Yours sincerely,

[Redacted Signature]

[Redacted Name]

Head of Regulatory & Market Economics

Attachment – Response to specific consultation questions

Question 1 - Do you agree with our proposals to set a performance commitment based on average spills, with financial consequences for companies that do not meet their targets?

While we recognise that some of the adjustments proposed in this methodology address some of our original concerns, we remain of the view that a storm overflow PC based on average spills has significant drawbacks. As currently drafted, we believe performance will be principally driven by factors not related to a company's underlying investment or operational performance. To mitigate these concerns, we believe that the metric could be further improved and targets should be set per company to reflect local circumstances.

The PC could be significantly enhanced if the very material impact rainfall variability has on performance could be accounted for.¹ This would enable companies to improve performance forecasting and avoid being heavily rewarded or penalised because of a reporting year being particularly dry or wet. Potential mechanisms that could be adopted to limit this impact include a balancing factor depending on average rainfall or introducing a rolling average approach. To illustrate the point, we note that the Environment Act 2021 requires a ten-year average when assessing if overflows meet its objectives and other weather affected PCs, eg: the leakage performance commitment, are based on a three-year rolling average.

We are unclear how Ofwat intends to set targets across the industry. We remain of the view that performance targets should be set on an individual company level. Setting a common performance target across all companies would not recognise the different starting positions of companies. Individual targets would avoid distorting incentives, with a common target easy to achieve for some and impossible for others.

One factor that influences reported performance using an average spills approach is the ratio of network overflows to STW storm tank overflows. STW overflows are observed to typically spill more frequently as they are at the end of the network – but there is significant variability in prevalence of storm overflows relative to STWs between companies. A company specific target could take this into account.

Owing to the level of importance customers place on this topic, we do agree that there should be financial incentives linked to performance. However, we believe some mechanism should be adopted to smooth the impacts of the exogenous factors that materially impact performance. We note that Ofwat has suggested that it may apply caps and collars to the storm overflows PC, which we support.²

We also agree that adoption of the 12/24 count method is sensible to limit the scale of inconsistency with the other metrics for storm overflow performance that are reported regularly in the media.

¹ As confirmed by the Environment Agency: <https://environmentagency.blog.gov.uk/2023/03/31/storm-overflow-spill-data-shows-performance-is-totally-unacceptable>

² Ofwat, PR24 Final Methodology, Appendix 8 Outcome delivery incentives, December 2022, Page 63.

Question 2 - Do you agree with our proposed approach to unmonitored storm overflows?

We agree with the principle of incentivising companies to adequately maintain their assets and to have good data. However, we believe the proposed approach is unduly punitive and inconsistent with Defra and the Environment Agency's expectations and approaches regarding monitor availability.

The Environment Agency consider over 90% availability to be a reasonable level of performance. This position supported by the Chartered Institution of Water and Environmental Management EDM good practice guidelines.³ Furthermore, Defra's current consultation on continuous river water quality monitoring recognises that EDMs will not be operational 100% of the time.⁴ It cites common reasons for outage being power failures, communication failures, instrument failure, damage to extreme weather or vandalism, theft and IT system failure.

Companies have not been funded to provide resilience against these factors, for example by having a second standby monitor or power supply. It would therefore be reasonable to allow companies a reasonable period of time to restore operation from when outage occurs. While this would ideally be nuanced to reflect the time needed to address each type of cause of data issue, we would support a simple deadband approach. For example, only applying a penalty rate of spills for assets recording less than 90% of data availability, with the first 10% using a pro-rata approach per asset. This would still provide incentive for companies to address issues quickly.

We can also see a potential issue with performance if the Environment Agency change their expectations around monitor accreditation for EDMs measuring spills to the environment. At the moment, these monitors do not require this accreditation. If this position changes and reporting can only be from accredited monitors, the industry would appear to have a significant decrease in performance until new monitors could be installed and accredited. We therefore suggest that should this arise, this PC should still permit unaccredited EDM data to be used, even if this creates further disparity with EDM data reported to the Environment Agency,

With regards to the proposal of a rate of 50 spills per year, we believe this could create a perverse incentive for companies where some assets typically spill more than 50 times per year to deprioritise maintenance for those sites. We appreciate the value of a simple metric, we would recommend an approach that is more site-specific, to ensure companies prioritise overflows proportionally to their environmental risk. We suggest a still punitive rate of 120% of the spill rate observed when the meter was operating correctly, applied once the asset availability drops below 90%.

Question 3 - Do you agree with our proposed approach to mid-period changes?

Yes, we agree.

³ Chartered Institution of Water and Environmental Management, Event Duration Monitoring Good Practice Guide 2021, Page 14. https://www.ciwem.org/assets/uploads/CIWEM_UDG_EDM_Good_Practice_Guide_2021_final.pdf

⁴ Department for Food, Environment and Rural Affairs, Consultation on Continuous Water Quality Monitoring and Event Duration Monitoring, April 2023, Annex A, Page 18
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1149922/Continuous_water_quality_monitoring_and_event_duration_monitoring_consultation_document_April_2023.1.pdf

The approach would be enhanced if a common definition is agreed for when a new overflow is identified or removed. For example, when a previously undiscovered overflow is found, it often requires an investigation to determine: (a) if it is connected to a company's network; and (b) if it is operational. In our experience, it can take up to six months to investigate, establish the facts, arrange permissions and install monitoring equipment on newly identified assets. We therefore recommend that this is allowed for and Ofwat provide sufficient clarity in the definition.

Question 4 - Do you agree with our proposed approach to emergency overflows?

Yes, we agree.

Question 5 - Do you have any further comments on this performance commitment?

The regulatory requirements to address storm overflows in AMP8 as set out in the Environment Agency's guidance for meeting the Environment Act 2021 are not equivalent for each company. Specifically, factors that influence if an overflow is a 'high priority' asset will vary depending on exogenous variables, such as presence of chalk streams or rivers designated as being 'sensitive areas – eutrophic'. This means that the scale of performance improvements expected will vary by company – further supporting our view that companies will need to have PC targets that reflect their local circumstances to account for this variability.