

Date: 23 May 2023

Ofwat
Centre City Tower
7 Hill Street
Birmingham
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By e-mail: pr24@ofwat.gov.uk

Dear Ofwat,

RE: Updating the storm overflows performance commitment (PC) definition for the 2024 price review (PR24)

Thank you for the opportunity to respond to the above consultation. We welcome Ofwat's desire to engage with the industry over the storm overflows PC definition and we are happy to provide our views on the proposals.

With 100% of our storm overflows monitored with EDMs, we support Ofwat setting a performance commitment based on average spills, with financial consequences for companies that do not meet their targets. This will protect customers from poor performance, and encourage companies to innovate to go further and faster efficiently. With our strong focus over the next regulatory period on addressing spills at designated bathing beaches and high priority environmental areas, we welcome stretching targets that ensure we deliver on our promises, and look to go further for our customers and communities.

We fully support incentives to encourage the full roll out of EDMs and ongoing maintenance to ensure they are fully operational and reporting accurate data. The incentives for failing to install and maintain 100% of monitors should be stringent.

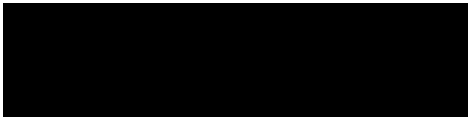
However, we do see some challenges with the approach Ofwat propose to take. Ofwat propose to set perfect operability of 100% despite these assets often being in harsh external conditions. It is reasonable to expect that field equipment cannot operate perfectly, even with thorough inspections and maintenance programmes, as effectiveness and performance is heavily affected by the environment and weather conditions they experience. It is for this reason that the Environment Agency sets its expected level at 90%. We would support this as the target, with further incentives in place to reward companies that go beyond this level.

We note the application of 50 spills as the benchmark for unmonitored overflows is material and will be effective. It is, however, somewhat arbitrary and ideally should have a clear reference point.

But of more concern is how this is reported to the public. There is already the propensity for customers and stakeholders to find the distinction between start/stop data v 12/24 calculated spills confusing. A further step whereby actual recorded data is adjusted by Ofwat to account for unmonitored spills could add confusion, so understanding how best to apply such penalties will need careful consideration. In the appendix we set out some alternatives to this approach which we think could deliver strong incentives without adjusting publicly reported data, such as adjusting incentive rates and applying gateways levels before incentives apply.

All of our responses to the consultation questions are in the appendix overleaf. I hope you find our comments helpful and would be happy to discuss any of the points raised.

Yours faithfully,



Dr Lisa Gahan
Group Director of Regulation, Strategy & Asset Management



APPENDIX – CONSULTATION QUESTIONS

Q1: 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?

Storm overflows play an important role in preventing sewage flooding to homes, businesses and land when the sewer network is overloaded by surface water runoff during wet weather. Amongst our customers and stakeholders, concern for the environment has increased in importance since PR19, particularly with regard to storm overflows. We therefore agree in principle with setting a performance commitment based on average spills, with financial consequences for companies that do not meet their targets.

However, calculated spills should not replace factual information in the public domain. Any proposed changes to spill numbers should be applied as a post-processing incentive calculation rather than being allocated back to individual data points in the EA annual data return so that the EA annual data remains an accurate public record of what is recorded through the EDMs.

We discuss this further in response to question 2 below.

Q2: Do you agree with our proposed approach to unmonitored storm overflows?

We support incentives on EDM availability and operability, however, we note that Ofwat's proposal could have unintended consequences.

By setting a fixed "50 spills" to any storm overflow that is not monitored for the whole of the reporting year could lead to differing data sets of performance – i.e, as recorded data v adjusted for low operability with 50 spills. The risk of data inaccuracies and consequential potential loss of public trust around reporting is of concern.

We would welcome Ofwat considering the following:

On the fixed assumption, we note that the fixed assumption is based on data from one year of data only – it has no alignment with the targets and deliverables within common practice. A level of 40 spills would align to the Water UK Storm Overflow Assessment Framework and therefore ensure regulatory consistency with the Storm Overflows Discharge Reduction Plan.

On the EDM operability, from a practical perspective achieving 100% operability for 356 days a year is not possible due to factors outside of a company's control. It would require redundancy, duplication of assets – which would not be an economic approach. We have considered a range of alternative options that would achieve the same outcome, but would not require differences between recorded and reported data:

- If the adjustment remains, a 'deadband' level between (say) 90% - 100%, whereby no adjustment is made, should be included in the calculation. **This is the simplest option and provide strong incentives.**
- If the adjustment remains without any deadband and a fixed company specific performance level is adopted, then an adjustment should be factored into the performance level targets for the purposes of the ODI calculation.
 - If we assume 95% availability of EDM monitoring, this should amount to an additional storm overflow target of 2.5 spills per year (5% * 50), or if we assume 90% availability of EDM monitoring, this should amount to an additional storm overflow target of 5 spills per year (10% * 50).
 - South West Water has a 2025 commitment in the Storm Overflows Discharge Reduction Plan to achieve discharges to an average of 20 per year. If we achieve

this with 90% operability, then using the proposed Ofwat approach the regulatory outcome of discharges would be estimated to be 25 per year (ie, the 20 that we achieve and the additional penalty of 5 set by Ofwat).

- Customers and stakeholders would likely be confused by some data reporting 20 spills, and some reporting 25. **We do not recommend this approach, for the reasons that there is then confusion between recorded and reported performance.**
- Another option is ODI RAG requirements and a gateway. Availability below a threshold (say 90%) could result in ineligibility for outperformance on the storm overflows ODI. **This option may not provide sufficient incentives to improve availability.**
- An alternative approach would be to adjust incentive rates to reflect availability, rather than adjusting reported performance. So, if a benchmark of 90% availability was set, then outperformance incentive rates could be lowered / underperformance incentive rates raised for availability of less than 90%. This would be symmetrical for availability above 90%. Based on the consultation, we would suggest this would be a 10% factor on the incentive rate per 1% (within the 80% - 100% range of availability).i.e. no outperformance would be possible at 80% availability / 2 times underperformance – with stronger outperformance incentives for 100% availability (although in reality this is unlikely to be operationally or economically efficient). **This options has attractions, but may not be as transparent to stakeholders that EDM availability is incentivised.**
- An alternative to adopting a fixed company specific performance level, if the adjustment remains without our proposed deadband, is to introduce dynamic target levels for this PC. Relative performance on EDM data availability could be incentivised across the industry, but with a deadband based on the position between an ex-ante target (say 90% availability) and industry median performance. This has the advantage of encouraging competitive, continuous improvement. We have previously written to Ofwat to highlight the benefit of such an approach to target-setting where there is data and definitional uncertainty. **This option would see a separate incentivised target for EDM availability, and promote continuous improvement. It would require a change to the PR24 methodology approach however.**

Q3: Do you agree with our proposed approach to mid-period changes?

We do not agree with this proposal. As is also noted in the consultation, our view is that allowing the number of storm overflows in the performance commitment to change during the period may discourage companies from closing storm overflows that are no longer required to be used. It would distort the analysis of performance over time.

If this proposal is adopted, there is the potential for companies to 'hold back' giving up the permits because:

- They do not want to increase risk to properties for flooding
- They will want to keep low spillers available to reduce average and access incentives
- They would also want to reduce costs on river monitoring so would be incentivised to reduce numbers.

It seems speculative to assume that few storm overflows will close in 2025-2030. As storm overflows that close, and new storm overflows will not spill, then the incentive properties to us seem appropriate.

Q4: Do you agree with our proposed approach to emergency overflows?

We note the proposal to introduce a new reporting requirement for companies' annual performance reports from 2023-24 on the number of spills from emergency overflows. We welcome the decision not to include reporting of emergency overflows within the outcomes framework, as the requirements for the storm overflows ensure companies are sufficiently incentivised to deliver service improvements for their customers. Whilst we have no objections to the proposal considered, it is difficult to determine the feasibility of reporting accurately for 2023-24 without sight of a methodology or revised regulatory accounting guidelines. We would be grateful for early sight of and request that the 2023-24 regulatory accounting guidelines be published sooner than April 2024.

Q5: Do you have any further comments on this performance commitment?

Our comments in response to this consultation should be read in conjunction with our response to Defra's consultation on Continuous Water Quality Monitoring and Event Duration Monitoring (the consultation is also due to close to comments by 23 May 2023). A copy of this response is therefore attached for your information.