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By email to water companies, environmental stakeholders and campaign groups, the Environment Agency, Natural Resources Wales, Natural England and CCW.

9 May 2023

Dear stakeholder

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

This letter sets out our proposed approach to the storm overflows performance commitment definition for the 2024 price review (PR24). It follows:

- our PR24 final methodology in December 2022;
- responses to our draft performance commitment definition, due by 31 January 2023; and
- workshops we have held with stakeholders in March and April 2023, including water companies, environmental regulators, consumer representatives and environmental stakeholders and campaign groups.[1]

We set out our overall approach (including the role of price reviews) in section 1, our proposals in section 2, and next steps in section 3. We include a draft performance commitment definition in annex 1 for comment.

We welcome views by **23 May 2023**. Please send responses to pr24@ofwat.gov.uk. This two-week consultation period reflects prior stakeholder engagement and enables us to update the performance commitment definition on our website in June 2023, so that water companies must take account of it when submitting their business plans in October 2023.

1. Our approach to regulating storm overflows

Water and wastewater companies are monopoly providers of an essential service and play a vital role in protecting and enhancing the environment. This is reflected in their statutory obligations, including those set out in section 94 of the Water Industry Act 1991 (with respect

[1] We have published slides from stakeholder workshops held on 4 and 12 April 2023 on our website.

to the provision of a sewerage system) and the Urban Waste Water Treatment (England and Wales) Regulations 1994.

There are significant concerns that the sector is not meeting its obligations or public expectations on the safe treatment and return of wastewater to the environment. The rollout of comprehensive monitoring has revealed the frequent use of storm overflows as part of the day-to-day operation of the wastewater system. This is not what was intended when storm overflows were established as a way to deal with unusually heavy rainfall. It cannot continue.

Improving the sector's impact on rivers and reducing harm from storm overflows will require sustained actions to address their root causes. But companies must act now. There is nothing in the regulatory regime that prevents companies from tackling these issues immediately, and we will not hesitate to act if we find companies have breached their obligations.

1.1 Price reviews

Every five years, we assess companies' business plans and set revenue allowances for the largest water companies through our price review process. This limits the amount of money that companies can recover from their customers, and includes sufficient funding for companies to efficiently operate their networks and to meet their statutory obligations.

In addition to meeting their obligations, we use our outcomes framework to set levels of service that companies are expected to deliver. As part of this, we specify measures of performance ('performance commitments') that reflect what companies are funded to deliver for customers and the environment. If companies perform below or above their targets ('performance commitment levels'), there are financial consequences ('outcome delivery incentives').

Companies that underperform against their targets incur underperformance payments, which reduce the amount of funds that companies can recover from their customers each year through bills. This should reduce the amount of money that is available for companies to distribute to their shareholders. If companies exceed their targets, they can receive 'outperformance payments' which are funded by customers for improving outcomes beyond the level that they were funded for in our price reviews.

The aim of this framework is to align the interests of companies and their investors with those of their customers and the environment, by ensuring companies are sufficiently incentivised to maintain and improve outcomes for customers and the environment – and face the financial consequences of how they perform. We set out our approach in more detail in Chapter 5 of our December 2022 final methodology for PR24.

Our approach to storm overflows reflects our statutory duties and the strategic policy statements of the UK government and Welsh Government, which we must act in accordance with.[2] Our approach also aligns with the UK government's storm overflows discharge reduction plan.[3]

1.2 Wider regulatory tools

In addition to our price reviews, we have a wide range of regulatory tools to help drive the sector to meet the challenges we face. These include the use of markets, enforcement, assurance, monitoring, licence conditions, charging rules, campaigns, and partnerships. We also operate alongside quality and environmental regulators in the sector, and co-ordinate and collaborate with our partners in the interests of customers and the environment.

We often use these tools in combination with the price review process to deliver the most effective approach. We hold companies to account by monitoring their performance. We use enforcement action to address breaches of legal obligations that we are responsible for enforcing. Where we decide to take enforcement action and impose a financial penalty on a company for breaching an obligation, this penalty is separate to any underperformance or outperformance payments.

We have an open investigation into all wastewater companies in England and Wales, opened in November 2021. It is looking into how wastewater companies are operating their sewage treatment works, including whether sewage has been discharged into the environment at times when this should not be happening. The investigation currently includes enforcement cases against six wastewater companies.

2. Performance commitments at PR24

In this section we set out our proposals for defining a performance commitment for storm overflows at PR24. As we set out in our PR24 final methodology, we will set performance commitment levels and outcome delivery incentives in our determinations in 2024.

We welcome views from stakeholders on these issues.

[2] See the UK government's strategic priorities for Ofwat (March 2022) and the Welsh Government's strategic priorities and objectives statement to Ofwat (December 2022).
[3] UK Government's storm overflows discharge reduction plan (August 2022).

2.1 Overall measure

We are **proposing to set the performance commitment based on a company's average spills each year** – the number of spills divided by the number of storm overflows.

In line with 2018 guidance produced by the Environment Agency, the number of spills would be counted using the '12/24' method. This partially reflects the duration of spills, by counting each spill that lasts longer than 12 hours as more than one spill (with each additional 24-hour period counted as one additional spill). For example, a spill event that lasts 60 hours would be counted as three spills – one spill of 12 hours and two spills of 24 hours.

For the avoidance of doubt, this performance commitment includes all spills from a company's storm overflows, including those that are within the terms of discharge permits issued by the appropriate agency.[4] This should incentivise companies to reduce spills over and above any statutory obligations, including any legally binding targets required by the UK or Welsh governments.

Some stakeholders have suggested using the average number of spills may not adequately capture the harm to the environment.

While we accept that the average spills measure is not a perfect reflection of harm to the environment, we consider it the best option available to us for PR24. The number of spills from a storm overflow should correlate with environmental harm to some degree, in part because the 12/24 method also reflects the duration of spills. Other performance commitments, such as for serious and total pollution incidents, should also provide additional incentives on companies to prevent harmful discharges.

When setting an incentive package, we need enough data over time to set effective performance commitment levels which reflect efficient expenditure allowances. We have this for average spills based on the 12/24 method, which companies have reported over the last few years, with around 91% of storm overflows installed with event duration monitors by December 2022. As companies begin to install more sophisticated monitors over the 2025-30 period under new legal requirements, we can consider a performance commitment based on data from these monitors in future price reviews.[5]

[4] The 'appropriate agency' means i) the Environment Agency in relation to England and ii) Natural Resources Wales in relation to Wales.
[5] For example, see the UK government's recent consultation on continuous water quality monitoring and event duration monitoring, published in April 2023.

2.2 Unmonitored overflows

We are **proposing to incentivise companies to install and maintain event duration monitors on their storm overflows**, with the aim for them to feel the financial consequences for not doing so through underperformance payments. In line with their wider obligations, companies are required to monitor and record discharges from storm overflows. One way to do this is through the installation of event duration monitors. For the purposes of this performance commitment, when we refer to 'unmonitored overflows' we mean those storm overflows where an event duration monitor was not installed or not operational.

Recent data has suggested that action is needed.[6] Companies are required or expected to install event duration monitors on 100% of their storm overflows by December 2023. While some have achieved this, overall coverage was around 91% in December 2022, and some companies are far off – such as Thames Water (62%) and Anglian Water (68%).

Even when companies have event duration monitors installed, they may not work all of the time. Based on companies' annual returns, we estimate that companies' monitors worked 92% of the time over 2022. We also estimate that around 1 in 6 monitors worked less than 90% of the time over the same period. This includes companies that report full coverage, with Severn Trent Water reporting that its monitors only worked 87% of the time. More significantly, our analysis suggests that nearly 30% of that company's monitors worked less than 90% of the time and 8% of its monitors worked less than half of the time.

To address this issue, for the purpose of calculating outcome delivery incentive payments, we are **proposing an unmonitored overflows adjustment**. This would require companies to assume a level of spills for any storm overflows that do not have monitors installed or are only partially monitored during the year. To provide strong incentives on companies to install and maintain their monitors, we propose that this is well above the average measured by the company's monitored storm overflows.

As a starting point, we suggest this is 50 spills and welcome views from stakeholders. This could change in future price review periods. Under our proposed approach, this will scale based on the uptime of each monitor – for example, if a monitor works for 50% of the time, the company would be required to assume 25 spills for when it was not monitored. We have based this proposed adjustment on reported data for 2022 which shows that around 1 in 6

[6] Our analysis is based on the annual returns from English companies reported to the Environment Agency in England and data published by Dŵr Cymru and Hafren Dyfrdwy in Wales (April 2023).

monitored storm overflows spilled more than 50 times each year (compared to a median average of 13 and mean average of 25).[7]

While this approach risks overstating the level of spills from a company's storm overflows, we consider this is outweighed by the benefits of providing a strong incentive on companies to consistently monitor their storm overflows in the first place. We also intend to clearly distinguish performance and payments associated with monitored and unmonitored storm overflows in our annual reporting requirements and communications to minimise any confusion among stakeholders.

We have considered alternatives proposed by some stakeholders during recent engagement, such as a fixed payment for each unmonitored overflow through a separate performance commitment or a gateway to outperformance payments. However, we consider our proposed approach provides a strong incentive on companies to have operational event duration monitors on their storm overflows in the first place, reducing the risk that they financially benefit from unmonitored overflows, in a targeted and proportionate manner.

2.3 Mid-period changes

We are **proposing that the number of storm overflows within scope can change during the period, with a provision for storm overflows that are closed**.

The number of storm overflows may change over the 2025-30 period, for example because new storm overflows are permitted by the appropriate agency (including when emergency overflows are reclassified as storm overflows), or they may be closed because they are no longer required. Companies' annual returns for 2022 has also shown large changes between years, with Thames Water reporting a net increase in storm overflows of 312 and Severn Trent Water reporting a net decrease of 192, compared to 2021.

Some stakeholders have suggested that allowing the number of storm overflows in our performance commitment to change during the period may discourage companies from closing storm overflows that are no longer required to be used, for example due to changes in network configuration. This is because, mathematically, they would prefer an open overflow with zero spills to a closed overflow.

While the number of storm overflows should be reasonably stable over the 2025-30 period, we consider it important to maintain flexibility within the performance commitment – with the number of storm overflows able to increase as new storm overflows are identified. If storm

[7] We estimate 17% of monitored storm overflows spilled more than 50 times in 2022 (23% in 2021).

overflows are identified mid-year, to minimise complexity we propose they enter the performance commitment from the following 1 January. Companies will be required to report this in their annual performance reporting. Under the performance commitment, all storm overflows and associated spills are to be included, regardless of whether they are permitted by the appropriate agency. This is so the onus is on companies to proactively and accurately identify and report their storm overflows. Performance commitments are one part of our regulatory toolkit. If we are concerned that the data a company has reported to us for this performance commitment is inaccurate, we will consider taking action to address this, using the relevant regulatory tool, for example through our price review reconciliation process or, if appropriate, using our enforcement powers.

We note the potential unintended consequence that a company may be disincentivised to close storm overflows when they are no longer required to discharge into the environment. While we expect relatively few closures prior to 2030, we consider it is proportionate to add a provision that enables closed storm overflows to remain in the denominator provided that the company provides evidence and assurance that the appropriate agency has confirmed a permit is no longer required in relation to that storm overflow.

2.4 Emergency overflows

We are **proposing to introduce new reporting requirements relating to emergency overflows** and to keep them separate from the storm overflows performance commitment.

Companies have over 6,000 'emergency overflows' on their networks.[8] Types of emergencies covered by emergency overflow permits issued by the environmental regulators may include electrical power failure or mechanical breakdown.[9]

Unlike storm overflows, the installation of event duration monitors on emergency overflows at pumping stations will not be completed until after 2025. Most emergency overflows on other parts of companies' networks are also not currently monitored by event duration monitors. Limited data currently suggests that emergency overflows spill less than once a year on average compared to around 20 for storm overflows.[10]

[8] Based on our assessment of drivers for the water industry national environment programme.
[9] As set out in the Environment Agency's guidance on environmental permits for storm overflows and emergency overflows (September 2018) and Natural Resources Wales's 'How to comply with your environmental permit' guidance (October 2014).
[10] Based on reported spills in 2022 from 460 of Southern Water's emergency overflows that have event duration monitors installed ('Summary spill data 2022').

We do not expect emergency overflows to be routinely used. When they are used, we expect the majority of discharges from emergency overflows to be captured by the serious or total pollution incidents performance commitments at PR24. Each discharge will increase a company's underperformance payments to its customers (or reduce its outperformance payments) and so we consider companies should be adequately incentivised to minimise discharges from emergency overflows.

Keeping emergency overflows separate from the storm overflows performance commitment reflects feedback from stakeholders, who noted the differences between them and supported keeping them as separate measures.

However, we propose to introduce a new reporting requirement for companies' annual performance reports from 2023-24 on the number of spills from emergency overflows. This will help us and stakeholders to assess how companies are performing as they install monitors on emergency overflows after 2025 and inform whether a change is required.

3. Next steps

This consultation follows substantial previous engagement, including producing a draft definition in December 2022, as well as holding workshops with stakeholders in March and April 2023, including water companies, environmental regulators, consumer representatives and environmental stakeholders and campaign groups.

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?

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

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

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

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

We welcome views on this consultation by **23 May 2023**. Please send your responses to pr24@ofwat.gov.uk. We intend to publish responses to this consultation on our website at

www.ofwat.gov.uk. Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.[11]

Informed by the responses that we receive, we intend to publish a revised performance commitment definition in June 2023. Companies must take account of this when preparing their business plans for submission by 2 October 2023.

We will produce draft determinations in mid-2024, with our final determinations in December 2024. Our price review package will come into effect from 1 April 2025. Until then, we expect companies to meet their existing legal requirements and deliver performance improvements in line with their existing commitments, including the 2019 price review (PR19) determinations and broader commitments.[12]

Yours sincerely

Jeevan Jones
Principal Economist, Ofwat

[11] If you think that information in your response should not be disclosed, please identify that information and explain why it should not be disclosed. We will consider this when deciding what information to publish. You have the right to object to our publication of the personal information that you disclose to us in submitting your response. If you do not want us to publish specific personal information that would enable you to be identified, our privacy policy explains the basis on which you can object to its processing and says more on how we process personal data. Information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws. Under the FoIA and the EIR, there are statutory Codes of Practice which deal with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

[12] Including commitments made alongside the UK government's storm overflows discharge reduction plan (August 2022) and improvements associated with the accelerated infrastructure delivery project (April 2023).

A1 Draft definition for the storm overflows performance commitment

Note: this draft definition is shown relative to the version we published in December 2022 with amendments in red and reflects stakeholder feedback.

Purpose: This performance commitment is designed to incentivise a progressive reduction in the adverse impacts of discharges from the company's storm overflows.

Benefits: Storm overflows must only be used in exceptional circumstances. This performance commitment encourages the company to operate and maintain its network and equipment in such a way as to reduce the adverse impacts of storm overflows on public health and the environment.

Version control

Version	Date of issue	Performance commitment changes
0.1	22 December 2022	Published at final methodology
0.2	9 May 2023	Revised version for consultation
1.0		

A1.1 Detailed definition of performance measure

The average number of spills per storm overflow will be calculated to two decimal places as follows:

$$\frac{Number\ of\ monitored\ spills}{Number\ of\ storm\ overflows} + Unmonitored\ storm\ overflows\ adjustment$$

~~= Total no. spills per calendar year~~

~~Total no. storm overflows~~

For the purpose of this performance commitment the 'Number of monitored spills' is the number of spills monitored by event duration monitors over the reporting period from all of the company's storm overflows as at 1 January of the reporting period. The 'unmonitored storm overflows adjustment' is set out in section A1.2.

A1.2 Additional detail on measurement units

Counting the number of spills

Spills shall be counted using the 12/24 counting method, as follows:

- Start counting when the first discharge occurs.
- Any discharge (or discharges) in the first 12-hour block are counted as one spill.
- Any discharge (or discharges) in the next and subsequent 24-hour blocks are each counted as one additional spill per block.
- Continue counting until there is a 24-hour block with no discharge.

For the next discharge after the 24-hour block with no discharge, begin again with the 12-hour and 24-hour block spill counting sequence. Monitoring frequency should be no longer than 2-minute intervals for high amenity waters and 15-minute intervals for medium and low amenity waters.[13]

Counting the number of storm overflows

For the purposes of this performance commitment, 'storm overflow' means any structure or apparatus: (a) which is comprised in the company's sewerage system, and (b) which, when the capacity of other parts of the system downstream or of storage tanks at sewage disposal works is exceeded, relieves them by discharging their excess contents into inland waters, underground strata or the sea.

Every storm overflow as at 1 January of the reported year is to be included, regardless of whether it is permitted by the appropriate agency (the Environment Agency in England and Natural Resources Wales in Wales). This includes combined sewer overflows (on gravity sewers, pumping stations or sewage treatment works) and settled storm overflows.

The number of storm overflows may change between reporting years for the following reasons:

- **New storm overflows**. Companies must report new storm overflows as they are identified or permitted by the appropriate agency. For the purposes of this performance commitment, new storm overflows and their associated spills must be included from 1

[13] The 12/24 counting method corresponds with the Environment Agency's approach to counting spills set out in 'Water companies: environmental permits for storm overflows and emergency overflows' of September 2018. Regarding the counting method and spill monitoring frequency, we expect to ~~use the version~~ take the approach set out in the Environment Agency's guidance which is in effect at the date of our PR24 final determinations, subject to the outcome of the PR24 determinations process.

January after the date that they are identified or permitted and reported accordingly.

- **Closed storm overflows**. By default, storm overflows that are closed are to be removed from the denominator of this performance commitment in the following reporting year. This is because the denominator is based on the number of storm overflows as at 1 January of the reporting year. However, a storm overflow which is the subject of a permit may remain in the denominator for the remainder of the 2025-30 period provided that the company provides evidence and assurance that the appropriate agency has confirmed a permit is no longer required in relation to that storm overflow.

Unmonitored storm overflows adjustment

In line with their wider obligations, companies are required to monitor and record discharges from storm overflows. One way to do this is through the installation of event duration monitors. For the purposes of this performance commitment, when we refer to 'unmonitored overflows' we mean those storm overflows where an event duration monitor was not installed or not operational. A monitor is considered 'operational' if it was functioning and could reliably record discharges if one occurred.

If a storm overflow is fully or partially unmonitored by an event duration monitor during the reporting year, the company is required to assume a level of spills for the period of time that it was unmonitored. In doing so, the company must assume 50 spills if a storm overflow is not monitored for the whole of the reporting year. This assumption scales by the period of time that it was monitored by an event duration monitor.

The **unmonitored storm overflows adjustment** (USOA) is calculated as:

$$USOA = \frac{(1 - A) * B * C}{C}$$

Where:

- **A: Uptime**. Percentage of the reporting period that a company's event duration monitors were operational (for all storm overflows as at 1 January of the reporting period). This is a simple average of the percentage of the reporting period that the monitor is reported as operational. For the purposes of this calculation, the reporting period is 1 January to 31 December, regardless of when an event duration monitor was installed. Storm overflows without event duration monitors should be considered to have 0% uptime.
- **B: Fixed assumption**. 50.
- **C: Number of storm overflows**. Number of storm overflows for the reporting period in line with the definition above.

A1.3 Specific exclusions

None.

A1.4 Reporting and assurance

The company must keep the spill records required for the 12/24 spill counting method set out above for at least 6 years from the date the company made the records.

The company will provide external third-party assurance, on an annual basis, that the company implements appropriate processes to identify ~~EDMs~~ event duration monitors that do not accurately report spills. The company will also provide a reconciliation of the performance reported under the performance commitment with any publicly available information, including that reported to each appropriate agency.

As part of this process, and to provide transparency for stakeholders on the number of reported storm overflows, within its annual reporting the company must separately report the number of storm overflows that have been:

- identified or newly permitted by the appropriate agency during the reporting year but will be included in the following reporting year;
- added to the reporting year because it was identified or newly permitted in the previous reporting year;
- closed but remain subject to a permit during the reporting year; and
- closed and the appropriate agency has confirmed a permit is no longer required in relation to those storm overflows during the reporting year – with supporting evidence provided by the company to Ofwat.

The company shall ensure that its outcome delivery incentive payments only relate to real performance changes and not definitional, methodological or data changes in performance commitments.

~~The company shall not benefit either because it has not installed event duration monitors (EDM) or because monitors are not working.~~

Table 1 – Definition parameters

Parameters	
Measurement unit and decimal places	Average number of spills per storm overflow, reported to two decimal places.
Measurement timing	Calendar year
Incentive form	Revenue

Parameters	
Incentive type	Outperformance and underperformance payments
Timing of underperformance and outperformance payments	In-period
Price control allocation	100% wastewater network plus
Frequency of reporting	Annual, on a calendar year basis. For example, performance assessment for 2025-26 will be based on the calendar year 2025, and 2029-30 assessment will be based on the calendar year 2029.
Any other relevant information	N/A
Links to relevant external documents	N/A