

UUWR_56

PR24 Draft Determination: UUW Representation

Area of representation: Outcomes – Total pollution incidents

August 2024

This document outlines our representation in response to Ofwat's draft determination related to the total pollution incidents performance commitment.

Reference to draft determination documents:

Delivering outcomes for customers and the environment, section 4.3, pg. 27-28

Delivering outcomes for customers and the environment, section 8.21, pg. 113-115

1. Key points

- **UUW accepts the common PCL set by Ofwat in the Draft Determination:** This reflects a 30% reduction over the 2025-30 period from the 2024-25 baseline aligned with the WISER.
- **We support the proposal for a change control process to ensure that measurement of performance is consistent with the Environment Agency Environmental Performance Assessment (EPA) over time:** However we are still concerned with the magnitude of uncertainty surrounding this measure. Within this document we detail the prospective regulatory guidance changes and the material uncertainties about how performance against this measure will be assessed and calibrated, as well as outline that there is limited or no data available for these changes. We believe Ofwat needs to thoroughly consider the impact of these points and address these concerns when implementing adjustments as part of the change control process.
- **In view of the future uncertainty about the definitions applying to this measure, a penalty collar may be appropriate:** Given the substantial potential scope and definitional changes that are likely to serve to increase the number of incidents counted by the metric, setting a penalty collar may well be an appropriate means of managing the risk of an unbalanced incentive.
- **We encourage Ofwat to set an enhanced reward threshold for this measure as described in the performance commitment methodology:** This will incentivise and therefore, drive better performance and outcomes for customers and the environment.

2. UUW's PR24 proposal

In our PR24 submission, UUW proposed a common PCL in line with the Ofwat methodology, aligned with projected upper quartile (as can be seen below in Table 1). Our submitted PCL was based on the current view of performance at that time. In line with the Ofwat methodology, we did not propose a collar for this PCL. We did propose an enhanced incentive rate threshold based around forecast frontier performance. We also adopted the indicative Ofwat ODI rate.

3. UUW's understanding of the position in the draft determination

Ofwat has set this performance commitment on a common basis in line with its PR24 methodology (as can be seen below in Table 1). Ofwat set the 2024-25 baseline position aligned to the PR19 PCL (19.50) and set the 2029-30 position at 13.65, a 30% reduction over the 2025-30 period from the 2024-25 baseline. This level of stretch aligns with the 30% target set out by the Environment Agency in the Water Industry Strategic Environmental Requirements (WISER).

Table 1: Ofwat Draft determination PCL for Total Pollution Incidents

	2025-26	2026-27	2027-28	2028-29	2029-30
Ofwat DD Position	18.33	17.16	15.99	14.82	13.65
UUW October Proposal	16.03	15.69	14.80	13.79	12.02

Source: PR24-DD-PCM_Total-pollution-incidents & UUW30 Performance Technical Document

There is no risk protection through cap and collar as this is a well established performance commitment. Nevertheless, the stated performance commitment level does not take account of upcoming and significant regulatory changes acknowledged by Ofwat and resulting in it proposing the new change control process. Ofwat

has given a higher ODI rate of £2.831m compared to its indicative ODI rate which UUW used in the October 2023 business plan submission, of £1.78m. No enhanced rate is included within the draft determination with Ofwat citing potential regulatory change as the reason for this.

4. Issues and implications arising from the draft determination

4.1 Changes in regulatory guidance impacting this measure

Prospective regulatory guidance changes, resulting from the Environment Agency consulting on changes to the EPA and its constituent metrics, and associated guidance documents, present material uncertainties about how performance for this measure will be assessed and calibrated. The current indications of what will be included within the Environment Agency consultation on changes to the EPA methodology indicate additional pollution classification criteria that is likely to further increase the number of future incidents, such as:

- Retrospective reporting of events;
- Continuous water quality monitoring results;
- Spills at WwTW below PFF permit requirements; and
- Potential future revision of guidance document 16_02 which will lead to change in categorisation of pollution incidents - The removal of category 4 classification will lead to additional category 3 incidents which will be included in this measure. These incidents are currently categorised as no impact. Removal of this category can only result in more category 3 incidents for all companies.

All of the above is unquantifiable uncertainty associated with this PC – both now and within AMP8. As revisions to the EPA have not yet been consulted upon we do not have certainty on what this may or may not include. This is potentially a very material issue and we believe it will necessitate careful consideration by Ofwat to manage the impact on this measure through the change control process.

Revised definitions for future incidents will likely be broader than those in the past. This means that these incidents are not reflected in historical performance data, nor the AMP8 forecasts or Ofwat's PCLs. For example, Continuous Water Quality Monitoring data is not available until installation begins in FY26 and PFF monitor installation will not be complete until FY27. This means that the historical data set is not representative of future performance. The consequence of this is significant because Ofwat has not limited the risk by applying an underperformance collar to the PC. It therefore has the potential for unrestricted penalty, and as such the penalty value is unknown. Ofwat estimates the P10 risk for this PC for UUW at -0.19% Ww RoRE1. However, we consider that this risk is significantly understated, as the risk posed by future regulatory changes has not been considered in Ofwat's P10 estimation. UUW's estimation of the P10 risk based on Ofwat's DD is more in the region of -0.27% Ww RoRE.

Ofwat does propose that the change control process could impact PCLs, ODIs and risk protections (e.g. caps, collars). Given that changes will be prospective, there will be no historic data set available to robustly calculate the impact on PCLs, etc. It is unclear how this new process will operate in practice and how Ofwat therefore intend to calculate revised PCLs, ODI and risk protections.

Ofwat's proposals for this new change control process are not well-defined in the draft determination documentation, particularly for an area of such significant uncertainty and financial risk. Such level of uncertainty at this stage of the PR24 process is concerning and we urge Ofwat to be mindful of this when addressing the significant uncertainties posed by this PC definition.

¹ Taken from cell U17 of Ofwat's DD document "PR24-DD-ODI-risk-5-Year-Additive-RoRE-Payments-model.xlsx" tab "% RoRE Wastewater Summary"

Ofwat does not propose a penalty collar on the basis that this is a well established performance commitment. However, given the substantial potential scope and definitional changes that are likely to serve to increase the number of incidents counted by the metric, the measure will evolve into something much less well established during AMP8. Given this, setting a penalty collar may well be an appropriate means of managing the risk of an unbalanced incentive.

We also note that Ofwat's justification for not setting an enhanced ODI rate rest on the uncertainty associated with future regulatory changes. This appears at odds with the reasoning for not setting an underperformance collar.

4.2 Removal of enhanced ODI rate

Ofwat proposed an enhanced ODI rate for this PC in the PR24 final methodology but has reversed this decision in the draft determination, removing the enhanced rate and thus increasing the negative skew of the overall Outcomes package. Ofwat cites potential regulatory change as a reason for this removal, which is out of step with its decision to introduce a change control process to accommodate such regulatory changes. We believe that for a measure such as this one, concerning pollutions to the environment, positive incentives for the best sector performance are important.

Since we believe this incentive will drive better performance, which will positively impact customers and the environment, we have updated our proposed outperformance enhanced threshold after deliberating the options outlined below. Our preferred choice is option 1, which can be seen below in Table 2, and is based on a recent and reliable dataset.

The options considered for the enhanced incentive reward threshold (EIRT) were:

- (1) EIRT based on a linear trend of frontier industry performance from FY17 to FY23;
- (2) EIRT based on frontier of company targets submitted for AMP8;
- (3) EIRT based on the difference between the UUW submitted PCL and submitted EIRT; and
- (4) EIRT as originally submitted by UUW in the October 2023 submission

Though we submitted our preferred choice (option 1), we are happy for Ofwat to consider any of these options as an alternative at final determination.

Table 2: UUW options considered for enhanced incentive reward thresholds

Option	2025-26	2026-27	2027-28	2028-29	2029-30
(1) EIRT based on the historic frontier	13.82	13.40	12.98	12.56	12.13
(2) EIRT based on frontier of company submitted targets	16.03	14.72	12.86	10.98	9.13
(3) EIRT based on the difference between submitted PCL and submitted EIRT	16.26	15.01	14.35	13.68	13.65
(4) EIRT as originally submitted	13.96	13.54	13.16	12.65	12.02

Source: UUW data analysis

5. What Ofwat can do in the final determination to address these issues

Change control process – There is uncertainty on how this will work in practice to address upcoming changes:

We urge Ofwat to thoroughly consider the concerns highlighted in this document, owing to prospective regulatory changes and limited to no historic data, and ensure they will be addressed as part of the change control process.

Enhanced reward – Reinstatement will encourage additional positive performance:

We urge Ofwat to reconsider its position on enhanced reward at final determination for the benefit of customers and the environment.

Penalty collar – May be appropriate given future uncertainty surrounding this measure:

We urge Ofwat to consider applying a penalty collar to manage the risk of an unbalanced incentive and reflecting the uncertainty associated with future regulatory changes.