Technical representation

Outcomes

South West Water

Bournemouth Water

Isles of Scilly Water

Bristol Water

Contents

1 Executive Summary

We agree with the principle of a balanced ODI risk profile, proposing in our plan challenging but realistic outcome targets that will improve environmental and customer outcomes, with an incentive mechanism that drives for improved performance and outcomes. However, based on the Draft Determination, ODIs are our biggest area of risk.

We have carefully considered and modelled the overall impact of the Draft Determination in making our representations we have set the key principles:

- We have accepted a large proportion of Ofwat's targeted performance levels and used these incentive levels as the basis for our assessment
- It is important to us that we are able to deliver on our four strategic priorities, setting challenging targets to support this but it is also essential that there are sufficient incentives to deliver, and that the assessments completed reflect company and industry positions
- We believe significant risk should be matched by equivalent incentives, especially where we are sector leading
- Overall the framework should see a material upside as well as downside, to avoid the current negative skew
- We recognise that there remains challenges in setting ODI packages and that Ofwat may wish to change the approach to narrow the overall range, aligning with indicative targets.

Reflecting on the challenges faced and potential risk associated with the draft determination outcome incentives our risk position of -6.6% to +2.1% is not tenable. We have therefore considered a stepped approach to accommodate and support much of the position within Ofwat's draft determination whilst managing our overall risk position. Our representation therefore includes:

- Frontier adjustments – we have applied higher incentives for those areas where SWB has consistently delivered frontier performance in internal sewer flooding and bathing water quality with this approach reflecting the simplest revisions to the draft determinations
- Focused representation – we adopt Ofwat's incentive rates and a large proportion of the performance levels in the draft determination. But we also adjust other performance commitments, in order to fully 'balance' the downside skew in Ofwat's draft determination, including adopting our bespoke ODIs reflecting the key environmental impact of these measures
- Full Framework Representation – we have reflected on how the focused framework still results in an ODI range above the indicative +/- 3% RoRE range. These impacts are being driven by the strong incentive rates Ofwat has applied, so we have created a package accepting specific aspects of the draft determination, overlaid with our view of incentives and various ODI protections.

The overview of these approaches are summarised in the table below:

Table 1 - ODI RORE ranges (P10/P90 ranges)

Approach	Underperformance as a % of RORE	Underperformance £m p.a. (averaged)	Outperformance as a % of RORE	Outperformance £m p.a. (averaged)
Business Plan	-2.1%	-43	1.9%	37
PR24 DD: Ofwat's risk analysis	-1.3%[1]	-32	0.8%	19
PR24 DD: our risk analysis	-6.6%	-166	2.1%	52
PR24 DD: frontier adjustment	-6.6%	-166	3.6%	91
PR24 DD: focused	**-4.8%**	**-120**	**4.1%**	**103**

[1] This is based on our analysis, although an Ofwat draft determination spreadsheet states this is -1.4% to 0.9%

Approach	Underperformance as a % of RORE	Underperformance £m p.a. (averaged)	Outperformance as a % of RORE	Outperformance £m p.a. (averaged)
PR24 DD: full framework[2]	-1.8%	-44	1.6%	40

We will continue to work constructively with Ofwat over the development of the incentive rates, ahead of the final determinations

1.1 Summary of the draft determination

In reviewing the outcomes in the draft determination and considering them against our business plan framework, as well as industry positioning we have identified the following key areas for consideration:

- Ofwat's risk approach – Ofwat's assessment of the ODI RoRE range in the draft determination is -1.3% to +0.8%. Ofwat accepts that the ODI design results in a downside skew (assumed to be offset by companies achieving outperformance via other RoRE levers, such as financing/ debt outperformance). Our view is that this assessment of risk does not adequately reflect the actual risk for the industry (particularly in areas such as pollutions). Our assessment of Ofwat's risk modelling results in a much broader and significant downside of -6.6% to +2.1%.

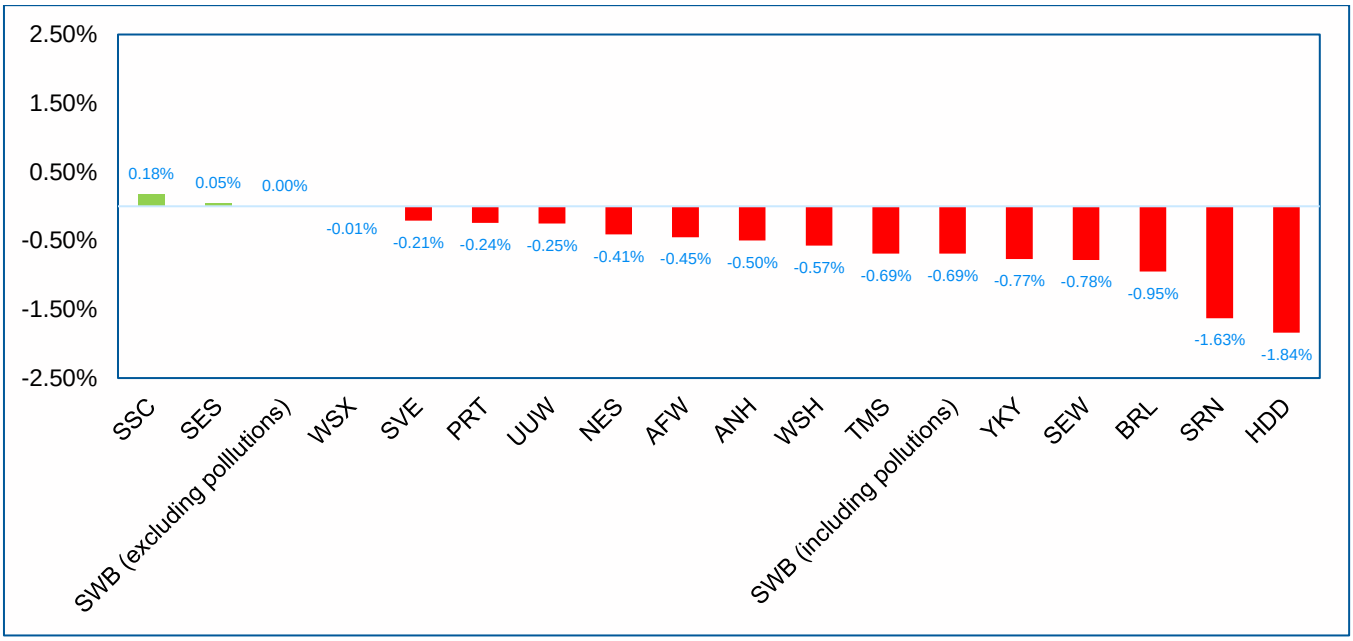
  Among other things, it appears as though Ofwat has assumed that P50 performance is aligned to the stretching performance commitment levels (PCLs) and also assumed that risk disappears as service improves. This is justified with reference to selective historical analysis as the basis of assumed performance improvements.

  Experience in AMP7, suggests that continued performance improvements are not being achieved and that industry P50 levels are worse than the PR24 PCLs – under the current outcomes framework, all but two companies do not have net outperformance for common ODIs and the range is +0.18 to -1.84% of RORE and an industry average of -0.57%. The figure below demonstrates the industry performance concerning common performance commitments penalty and rewards over AMP7 as a percentage of RoRE.[3] For SWB this also highlights the significant impact of pollutions, where overall performance would have been balanced excluding the material and unbalanced impact of this one measure.

[2] This framework is included in representation SBBDD10_L3_Finance_risk_and_return and in ADD18

[3] Source: Oxera analysis based on Ofwat's Water Company performance Report data (2023) and company APR24 data

Figure 1 - Companies average performance against common PCs over PR19, excluding PCC due to potential COVID-19 end of period reconciliation adjustments (2020/21-2023/24, % of RoRE p.a.)



- Stronger incentive rates – For PR24 Ofwat has prioritised 'stronger' incentives – the majority of incentives rates have increased in the draft determination compared to Ofwat's indicative rates as well as those applied in AMP7. For the most part, our 'focused' representation adopts the draft determination incentive rates (which may still result in ODI risk ranges that are inconsistent with Ofwat's objective of meeting the indicative +/- 3% RoRE range).

  Our 'full framework' representation then adopts our assessment of incentive rates. These were set following a four-step process: 1) setting the customer preferred overall package level 2) allocating the package across PCs using customer preferences 3) calculating proposed top-down rates using Ofwat models 4) calculating proposed top-down rates for PCs not covered by Ofwat models. We have explored further the importance of customer preferences in top-down approaches to setting incentives in our supporting ODI think-piece (Worthless or priceless? What is the value of listening to customers when setting Outcome Delivery Incentives?). We do note that Ofwat wrote to water companies to reflect on *"two consistent issues highlighted to us relating to discharge permit compliance and water quality contacts."* We have factored this into our representations.

- Customer and company protections - Whilst the aggregate sharing mechanism has a place in the outcomes framework (to mitigate against extreme exogenous factors) it should not override ODI protections for individual performance commitments, in particular over the inclusion of deadbands. For example, on deadbands, the CMA noted the following appropriate circumstances for their application:
  a. The measure itself allows very little tolerance: In these cases, a company might 'miss' the PC without necessarily having objectively failed in management of the commitment.
  b. Delivery of the PC is not wholly within companies' control: circumstances outside management control could lead to a small underperformance.
  c. The measure is new, and its relation to desired company management behaviours and outcomes is not clear: setting a deadband can offer some reassurance to companies, while maintaining the incentive to deliver good performance.

  The CMA also noted as part of the PR19 redetermination that collars mitigate the risk that underperformance on performance commitment could lead to extreme penalty levels for companies – indicating that individuals performance commitment collars, rather than relying on the aggregate sharing mechanism, is appropriate.
  We explore the regulatory precedent for various performance commitments in our focused representation and our full framework representation.

- Unbalanced position for ODIs – with three ODIs having penalty only, and some have 'natural limitations' to outperformance there may inevitably be an imbalance in the overall ODI risk range. However, a further imbalance arises when the outperformance range available to frontier or upper quartile performing companies in service areas most valued by customers, such as internal sewer flooding and bathing water quality, are not sufficient to offset the downside risk for lower quartile or bottom performance – which may arise in a similar area

- Bespoke performance commitments – these have been an established part of the outcomes framework and we support this continuing to be a part of the overall package – but the allowance and allocation for this should be consistently applied across companies (with some companies having both outcome and output measures allowed, such as the number of lead pipes replaced and the number of collaborative projects delivered)

- Customer measures of experience - in addition to all of the above, Ofwat should re-consider the cross-sector benchmark and revert back to a relative incentive approach (comparing a company's C-MeX score with other water companies), which would ensure there is consistency in how incentives for C-MeX, D-MeX and BR-MeX are calculated.

1.2 Our focused representation and our full framework representation

1.2.1 Frontier Adjustment Representation

Approach	Underperformance as a % of RORE	Underperformance £m p.a. (averaged)	Outperformance as a % of RORE	Outperformance £m p.a. (averaged)
PR24 DD: frontier adjustment representation	-6.6%	-166	3.6%	91

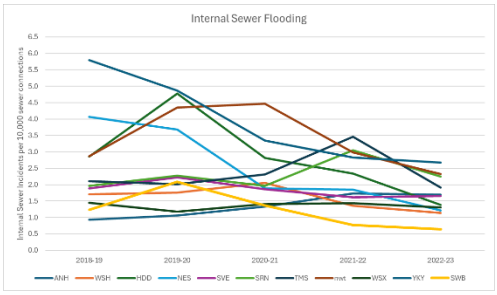
Whilst we recognise that we must improve upon our pollutions performance (if Ofwat continues to measure performance on a normalised basis, using sewer length), due to the strength of the draft determination incentive rates, the size of the penalty on total pollution incidents alone could result in the aggregate sharing mechanism applying (as we calculate that AMP7 industry performance is significantly different to the service levels that could be achieved based on Ofwat's assumptions over P50 performance improvements).

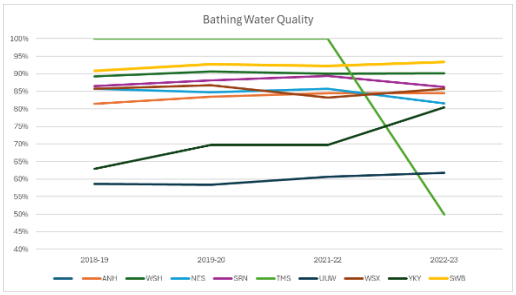
Having reflected on the scale of the downside risk, we considered areas where we could propose simple and relatively light-touch revisions that Ofwat could adopt at the final determinations. As the incentive framework should be balanced, this approach only revises two metrics where we are sector-leading – internal sewer flooding and bathing water quality. These revisions aim to 'uplift' the lower level of outperformance available to the industry. These light-touch revisions were to:

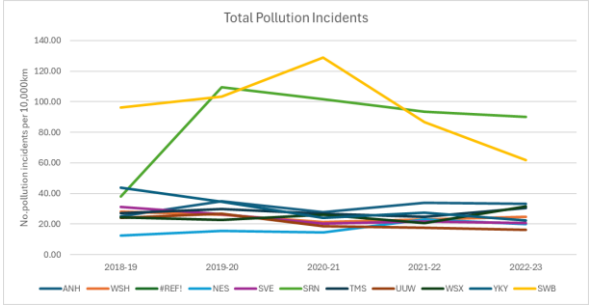
- Apply a multiplier of 2 to the standard incentive (and resulting enhanced threshold) for internal sewer flooding to reflect the relative importance of this measure (which has one of the most negative impacts on customers)
- Setting the bathing water quality target as a common industry target. We have proposed this be set at the upper quartile range for the industry – as SWB whilst achieving frontier performance would not receive any outperformance.

Whilst this is a simple option (as it is most closely aligned to the draft determination) it does not reflect a balanced position (-6.6% / +3.6%). We therefore concluded that further revisions would be required to address the imbalance in the ODI RoRE risk that we have been presented with at the draft determinations.

The charts below highlight the historical performance for these three key measures noted above:







1.2.2 Focused Representation

Approach	Underperformance as a % of RORE	Underperformance £m p.a. (averaged)	Outperformance as a % of RORE	Outperformance £m p.a. (averaged)
PR24 DD: focused representation	**-4.8%**	**-120**	**4.1%**	**103**

We recognise Ofwat wishes to apply standardised incentive rates, which prioritises uniform unit rates. For this representation, we assume the majority draft determination incentive rates are adopted. In addition to the representation relating to the frontier performance balance, we considered the following revisions:

- Water quality contacts – applying a multiplier of 0.25 to the incentive rate and setting the PCLs as per the levels set at the business plan (for SWB)
- Total pollution incidents - updating pollutions targeting to align with the proposals we are making within the EPA consultation
- Serious pollution incidents – applying a deadband
- Discharge permit compliance – applying a deadband
- Operational GHG emissions (water and wastewater) – setting the PCLs as per the levels set at the business plan (as we are not accepting the sector-wide base cost adjustments)
- Embodied GHG emissions - applying a multiplier of four to the business plan incentive rate

1.2.3 Full Framework Representation

Approach	Underperformance as a % of RORE	Underperformance £m p.a. (averaged)	Outperformance as a % of RORE	Outperformance £m p.a. (averaged)
PR24 DD: full framework representation[4]	-1.8%	-44	1.6%	40

Whilst we recognise Ofwat wishes to apply standardised incentive rates, which prioritises uniform unit rates, if Ofwat consider our focused representation results in a level ODI RoRE risk that exceeds the -/+ 3% RoRE indicative range, then adjusting the size of the incentive rates could be considered. As this representation includes materially different incentive rates, we have had to apply caps and collars consistent with our business plan approach. This representation is however not just restating the business plan framework as we have accepted a number of interventions, such as:

- The removal of the deadbands for mains repairs and unplanned outage
- The common PCLs for the majority of the performance commitments (other than for total pollution incidents).

1.3 Other representation areas

In addition to our 'focused' representation and 'full framework' representation, we have explored the following topics in this representation:

- Outcomes risk modelling – as Ofwat's assessment of the ODI RoRE range is materially different to our assessment, we have examined Ofwat's risk models – as outlined in Section 2. We highlight pollution incidents in this representation as an example of why Ofwat's assumptions on risk may be mis-calibrated. Further information on our ODI RoRE calculations are included in our finance, risk and return representation document.

- Incentive rates - in Ofwat's QAA assessment our approach to ODIs was highlighted as not meeting Ofwat's expectations, but that this was not considered material (to the overall QAA categorisation). The key factor was insufficient evidence to support our incentive rates, as well as evidence to support our approach to balancing the RoRE risk. We have further explored the impact of the draft determination incentive rates and our business plan incentive rates – as outlined in Section 5. We have also included an additional supporting 'think-piece' - Worthless or priceless? What is the value of listening to customers when setting Outcome Delivery Incentives? - that further reflects on the importance of customer preferences in setting top-down incentives.

[4] This framework is included in representation SBBDD10_L3_Finance_risk_and_return and in ADD18

- The Isles of Scilly – in our business plan we proposed exclusions for a number of performance commitments and for reporting on separate performance commitments for the Isles of Scilly. To be as constructive as possible at the draft determination, we have accepted all of Ofwat's interventions in this area and have therefore removed these performance commitments (and exemptions from the common performance commitments) from our outcomes framework. This is confirmed in Section 11.

- Forecast Data and 2024-25 ODI Performance Model – we have highlighted any material changes from our business plan forecasts in Section 12.

- Data tables - Our draft determination business plan data tables includes the full framework representation ODIs in ADD18 and our view of incentives in OUT7 as this aligns with our risk and return expectations. However, we have also included separate tables on ADD18 and OUT7, which reflects the 'focused' representation for ODIs.

- Alternative proposals for the outcomes framework - we recognise that setting incentives based on top-down approaches does have drawbacks. In our business plan, in addition to exploring how top-down rates could be set, we also explored two further alternative approaches. These are explored again in Section 14.

2 Outcomes Risk Modelling

Ofwat has recently stated that it has *"given careful consideration to the issue around the potential risk of downside skew in outcome delivery incentives and increased the upside."*[5] For the sector to remain investable there must not just be a focus on 'stronger' incentives and never-ending stretches to target levels, creating downside risk and low ranges of outperformance, but a focus too on reasonable upside from operational outperformance.

We support Ofwat's desire to simplify the price review at PR24 and we recognise that performance commitments was one of the areas of the methodology that Ofwat set this objective. We will always support a framework where our customers remain at the centre of defining the service measures we are incentivised to meet. However, Ofwat's draft determinations, despite what the regulator has said publicly, has resulted in an ODI framework that cannot meet the PR24 methodology requirement of a balance in risk and return.

Ofwat's approach links top-down incentive rates to historical performance and de-links customer preferences in calculations. Ofwat then justifies its 'stronger' incentives alongside stretching PCLs with fewer ODI risk protections, to create an ODI framework that has downside skew. Ofwat justifies this skew with reference to financing outperformance for the notional company, with question over the credibility of these assumptions.

The approach proposed by Ofwat at PR24 results in a risk-return that is not balanced and has significant potential financial penalties (even for the notional company).

For each PC, we create a five-year view of performance for a best-case (P90) & worst-case (P10) scenario. The table below shows our five-year view of P10 performance for Water Supply Interruptions, as an example.

Table 35: Percentile combination for a five-year view of P10 performance for Water Supply Interruptions

	Year 1	Year 2	Year 3	Year 4	Year 5
Performance Percentile	P10	P10	P40	P50	P50

This approach is simple to follow but relies on assumptions about the frequency of performance percentiles. While this approach gives a more realistic representation of the frequency of a P10/P90 level of performance in a 5-year period than the simple additive approach, we may over- or under-state the size of risk.

The outcomes framework is intrinsically linked to risk and return. The ODI package is therefore critical to achieving an appropriate balance of risks and rewards between customers, management and our shareholders. Setting the wrong incentives may mean that companies are subject to performance risk in areas beyond their control, or are overly incentivised to perform on certain areas. In addition, too much risk has the potential to increase financing costs. The RoRE framework, if we follow precisely the PR24 methodology and draft determinations, would continue to exhibit a material asymmetry for ODI incentives.

An appropriate outcomes incentives package should therefore be aimed at areas that customers value, be proportionate in terms of willingness-to-pay and the impact on RORE and reflect the boundaries of the regulatory framework.

It cannot be true, as Ofwat has concluded, that the industry can have stronger incentives and more stretching targets, but less outcomes risk. Ofwat has based this assumption on its risk modelling (this modelling was not available before the draft determinations were published). This risk modelling at best includes miscalibrated risk analysis and at worst, simply paints a picture of future industry performance improvements that is not based on reality, even for the cost-efficient companies.

Yet Ofwat's RORE ranges are based on a number of key assumptions:

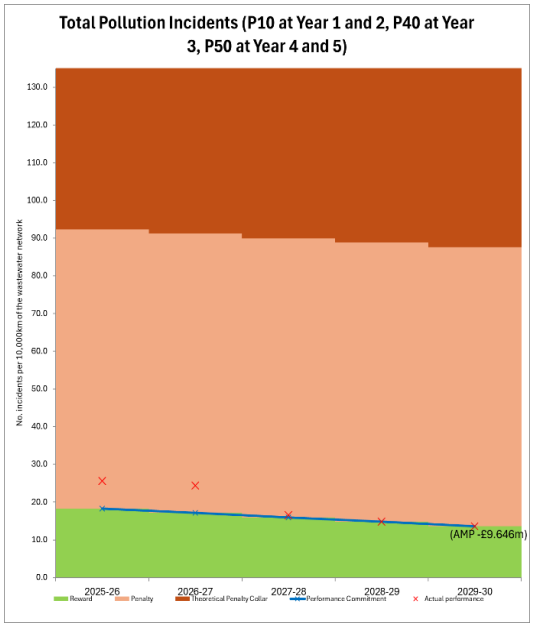
- The application of selective historical performance analysis as the basis for the risk ranges
- The assumption that P50 performance equals the PCL for all performance commitments, regardless of the stretch required throughout the five-year period
- The assumption that P10 levels assume the PCL is met for two-three years of the five-year reporting period
- RoRE risk simulations are fixed, in that it is not a random draw from some distribution. Instead, each company's five-year P10 outcome is the sum of the following annual outcomes (generally P10 + P10 + P40 + P50 + P50), with the converse true for the five year P90 outcome (generally P90 + P90 + P60 + P50 + P50), as shown in table 35 below
- The assumtion that a cost efficient company can outperform the forecast performance levels, even though historical performance suggests this cannot be true

[5] Ofwat (2024) City Briefing - transcript

By Ofwat's own admission:

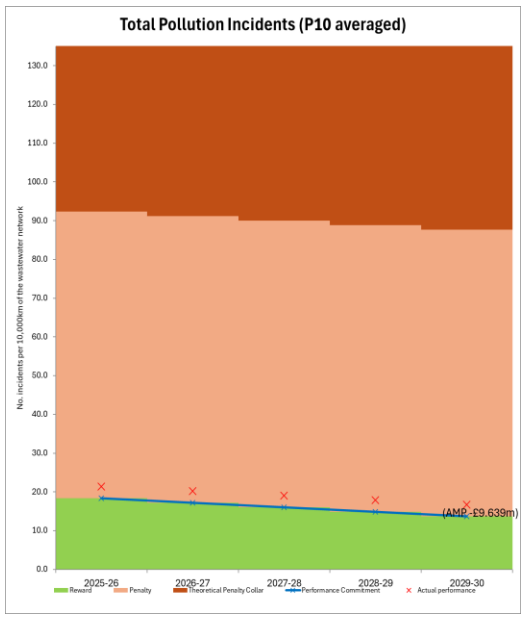
- The approach may over- or under-state the size of risk (in our view, it under-states the downside risk)
- There is a "small amount of skew towards negative payments" which is justified via financing outperformance (which we believe is not possible for the notional company)

We are not sure how this can over-state the risk, unless Ofwat were setting PCLs at levels below historical performance. As this is not the case, this must clearly under-state the risk. The definition of risk here is a net impact that should be balanced by opportunity to outperform, which is a necessary condition for balanced incentives in this framework. It risks undermining the principles of economic regulation behind Ofwat's duties, something we have had concerns about since PR19[6].



Ofwat's modelling is particularly questionable for total pollution incidents. The P10 average range assumes we would only incur seven additional pollutions above the PCL. This is partly because Ofwat assume the industry P10 equals the P50 in two of the five years. But it is also partly because Ofwat's expectations of service delivery, based on the cost allowances given to companies, with no consideration to marginal cost is not reflective of industry performance. We explore these risk assumptions further below, using pollution incidents as an example.

Using Ofwat's published PCLs (we explain separately in the Outcomes and priorities: Storm Overflows and Pollution section of this document why we disagree with this PCL) Ofwat's assumptions result in the following P10 ranges:



[6] Bristol Water (2021) Regulating for consensus and trust

These risk ranges indicate South West Water would, at worst, be expecting underperformance of circa seven pollution incidents above the PCLs. But Ofwat's assumed risk ranges are much narrower than recent outturn data would suggest and not centred around a justifiable P50 level of stretch when compared to outturn performance or company performance forecasts. As Ofwat has prioritised 'stronger' incentives, if Ofwat's P10 levels are proven to understate the size of risk, then the expected underperformance companies would see in AMP8 are a lot more alarming than Ofwat has indicated in its draft determinations.

Based on our analysis, Ofwat has clearly (i) miscalibrated the risk ranges and (ii) unjustifiably assumed that the PR24 PCL equals the 50th percentile (i.e. p50, or median/midpoint) around which these apply. Adjusting only the most unjustified assumptions, the P10/P90 out- and underperformance range would lie between -124% (underperformance) and 32% (outperformance) above and below the PCL. The four figures below show have we have calculated these risk ranges.

Figure 2 - POL figure 1: Ofwat risk assessment implications for total pollute on incidents performance ranges

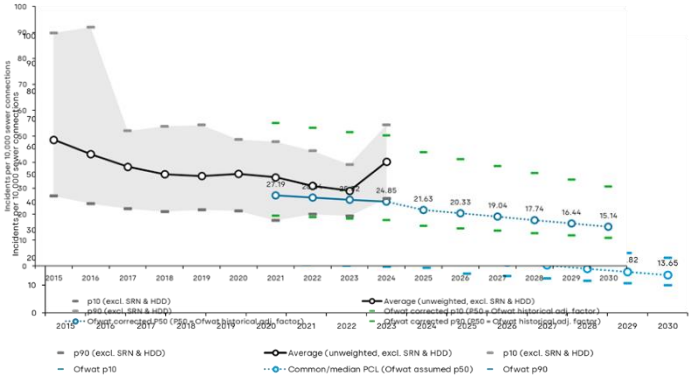


Figure 3 - POL figure 2: Ofwat's adjusted P50, but corrected P10-P90 range, vs outturn

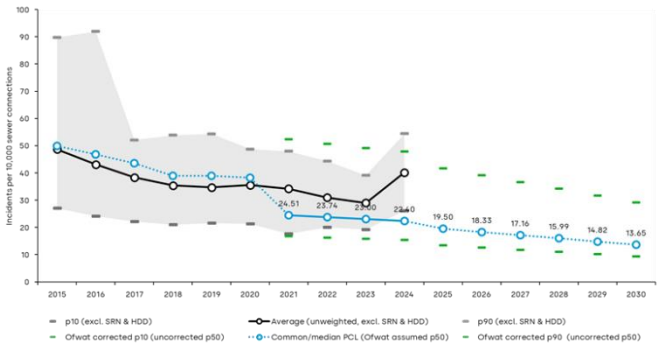


Figure 4 - POL figure 3: Ofwat's unadjusted P50 and corrected P10-P90 range, vs outturn

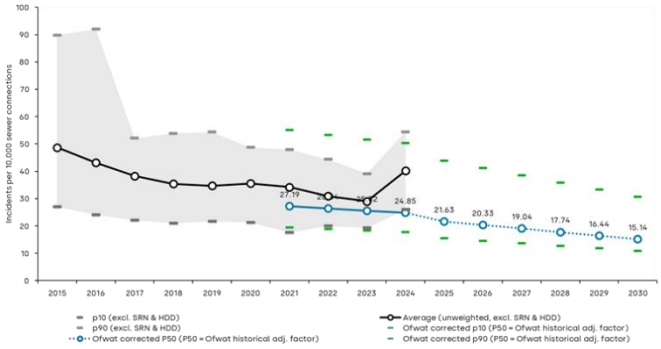
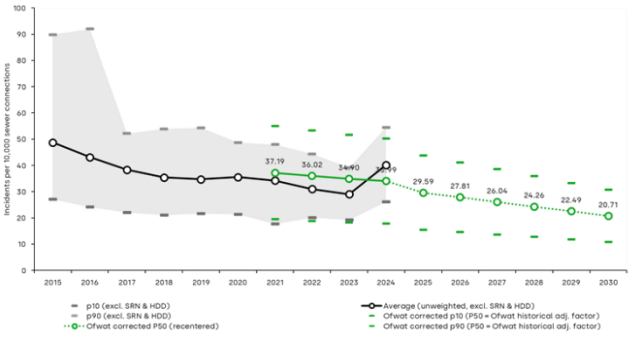
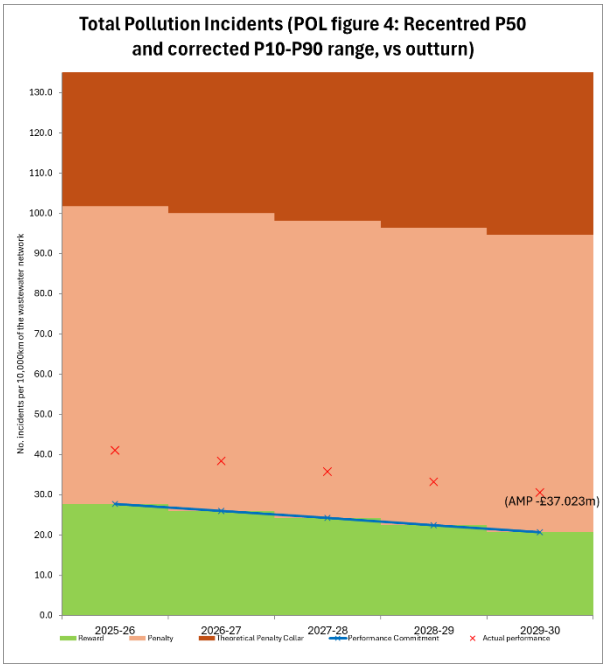


Figure 5 - POL figure 4: Recentred P50 and corrected P10-P90 range, vs outturn





By continuing to use total pollution incidents as an example, we note the following:

- P10/P90 ranges: Ofwat currently estimates a (recentred) P10-P90 risk range of -45% to 28% against the historical PCL, as reflected in PC terms in POL figure 1. However, correcting for only the most obvious and unjustified assumptions (bulleted below), we can show that the true, median-centred risk range is closer to -113% to 32%. POL Figure 2 reflects the latter correction in PCL terms, based on the following corrections to Ofwat's selective adjustments:
    - Considering all relevant companies, thus including SWB (which Ofwat excludes as an 'outlier') but excluding HDD (for which the target is not set based on this analysis and who has a separate PCL than the rest of the industry)
    - Focussing only on PR19 out- and performance ranges, given that companies had more lax, company specific targets at PR14. The latter are demonstrably less challenging than the common PR24 PCLs, which are evidently a continuation of the PR19 targets.
    - Including 2023/24 performance data.

- Recentring the P50: Ofwat currently uses an 'adjustment factor' to recentre P50s where historical PCL have proved more or less stringent than the true median/P50 position implied by its risk ranges. For the corrected POL range above, if we were to remove the recentring, the risk range would be more left-skewed, between -124% to 21%, with the P50 position at -11% (implying that the true P50 would have been less stringent than the PCL). This is reflected in PCL terms in POL figure 3.
- ODI rate implications: Ofwat's ODI rates are linked to historical performance. If Ofwat accepts its performance improvements are over-stated, we would expect the relevant ODI rate to reduce significantly to keep the downside P10 risk to -0.6% of RoRE.
- Alternative P50 applied to Ofwat's existing ODIs: POL figure 4 is only illustrative (simply taking the PCL implied by the midpoint of Ofwat's corrected range) but if applied to Ofwat's ODIs, the expected downside is far more stretching than circa £10m, in fact it is almost four times higher at circa £37m.

In addition, Ofwat's additive approach uses five year P10 and P90 ranges to avoid the risk of overstating skew. We disagree that this approach will produce valid ranges of risk as it assumes a static scenario, where risk does not increase as service levels improve. The trends in industry performance and in our What Base Buys analysis demonstrate this clearly.

This risk analysis is explored further in representation **SBBDD10_L3_Finance_risk_and_return**.

Ofwat seem to have misunderstood our ODI risk analysis in the QAA assessment *"The company has not provided compelling evidence to support its proposals for lower incentive rates due to overexposure on risk of return. The reduction in size of incentives risks providing insufficient incentive for companies to improve performance. South West Water proposed different ODI rates for all common performance commitments for both the South West area and Bristol area. The company set out that the indicative rates represent a risk on return on regulatory equity (RoRE) greater than +1-3% when taking an additive approach. This is not consistent with our guidance in the PR24 methodology, where we explained that the ±1-3% is the expected return for an efficient company with a mix of out and underperformance across the different PCs and with risk protections such as caps and collars applied. The additive approach applied by South West Water is unrealistic and overestimates the risk."*

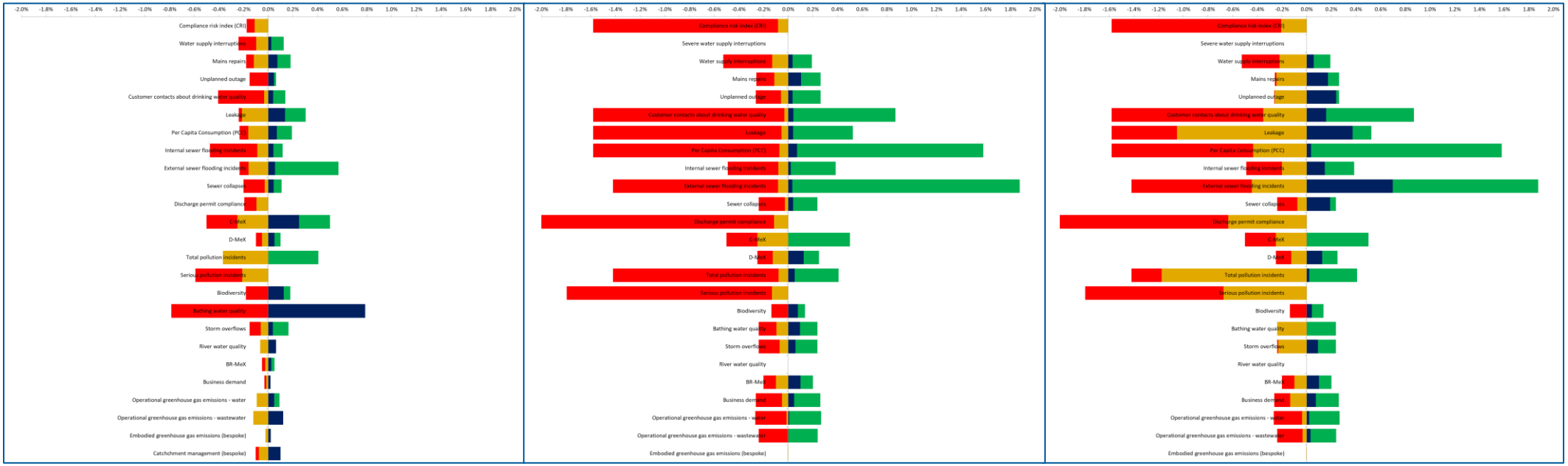
We considered customer insights, regulatory precedent and the overall balance of risk as part of our assessment for estimating ODI risk. For the business plan, our analysis tested what ODI risk existed through Monte Carlo simulation In two stages – first assuming independent distributions based on P10 and P90 ranges for each measure, and then linking the probability for related measures such as leakage, supply Interruptions and mains repairs, and flooding, pollution and storm overflows. We considered the overall ODI design through this suite of analysis. We also tested through Monte-Carlo simulation a range of scenarios.

The plan itself stretched performance based on consistent set of analysis which was used to assess risk, and was based on considering median and benchmark company performance. The additive approach and ODI designs considered areas of out and underperformance across different PCs. And Ofwat observe an additive approach as being valid (and similar to the Monte Carlo approach in the DD). Ofwat recognise that a Monte Carlo approach risks under- or overstating the negative skew in historical performance data for individual performance commitments through assuming a normal distribution of performance.

Finally, our ODI package must be considered alongside the allowed cost of equity (as well as any flawed assumptions Ofwat has made over financing outperformance). The CMA aimed up the allowed cost of equity on the basis of the regulatory framework (in particular ODIs) being negatively asymmetric, and to avoid the negative consequences of setting the allowed cost of capital too low. In order for Ofwat to depart from the CMA's approach, we expected Ofwat at the draft determinations to demonstrate that its ODI framework was indeed symmetrical – it is not symmetrical and its justification that this can be balanced via financing outperformance, does not work for the notional company.

Our business plan included a balanced ODI framework (ODI RORE range on the left). Ofwat justifies its interventions using its approach to risk analysis (ODI RORE range in the middle). Our risk analysis, based on Ofwat's interventions, concludes that there is a much greater degree of downside skew (ODI RORE range on the right).

Figure 6 – ODI risk frameworks



Approach	Underperformance as a % of RORE	Underperformance £m p.a. (averaged)	Outperformance as a % of RORE	Outperformance £m p.a. (averaged)
Business Plan	-2.1%	-43	1.9%	37
PR24 draft determinations: Ofwat's risk analysis	-1.3%	-32	0.8%	19
PR24 draft determinations: our risk analysis	-6.6%	-166	2.1%	52

3 Incentive Rates and Customer Research

The National Audit Office principles of effective regulation are absolutely clear that regulators with a specific duty to protect consumers need to embed the citizen perspective in all aspects of their work.

Ofwat's indicative ODI rates for PR24 differ materially from those set at PR19 – and there is no compelling evidence that Ofwat's PR24 draft determination rates are more appropriate than those at PR19 (either because the method used objectively better reflects the benefits and costs of delivering performance; and / or because benefits and costs have changed since PR19). Whilst Ofwat's draft determination ODI risk modelling on face value suggests otherwise, in our view Ofwat's indicative rates also indicated a material increase in the amount of RoRE that would be at risk from ODIs at PR24. Simply put, Ofwat's rates did not appear to be consistent with its view of a +/-1% to +/-3% RoRE risk range and such a range could not be achieved for South West Water (a cost efficient company for wholesale water) based on the indicative rates provided to the industry.

As set out by Ofwat in August 2023[7], Ofwat's original intention was to set ODI rates for PR24 in relation to customer values. Ofwat intended to set these on the basis of one piece of research, led by Ofwat working closely with Consumer Council for Water (CCW), companies and stakeholders (the collaborative research). However Ofwat encountered more challenges than originally envisaged both in conducting the collaborative research and then using its findings to set indicative ODI rates.

The eventual approach contrasts to the approach that Ofwat set out at PR19 whereby companies were required to provide triangulated marginal benefit values representing the value of the unit benefits of a change in service to their customers/region.

Ofwat used three sources of customer research (about priorities or value generally) and combines these to provide a customer priority rating that underpins the development of the Ofwat indicative ODIs.[8] Ofwat's top-down approach, developed in 2023, just prior to companies' business plan submissions, applies three sources of existing primary customer research. This made best use of the sources available at the time of moving to a top-down approach from the planned bottom-up one. Ofwat's approach to top-down indicative rates was to use their customer priorities to define the proportion of regulated equity for each PC. Rather than using customer preferences, Ofwat used an anchor of 0.5% per PC which is allocated to medium priority PCs, with 0.6% allocate to high priority and 0.4% to lower priority PCs. Our top-down incentive rates were intended to be a constructive, pragmatic approach in light of the guidance for PR24. A key principle of our approach was to align as closely as possible to Ofwat's top-down approach, whilst incorporating more robust evidence on customer preferences for ODIs.

Ofwat's principles of good customer research are clear that research should be fit for the purpose to which it is being used. We note that not all of the pieces of customer research used to inform Ofwat's customer prioritisation were undertaken with this use in mind and have been retrospectively applied for this purpose (as the solution to Ofwat's problems over its mapping exercise). This contrasts to our dedicated Outcome Delivery Incentive customer research which explores customers views.

Likewise, Ofwat's choice of the average amount of RoRE to allocate to each PC (0.5% RoRE) is arbitrary. Adjusting the range by 0.1% RoRE to reflect low and high customer views was also arbitrary. Based on Ofwat's logic and the evidence it presented, it could have selected a materially different number.

The incentive rates we proposed in our business plan reflected a constructive, pragmatic approach in light of the guidance for PR24 and in light of the fact of the delayed timetable regarding Ofwat's approach to setting incentive rates.

[7] Ofwat (August 2023) PR24: Using collaborative customer research to set outcome delivery incentive rates

[8] Ofwat (2023) PR24: Using collaborative customer research to set outcome delivery incentive rates

Our incentive rates were linked to the findings from customer research which had been designed explicitly to provide quantifiable customer preferences to inform the calculation of top-down ODIs in line with the approach proposed in the Bristol Water think-piece and used by Ofwat in it's top-down approach.[9]

As a summary of how we applied customer research:

- Step 1: customer research establishes preferences for overall ODI risk based on preferences for bill variability
- Step 2: customer research (ranking PCs and best-worst choice exercises) establishes direct weightings for RoRE purposes
- Step 3: these rates were then 'triangulated' against Ofwat's indicative rates – triangulation was a method supported by Ofwat at PR19

This robust approach was explained in further detail in a supporting document for our business plan, on how to calculate customer informed top-down ODI rates.

In response to the draft determinations we have included an additional supporting 'think-piece' - Worthless or priceless? What is the value of listening to customers when setting Outcome Delivery Incentives? - that further reflects on the importance of customer preferences in setting top-down incentives. We bring out below a couple of findings from this report, as these statements highlight the importance of meaningfully understanding and embedding the customer voice into the heart of ODIs, which is what our approach to top-down incentives aimed to achieve:

"The situation companies find themselves in today is complex and uncomfortable – Ofwat continues to use the language of supporting customer engagement and of the need for water companies to improve their performance in order to regain customer trust. However, when it comes to the ODI framework, the voice of the customer appears less important."

"To fully integrate the customer voice, it is important to triangulate all the available information recognising the relative complementary strengths of the studies."

The alignment between the customer research Ofwat relied on and the amount of RoRE that Ofwat initially allocated to each PC was also highly subjective. At the draft determination Ofwat has further revised its incentive rates. We highlight a selection of these below:

[9] Bristol Water (2022) A simplified approach to setting ODI rates

Table 2 – Differences in Customer Preferences in ODI rate setting

Common Performance Commitment	Ofwat top-down customer research ranking	Ofwat revised ranking at Draft Determination	SWW national customer research ranking
External sewer flooding	H	H	M
Water supply interruptions	H	H	M
Customer contacts	H	H	L
Serious pollution incidents	M	M	H
Storm overflows	M	H	M
Total pollution incidents	M	H	L
Unplanned outage	M	M	L
Per capita consumption	L	H	M

The most notable revisions are for customer contacts about water quality and total pollution incidents where the customer ranking in the national study is for Low ODIs and the regulatory judgement is High.

For pollutions, we can see that customers feel strongest about the serious incidents and therefore prioritise these over total pollution incidents. It is really noticeable that the Ofwat's revised regulatory judgement at Draft Determination has moved away from the customer preferences found in the national study for this PC.

Priorities are lower in the national study than Ofwat's Draft Determination rating for three PCs that have a direct impact on households (external sewer flooding, water supply incidents and water quality contacts).

Priorities are also lower for Storm Overflows, Total Pollution Incidents, Per Capita Consumption and Unplanned Outage. The first three of these PCs are areas where Ofwat has increased the ranking to accommodate the Government Strategic Priorities. This implies that the amendments for these priorities are not aligned with customer preferences.

We are again reminded of a warning from the 'think-piece' - Worthless or priceless? What is the value of listening to customers when setting Outcome Delivery Incentives? - that further reflects on the importance of customer preferences in setting top-down incentives:

"Integrating the voice of the customer within the ODI process is essential to ensure that ODIs reflect customers preferences and limit unintended consequences that lead to outcomes that are not in customers' best interests."

Our customer research is robust, relevant and complements Ofwat's existing ODI customer research. We therefore re-apply our business plan incentive rates.

4 Focused Representation

In this representation we adopt the majority of Ofwat's incentive rates. However, due to the downside skew that the draft determination position presents us with we are representing on 12 performance commitments, in order to 'balance' the downside skew in Ofwat's draft determination. Our business plan bespoke PCLs are also included.

Table 3 – Focused Representation incentive rates

Performance Commitment	SWB Incentive rate	BRL Incentive rate
Internal Sewer Flooding	9.854*	N/A
External Sewer Flooding	1.83	N/A
Water Quality Contacts	3.886*	2.069*
Compliance Risk Index	0.755	0.253
Water Supply Interruptions	0.469	0.164
River Water Quality	N/A	N/A
Bathing Water Quality	9.901	N/A
Total Pollution Incidents	0.638	N/A
Serious Pollution Incidents	1.747	1.406
Discharge Permit Compliance	4.785	0.556
Storm Overflows	1.059	N/A
Leakage	0.909	0.848
Per Capita Consumption	0.438	0.142
Business Demand	0.254	0.2
Mains Repairs	0.14	0.045
Unplanned Outage	2.823	0.95
Sewer Collapses	1.482	N/A
Biodiversity	2.468	0.472
Operational GHG emissions (water)	0.000188	0.000188
Operational GHG emissions (wastewater)	0.000188	N/A
Embodied greenhouse gas emissions (bespoke)	0.125	N/A
Catchment management (bespoke)	0.000816*	N/A

*Adjusted rates. We have adjusted incentive rates for internal sewer flooding (SWB) and for water quality contacts (SWB and BRL) compared to the draft determination rates. We have adjusted catchment management (SWB) compared to the business plan rates.

In this focused representation we only make representations for the following performance commitments:

SWB:

- Water quality contacts
- Internal sewer flooding
- Total pollution incidents
- Serious pollution incidents
- Bathing water quality
- Discharge permit compliance
- Operational GHG emissions (water and wastewater)

BRL:

- Water quality contacts
- Serious pollution incidents
- Discharge permit compliance
- Operational GHG emissions (water)

This representation results in an ODI RoRE risk range of -4.8% to +4.1%.

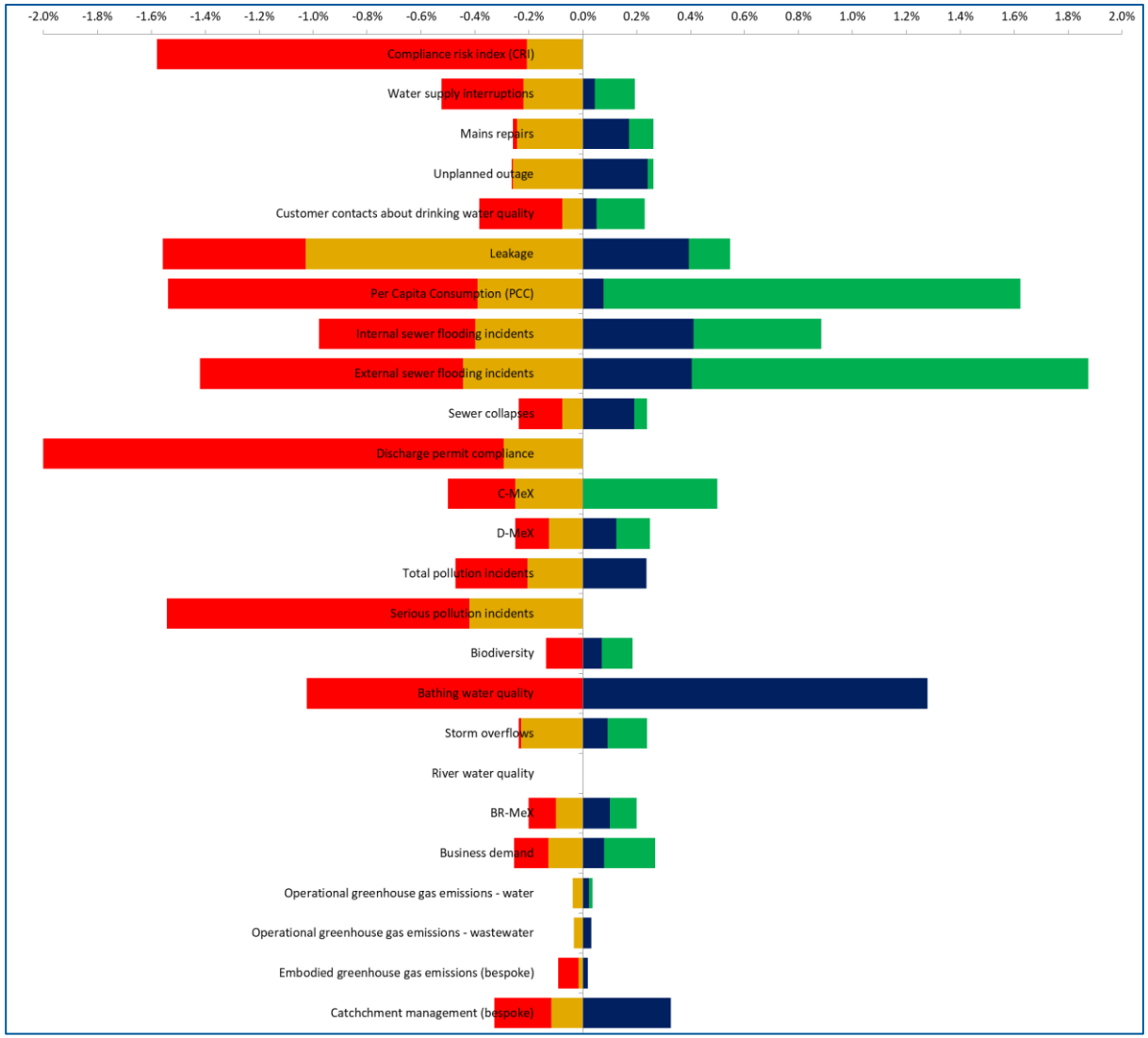
Table 4 - ODI RORE ranges (P10/P90 ranges) – focused representation - Appointee Outcome Delivery Incentives (£m, 2022-23 prices)

Focused representation	Penalty RORE (P10)	Penalty RORE	Within P10	Penalty	Reward	Enhanced Reward	Within P90	Reward RORE	Enhanced Reward RORE	Reward RORE (P90)
Compliance risk index (CRI)	-0.21%	-1.58%	(5.16)	(39.41)				0.00%		0.00%
Water supply interruptions	-0.22%	-0.52%	(5.49)	(13.10)	1.51	3.30	1.14	0.19%	0.13%	0.05%
Mains repairs	-0.24%	-0.26%	(6.11)	(6.46)	6.54		4.30	0.26%		0.17%
Unplanned outage	-0.26%	-0.26%	(6.46)	(6.56)	6.56		5.98	0.26%		0.24%
Customer contacts about drinking water quality	-0.08%	-0.38%	(1.90)	(9.57)	5.72		1.28	0.23%		0.05%
Leakage	-1.03%	-1.56%	(25.67)	(38.86)	5.94	7.68	9.83	0.55%	0.31%	0.39%
Per Capita Consumption (PCC)	-0.39%	-1.54%	(9.76)	(38.37)	40.52		1.94	1.62%		0.08%
Internal sewer flooding incidents	-0.40%	-0.98%	(9.95)	(24.44)	2.36	19.71	10.25	0.88%	0.79%	0.41%
External sewer flooding incidents	-0.44%	-1.42%	(11.09)	(35.43)	2.34	44.47	10.07	1.88%	1.78%	0.40%
Sewer collapses	-0.08%	-0.24%	(1.89)	(5.93)	5.93		4.74	0.24%		0.19%
Discharge permit compliance	-0.29%	-2.62%	(7.32)	(65.34)				0.00%		0.00%
C-MeX	-0.25%	-0.50%	(6.24)	(12.48)	12.48		0.00	0.50%		0.00%
D-MeX	-0.13%	-0.25%	(3.12)	(6.24)	6.24		3.12	0.25%		0.13%
Total pollution incidents	-0.21%	-0.47%	(5.12)	(11.77)	5.90		5.90	0.24%		0.24%
Serious pollution incidents	-0.42%	-1.54%	(10.48)	(38.48)				0.00%		0.00%

Focused representation	Penalty RORE (P10)	Penalty RORE	Within P10	Penalty	Reward	Enhanced Reward	Within P90	Reward RORE	Enhanced Reward RORE	Reward RORE (P90)
Biodiversity	0.00%	-0.14%	0.00	(3.39)	4.62		1.76	0.19%		0.07%
Bathing water quality	0.00%	-1.02%	0.00	(25.54)	31.88		31.88	1.28%		1.28%
Storm overflows	-0.23%	-0.24%	(5.72)	(5.93)	5.93		2.28	0.24%		0.09%
River water quality	0.00%	0.00%	0.00	0.00	0.00		0.00	0.00%		0.00%
BR-MeX	-0.10%	-0.20%	(2.50)	(4.99)	4.99		2.50	0.20%		0.10%
Business demand	-0.13%	-0.26%	(3.20)	(6.38)	6.69		1.99	0.27%		0.08%
Operational greenhouse gas emissions - water	-0.04%	-0.04%	(0.92)	(0.92)	0.92		0.57	0.04%		0.02%
Operational greenhouse gas emissions - wastewater	-0.03%	-0.03%	(0.81)	(0.81)	0.81		0.81	0.03%		0.03%
Embodied greenhouse gas emissions (bespoke)	-0.02%	-0.09%	(0.39)	(2.27)	0.48		0.48	0.02%		0.02%
Catchment management (bespoke)	-0.12%	-0.33%	(2.94)	(8.16)	8.16		8.16	0.33%		0.33%
Total	-5.3%		(132)				109			4.4%
Total, excluding MeXs	-4.8%		(120)				103			4.1%
Total, excluding MeXs and bespoke PCs	-4.7%		(117)				95			3.8%

The yellow and blue bars represent the P10 and P90 ranges for each incentive. Red and dark green bars fall outside of the P10 and P90 expected performance range, and light green represents the potential impact of enhanced ODI performance incentive rates.

Figure 7 – ODI RoRE risk range – focused representation



4.1 Outcomes and Priorities: Water Quality and Resilience

4.1.1 Customer contacts about water quality

Ofwat has intervened at the draft determination, applying different PCLs to those stated in our business plan. Ofwat did also change its methodology expectations – this PCL was initially expected to be set on a common industry basis but Ofwat has, as we requested in our business plan, set the PCLs on a company-specific basis. We welcome Ofwat's revision to set the PCLs as company-specific.

The SWB profile was linked to our planned water treatment works upgrades – forecast improvement rates may not be linear - we expect enhancements to materialise after 2028-29. As South West Water is a cost-efficient company for wholesale water, this revision is proportionate.

Table 5 – Performance Commitment Levels – SWB Water Quality Contacts

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. contacts per 1,000 population	1.33 (PR19 definition)	1.34	1.24	1.15	1.05	0.87
Standard underperformance collar	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Underperformance deadband	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Outperformance deadband	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Standard outperformance cap	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Enhanced outperformance cap	No. contacts per 1,000 population		NA	NA	NA	NA	NA

On 20 August 2024 Ofwat wrote to companies to note that several companies had raised concerns about the size of the ODI rate for the water quality contacts performance commitment. Ofwat stated:

"While ensuring high water quality standards is very important, we need to balance this against the risk of any adverse incentives and financial risk."

Although Ofwat did not state how the ODI should be adjusted we have proposed a simple adjustment, by applying a multiplier of 0.25%.

4.2 Outcomes and Priorities: Storm Overflows and Pollution

4.2.1 Internal sewer flooding

In the QAA Ofwat praised our ambitions for our proposed performance target for internal sewer flooding. As an industry-leading company on this area of service, we would like to highlight to Ofwat the disproportionate impact of its outcomes framework - there is a natural 'cap' on outperformance for this metric, which does not then compensate for the underperformance companies are now facing for other ODIs, such as for total pollution incidents. We have considered this imbalance further in the appendix to this representation document - by considering alternative ODI proposals– these range from simple revisions (aligning as closely to the draft determination as possible) to more novel approaches.

Ofwat has intervened at the draft determination, by applying a PCL at 1.15 incidents per 10,000km of sewer connections by 2029-30 throughout the reporting period, to be delivered from total expenditure. We have adopted these industry common levels of service.

Ofwat has also intervened by setting the enhanced outperformance threshold at 0.63 by 2029-30. The inclusion of enhanced ODIs for four metrics, accompanied with frontier levels of threshold performance, results in theoretical outperformance that may not be attainable. All companies aspire to deliver sector leading levels of service for their customers, but the outcomes framework, as currently designed, is now too stretching and too loaded with downside risk. The enhanced threshold level has therefore been re-set for internal sewer flooding.

Table 6 – Performance Commitment Levels – SWB Internal Sewer Flooding

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number per 10,000 sewer connections	0.80	1.31	1.29	1.24	1.20	1.15
Standard underperformance collar	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Underperformance deadband	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Outperformance deadband	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Standard outperformance cap	Number per 10,000 sewer connections		1.00	1.00	1.00	1.00	1.00
Enhanced outperformance cap	Number per 10,000 sewer connections		0.00	0.00	0.00	0.00	0.00

4.2.2 Total pollution incidents

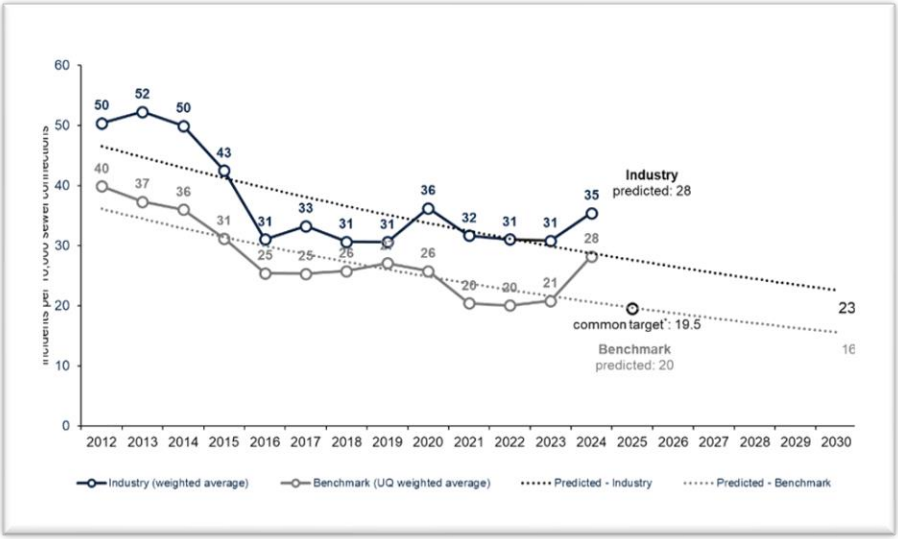
Ofwat has intervened at the draft determination to set an industry common PCL based on its interpretation of a WISER obligation (by applying the expectation of at least a 30% reduction of all pollution incidents (category 1 to 3) by 2030 on the 2024-2025 targets, to the targets for AMP8). We have fundamental objections to this revision, which we outline below.

Ofwat has intervened and removed the collar that we proposed in our business plan. We have fundamental objections to this revision. For PR24 Ofwat's rates are materially higher than PR19. The CMA as part of the PR19 redetermination concluded that collars mitigate the risk that underperformance on one performance commitment could lead to extreme penalty levels for companies – individuals performance commitment collars, rather than relying on the aggregate sharing mechanism, is appropriate. Our collar level was supported by our 'what base buys' analysis of industry performance, based on allowed base expenditure. Likewise, our customers rank this performance commitment as a 'low' priority (compared to Ofwat's uplift at the draft determination from a 'medium' to a 'high' customer ranking). The application of a collar reflects the low preference our customers assign to this performance commitment.

Ofwat has also removed the enhanced ODIs for total pollution incidents. We have no objections to this intervention.

4.2.2.1 Target setting and risk overview

Comparison of companies' performance against common performance commitments can be a valuable tool for both understanding how our own performance can evolve over time and for the purposes of setting PCLs as part of the price review process. Based on historical analysis, the industry will struggle to achieve the end of AMP7 stretching targets and then struggle to achieve the Ofwat application of the WISER 30% reduction. The cost-efficient companies will also not achieve the Ofwat application of the WISER 30% reduction.



Benchmarking performance on the normalised metric does however have significant limitations. In the case of total pollution incidents (categories 1 to 3) the PC used by Ofwat does not seem suitable, on its own, for direct comparisons of performance between companies. The fact that it is a measure reported on by the Environment Agency alone does not imply that it is a reasonable or reliable way to benchmark companies' performance on pollution incidents.

The source of category 1 to 3 pollution events is not predominantly from sewers. In reality, less than 50% of pollutions occur on the network. Rather, these pollution events arise from a wider set of system assets which includes sewers, pumping stations and sewage treatment works.

Ofwat is alert to how external, exogenous, effects, can impact on companies' performance. In its July 2023 information note relating to the impact of enhancements on performance, Ofwat states that in the context of leakage and per capita consumption it may use econometric analysis to take account of a range of exogenous factors when setting the PCLs. We suggest that there are grounds for taking account of such factors in other areas of companies' performance, including in relation on pollution incidents.

In addition, Ofwat's risk ranges are much narrower than recent outturn data would suggest (implying too high ODI incentive rates have been set), and not centred around a justifiable P50 level of stretch when compared to outturn performance or company performance forecasts. Ofwat's 30% stretch in the PCL, and its accompanying assessment of 'symmetrical' risk ranges around it, is clearly untethered from what companies have been delivering over AMP7 and prior (and would introduce significant downside risk to SWB, and industry more broadly). In our view, Ofwat would at least need to adjust (reduce) its ODI rates, as well as reconsider its PCLs too.

4.2.2.2 Sewer length data error

For the business plan, and as confirmed in response to query OFW-OBQ-SBB-088, for total pollution incidents, we proposed that this measure should not be normalised and that it should instead be reported as the absolute number of pollution incidents. The data we included in OUT5 showed the absolute number of pollution incidents and the number when normalised per 10,000 km of the wastewater network. Our business plan data tables assumed a change in the sewer length, as per the guidance stated in the data table guidance.

However for the draft determination, we note that there is now inconsistency in what normaliser (the size of sewer length) should be used for this metric. As per query OFW-IBQ-SBB-006, we asked Ofwat the following:

"On page 112 of the draft determination outcomes appendix, Ofwat states: "This performance commitment [total pollution incidents] measures the total number of pollution incidents per 10,000km of sewer length in 2017-18." However, on page 41 of the PR24 data tables guidance (section 1: outcomes), Ofwat provide guidance on the sewer length for the total pollution incidents performance commitment. The guidance states our expectation is that the correct affiliation is "For 2021-22 to 2025-26, this is the sewer length value from 2017-18. For 2026-27 to 2030-31, this is the sewer length value from 2022-23".

"Could Ofwat please confirm that the correct definition is "For 2021-22 to 2025-26, this is the sewer length value from 2017-18. For 2026-27 to 2030-31, this is the sewer length value from 2022-23"."

Ofwat responded:

"For analysis and setting of the PCL we have normalised values against 2017-18 sewer length throughout the 2020-25 period. This allowed us to consistently review historical performance against expected future stretch. We also considered that retaining the 2017-18 throughout the 2025-30 period for the purpose of PCL setting provided greater clarity to stakeholders.

"All PCLs for total pollution incidents for the years 2025-26 to 2029-30 have been normalised against the 2017-18 sewer length. This is consistent with current Environmental Performance Assessment (EPA) reporting guidance for 2020-25. At present there are no updates to the EPA guidelines for 2025-30.

"We will consider how to best normalise the total pollution incidents PCLs for the 2025-30 period in our final determinations based on the latest view available of the proposed EPA reporting guidance for the 2025-30 period."

Whilst we understand Ofwat's desire to ensure consistency in how the PCLs are set at the start of the reporting period, this new approach, which is a change to the expectations outlined in the methodology, creates inconsistency and uncertainty for all parties.

The inconsistency arises because Ofwat say that the 2017-18 sewer length has been used to set a 30% reduction, but it appears as though a sewer length at 22,712 has been used. Adjusting the sewer length for the 2017-18 value should result in a different normalised reduction, compared to what Ofwat has published in its PCL model.

	Baseline	Draft Determination Performance Commitment Levels					Percentage reduction (2029-30 versus baseline)
	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	
No. incidents per 10,000km of the wastewater network	19.50	18.33	17.16	15.99	14.82	13.65	30
No. incidents	44	41	38	36	33	31	
Sewer Length (km)	22712	22712	22712	22712	22712	22712	

	Baseline	Draft Determination (adjusted for 2017-18 sewer length) Performance Commitment Levels					Percentage reduction (2029-30 versus baseline)
	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30	
No. incidents per 10,000km of the wastewater network	25.23	23.51	21.79	20.64	18.92	17.78	30
No. incidents	44	41	38	36	33	31	
Sewer Length (km)	17440	17440	17440	17440	17440	17440	

4.2.2.3 Sewer length updates

Throughout AMP7, a 'frozen' sewer length from 2017-18 has been applied as the normaliser. This methodology, of basing performance on a fixed point in tie, is line with the Environment Agency's monitoring of pollution incidents in its EPA. We object to the 'freezing' of the sewer length, if sewer length continues to be applied as the normaliser.

Sewer lengths are not fully observable. It consists of legally transferred assets which have been assessed by companies using different and inconsistent methods. It is only SWW that has a significant difference from the EPA kilometre to the current position – around 32%.

When private sewers transferred in 2011, Companies estimated the length of transferred sewer using a model developed by WRc. These were high level estimates which in many cases were inaccurate due to a lack of sewer records.

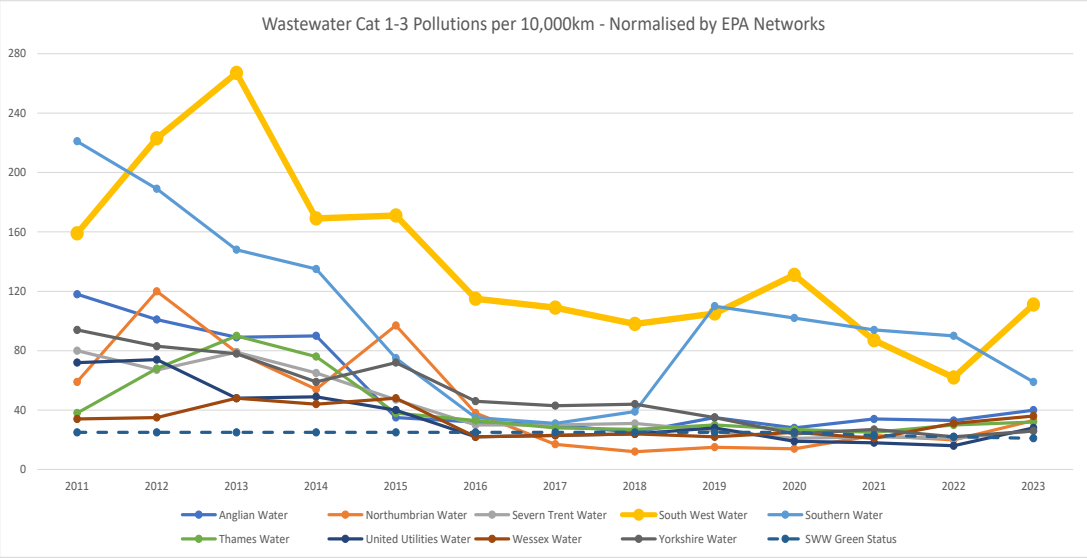
In 2011, Ofwat wrote to all companies setting out the need for companies to improve the quality of their records and estimates over a 10-15 year timeline. Despite this SWW have been the only company to significantly review and improve the accuracy of our records.

We continue to seek innovative ways to improve accuracy having established (with a third party) a sector leading spatial modelling tool which visualises the sewers through existing assets, properties being charged wastewater bills and respecting the curtilage of the property. Based on this review the sewer length has increased to 25,368 (including identifying new developer sites assets to). This stands to increase this variance further to 45%. We believe companies should not be penalised for continuously improving the quality and accuracy of their data.

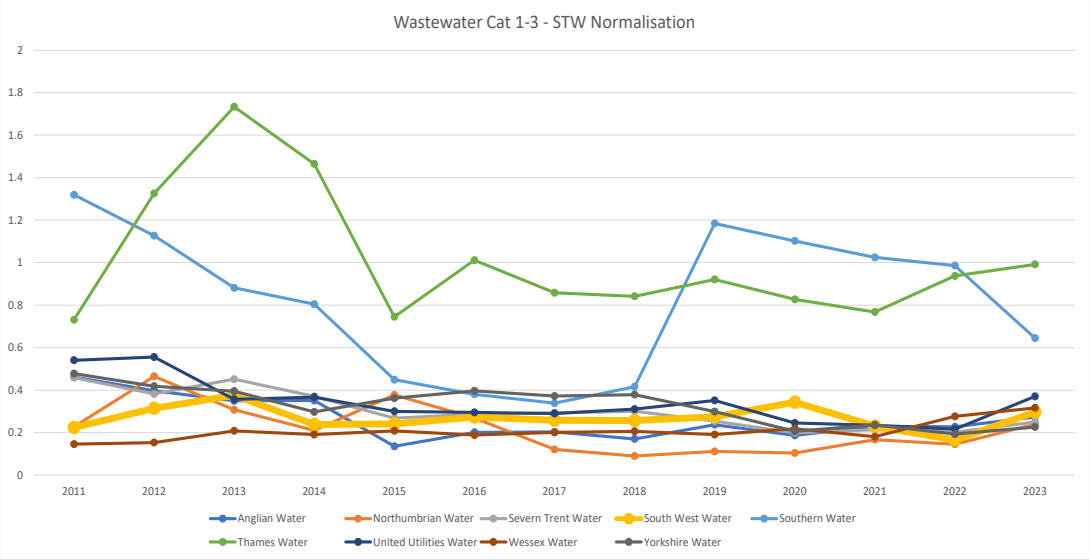
The use of networks is not representative as it reflects only c.50% of the cause of pollutions. More than half of SWW's pollutions have nothing to do with the network. For 2023, only 35% of pollution incidents came from networks.

If the normalisation factor were changed from networks to treatment works South West Water would no longer be an outlier but would be within the relative industry performance. The relative performance for other companies (excluding Thames where the number of STW is disproportionately low for the km sewers) remains broadly consistent.

Network Normalisation



Treatment Works Normalisation



Perversely, the current EPA makes it harder to protect the environment.

There is a risk that what can be measured is favoured over what is important.

All the areas where the Government's Environmental Improvement Plan (EIP) states we should invest in are not part of the EPA, such as overflows, river and coastal quality, net zero, nutrient reduction and natural capital.

The EPA does not provide the flexibility in delivery to deliver early in response to external factors. For example, the change in scope of our Exmouth scheme alongside the acceleration of Kenn & Kennford and Wilmington – which are overall beneficial to the environment - still led to a failure in the current WINEP EPA reporting.

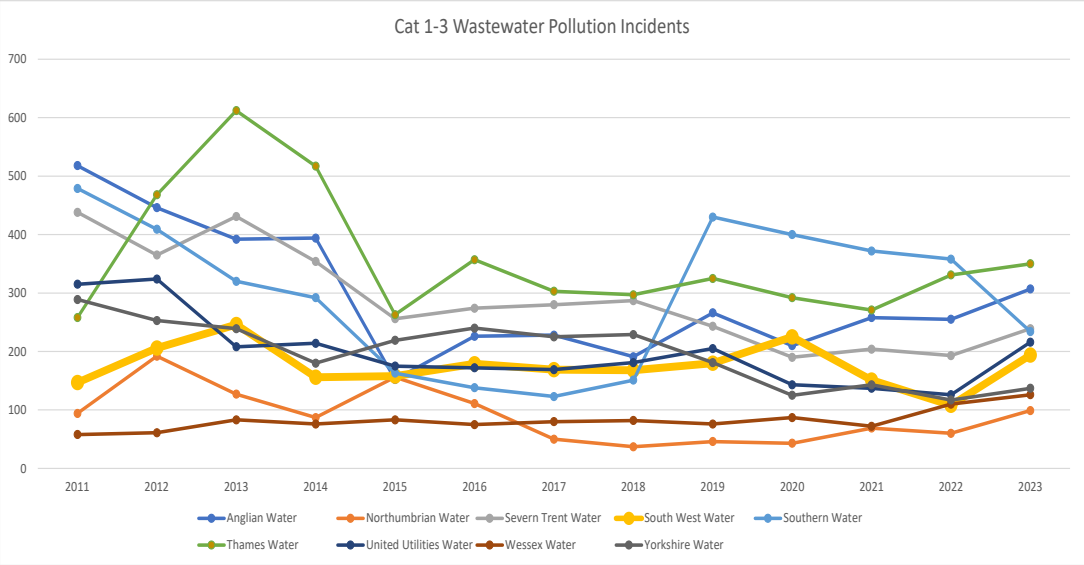
The current approach does not encourage nature-based solutions. A more rigid framework dampens the ability to use nature-based solutions further – given these solutions can take longer to implement and may not be consistent with fixed delivery timescales.

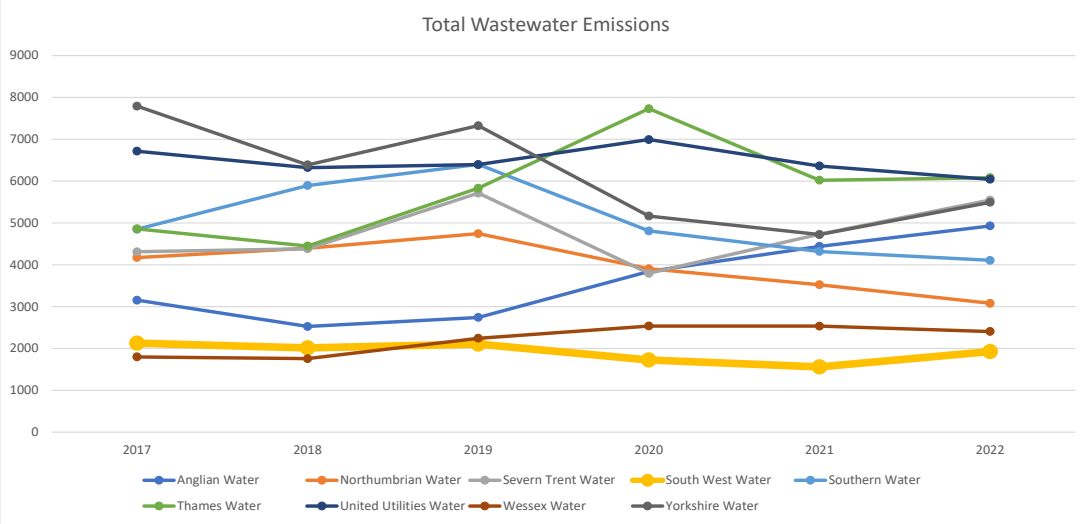
In addition, if the sewer length value from 2022-23 is used as the sewer length (as Ofwat's PR24 methodology had originally stated) then the data does require a revision.

4.2.2.4 Sewer length normaliser, absolute pollutions and the EPA consultation

Whilst we are disappointed that the Environment Agency EPA consultation has been further delayed, we consider that the current EPA framework does atypically have an adverse affect on SWW in a specific way – more so than other companies.

In 2022, SWW had the second lowest absolute pollution levels in the sector. But the second highest normalised levels of pollutions. We have had zero Cat-1 events for 5 years.





Irrespective of the data error and approach to freezing the sewer length, our ultimate conclusion is that the approach to measuring total pollution incidents on a normalised basis should change. The current approach unfairly penalises South West Water and the application of the benchmarking gives a biased impression of our performance to our customers. In addition, the application of the WISER 30% reduction applied on a normalised basis results in the number of absolute pollutions SWB is required to achieve results in:

- SWB absolute targets set at the frontier for the industry
- SWB's absolute targets set at a level that is far more stretching than the three cost efficient companies
- Of the three cost efficient companies, Wessex Water would have the most stretching absolute targets, but even by 2029-30, their absolute target (at 47) would still be less stretching than the absolute target we proposed in our business plan (At 45)

Sewer length varies for many reasons, including population (served/density), historical legacy and geography/topography. We have by far the lowest number of sewer lengths of all companies. It is therefore not surprising that the company has a higher number of incidents per 10,000 km sewer length than most. We tend to perform in the middle of the pack on absolute numbers but move to the bottom when data is normalised on sewer length.

On industry performance, Ofwat's draft determinations also recognises outliers. It has acknowledged that the sewerage system for Hafren Dyfrdwy is small and therefore agrees to not be appropriate to set the PCL on the basis of the rest of the industry. In making this decision, Ofwat recognises that a company is out of step with other companies. This principle can also be extended to large companies. The way that all wastewater networks are maintained and operated reflects their unique characteristics: the size of the operating region (size of geographical area, length of network) the density of connections, the nature of the landscape and number of wastewater treatment works and pumping stations. Our current sewer network reflects legacy decisions, i.e. the size of the operating region, the density of connections, and the nature of the landscape has driven investment in the sewer network. The size and structure of our sewer network (e.g. layout, sewer type, sewer diameter, etc.) directly reflect these factors. Most of our sewers remain of small diameter – which are more prone to blocking. To that extent, our sewer system is more like the network of Hafren Dyfrdwy, rather than larger companies such as Thames Water or United Utilities. We would therefore again urge Ofwat to consider whether adjustments to our targets would be appropriate.

Estimating risk or an appropriate PCL has been complicated at the draft determination because a) Ofwat has indicated the PR24 PCLs may be revised in-period following EPA revisions and b) an EPA consultation on future revisions has been due for publication but not yet been published.

The EPA methodology for serious pollutions is:

a) based on absolute numbers
b) provides a target of 1 pollution for the smaller companies which is half of the larger companies who are allowed 2 pollutions in 2024

We recommend the same methodology is applied for category 1-3 pollutions, which will ensure consistency across the measures without affecting the RAG status of most of the other companies.

The category 1-3 pollutions measure should therefore be:

a) based on absolute numbers of pollutions (derived from the normalised target) and
b) provide a target for the smaller companies which is half of the larger ones

Looking at the top four largest water companies to achieve the EPA green status in 2023 they have to target an average of 188 category 1-3 pollutions based on the current methodology. We recommend that the smaller water companies target should be half of this at 94 category 1-3 pollutions for a 'green status. Therefore anything over this level would be an 'amber status' and then red based on a target level determined by the EA (it would be 169 based on 2023 equivalent position).

As part of the PR19 redetermination the CMA concluded that collars mitigate underperformance risk where one performance commitment could lead to extreme penalty levels for companies – this is exactly what the sector is facing on pollution incidents. We also therefore proposed a collar at 1% RoRE above the absolute target of 94 pollutions (a level that equals the collar for water supply interruptions) and a cap at 0.5% RoRE.

Table 7 – Performance Commitment Levels – SWB Total Pollution Incidents

SWB	Unit	Baseline forecast	Performance Commitment Level (sewer length at 17,440)				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. incidents per 10,000km	25.80	53.9	53.9	53.9	53.9	53.9
Standard underperformance collar	No. incidents per 10,000km		72.35	72.35	72.35	72.35	72.35
Underperformance deadband	No. incidents per 10,000km		NA	NA	NA	NA	NA
Outperformance deadband	No. incidents per 10,000km		NA	NA	NA	NA	NA
Standard outperformance cap	No. incidents per 10,000km		44.65	44.65	44.65	44.65	44.65
Enhanced outperformance cap	No. incidents per 10,000km		NA	NA	NA	NA	NA

Table 8 - impact of absolute pollution reductions required to meet draft determination 30% WISER on normalised targets

	Historic Outturn							Business Plans		Draft Determination				
Total number of incidents	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25 forecast	2024-25 baseline	2025-26	2026-27	2027-28	2028-29	2029-30
ANH	228	191	266	210	258	255	307	211	149	140	131	122	113	104
WSH	103	102	94	77	83	89	107	78	70	66	62	57	53	49
HDD	6	4	2	5	2	2	5	5	4	4	4	3	3	3
NES	50	37	46	43	69	60	99	58	58	55	51	48	44	40
SVE	280	291	248	190	204	193	239	181	182	171	160	149	138	127
SRN	139	151	434	402	372	358	234	193	77	72	67	63	58	53
TMS	303	297	325	292	271	331	350	367	212	199	187	174	161	148
UUW	171	185	207	143	137	126	216	124	150	141	132	123	114	105
WSX	80	82	76	87	72	110	126	90	68	64	59	55	51	47
YKY	225	229	181	125	143	117	137	97	101	95	89	83	77	71
SWB	**169**	**168**	**180**	**225**	**151**	**108**	**194**	**45**	**44**	**41**	**38**	**36**	**33**	**31**
Frontier (excluding HDD)	50	37	46	43	69	60	99	45	44	41	38	36	33	31
Average cost efficient companies (SVE, UUW, WSX)	177	186	177	140	138	143	194	132	133	125	117	109	101	93

4.2.3 Serious pollution incidents (water and wastewater)

Ofwat has intervened at the draft determination to remove the deadband and collar we included in our business plan.

As serious pollutions is inextricably linked to pollutions risk, a deadband is still appropriate (please see our full framework representation for a full explanation).

Table 9 – Performance Commitment Levels – SWB Serious Pollution Incidents

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number	2	0	0	0	0	0
Standard underperformance collar	Number		10	10	10	10	10
Underperformance deadband	Number		2	2	2	2	2
Outperformance deadband	Number		NA	NA	NA	NA	NA
Standard outperformance cap	Number		NA	NA	NA	NA	NA
Enhanced outperformance cap	Number		NA	NA	NA	NA	NA

Table 10 – Performance Commitment Levels – BRL Serious Pollution Incidents

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number	0	0	0	0	0	0
Standard underperformance collar	Number		10	10	10	10	10
Underperformance deadband	Number		2	2	2	2	2
Outperformance deadband	Number		NA	NA	NA	NA	NA
Standard outperformance cap	Number		NA	NA	NA	NA	NA

Enhanced outperformance cap	Number	NA	NA	NA	NA	NA

4.2.4 Bathing water quality

Ofwat has intervened at the draft determination to apply company-specific forecasts as the PCLs and it sets caps and collars at 0.5% RORE, based on the Ofwat incentive rates.

In our business plan we recommended that the PCLs be set on an industry common basis – we again urge Ofwat to consider this approach. On the forecast PCLs Ofwat has set for the industry, the industry upper quartile results in a PCL of 89.8% by 2029-30; this is the PCL that we propose be adopted. As a frontier company, Ofwat's approach does not reflect the level of investment required to upkeep the excellent standard of bathing waters, neither does it reflect the fact that due to our historical high standards of service, there is little room for actual outperformance.

Table 11 – Forecast Performance – Bathing Water Quality

Bathing Water Quality	Unit	2024-25 baseline	2025-26	2026-27	2027-28	2028-29	2029-30
SWB	%	93.5	93.5	93.5	93.7	94.2	94.4
Industry Frontier	%	93.5	93.5	93.5	93.7	94.2	94.4
Industry Upper Quartile	%	87.9	89.1	89.5	89.5	89.5	89.8

Over a third of all the bathing waters in the country are situated in our region. Customers and stakeholders often, rightfully, challenge us over performance they read about from other regulators.

We have sector leading bathing water quality. But the PR24 definition does not reflect this. The PR24 definition, far from helping customers understand performance, will lead to confusion. This is not transparent. The PR24 definition may be confusing for customers because:

a) It is not the same as the Environment Agency's bathing water classifications, which publicises whether a water company's bathing water sites meet or exceed the minimum standard 'sufficient' classifications.
b) Bathing waters which cannot be impacted by a water company in the discharge of its functions should be excluded. However, Ofwat states that determining if/ when this applies will be undertaken in conjunction with the Environment Agency prior to the start of the 2025-30 period and set out in the PR24 final determinations. At the draft determination Ofwat has now explicitly asked companies "to review the identified lists of designated bathing water sites and our proposed interventions. We request that they accept these interventions or provide sufficient and convincing evidence to support an alternative approach at an individual bathing water level." But Ofwat's interventions have not excluded bathing waters which cannot be impacted by a water company in the discharge of its functions. So the presumption seems to still be that all classification risk is down to WaSC assets.

As confirmed in response to query OFW-OBQ-SBB-088, for bathing water quality we commented on inconsistencies in the historic data that Ofwat has been referring to. We cautioned that if the definition changed following Ofwat's review of the historic data and incentive calculation data that only then should the targets proposed in the plan also be reviewed too.

At the time of the business plan submissions, SWB was responsible for 151 bathing waters. Based on draft determination industry data, the impact of setting the PCL on an industry common basis would result in the following outcomes design:

Table 12 – Performance Commitment Levels – SWB Bathing Water Quality

SWB	Unit	Baseline forecast	Indicative Performance Commitment Level (based on draft determination industry data)				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	93.5	89.1	89.5	89.5	89.5	89.8
Standard underperformance collar	%		86.9	86.9	86.9	86.9	86.9
Underperformance deadband	%		NA	NA	NA	NA	NA
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		92.7	92.7	92.7	92.7	92.7
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

4.3 Outcomes and Priorities: Net Zero and Environmental Gains

4.3.1 Discharge permit compliance

Ofwat has intervened at the draft determination to remove the deadbands. This is despite the fact that for CRI, Ofwat is allowing for external factors (element of uncertainty) once performance leaves the company control.

Please see our full framework representation for a full explanation for our justification for deadbands for WaSCs and WoCs.

Table 13 – Performance Commitment Levels – SWB Discharge Permit Compliance

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	99.0	100.0	100.0	100.0	100.0	100.0
Standard underperformance collar	%		NA	NA	NA	NA	NA
Underperformance deadband	%		99.0	99.0	99.0	99.0	99.0
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		NA	NA	NA	NA	NA
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

Table 14 – Performance Commitment Levels – BRL Discharge Permit Compliance

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	100.0	100.0	100.0	100.0	100.0	100.0
Standard underperformance collar	%		NA	NA	NA	NA	NA
Underperformance deadband	%		91.7	91.7	91.7	91.7	91.7
Outperformance deadband	%		NA	NA	NA	NA	NA

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Standard outperformance cap	%		NA	NA	NA	NA	NA
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

4.3.2 Operational greenhouse gas emissions (water and wastewater)

Ofwat has intervened to adjust the PCLs (with an accompanying base cost sector-wide net zero cost adjustment) and to set the cap and collar at 0.5% RoRE.

We are rejecting the base cost sector-wide net zero cost adjustment and therefore proposing the PCLs as per our business plan. We explain further in our representation SBBDD09_L3_Cost_and_efficiency our rationale for rejecting the base cost sector-wide cost adjustments. Our cap and collars are not set at 0.5% RoRE but reflect a view of outcomes risk 'in the round' (these are new performance commitments).

Ofwat also noted in its QAA that our plan was also unambitious for the South West area in our proposed performance target for greenhouse gas emissions from our wastewater activities. Ofwat has however not neglected to consider our bespoke ODI on embodied greenhouse gas emissions, which goes further than the common metric on operational greenhouse gas emissions. Ofwat should also consider our wastewater plans 'In the round' - our plan proposed the lowest internal sewer flooding target (at a normalised level) of all water and sewerage companies, as well as proposing one of the lowest external sewer flooding targets of all water and sewerage companies.

Our operational greenhouse gas emissions for SWB (water), SWB (waste) and BRL (water) all forecasted emissions growth between 2022/23 and 2029/30. The predicted growth in operational emissions is largely a result of additional energy consumption from new treatment processes and infrastructure planned to be deployed during AMP8 towards ensuring a resilient and regulatory compliant service. Most notably the additional energy consumption expected during AMP8 will be a result of desalination, North Devon green recovery, WRMP, DRMP and WINEP activity. The planned AMP8 investments in projects that aim to reduce emissions, including plans for energy efficiency, renewable energy, the transition to electric vehicles, and controlling process and fugitive emissions, is simply insufficient to keep pace with the additional emissions predicted to be added from the AMP8 capital investment programme.

Table 15 – Performance Commitment Levels – SWB Operational GHG Emissions (water)

SWB (water)	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e	61137	67194	65944	66042	67405	70045
Standard underperformance collar	Tonnes CO2e		70692	70692	70692	70692	70692
Underperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Outperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e		63960	63960	63960	63960	63960
Enhanced outperformance cap	Tonnes CO2e		NA	NA	NA	NA	NA

Table 16 – Performance Commitment Levels – BRL Operational GHG Emissions (water)

BRL (water)	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e	26575	30548	29985	29851	29714	29689
Standard underperformance collar	Tonnes CO2e		31455	31455	31455	31455	31455
Underperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Outperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e		28460	28460	28460	28460	28460
Enhanced outperformance cap	Tonnes CO2e		NA	NA	NA	NA	NA

Table 17 – Performance Commitment Levels – SWB Operational GHG Emissions (wastewater)

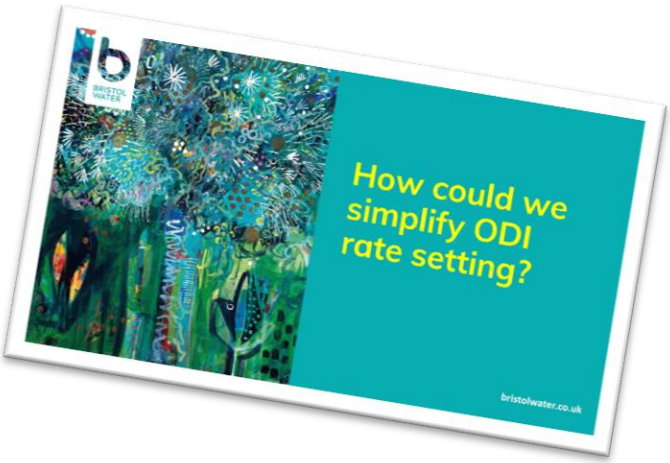
SWB (wastewater)	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e	83001	83707	82606	84377	86932	89562
Standard underperformance collar	Tonnes CO2e		89709	89709	89709	89709	89709
Underperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Outperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e		81165	81165	81165	81165	81165
Enhanced outperformance cap	Tonnes CO2e		NA	NA	NA	NA	NA

5 Incentive Rates

An effective ODI framework should be able to deliver real benefits to customers while providing the notional company with both the flexibility and incentives to improve performance, where appropriate through investment.

Neither the original approach to setting ODI rates based on the collaborative research for ODI rates, nor Ofwat's revised approach based on top-down RORE allocations, delivered robust valuations.

Ofwat signalled that they were open to considering alternative ODI rates to the indicative industry rates they proposed prior to business plan submissions. In the PR24 methodology Ofwat stated that *"during the price review we will fully consider evidence provided to us. A company that demonstrates its proposed alternative is justified will pass the relevant [QAA] expectation and so, contrary to concerns raised in stakeholder responses, their Board's ability to provide assurance of their specific proposals should not be compromised. Specifically, we expect…compelling evidence for an alternative view on the rate of return and marginal benefit estimates – this a high bar but nonetheless an option for companies… and sufficient and convincing evidence for alternative indicative benefit sharing factors."* Likewise in the June 2023 outcomes working group Ofwat requested feedback on their top-down approach to ODI rate setting for them to take into account at draft determinations "we encourage companies to include feedback on both the top-down approach and the indicative rates as part of their business plan submission. This will help to inform how we set rates at draft determinations."



Our business plan outlined the timetable for our engagement over the development of ODIs throughout the PR24 period. Whilst we do not repeat the numerous steps we took to engage, we do highlight again how we have been leading the industry on setting top-down incentive rates. For example, in January 2022 we submitted a think-piece to the Future Ideas Lab, asking how could we simplify ODI rate setting?[10] We proposed that if Ofwat's desire was to simplify ODI rates by determining customer valuations for marginal benefits and thereby removing considerations of marginal cost and willingness-to-pay valuations, that Ofwat should go even further, by instead proposing that customer research should be used to allocate ODI incentives top down to common performance areas, particularly one aligned to RORE /RCV allocation. This approach would then avoid the complexity of mapping customer valuations to marginal benefits for the common PCs.

In October 2023, seven companies rejected some or all of Ofwat's indicative ODI rates:

- Four companies, including South West Water (Welsh Water, Hafren Dyfrdwy and Portsmouth Water) rejected Ofwat's rates for all performance commitments
- Three companies (Anglian, Southern Water and South East Water) rejected a subset of Ofwat's rates. Anglian Water also uses customer research data and social valuations to propose alternative rates

Whilst the remaining nine companies did not reject Ofwat's ODI rates per se, most still raised several concerns:

- All note the negative, penalty skew of Ofwat's proposed outcome/ODI package, especially on certain measures (like PCC, business demand, serious pollution, etc.);
- Some note that this negative skew is exacerbated by higher ODI rates (especially on PCC), less protections, and penalty only performance commitments and PCDs;
- Some note that they received the top-down, revised rates too late to validate (e.g. Northumbrian Water, SES Water and United Utilities);
- Some indicated they would be seeking further engagement and/or review prior to draft determinations (e.g. Northumbrian Water and South Staffs) .

[10] Bristol Water (2022) A simplified approach to setting ODI rates

We also note that these companies generally proposed a range of protections across most performance commitments, including deadbands and caps /collars, and decreases to the indicative standard ODI rates.

Table 18 – Industry adoption of indicative ODI rates

Company	Did the company use the indicative ODI rates?
ANH	Yes, for some performance commitments. Alternative rates proposed for SPI, PCC, BD and POL
HDD	No – alternative ODI rates proposed
NES	Yes, for all performance commitments
SVT	Yes, for all performance commitments
SWB	No – alternative ODI rates proposed
SRN	Yes, for some performance commitments. Alternative rates proposed for SPI, PCC, BD and POL
TMS	Yes, for all performance commitments
UUW	Yes, for all performance commitments
WSH	No – alternative ODI rates proposed
WSX	Yes, for all performance commitments
YKY	Yes, for all performance commitments
AFW	Yes, for all performance commitments
BRL	No – alternative ODI rates proposed
PRT	No – alternative ODI rates proposed
SEW	Yes, for some performance commitments. Alternative rates proposed for LEA, PCC, BD and MAR
SSC	Yes, for all performance commitments
SES	Yes, for all performance commitments

At the draft determination, Ofwat has revised its approach to setting top-down incentive rates. We have summarised in the table overleaf notable revisions, as well as our observations on these changes. Whilst the interventions are understandable, the decisions still boil down to regulatory judgement.

Table 19 - Ofwat's top-down incentive rates

Policy area	Draft Determination Intervention	Our observations
Grouping companies based on size	A grouping for large companies (including South West Water, a grouping for small companies (including Bristol) and the decision to treat Hafren Dyfrdwy and Portsmouth Water separately from both groups	Seeking customer views on the overall allocation of risk removes the requirement of the regulator to create abstract groupings (as per our business plan approach). The decision to include South West Water in the 'large' companies for total pollution incidents further contributes to a materially higher incentive rate than that at PR19.
Adjustments to the demand PCs	Disaggregated rate calculation for the three PCs (leakage, PCC and business demand)	Whilst we welcome the disaggregation, we still oppose Ofwat's approach to top-down incentives (as explained in the table below).
Prioritisation of PCs	Update the starting RoRE categorisation of strategically prioritised PCs to 'high'	This approach further removes the link between customer preferences and incentives. This step could be avoided if an alternative approach to top-down incentive rates is adopted (as per our business plan approach).
Adjustments to mains repairs and water supply interruptions	Uplift the median unit rates for to mains repairs and water supply interruptions to ensure rates are at least as 'strong' as PR19	The comparison to the PR19 rates seems to override Ofwat's PR24 methodology, namely that PR19 rates were not reliable (because of the PR19 marginal costs that companies had proposed).

In addition, we question some of the assumptions within the ODI models (Over the selective judgements of appropriate historical performance) published at the draft determination. We summarise our observations on Ofwat's approach in the table below:

Table 20 – draft determination ODI models

Performance Commitment	Observations on Ofwat's models
Total pollution incidents	• Incentive rate is being materially impacted by SRN and SWB (43% instead of 13% without). • Selective data - PCL data missing for HDD and WSX (pre-PR19). Including this data would change the incentive rates

Performance Commitment	Observations on Ofwat's models
Serious pollution incidents	• There is uncertainty over comparability – Ofwat measures the difference between a proxy PCL based on the historic EPA threshold and performance for 2011-12 to 2022-23. The EPA threshold decreases significantly over time. The proxy PCL from 2020-21 to 2024-25 is based on the green EPA threshold, which trends to zero by 2025. The resulting uncertainty range is not particularly sensitive over time. This is also inconsistent with discharge permit compliance and CRI (other statutory metrics) where uncertainty modelling assesses the difference between historic 100% compliance and performance • Outlier included - HDD is included with a large outperformance – removing this will have an impact on the rates. • On the application: o Roundings in the calculations o The calculation allows for overlap with the total pollution incident rate (even though Ofwat wanted to avoid duplication in incentive rate setting).
Discharge Permit Compliance	• Selective data - data from 2017-18 to 2021-22 is used in the uncertainty calculation. Adding 2022-23 slightly reduces uncertainty which will increase the ODI rate • Application - PCL is set to 100% in the model. This causes a large increase in rates
Water demand PCs – leakage and PCC	Uncertainty of data – Ofwat uses three sets of data for 2019-20 to 2021-22 (based on three year average). Ofwat has created a synthetic PCL (three-year average baseline for 2019-20) by back casting the average rate of change in the three-year trend for AMP7.
Water demand PCs – business demand	Selective data – data only used for three years.
Water quality contacts **Bathing water quality**	Uncertainty of data – Incentive rate is being impacted by missing data for TMS and SEW Application - Large difference in number of sites between companies.

Although not an exhaustive list, the table below shows the consequences of these subjective regulatory decisions.

Table 21 – Ofwat's uplifts to PR24 indicative ODI rates

Performance Commitment	SWB rate	BRL rate	Reason for uplift	SWB rate	SWB rate (% change)	BRL rate	BRL rate (% change)
Pollution Incidents	0.518		Override customer preference to align to govt strategic priorities	0.638	23%		
Storm Overflows	0.868			1.059	22%		

Leakage	0.365	0.365	Disaggregated rate calculation for the demand PCs	0.909	149%	0.848	132%
Mains Repairs	0.162	0.061		0.140	-14%	0.045	-26%
Unplanned Outage	1.111	0.649	Removed adjustments based on performance trends	2.823	154%	0.950	46%
Sewer Collapses	0.498			1.482	198%		

The perils of regulatory judgement and the complexity of balancing risk and return trade-offs in the price review process was first explored in a think-piece we submitted to the Future Ideas Lab.[11] Our incentive rates address the need for regulatory interventions in setting top-down incentive rates.

[11] Bristol Water (2021) Regulating for consensus and trust

Ofwat's draft determinations also refers to an independent review of the regulator's PR24 approach to ODIs.[12] This review expresses concern in a number of areas, regarding Ofwat's approach to setting top-down incentives:

- Scale of incentives compared to PR19: the report recommends Ofwat consider the scale of the changes to the size of the incentives. Where a particular company is to see a large change in a given ODI rate from PR19, the report recommends that the change could be done in 'stages' such that the consistent rate is achieved in PR29 – and a move towards it is achieved in PR24.
- Actual levels of equity at risk: the report notes that in setting a consistent unit rate across companies, by definition Ofwat is unable to set a consistent level of equity at risk. Under the current ODI rates, some companies have a level of equity at risk significantly above or below the level set by Ofwat (i.e. there is an inconsistency). Stretching but achievable performance: the report concludes the following: "For some PCs, the range in performance Ofwat uses to calculate its initial rates (used to determine a median, and not directly in calculating the rates) is not achievable on the upside (Supply interruptions, and Water quality contacts) and approaching the limits of what is achievable for others (e.g. Internal sewer flooding, External sewer flooding, and Unplanned outage). These performance ranges are only directly used to determine the initial, and not final, rates. However, because the initial rate for the median company determines the final rates, it is recommended that Ofwat considers whether the performance range should be adjusted to reflect what is more likely to be achievable."
- Potential skew in expected returns: whilst outside the scope of the review, the report notes that Ofwat should consider negative skew as part of its 'in the round' assessment of ODI risk.

Ofwat's final conclusions are that it has set stronger incentives, whilst at the same time forecasting that companies will not face material changes to risk (despite the stronger incentives and more stretching targets). These conclusions are not true, as we highlight in our ODI risk modelling.

Finally, Ofwat's unit rates result in material risk. Examples of these unit rates, compared to our unit rates, are summarised below.

[12] Grant Thornton (2024) A review of Ofwat's PR24 approach to ODIs

Table 22 - Ofwat's top-down incentives rates versus our top-down incentive rates

Performance commitment	Unit	Unit denominator	DD Incentive rate (£)	DD Unit rate (£)	BP Incentive rate (£)	BP Unit rate (£)
Water quality contacts - SWB[13]	Customer contacts	Population (2,293,361)	15,544,000	6,800 per customer contact	1,784,000	778 per contact
Water quality contacts - BRL	Customer contacts	Population (1,235,941)	8,277,000	6,800 per customer contact	906,000	733 per contact
Pollution incidents (cat. 1-3 wastewater)	Pollution incidents	Sewer length (17,440km)	638,000	366,000 per incident	175,000	100,500 per incident
Average spills per storm overflow	Number of spills	Number of storm overflows (1,342)	1,059,000	790 per spill	306,000	228 per spill

As we cannot support the introduction of Ofwat's top-down incentive rates, we seek assurances from Ofwat that our business plan incentives be applied at the final determinations.

Our four-step process to determining top-down ODIs was outlined in our business plan submission. A key principle of the process was to align as closely as possible to Ofwat's top-down approach whilst incorporating more robust evidence on customer preferences for ODIs. In summary, these four steps consisted of:

1. Set customer preferred overall package level, by considering variability in the bill level
2. Allocate package across PCs using triangulated customer preferences
3. Calculate proposed top-down rates using Ofwat models
4. Calculate proposed top-down rates for PCs not covered by Ofwat models

Our approach to setting incentives accurately aligned to our customers' preferences, reflected a simplified approach to rate setting and was complementary to Ofwat's approach (as our rates were triangulated via Ofwat's indicative ODI models).

The adoption of our approach to top-down incentives in our business plan was also supported by the Watershare+ Customer Advisory Panel: *"We are satisfied that the company's approach to incentive rate setting has incorporated the findings from its customer research activities. These were designed to provide quantifiable customer preferences to inform the calculation of top-down incentives in line with the approach used by Ofwat in its top-down approach. We are clear that the company's approach is in the best interests of customers and reflect their clearly evidenced preferences."*

The Watershare+ Customer Advisory Panel further concluded that: *"We support the company's approach to incentive rate setting because…we support its evidenced reflection of customer priorities and appropriate risk-reward balance."*

Further information on our four-step process to determining top-down ODIs was provided in a supporting third-party report from ICS Consulting, 'PR24 Outcome Delivery Incentive rates'.

[13] On 20 August 2024 Ofwat wrote to companies to note that several companies had raised concerns about the size of the ODI rate for the water quality contacts performance commitment

For completeness we have summarised in the table below a comparison of the incentive rates – the industry indicative ODIs, the draft determination ODIs and the final ODIs that we have proposed (these are unchanged from our business plan and can be found in data table OUT7).

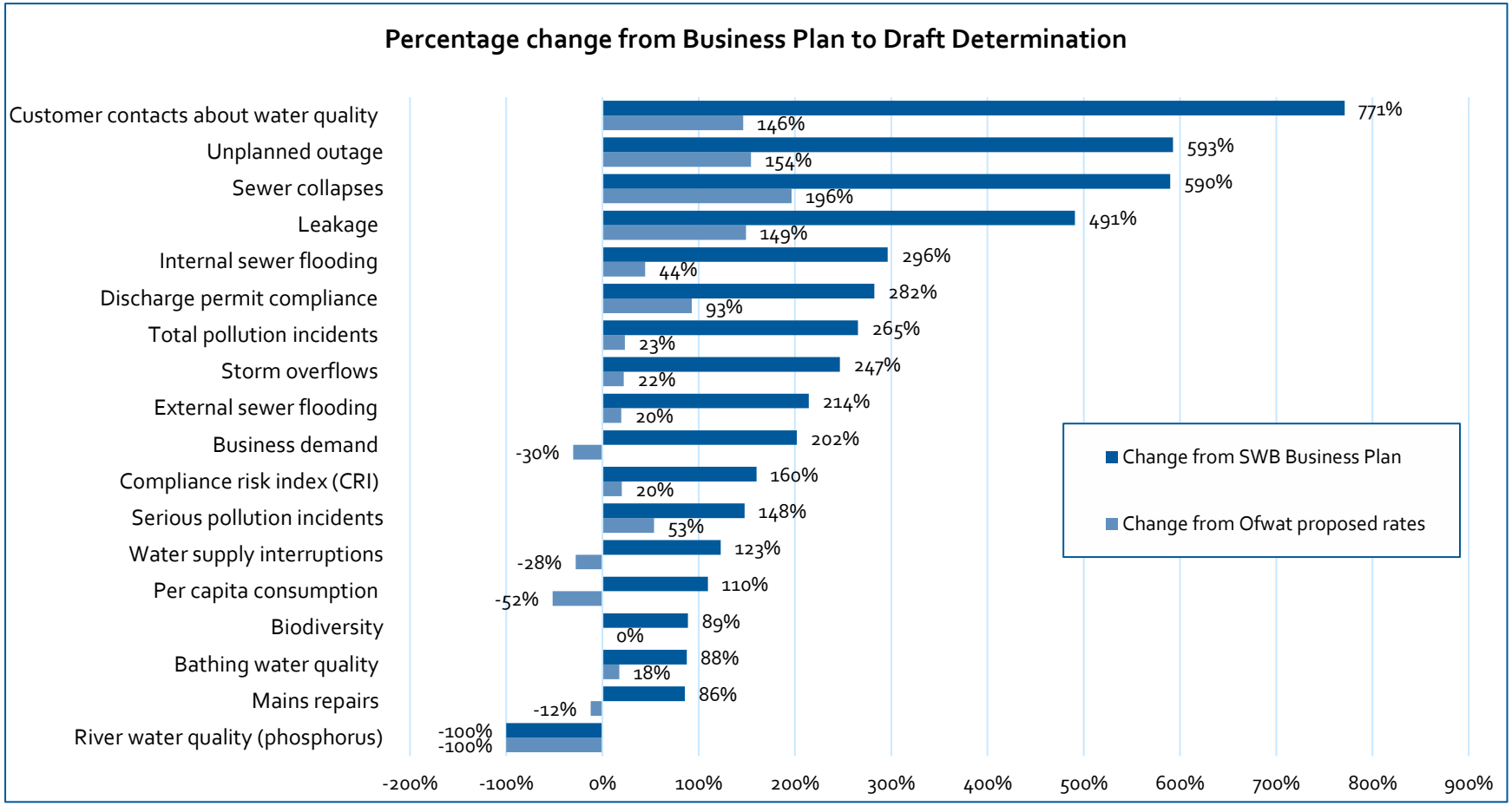
Table 23 – Summary of PR24 indicative rates, PR24 draft determination rates and the SWB business plan rates

Performance Commitment	Ofwat Indicative Incentive Rates			Ofwat Draft Determination Incentive Rates			Business Plan		
	Customer preferences	SWB Incentive rate	BRL Incentive rate	Customer preferences	SWB Incentive rate	BRL Incentive rate	Customer preferences	SWB Incentive rate	BRL Incentive rate
Internal Sewer Flooding	High	3.412	N/A	High	4.927	N/A	Medium	1.243	N/A
External Sewer Flooding	High	1.528	N/A	High	1.83	N/A	Medium	0.582	N/A
Water Quality Contacts	High	6.312	3.204	High	15.544	8.277	Low	1.784	0.906
Compliance Risk Index	High	0.628	0.319	High	0.755	0.253	High	0.29	0.147
Water Supply Interruptions	High	0.65	0.332	High	0.469	0.164	Medium	0.211	0.108
River Water Quality	Medium	0.00066	N/A	Medium	N/A	N/A	High	0.000335	N/A
Bathing Water Quality	Low	8.417	N/A	Low	9.901	N/A	High	5.278	N/A
Total Pollution Incidents	Medium	0.518	N/A	High	0.638	N/A	Low	0.175	N/A
Serious Pollution Incidents	Medium	1.138	1.363	Medium	1.747	1.406	High	0.705	0.781
Discharge Permit Compliance	Medium	2.482	0.088	Medium	4.785	0.556[14]	High	1.251	0.044
Storm Overflows	Medium	0.868	N/A	High	1.059	N/A	Low	0.306	N/A
Leakage	Medium	0.365	0.365	High	0.909	0.848	Medium	0.154	0.154
Per Capita Consumption	Low	0.907	0.431	High	0.438	0.142	Medium	0.209	0.099
Business Demand	Low	0.365	0.365	Low	0.254	0.2	Low	0.084	0.084
Mains Repairs	Medium	0.162	0.061	Medium	0.14	0.045	Medium	0.076	0.028
Unplanned Outage	Medium	1.111	0.649	Medium	2.823	0.95	Medium	0.408	0.238

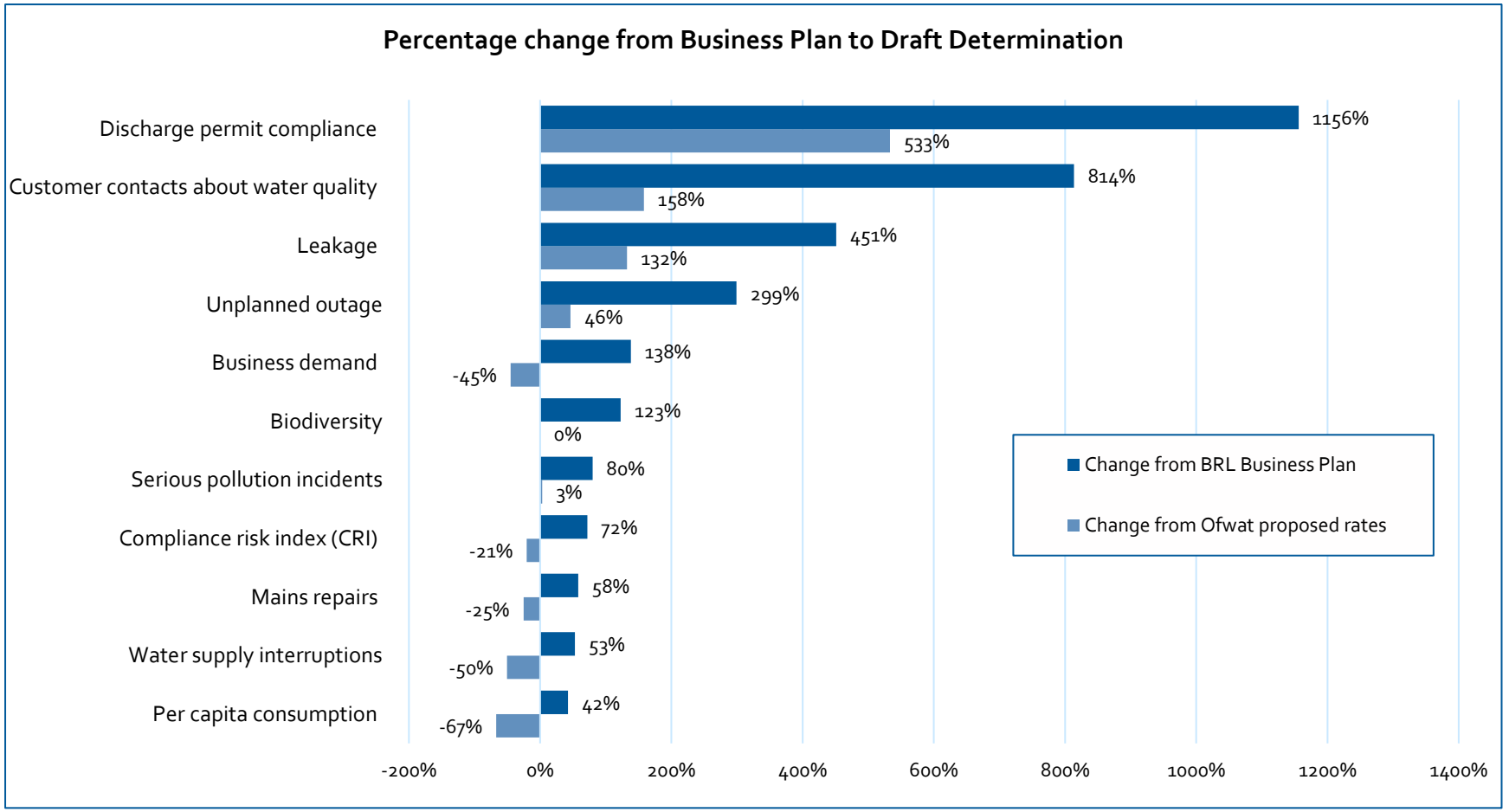
[14] On 20 August 2024 Ofwat wrote to water companies to highlight that it was considering adjusting WoC company-specific performance ranges, which Ofwat uses to set their top-down incentive rates. Ofwat did come to any final decisions over how it would set the ODI rate for discharge permit compliance in this letter.

Performance Commitment	Ofwat Indicative Incentive Rates			Ofwat Draft Determination Incentive Rates			Business Plan		
	Customer preferences	SWB Incentive rate	BRL Incentive rate	Customer preferences	SWB Incentive rate	BRL Incentive rate	Customer preferences	SWB Incentive rate	BRL Incentive rate
Sewer Collapses	Medium	0.498	N/A	Medium	1.482	N/A	Medium	0.215	N/A
Biodiversity	Low	N/A	N/A	N/A	2.468	0.472	Medium	1.307	0.212
Operational GHG emissions (water)	Low	N/A	N/A	N/A	0.000188	0.000188	Low	0.000409	0.000326
Operational GHG emissions (wastewater)	Low	N/A	N/A	N/A	0.000188	N/A	Low	0.000572	N/A

Some of the percentage changes, when compared to our business plan, or even when compared to the Ofwat indicative rates, are extremely excessive. The more extreme percentage changes for SWB relate to customer contacts about water quality, unplanned outage, sewer collapses and leakage.



The more extreme percentage changes for BRL relate to discharge permit compliance, customer contacts about water quality and leakage.



If we leave aside Ofwat's risk modelling and we also leave aside the disconnect between customer preferences and the 'strength' of incentive rates, we still cannot accept Ofwat's incentive rates. We shall take one example to underline this fundament disagreement – the incentive rates for water quality contacts. If Ofwat's draft determination incentive rates are compared to its indicative incentive rates, these represent a 146% increase for SWB and a 158% increase for BRL. If Ofwat's draft determination incentive rates are compared to our business plan incentive rates (which we are again proposing in our representations) these represent a 771% increase for SWB and an 814% increase for BRL.

These are extremely high increases, which Ofwat would concede, as its aim is to set 'stronger' incentives. But by setting incentives on customer contacts at these levels, it is not at all clear whether Ofwat has considered how this might potentially conflict with or complement incentives set for other measures and whether it is reflecting of a balanced ODI framework 'in the round'.

We would again remind Ofwat of the findings of the Gray review, which highlighted a concern that the balance of risk and reward had previously been tilted too far towards uncertain and potentially large penalties for failure, with relatively limited rewards for outperformance or innovation:[15]

"We are sympathetic to the suggestion that the balance of risk and reward is tilted too far towards uncertain and potentially large penalties for failure, with relatively limited rewards for outperformance or innovation… In this respect we see strong linkages between the use of incentives and the burden of regulation. Companies need more ownership of their business plans and more flexibility to change them, within the overall price control constraint, without feeling the need for case-by-case Ofwat approval and without detailed Ofwat monitoring."

The incentive rates that we are subject to are an important factor in the decisions that we make; our financial performance and our risk-return balance; and the amount of capital that we have to invest for customers. It is therefore important that the ODI regime, including incentive rates, at PR24 is well designed. Carefully reviewing Ofwat's indicative incentive rates with this in mind raised a number of concerns. We have therefore concluded that we cannot accept Ofwat's proposed draft determination incentive rates and have instead again proposed our business plan's incentive rates. The only exception to this is river water quality, where Ofwat has now applied a non-financial (reputational) incentive and we have accepted this draft determination revision.

[15] DEFRA (2011) Review of Ofwat and consumer representation in the water sector

6 Full Framework Representation

Whilst we adopt the draft determination incentives as part of our focused representation, the draft determination top-down incentives results in an incentive package that assumes a disproportionate level of downside risk and even this risk is based on modelling that understates the size of the risk.

In this representation, we have reflected on how the focused framework still results in an ODI range above the indicative +/- 3% RoRE range. These impacts are being driven by the strong incentive rates Ofwat has applied, so we have created a package based on Ofwat's draft determination, accepting many of the draft determination interventions, but also adopting our business plan incentives and various ODI protections. Our business plan bespoke PCLs are also included.

Table 24– Full Framework Representation incentive rates

Performance Commitment	SWB Incentive rate	BRL Incentive rate
Internal Sewer Flooding	1.243	N/A
External Sewer Flooding	0.582	N/A
Water Quality Contacts	1.784	0.906
Compliance Risk Index	0.29	0.147
Water Supply Interruptions	0.211	0.108
River Water Quality	0.000335	N/A
Bathing Water Quality	5.278	N/A
Total Pollution Incidents	0.175	N/A
Serious Pollution Incidents	0.705	0.781
Discharge Permit Compliance	1.251	0.044
Storm Overflows	0.306	N/A
Leakage	0.154	0.154
Per Capita Consumption	0.209	0.099
Business Demand	0.084	0.084
Mains Repairs	0.076	0.028
Unplanned Outage	0.408	0.238
Sewer Collapses	0.215	N/A
Biodiversity	1.307	0.212
Operational GHG emissions (water)	0.000409	0.000326
Operational GHG emissions (wastewater)	0.000572	N/A
Embodied greenhouse gas emissions (bespoke)	0.125	N/A
Catchment management (bespoke)	0.000204	N/A

As this representation includes materially different incentive rates, we have had to apply caps and collars as per our business plan. This representation is however not just restating the business plan framework as we have accepted a number of interventions, such as:

- The removal of the deadbands for mains repairs and unplanned outage
- The common PCLs for the majority of the performance commitments (other than for total pollution incidents)

In this full framework representation we have recommended revisions to the following PCLs:

SWB:

- Water quality contacts
- Total pollution incidents
- Bathing water quality
- River water quality

- Operational greenhouse gas emissions (water and wastewater)

BRL:

- Mains repairs (BRL only)
- Water quality contacts
- Operational greenhouse gas emissions (water)

A greater number of deadbands have been applied in this representation – deadbands also apply to supply interruptions, external sewer flooding and storm overflows.

This representation results in an ODI RoRE risk range of -1.8% to +1.6%.

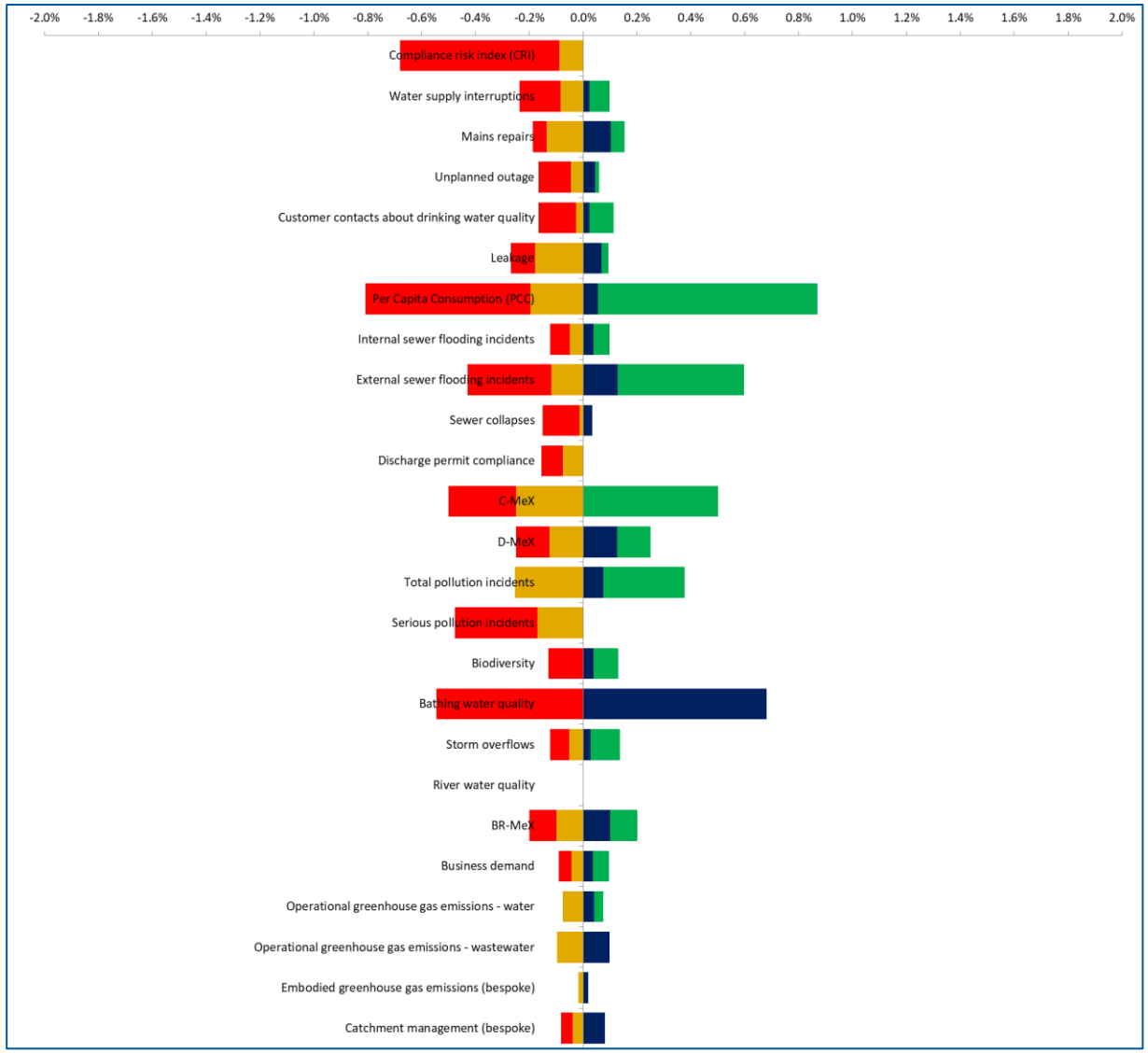
Table 25 - ODI RORE ranges (P10/P90 ranges) – full framework representation - Appointee Outcome Delivery Incentives (£m, 2022-23 prices)

Full framework representation	Penalty RORE (P10)	Penalty RORE	Within P10	Penalty	Reward	Enhanced Reward	Within P90	Reward RORE	Enhanced Reward RORE	Reward RORE (P90)
Compliance risk index (CRI)	-0.09%	-0.68%	(2.20)	(16.97)				0.00%		0.00%
Water supply interruptions	-0.09%	-0.24%	(2.12)	(5.89)	0.76	1.66	0.57	0.10%	0.07%	0.02%
Mains repairs	-0.14%	-0.19%	(3.40)	(4.65)	3.83		2.54	0.15%		0.10%
Unplanned outage	-0.05%	-0.17%	(1.12)	(4.16)	1.46		1.09	0.06%		0.04%
Customer contacts about drinking water quality	-0.03%	-0.17%	(0.65)	(4.15)	2.80		0.59	0.11%		0.02%
Leakage	-0.18%	-0.27%	(4.43)	(6.69)	1.02	1.32	1.67	0.09%	0.05%	0.07%
Per Capita Consumption (PCC)	-0.19%	-0.81%	(4.86)	(20.18)	21.68		1.36	0.87%		0.05%
Internal sewer flooding incidents	-0.05%	-0.12%	(1.26)	(3.08)	0.66	1.77	0.93	0.10%	0.07%	0.04%
External sewer flooding incidents	-0.12%	-0.43%	(2.95)	(10.69)	0.75	14.16	3.21	0.60%	0.57%	0.13%
Sewer collapses	-0.01%	-0.15%	(0.36)	(3.75)	0.86		0.85	0.03%		0.03%
Discharge permit compliance	-0.08%	-0.16%	(1.91)	(3.87)				0.00%		0.00%
C-MeX	-0.25%	-0.50%	(6.24)	(12.48)	12.48		0.00	0.50%		0.00%
D-MeX	-0.13%	-0.25%	(3.12)	(6.24)	6.24		3.12	0.25%		0.13%
Total pollution incidents	-0.25%	-0.25%	(6.31)	(6.31)	4.51		1.85	0.18%		0.07%
Serious pollution incidents	-0.17%	-0.48%	(4.23)	(11.89)				0.00%		0.00%

Full framework representation	Penalty RORE (P10)	Penalty RORE	Within P10	Penalty	Reward	Enhanced Reward	Within P90	Reward RORE	Enhanced Reward RORE	Reward RORE (P90)
Biodiversity	0.00%	-0.13%	0.00	(3.25)	3.25		0.97	0.13%		0.04%
Bathing water quality	0.00%	-0.55%	0.00	(13.62)	17.00		17.00	0.68%		0.68%
Storm overflows	-0.05%	-0.12%	(1.30)	(3.09)	3.41		0.66	0.14%		0.03%
River water quality										
BR-MeX	-0.10%	-0.20%	(2.50)	(4.99)	4.99		2.50	0.20%		0.10%
Business demand	-0.04%	-0.09%	(1.06)	(2.24)	2.37		0.87	0.09%		0.03%
Operational greenhouse gas emissions - water	-0.07%	-0.07%	(1.86)	(1.86)	1.86		0.98	0.07%		0.04%
Operational greenhouse gas emissions - wastewater	-0.10%	-0.10%	(2.44)	(2.44)	2.44		2.44	0.10%		0.10%
Embodied greenhouse gas emissions (bespoke)	-0.02%	-0.01%	(0.43)	(0.32)	0.48		0.48	0.02%		0.02%
Catchment management (bespoke)	-0.04%	-0.08%	(0.97)	(2.04)	2.04		2.04	0.08%		0.08%
Total	**-2.2%**		**(56)**				**46**			**1.8%**
Total, excluding MeXs	**-1.8%**		**(44)**				**40**			**1.6%**
Total, excluding MeXs and bespoke PCs	**-1.7%**		**(42)**				**38**			**1.5%**

The yellow and blue bars represent the P10 and P90 ranges for each incentive. Red and dark green bars fall outside of the P10 and P90 expected performance range, and light green represents the potential impact of enhanced ODI performance incentive rates.

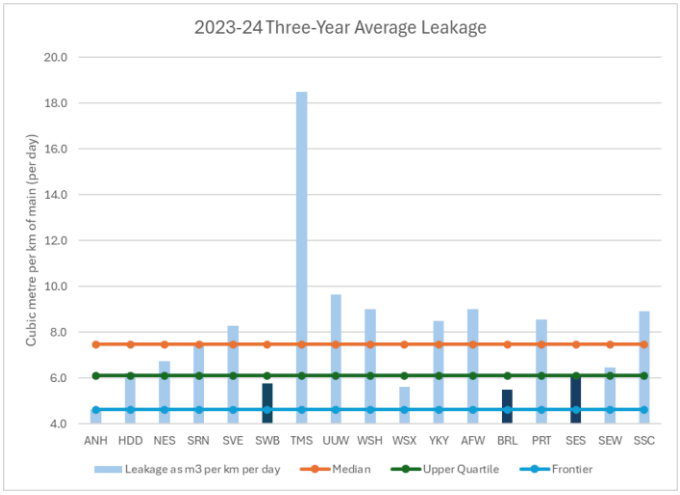
Figure 8 – ODI RoRE risk range – full framework representation

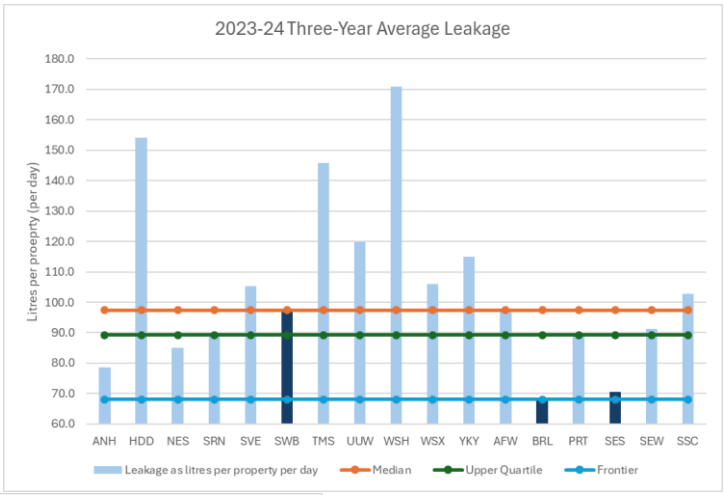


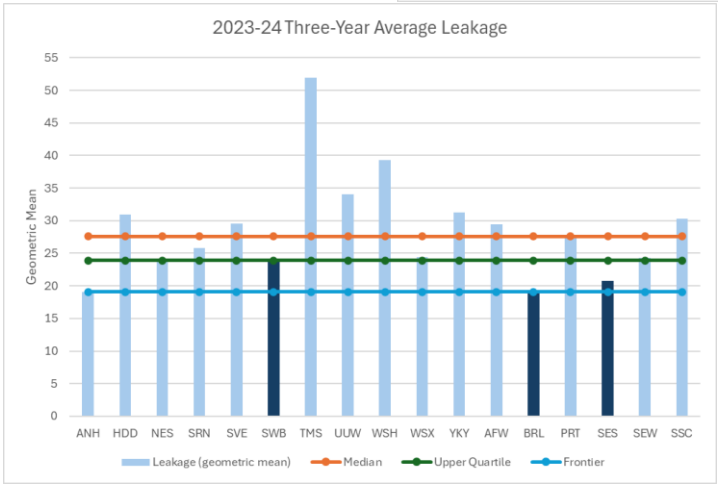
6.1 Outcomes and Priorities: Water Quality and Resilience

6.1.1 Leakage

Ofwat has intervened at the draft determination to set the proposed 2024-25 level of performance to equal to the expected PR19 PCL level where a company is not forecasting to deliver its PR19 PCL level. For SWB, we are forecasting to achieve our end of AMP7 position (a 15% reduction), whereas for BRL we are not forecasting to achieve our end of AMP7 position (a 21.2% reduction). Although BRL performance is not on track to meet such stretching PCLs, BRL is still at the or better than the industry upper quartile (including when normalised for the geometric mean, a method Ofwat used at the PR19 FD - which was a change to their PR19 DD method - to calculate the leakage efficiency benchmark.).







Our leakage performance commitments are aligned to the annual profiles in our WRMPs. In our business plan we committed to a cumulative 31% reduction in leakage levels across Devon, Cornwall and Bournemouth and a cumulative 26% reduction in leakage levels in Bristol (compared to baseline levels in 2019-20) by 2029-30. We are still committed to these reductions in leakage by 2029-30.

Our ODI risk modelling has assumed we must meet the percentage reductions as per the business plan. However, the BRL leakage three-year averages are impacted by performance in AMP7. We are still committed to a 26.4% reduction in 2029-30, as per our business plan and as per the draft determinations. We show in the tables below both the PCLs based on the WRMP annual profile and the PCLs based on the percentage reductions that we committed to in our business plan. To achieve these percentage reductions for BRL, we would be required to adjust the annual forecasts – these revisions would not align to the WRMP annual profile that currently shows in the BRL data tables CW5, OUT4 and OUT1.

Table 26 – Performance Commitment Levels – SWB Leakage

SWB	Unit	Baseline forecast		Indicative Performance Commitment Level (WRMP annual profile)				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Megalitres per day (Ml/d)	124.2	105.6	100.1	91.5	92.6	89.4	86.0
Performance Commitment Level	%		15.0%	19.4%	26.4%	25.4%	28.0%	30.8%
Performance Commitment Levels (annual)	Megalitres per day (Ml/d)		86.0	95.8	92.6	89.4	86.2	82.3
Standard underperformance collar	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Underperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Outperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Standard outperformance cap	Megalitres per day (Ml/d)			95.6	91.8[16]	86.9	82.0	77.4
Enhanced outperformance cap	Megalitres per day (Ml/d)			91.7	87.4	83.5	79.5	75.7

Table 27 – Performance Commitment Levels – BRL Leakage

BRL (WRMP)	Unit	Baseline forecast		Indicative Performance Commitment Level (WRMP annual profile)				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Megalitres per day (Ml/d)	40.7	38.0	35.0	32.6	31.1	30.5	29.9
Performance Commitment Level	%		6.6%	13.9%	19.8%	23.6%	25.1%	26.4%

[16] The standard outperformance cap is aligned to the percentage reductions stated in the draft determination – these may need to be revised to align to the SWB WRMP

BRL (WRMP)	Unit	Baseline forecast		Indicative Performance Commitment Level (WRMP annual profile)				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (annual – WRMP annual profile)	Megalitres per day (Ml/d)		35.0	31.7	31.1	30.4	29.9	29.5
Standard underperformance collar	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Underperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Outperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Standard outperformance cap	Megalitres per day (Ml/d)			31.5	30.7	29.7	28.4	27.3
Enhanced outperformance cap	Megalitres per day (Ml/d)			29.9	29.2	28.6	27.6	26.8

Table 28 – Performance Commitment Levels – BRL Leakage adjusted profile

BRL	Unit	Baseline forecast		Indicative Performance Commitment Level				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Megalitres per day (Ml/d)	40.7	38.0	32.1	31.6	31.1	30.5	29.9
Performance Commitment Level	%		6.6%	21.2%	22.4%	23.6%	25.0%	26.4%
Performance Commitment Levels (annual – adjusted profile to meet business plan reductions)	Megalitres per day (Ml/d)		35.0	22.9	36.8	33.5	21.2	35.1

6.1.2 Per capita consumption (PCC)

Ofwat has accepted the SWB PCC profile, however our target below reflects our latest WRMP annual profile (this ensures we meet a 128.9 annual target in 2029-30 and achieve a 10.4% reduction in that year).

In the QAA Ofwat noted that our plan was less ambitious for PCC for BRL. For BRL Ofwat has intervened and adjusted the PCL, with an annual target of 137.2 in 2029-30 (a 7.5% reduction). We do not accept the BRL draft determination PCC profile. Our PCC performance commitments are aligned to the annual profiles in our WRMPs. Our BRL PCC profile is aligned to the end of AMP8 percentage reductions as per our business plan (to achieve a 4.4% reduction by 2029-30).

Ofwat has removed the enhanced ODIs for PCC and the enhanced cap. We have no objections to this intervention. Ofwat also intervened and removed the collar we had applied in our business plan risk framework – we have accepted this intervention, on the proviso that our incentive rates are accepted.

Table 29 – Performance Commitment Levels – SWB PCC

SWB	Unit	Baseline forecast		Indicative Performance Commitment Level (WRMP annual profile)				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Litres/ person/ day (l/p/d)	146.0	149.0	140.2	136.3	134.8	132.9	130.8
Performance Commitment Level	%		-2.1%	4.0%	6.7%	7.7%	9.0%	10.4%
Performance Commitment Levels (annual)	Litres/ person/ day (l/p/d)		147.1	136.3	135.3	132.7	130.8	128.9
Standard underperformance collar	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Underperformance deadband	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Outperformance deadband	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Standard outperformance cap	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Enhanced outperformance cap	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA

Table 30 – Performance Commitment Levels – BRL PCC

BRL	Unit	Baseline forecast		Indicative Performance Commitment Level (WRMP annual profile)				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Litres/ person/ day (l/p/d)	148.9	146.1	147.0	147.4	146.7	144.3	142.4
Performance Commitment Level	%		1.9%	1.3%	1.0%	1.5%	3.1%	4.4%
Performance Commitment Levels (annual)	Litres/ person/ day (l/p/d)		146.5	149.6	146.1	144.2	142.5	140.5
Standard underperformance collar	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Underperformance deadband	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Outperformance deadband	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Standard outperformance cap	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA
Enhanced outperformance cap	Litres/ person/ day (l/p/d)			NA	NA	NA	NA	NA

6.1.3 Business demand

Our business demand performance commitments are aligned to the annual profiles in our WRMPs. Whilst the SWB business demand profile is now more stretching (as we accept meeting a 1.5% reduction by 2029-30) our BRL business demand profile is still aligned to the end of AMP8 percentage reductions as per our business plan (to achieve a 2.9% reduction by 2029-30).

Ofwat has intervened to introduce an end-of-period PCL adjustment mechanism (applicable if outturn performance is ±3% greater than the PCL) and changed the timing from in-period to an end of period ODI. We have no objections to these interventions.

Ofwat has also intervened to set the cap and collar at 0.5% RoRE, based on the Ofwat incentive rates. As we have adopted our top-down incentive rates, we have proposed alternative collar levels (set at the same level as our business plan).

Table 31 – Performance Commitment Levels – SWB Business Demand

SWB	Unit	Baseline forecast		Indicative Performance Commitment Level				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Megalitres per day (Ml/d)	150.2	154.7	152.4	151.9	150.4	149.1	148.0
Performance Commitment Level	%		-3.0%	-1.4%	-1.1%	-0.1%	0.7%	1.5%
Performance Commitment Levels (annual)	Megalitres per day (Ml/d)		153.4	151.9	150.4	149.0	147.9	147.0
Standard underperformance collar	Megalitres per day (Ml/d)			173.3	171.5	170.2	168.7	167.3
Underperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Outperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Standard outperformance cap	Megalitres per day (Ml/d)			134.3	132.5	131.2	129.7	128.3
Enhanced outperformance cap	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA

Table 32 – Performance Commitment Levels – BRL Business Demand

BRL	Unit	Baseline forecast		Indicative Performance Commitment Level				
		2019-20	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels (three-year average)	Megalitres per day (Ml/d)	59.5	57.0	57.8	58.6	58.4	58.1	57.8
Performance Commitment Level	%		4.2%	2.9%	1.6%	1.9%	2.4%	2.9%
Performance Commitment Levels (annual)	Megalitres per day (Ml/d)		58.6	58.7	58.4	58.2	57.8	57.4
Standard underperformance collar	Megalitres per day (Ml/d)			65.1	65.3	65.3	65.3	65.3
Underperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Outperformance deadband	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA
Standard outperformance cap	Megalitres per day (Ml/d)			49.3	49.5	49.5	49.5	49.5
Enhanced outperformance cap	Megalitres per day (Ml/d)			NA	NA	NA	NA	NA

6.1.4 Compliance risk index (CRI)

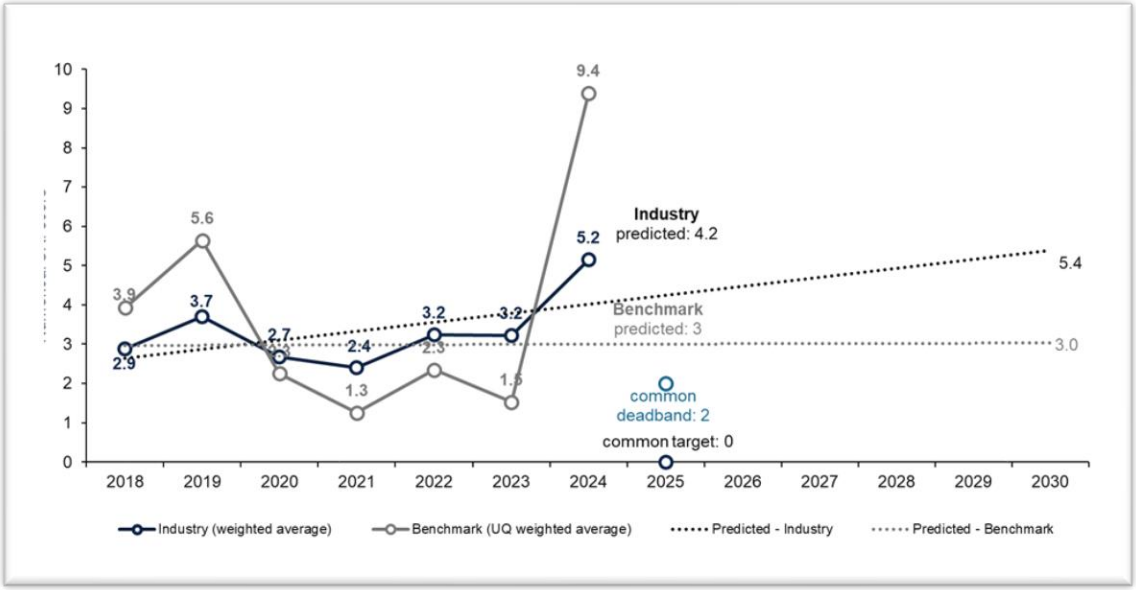
Ofwat has intervened to remove the collar (at 9.50) and applied a profiled reduction to the deadband to a CRI score of 1.0 by 2029-30.

At PR19 Ofwat set the collar for CRI at a score of 9.50, which was the upper quartile of the collars that companies proposed in their revised PR19 business plans. This was the collar level we included in our business plan, however, to be pragmatic, we have accepted Ofwat's removal of the collar.

Whilst we accept the removal of the collar, we have applied the deadband as per our business plan. A deadband helps improve the symmetry of the package overall in terms of the balance of risk and reward.

The CRI measure includes performance at both our assets and at customer taps. Performance at customer taps is largely outside management control. Industry performance trends would suggest a deadband higher than one. However, to ensure consistency with regulatory precedent, we have proposed a deadband level of 1.50 CRI for all years. This reflects the deadband level as per the CMA PR19 redeterminations, post reflecting the metaldehyde ban. Analysis of historical data suggests that WaSC performance is deteriorating over AMP7 and, as such, could continue to deteriorate through to 2030.

	2020-21	2021-22	2022-23	2023-24
WaSC upper quartile performance	1.80	2.51	2.66	2.23



Keeping the deadband at 1.50 (rather than reducing further to 1.00) therefore represents a stretching target given that WaSC upper quartile performance has only been below the 2.00 deadband once so far in AMP7.

Table 33 – Performance Commitment Levels – SWB CRI

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number	2.00	0.00	0.00	0.00	0.00	0.00

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Standard underperformance collar	Number		NA	NA	NA	NA	NA
Underperformance deadband	Number		1.50	1.50	1.50	1.50	1.50
Outperformance deadband	Number		NA	NA	NA	NA	NA
Standard outperformance cap	Number		NA	NA	NA	NA	NA
Enhanced outperformance cap	Number		NA	NA	NA	NA	NA

Table 34 – Performance Commitment Levels – BRL CRI

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number	4.71	0.00	0.00	0.00	0.00	0.00
Standard underperformance collar	Number		NA	NA	NA	NA	NA
Underperformance deadband	Number		1.50	1.50	1.50	1.50	1.50
Outperformance deadband	Number		NA	NA	NA	NA	NA
Standard outperformance cap	Number		NA	NA	NA	NA	NA
Enhanced outperformance cap	Number		NA	NA	NA	NA	NA

6.1.5 Customer contacts about water quality

Ofwat has intervened at the draft determination, applying different PCLs to those stated in our business plan. Ofwat did also change its methodology expectations – this PCL was initially expected to be set on a common industry basis but Ofwat has, as we requested in our business plan, set the PCLs on a company-specific basis. We welcome Ofwat's revision to set the PCLs as company-specific. We have however reverted back to our business plan PCLs for SWB and BRL.

The SWB profile was linked to our planned water treatment works upgrades – forecast improvement rates may not be linear - we expect enhancements to materialise after 2028-29. As South West Water is a cost-efficient company for wholesale water, this revision is proportionate.

As confirmed in response to query OFW-OBQ-SBB-088, for water quality contacts we expressed views on the impact of the definition revisions (the introduction of new communication channels and the process behind the reporting of repeat contacts) on the reliability of the historic data. In response to query OFW-OBQ-SBB-243 we confirmed that the historical data for SWB and BRL reported in the PR24 data tables was not compliant with the latest DWI information letter but that data for SWB and BRL from 2025-26 onwards was compliant with the latest information letter. Ofwat's BRL intervention does not take into account the change to definition.

In the QAA Ofwat noted that our plan was less ambitious for water quality contacts. Ofwat's desire to set 'stretching' targets in this area is questionable as this potentially conflicts with DWI guidance - the DWI wants water companies to encourage customers to contact them about water quality issues. Continually setting 'stretching' targets in this area may actually encourage companies to actively push customers away and try and avoid any contacts. In addition, Ofwat's revisions for the BRL would also have resulted in the region being instructed to deliver upper quartile levels of service (with no additional investment to meet these PCLs). We have reverted back to our business plan PCLs for both BRL. Although the PCLs are company-specific, when comparing our proposed PCLs to the industry draft determinations, BRL's are either at or close to the median position.

Table 35 – Forecast Performance – Water Quality Contacts

	2025-26	2026-27	2027-28	2028-29	2029-30
SWB	1.34	1.24	1.15	1.05	0.87
BRL	0.91	0.88	0.86	0.84	0.82
Median	0.91	0.88	0.85	0.81	0.78

If Ofwat were to intervene again on the PCLs, then it should the change in definition to reflect social media and counting contacts on multiple Issues more than once (which does not apply for DWI reporting until 1 January 2024). We quantified this uplift as 0.1 contacts in our business plan.

Table 36 – Performance Commitment Levels – SWB Water Quality Contacts

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. contacts per 1,000 population	1.33 (PR19 definition)	1.34	1.24	1.15	1.05	0.87
Standard underperformance collar	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Underperformance deadband	No. contacts per 1,000 population		NA	NA	NA	NA	NA

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Outperformance deadband	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Standard outperformance cap	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Enhanced outperformance cap	No. contacts per 1,000 population		NA	NA	NA	NA	NA

Table 37 – Performance Commitment Levels – BRL Water Quality Contacts

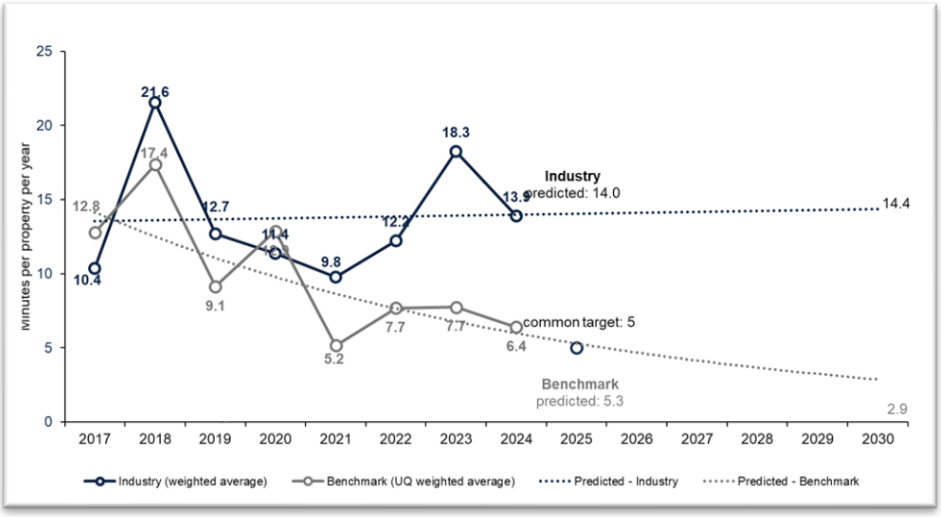
BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. contacts per 1,000 population	0.83 (PR19 definition)	0.91	0.88	0.86	0.84	0.82
Standard underperformance collar	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Underperformance deadband	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Outperformance deadband	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Standard outperformance cap	No. contacts per 1,000 population		NA	NA	NA	NA	NA
Enhanced outperformance cap	No. contacts per 1,000 population		NA	NA	NA	NA	NA

6.1.6 Water supply interruptions

Ofwat has intervened at the draft determination, by applying a PCL at 00:05:00 throughout the reporting period, to be delivered from base expenditure, it has adjusted the collar levels to match 1% RoRE, it has removed the deadband we included in our business plan and it has set the enhanced outperformance threshold at 00:02:36 for all years of the reporting period.

The PCL is the same PCL as that set for the final year of PR19. Ofwat's assumption that everyone meets their end of PR19 targets however is not realistic, as Ofwat has not made any adjustments for the impact of external factors on water supply interruption performance. As confirmed in response to query OFW-OBQ-SBB-088, for water supply interruptions, we proposed an additional threshold be added to the definition (for the exclusion of third-party major events) at the draft determinations.

In the draft determination Ofwat state that "we are setting performance commitment levels so they are consistent with the expected performance of efficient companies."[17] Based on our modelling, this is not the case. Although Ofwat has said that its proposed expenditure on resilience and interconnectors should help companies reduce water supply interruptions, the benefits of such expenditure would not be prevalent until the long-term.[18] Likewise, based on historical analysis, the industry will struggle to achieve the end of AMP7 stretching targets and then struggle to achieve the Ofwat end of AMP8 targets.



As a result, we have again included a deadband level for this performance commitment (we have reduced the deadband from three minutes above the target, to two minutes, to reflect the revision to the PCL).

We have set a higher collar level than what was included in our business plan. However, expecting an equivalent value of 1.0% RORE to be set at risk is arbitrary and would not align to our customer preferences.

Although the enhanced threshold is more stretching than that proposed in our business plan (at 00:03:30) we have adopted the threshold (this is now stated in OUT7).

Table 38 – Performance Commitment Levels – SWB Water Supply Interruptions

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Hours:minutes:seconds	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00

[17] Ofwat (2024) PR24 draft determinations: Expenditure allowances
[18] Ofwat (2024) PR24 draft determinations: Expenditure allowances

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Standard underperformance collar	Hours:minutes:seconds		00:26:15	00:26:15	00:26:15	00:26:15	00:26:15
Underperformance deadband	Hours:minutes:seconds		00:07:00	00:07:00	00:07:00	00:07:00	00:07:00
Outperformance deadband	Hours:minutes:seconds		NA	NA	NA	NA	NA
Standard outperformance cap	Hours:minutes:seconds		00:02:36	00:02:36	00:02:36	00:02:36	00:02:36
Enhanced outperformance cap	Hours:minutes:seconds		00:00:00	00:00:00	00:00:00	00:00:00	00:00:00

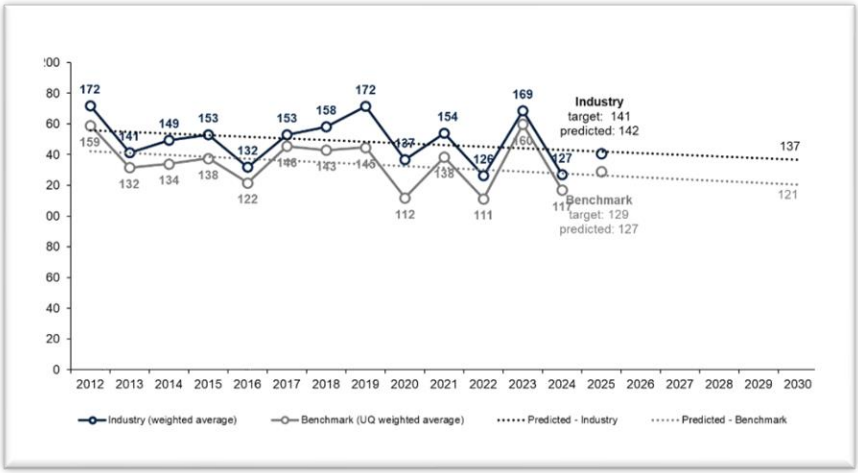
Table 39 – Performance Commitment Levels – BRL Water Supply Interruptions

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Hours:minutes:seconds	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00	00:05:00
Standard underperformance collar	Hours:minutes:seconds		00:24:05	00:24:05	00:24:05	00:24:05	00:24:05
Underperformance deadband	Hours:minutes:seconds		00:07:00	00:07:00	00:07:00	00:07:00	00:07:00
Outperformance deadband	Hours:minutes:seconds		NA	NA	NA	NA	NA
Standard outperformance cap	Hours:minutes:seconds		00:02:36	00:02:36	00:02:36	00:02:36	00:02:36
Enhanced outperformance cap	Hours:minutes:seconds		00:00:00	00:00:00	00:00:00	00:00:00	00:00:00

6.1.7 Mains repairs

Ofwat has intervened to adjust the PCL for BRL (an adjustment for enhancement expenditure related to mains renewals expenditure), to remove the deadbands and to set the cap and collar at 0.5% RoRE.

Performance on the metric is volatile for the industry. Nevertheless, both the downward trend across benchmark companies, as well as the benchmark's consistent outperformance relative to the industry average, suggest that base buys service improvements in mains repairs; we have challenged ourselves for our performance commitment levels as a result.



For BRL, our strategy to maintain asset health is to increase the level of mains renewals compared to historic levels, in AMP8 and beyond, and to further reduce leakage (a customer priority). Ofwat appear to have assumed the same burst benefit of a main replaced when targeting a burst main and a main replaced that is not necessarily bursting but is causing water quality issues. We do not agree with this assumption. We had already included the burst benefit overlap with the water quality mains and leakage mains and reduced the enhancement accordingly; hence base expenditure was already covering those overlaps so customers would not pay twice. Ofwat may therefore have overlooked this. In addition, Ofwat has said that its proposed additional allowances for mains renewals should help companies reduce mains repairs.[19] As we are rejecting the sector-wide base cost adjustment for mains renewals, we are proposing our BRL PCLs reflect the business plan ambitions. We explain further in our representation SBBDD09_L3_Cost_and_efficiency our rationale for rejecting the base cost sector-wide cost adjustments.

We know that this measure is heavily influenced by ground movements caused by certain weather conditions – notably rapid thaws in winter and prolonged periods of hot, dry weather. The impact of such events was seen across the sector in 2022 when we saw more bursts in the summer and winter thaw periods. Despite this, we have accepted the intervention over the deadband removal, on the proviso that our incentive rates are accepted. Although we have removed the deadband for this metric, the regulatory precedent should be noted regarding the adoption of a deadband for this metric; the CMA was supportive of deadbands for asset health measures such as mains repairs and unplanned outage. If Ofwat continue to insist on introducing further risk to the ODI framework, via their interventions, we would need to re-evaluate the deadbands for this metric.

[19] Ofwat (2024) PR24 draft determinations: Expenditure allowances

Table 40 – Performance Commitment Levels – SWB Mains Repairs

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. per 1,000 km of mains	131.6	131.3	130.9	130.6	130.3	130.0
Standard underperformance collar	No. per 1,000 km of mains		175.0	175.0	175.0	175.0	175.0
Underperformance deadband	No. per 1,000 km of mains		NA	NA	NA	NA	NA
Outperformance deadband	No. per 1,000 km of mains		NA	NA	NA	NA	NA
Standard outperformance cap	No. per 1,000 km of mains		95.8	95.4	95.1	94.8	94.5
Enhanced outperformance cap	No. per 1,000 km of mains		NA	NA	NA	NA	NA

Table 41 – Performance Commitment Levels – BRL Mains Repairs

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. per 1,000 km of mains	130.7	130.3	130.0	129.5	128.9	128.2
Standard underperformance collar	No. per 1,000 km of mains		175.0	175.0	175.0	175.0	175.0
Underperformance deadband	No. per 1,000 km of mains		NA	NA	NA	NA	NA
Outperformance deadband	No. per 1,000 km of mains		NA	NA	NA	NA	NA
Standard outperformance cap	No. per 1,000 km of mains		93.5	91.3	89.1	86.9	84.8
Enhanced outperformance cap	No. per 1,000 km of mains		NA	NA	NA	NA	NA

6.1.8 Unplanned outage

Ofwat has intervened to set at PCL of 2.14% by 2029-30 (although Ofwat sets a glidepath for BRL), to remove the deadbands and to set the cap and collar at 0.5% RoRE.

As confirmed in response to query OFW-OBQ-SBB-088, for unplanned outage, in our business plan we expressed concerns over the removal of the exception for changes in raw water quality. We took this into account when setting the common performance commitment level and the proposed deadband ranges. Although we have removed the deadband for this metric, the regulatory precedent should be noted regarding the adoption of a deadband for this metric; the CMA was supportive of deadbands for asset health measures such as mains repairs and unplanned outage. If Ofwat continue to insist on introducing further risk to the ODI framework, via their interventions, we would need to re-evaluate the deadbands for this metric.

Table 42 – Performance Commitment Levels – SWB Unplanned Outage

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	2.14	2.14	2.14	2.14	2.14	2.14
Standard underperformance collar	%		8.70	8.70	8.70	8.70	8.70
Underperformance deadband	%		NA	NA	NA	NA	NA
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		0.00	0.00	0.00	0.00	0.00
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

Table 43 – Performance Commitment Levels – BRL Unplanned Outage

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	2.94	2.78	2.62	2.46	2.30	2.14
Standard underperformance collar	%		8.70	8.70	8.70	8.70	8.70
Underperformance deadband	%		NA	NA	NA	NA	NA

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		0.00	0.00	0.00	0.00	0.00
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

6.2 Outcomes and Priorities: Storm Overflows and Pollution

6.2.1 Internal sewer flooding

In the QAA Ofwat praised our ambitions for our proposed performance target for internal sewer flooding. As an industry-leading company on this area of service, we would like to highlight to Ofwat the disproportionate impact of its outcomes framework - there is a natural 'cap' on outperformance for this metric, which does not then compensate for the underperformance companies are now facing for other ODIs, such as for total pollution incidents. We have considered this imbalance further in the appendix to this representation document - by considering alternative ODI proposals– these range from simple revisions (aligning as closely to the draft determination as possible) to more novel approaches.

Ofwat has intervened at the draft determination, by applying a PCL at 1.15 incidents per 10,000km of sewer connections by 2029-30 throughout the reporting period, to be delivered from total expenditure. We have adopted these industry common levels of service.

Ofwat has also intervened by setting the enhanced outperformance threshold at 0.63 by 2029-30. Although the enhanced threshold is more stretching than that proposed in our business plan (at 0.80 for all reporting years) we have adopted the threshold (this is now stated in OUT7) under this framework.

Table 44 – Performance Commitment Levels – SWB Internal Sewer Flooding

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number per 10,000 sewer connections	0.80	1.31	1.29	1.24	1.20	1.15
Standard underperformance collar	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Underperformance deadband	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Outperformance deadband	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Standard outperformance cap	Number per 10,000 sewer connections		0.78	0.76	0.71	0.67	0.63
Enhanced outperformance cap	Number per 10,000 sewer connections		0.00	0.00	0.00	0.00	0.00

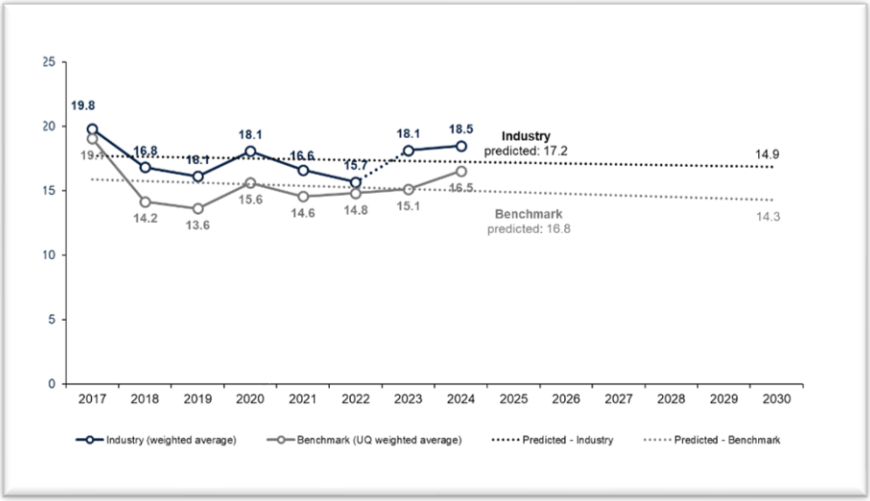
6.2.2 External sewer flooding

In the PR24 methodology Ofwat stated that the PCL should be set on a common basis but at the draft determination the PCLs have been set as company-specific.

In the QAA Ofwat praised our ambitions for our proposed performance target for external sewer flooding.

Ofwat has intervened at the draft determination, by removing the collar, removing the deadband we included in our business plan and it has set the enhanced outperformance threshold at 11.08 by 2029-30 for all years of the reporting period.

As there have not been common targets for this performance commitments at PR19, we caution against relying solely on past performance. However, our ambitions do clearly Indicate a 'step-change' compared to where the industry would be forecasting to achieve based on historical performance.



We have again proposed an underperformance and outperformance deadband at one incident per 10,000 connections above the performance commitment level. The deadband is reflective of our ambitious levels of service - it is a level that is still more stretching the forecast industry performance, as well as being more stretching than forecast cost-efficient benchmarked performance. But this is also to reflect the uncertainty for weather impacts on performance. The existence and severity of weather events are outside of the control of the water and wastewater companies; and when those events arise there are – by the nature of the event – substantial impacts on customers. Therefore, when that event does happen, we recognise that our customers will want their water company to focus on what is needed during and in the immediate aftermath of that event. However, the inclusion of a deadband is intended to mitigate ODI risk - the inclusion of a deadband does not impact our obligations of service we wish to provide to our customers (we may still be reporting of a failure to meet the target) but this approach does reduce the exposure of water and wastewater companies to risks that they cannot control.

Table 45 – Performance Commitment Levels – SWB External Sewer Flooding

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number per 10,000 sewer connections	14.09	14.51	13.97	13.43	12.89	12.36
Standard underperformance collar	Number per 10,000 sewer connections		NA	NA	NA	NA	NA

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Underperformance deadband	Number per 10,000 sewer connections		15.51	14.97	14.43	13.89	13.36
Outperformance deadband	Number per 10,000 sewer connections		NA	NA	NA	NA	NA
Standard outperformance cap	Number per 10,000 sewer connections		13.23	12.69	12.15	11.61	11.08
Enhanced outperformance cap	Number per 10,000 sewer connections		0.00	0.00	0.00	0.00	0.00

6.2.3 Total pollution incidents

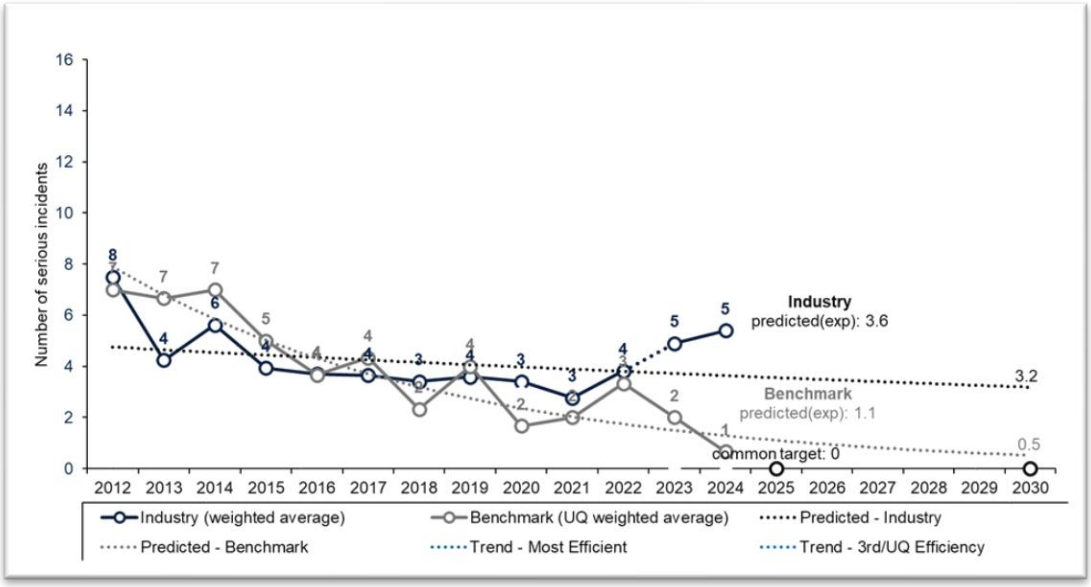
Ofwat has intervened at the draft determination to set an industry common PCL based on its interpretation of a WISER obligation (by applying the expectation of at least a 30% reduction of all pollution incidents (category 1 to 3) by 2030 on the 2024-2025 targets, to the targets for AMP8). We have fundamental objections to this revision, which we outline in the focused representation.

6.2.4 Serious pollution incidents (water and wastewater)

Ofwat has intervened at the draft determination to remove the deadband and collar we included in our business plan. This is despite the fact that for CRI, Ofwat is allowing for external factors (element of uncertainty) once performance leaves the company control.

As confirmed in response to query OFW-OBQ-SBB-088, for serious pollution incidents we reserved caution against the inclusion of the metric in the outcomes framework due to potential double-counting with environmental fines. We took this into account in our proposal for a deadband for this metric.

Based on industry forecast performance, as well as forecast performance of the cost benchmarked companies, the industry will not achieve full compliance for this performance commitment.



A deadband helps improve the symmetry of the package overall in terms of the balance of risk and reward.

Based on analysis of the cost-efficient companies, a deadband of one would be appropriate. We have however again proposed this level be set to two, with the additional incident reflecting the potential double-counting with environmental fines.

Table 46 – Performance Commitment Levels – SWB Serious Pollution Incidents

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number	2	0	0	0	0	0

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Standard underperformance collar	Number		10	10	10	10	10
Underperformance deadband	Number		2	2	2	2	2
Outperformance deadband	Number		NA	NA	NA	NA	NA
Standard outperformance cap	Number		NA	NA	NA	NA	NA
Enhanced outperformance cap	Number		NA	NA	NA	NA	NA

Table 47 – Performance Commitment Levels – BRL Serious Pollution Incidents

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Number	0	0	0	0	0	0
Standard underperformance collar	Number		10	10	10	10	10
Underperformance deadband	Number		2	2	2	2	2
Outperformance deadband	Number		NA	NA	NA	NA	NA
Standard outperformance cap	Number		NA	NA	NA	NA	NA
Enhanced outperformance cap	Number		NA	NA	NA	NA	NA

6.2.5 Storm overflows

Our DWMP includes commitments of 75% of storm overflows discharging into or close to high priority sites to be addressed by 2035, 100% of storm overflows discharging into or close to high priority sites are addressed by 2045, 100% of all storm overflows are addressed by 2050, consistent with the storm overflow reduction plan.

Ofwat has intervened at the draft determination to apply a stretch to base expenditure, resulting in a PCL of 16.5, the removal of our underperformance deadband and it has set caps and collars at 0.5% RORE, based on the Ofwat incentive rates

As an outstanding company we have now committed to reducing the average spill frequency per storm overflow to at most 16.5 by 2030.

As per our business plan, we have proposed an underperformance deadband, set at the 2024-25 baseline forecast for every year of AMP8, in order to protect the company against small variations in performance beyond management's control. As confirmed in response to query OFW-OBQ-SBB-043, OFW-OBQ-SBB-081 and OFW-OBQ-SBB-088, we raised concerns over the unmonitored storm overflows adjustment for event duration monitors (EDMs) for this performance commitment. Specifically, we stated that our performance commitment levels assumed that EDM uptime adjustment would be set at 90% and that if it was instead set at 100% that we would need to reconsider the performance commitment levels. We note that the draft determination intervention has resulted in a revision to the definition (with the monitored and unmonitored spills being measured via separate performance commitments). Due to the EDM uptime adjustment for unmonitored spills, a deadband for the monitored spills is still justified.

Ofwat's stronger incentive rates and approach to caps and collars at 0.5% RORE results in a 'lower' collar level than our business plan. We have applied a 'higher' collar level, reflecting our incentive rates. However, expecting an equivalent value of 0.5% RORE to be set at risk is arbitrary and would not align to our customer preferences (whilst Ofwat now ranks this as a 'high' priority, our customer research indicates it should be a medium priority).

Table 48 – Performance Commitment Levels – SWB Storm Overflows

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Average no. spills per overflow	20.00	19.50	18.75	18.25	17.75	16.50
Performance Commitment Levels	% uptime adjustment		97.00	97.25	97.50	97.75	98.00
Standard underperformance collar	Average no. spills per overflow		30.1	30.1	30.1	30.1	30.1
Underperformance deadband	Average no. spills per overflow		20.0	20.0	20.0	20.0	20.0
Outperformance deadband	Average no. spills per overflow		NA	NA	NA	NA	NA
Standard outperformance cap	Average no. spills per overflow		7.0	7.0	7.0	7.0	7.0
Enhanced outperformance cap	Average no. spills per overflow		NA	NA	NA	NA	NA

6.2.6 Bathing water quality

Ofwat has intervened at the draft determination to apply company-specific forecasts as the PCLs and it sets caps and collars at 0.5% RORE, based on the Ofwat incentive rates.

In our business plan we recommended that the PCLs be set on an industry common basis – we again urge Ofwat to consider this approach. On the forecast PCLs Ofwat has set for the industry, the industry upper quartile results in a PCL of 89.8% by 2029-30; this is the PCL that we propose be adopted. As a frontier company, Ofwat's approach does not reflect the level of investment required to upkeep the excellent standard of bathing waters, neither does it reflect the fact that due to our historical high standards of service, there is little room for actual outperformance.

Table 49 – Forecast Performance – Bathing Water Quality

Bathing Water Quality	Unit	2024-25 baseline	2025-26	2026-27	2027-28	2028-29	2029-30
SWB	%	93.5	93.5	93.5	93.7	94.2	94.4
Industry Frontier	%	93.5	93.5	93.5	93.7	94.2	94.4
Industry Upper Quartile	%	87.9	89.1	89.5	89.5	89.5	89.8

Over a third of all the bathing waters in the country are situated in our region. Customers and stakeholders often, rightfully, challenge us over performance they read about from other regulators.

We have sector leading bathing water quality. But the PR24 definition does not reflect this. The PR24 definition, far from helping customers understand performance, will lead to confusion. This is not transparent. The PR24 definition may be confusing for customers because:

a) It is not the same as the Environment Agency's bathing water classifications, which publicises whether a water company's bathing water sites meet or exceed the minimum standard 'sufficient' classifications.
b) Bathing waters which cannot be impacted by a water company in the discharge of its functions should be excluded. However, Ofwat states that determining if/ when this applies will be undertaken in conjunction with the Environment Agency prior to the start of the 2025-30 period and set out in the PR24 final determinations. At the draft determination Ofwat has now explicitly asked companies "to review the identified lists of designated bathing water sites and our proposed interventions. We request that they accept these interventions or provide sufficient and convincing evidence to support an alternative approach at an individual bathing water level." But Ofwat's interventions have not excluded bathing waters which cannot be impacted by a water company in the discharge of its functions. So the presumption seems to still be that all classification risk is down to WaSC assets.

As confirmed in response to query OFW-OBQ-SBB-088, for bathing water quality we commented on inconsistencies in the historic data that Ofwat has been referring to. We cautioned that if the definition changed following Ofwat's review of the historic data and incentive calculation data that only then should the targets proposed in the plan also be reviewed too.

At the time of the business plan submissions, SWB was responsible for 151 bathing waters. Based on draft determination industry data, the impact of setting the PCL on an industry common basis would result in the following outcomes design:

Table 50 – Performance Commitment Levels – SWB Bathing Water Quality

SWB	Unit	Baseline forecast	Indicative Performance Commitment Level (based on draft determination industry data)				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	93.5	89.1	89.5	89.5	89.5	89.8
Standard underperformance collar	%		86.9	86.9	86.9	86.9	86.9
Underperformance deadband	%		NA	NA	NA	NA	NA
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		92.7	92.7	92.7	92.7	92.7
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

We note Ofwat's request at the draft determinations for companies to submit forecast classifications for the new sites (designated by Defra on 13 May 2024) and to therefore update any information submitted previously.

Planning class data from 2015-2023 has been collated. Predictions for bathing waters, including the six new sites, were then made based on the historical classifications and upcoming improvement schemes. We have included four scenarios that include and exclude these bathing sites. But this will not address the fact that the measure is different to how another regulator publicises water company performance.

In May 2024 there were six new designations in SWB's region this brings the total to 157:

•Lyme Regis Church Cliff Beach

•Coastguards Beach, Erme Estuary

•Dittisham, Dart Estuary

•Steamer Quay, Dart Estuary

•Stoke Gabriel, Dart Estuary

•Warfleet, Dart Estuary

6.2.6.1 Bathing water quality scenarios

We consider a range of scenarios below.

Table 51 - Bathing water quality summary table – scenario adjustments

	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Scenario 1	89.7%	90.3%	90.8%	91.2%	91.8%	91.8%
Scenario 2	87.9%	88.6%	89.2%	89.8%	90.8%	90.8%
Scenario 3	90.3%	90.5%	90.8%	91.2%	91.8%	91.8%
Scenario 4	88.5%	89.1%	89.6%	90.2%	91.0%	91.0%

Table 52 - Scenario 1 – All bathing waters (157 bathing waters)

The first scenario includes all bathing waters and reflects how the basis of the business plan submission, plus the six new bathing waters introduced in May 2024. The bathing water quality (BWQ) output from this scenario is predicted performance based on the previous measurement methodology.

	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Scenario 1	90.6%	89.7%	90.3%	90.8%	91.2%	91.8%	91.8%

The initial decrease observed in 2024-2025 is due to four of the newly designated bathing waters being poor. Increases are predicted for the following years, due to expected completion of improvement schemes.

It is likely that the 4 bathing waters that were poor in 2023-2024 (before the new designations in 2024) will remain poor for a few years. The earliest of the improvement schemes do not finish until 2026.

Steamer Quay and Stoke Gabriel will remain poor indefinitely. The 2023-24 results have shown it is impossible for them to reach sufficient in the next four years.

This output includes Porthluney, which is a poor bathing water with no impacting SWW assets.

Table 53 - Scenario 2 – Bathing waters with SWW potential impacting assets (Specific Exclusions) (103 bathing waters)

Scenario 2 looks at the predicted performance outcomes if only sites with impacting SWW assets are included (as currently demonstrated on the SWW bathing season EDM return/Beach Live and WaterFit Live alert systems). This is the proposed methodology for PR24.

	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Scenario 2	88.5%	87.9%	88.6%	89.2%	89.8%	90.8%	90.8%

By removing the sites with no impacting assets, we lose 45 sites with Excellent classification from the metric. As such, the 2023-24 output for scenario 2 is 2.1 percentage points lower than scenario 1.

The percentage decreases further as the six newly designated sites are added.

If scenario 2 is the only option, we may need an adjusted baseline.

Table 54 - Scenario 3 – Defra Planning Class (157 Bathing Waters)

Scenario 3 was included to observe the BWQ output if the DEFRA classification was used. This would include discounted samples following signed short-term pollutions.

	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Scenario 3	92.6%	90.3%	90.5%	90.8%	91.2%	91.8%	91.8%

Unsurprisingly the metric is initially higher however, the improvement schemes will not be completed any faster. There is no difference between using planning class and DEFRA class by 2026-27.

Table 55 - Scenario 4 – Only Impacting assets and SODRP (117 bathing waters)

The final scenario is a repeat of scenario 2, with the addition of bathing waters which may have impacting assets under the Storm Overflow Discharge Reduction Plan (SODRP) 1km rule. This states that any storm overflows within 1km (hydrological continuity) of a designated bathing water area must be improved to 2 or 3 spills per bathing season.

	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Scenario 4	89.1%	88.5%	89.1%	89.6%	90.2%	91.0%	91.0%

14 additional sites including 11 excellent bathing waters, gives us an initial 0.6 percentage point increase.

The metric is consistently higher than scenario 2.

We see less of a percentage point drop whilst also maintaining some security against bathing waters we are not associated with dropping class.

There is less of a buffer in the output drop when we have fewer sites so may still require an adjusted baseline.

6.2.7 Sewer collapses

Ofwat has intervened at the draft determination to set the cap and collar at 0.5% RoRE. As we have adopted our top-down incentive rates, we have proposed alternative collar levels (set at the same level as our business plan).

We have applied a 'higher' collar level, reflecting our incentive rates. However, expecting an equivalent value of 0.5% RORE to be set at risk is arbitrary and would not align to our customer preferences.

Table 56 – Performance Commitment Levels – SWB Sewer Collapses

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	No. per 1,000km of sewer network	10.48	13.17	12.35	11.53	10.71	9.87
Standard underperformance collar	No. per 1,000km of sewer network		29.00	29.00	29.00	29.00	29.00
Underperformance deadband	No. per 1,000km of sewer network		NA	NA	NA	NA	NA
Outperformance deadband	No. per 1,000km of sewer network		NA	NA	NA	NA	NA
Standard outperformance cap	No. per 1,000km of sewer network		9.17	8.35	7.53	6.71	5.87
Enhanced outperformance cap	No. per 1,000km of sewer network		NA	NA	NA	NA	NA

6.3 Outcomes and Priorities: Net Zero and Environmental Gains

6.3.1 River water quality (phosphorus)

We support Ofwat's decision to apply a reputational (non-financial) incentive to this performance commitment.

We have included a new profile in data table CWW19, which now also shows in OUT5.64 and OUT5.65 for the years 2026-27 to 2030-31. This reflects our plans for the price control deliverable for Nutrients Schemes by conventional (grey) solutions.

Table 57 – Performance Commitment Levels – SWB River Water Quality (Phosphorus)

SWB	Constant	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Total load of phosphorus from all of the company's wastewater treatment works in 2020	1825004.71						
Phosphorus (Kg of P) emitted in 2020 from treatment works that had a phosphorus limit for the latest calendar year.		225625.62	233336.44	400,586.06	410,885.77	425,309.33	453,613.00
Phosphorus (Kg of P) emitted in the latest calendar year from treatment works that had a phosphorus limit.		173003.73	183351.74	224,108.88	224,729.42	227,084.99	223,151.92
Change (Kg of P) in phosphorus discharged from treatment works		52621.89	49984.7	176,477.19	186,156.36	198,224.34	230,461.08
Phosphorus (Kg of P) prevented from entering rivers from partnership working in 2020		0	0	0	0	0	0
Change (Kg of P) in phosphorus prevented from entering rivers from partnership working		0	0	0	0	0	0
Reduction (Kg of P) in phosphorus from 2020		52621.89	49984.7	176,477.19	186,156.36	198,224.34	230,461.08
Reduction in phosphorus as a percentage of load discharged from treatment works in 2020		2.88%	2.74%	9.67%	10.20%	10.86%	12.63%

6.3.2 Biodiversity

We have noted Ofwat's revision to the biodiversity PCL, which was amended post-publication of the draft determination, via an industry query response that the calculation of the sector median should be revised. Ofwat stated:

"The calculation of the sector median included values from 2025-26 to 2029-30 which resulted in double-counting performance as the units are already accumulative from the baseline level of biodiversity units. We are proposing to set the revised PCL for 2029-30 at 0.73 total net change in biodiversity units for area of land served (per 100km2). This equates to the sector median level in 2029-30.

"We note the same issue has occurred in the calculation of the 2028-29 sector median. We are proposing to set the revised PCL for 2029-30 at 0.08 total net change in biodiversity units for area of land served (per 100km2). This equates to the sector median level in 2028-29."

Ofwat also intervened to set caps and collars at 0.5% RORE, based on the Ofwat incentive rates.

We accept the common PCL but adjust the caps and collars based on our incentive rates.

Table 58 – Performance Commitment Levels – SWB Biodiversity

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Net change in Biodiversity units	0.00	0.00	0.00	0.00	0.08	0.73
Standard underperformance collar	Net change in Biodiversity units		0.00	0.00	0.00	-1.92	-1.27
Underperformance deadband	Net change in Biodiversity units		0.00	0.00	0.00	0.15	1.97
Outperformance deadband	Net change in Biodiversity units		0.00	0.00	0.00	0.15	1.97
Standard outperformance cap	Net change in Biodiversity units		0.00	0.00	0.00	0.00	0.00
Enhanced outperformance cap	Net change in Biodiversity units		0.00	0.00	0.00	2.08	2.97

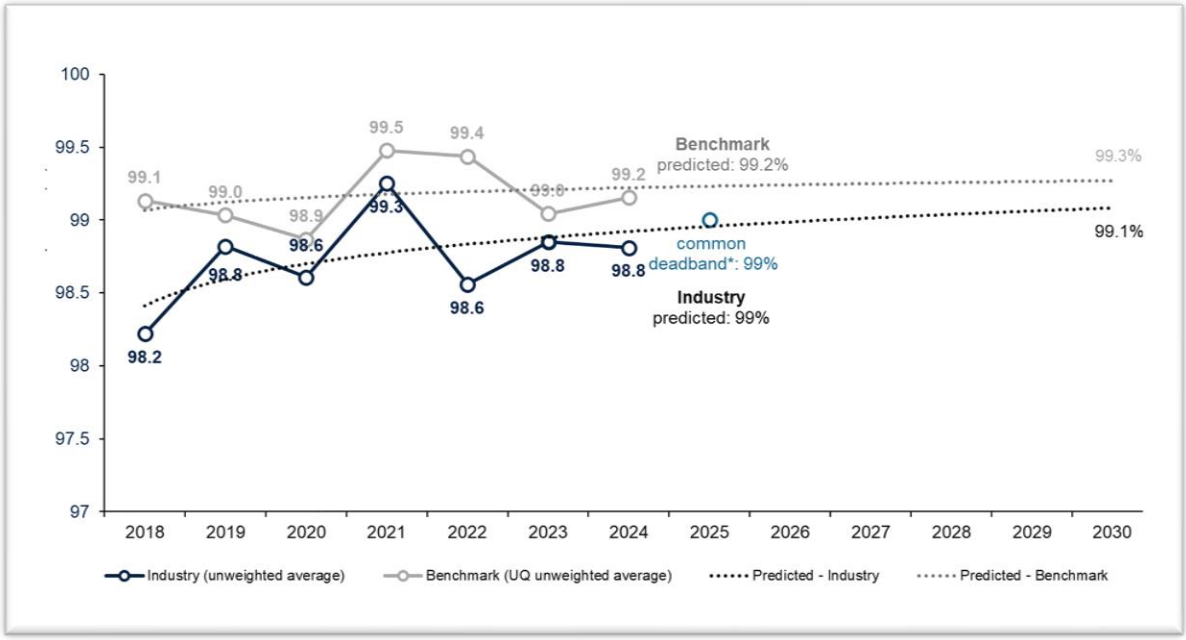
Table 59 – Performance Commitment Levels – BRL Biodiversity

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Net change in Biodiversity units	0.00	0.00	0.00	0.00	0.08	0.73
Standard underperformance collar	Net change in Biodiversity units		0.00	0.00	0.00	-2.92	-2.27
Underperformance deadband	Net change in Biodiversity units		NA	NA	NA	NA	NA
Outperformance deadband	Net change in Biodiversity units		NA	NA	NA	NA	NA
Standard outperformance cap	Net change in Biodiversity units		0.00	0.00	0.00	3.08	3.73
Enhanced outperformance cap	Net change in Biodiversity units		NA	NA	NA	NA	NA

6.3.3 Discharge permit compliance

Ofwat has intervened at the draft determination to remove the deadbands. This is despite the fact that for CRI, Ofwat is allowing for external factors (element of uncertainty) once performance leaves the company control.

Based on industry forecast performance, as well as forecast performance of the cost benchmarked companies, the industry will not achieve full compliance for this performance commitment.



A deadband is critical given that performance will be impacted by factors beyond management control. A deadband also helps improve the symmetry of the package overall in terms of the balance of risk and reward.

The removal of deadbands for statutory compliance performance commitments means that many companies will expect penalties as the base case. This aligns with precedents and comments set through the CMA and by Ofwat.

The CMA concluded that:

"We also agree that deadbands may be appropriate in certain circumstances. Deadbands may be appropriate where outcomes may not be fully within the control of management such as in the following circumstances:

"(a) The measure itself allows very little tolerance: In these cases, a company might 'miss' the PC without necessarily having objectively failed in management of the commitment. Ofwat set deadbands for the two statutory PCs (the water quality index CRI, and Treatment works compliance), for which the PC level is full compliance (an index score of zero, or 100% treatment works compliance).

"(b) Delivery of the PC is not wholly within companies' control: circumstances outside management control could lead to a small underperformance.

"(c) The measure is new, and its relation to desired company management behaviours and outcomes is not clear: setting a deadband can offer some reassurance to companies, while maintaining the incentive to deliver good performance."[20]

In addition, Ofwat concluded:

[20] Competition & Markets Authority (2021) Final Report - Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations

"We consider that deadbands are required for compliance related performance commitments such as CRI and Treatment Works Compliance because the relevant regulatory bodies (DWI and Environment Agency) require 100% compliance (e.g. no quality related failures). However, in practice this is very difficult to achieve and it is likely that almost every company would be subject to an underperformance penalty in each year of the period if there were no deadbands. Both quality regulators are supportive of deadbands for these performance commitments. Their inclusion and value was agreed with both regulators at the [PR19] initial assessment of plans, draft and final determination phases."[21]

We also note that Ofwat wrote to water companies on 20 August 2024 entitled 'ODI rates (discharge permit compliance, water quality contacts) General Response'. Ofwat stated *"Due to consistent feedback raised by companies in early engagement so far to the draft determinations related to the Discharge permit compliance and Water quality contacts ODI rates, we are issuing a response to all companies to provide assurance around these concerns. We will factor in any additional feedback and information ahead of final determinations"*. A deadband could help solve the issue of the size of the incentive rates.

The expectation for full compliance, without any deadband, drives downside risk (even if remote). Ofwat's decision is particularly surprising for water only companies considering Ofwat's own analysis. Ofwat has previously stated that "due to the low number of water treatment works that WoCs have, a single failure can mean a reduction in compliance of between 2% and 25%, depending on the company. As such, there would be a degree of volatility around a discharge permit compliance measure for WoCs, given the low number of permits. This may need to be considered when looking at the overall balance of risk and return for all companies at the PR24 determination phase."[22]

For SWB we have set the deadband at 99%. This deadband level would be in line with the Environment Agency (EA) guidance, where performance less than 99% is considered not acceptable and attracts an Amber rating in the Environmental Performance Assessment. There is merit in aligning the performance framework to that used by the EA for this measure (given the EA defines the measure).

For BRL we have set the deadband at the equivalent to one discharge failure.

Table 60 – Performance Commitment Levels – SWB Discharge Permit Compliance

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	99.0	100.0	100.0	100.0	100.0	100.0
Standard underperformance collar	%		NA	NA	NA	NA	NA
Underperformance deadband	%		99.0	99.0	99.0	99.0	99.0
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		NA	NA	NA	NA	NA
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

[21] Ofwat (2020) Reference of the PR19 final determinations: Costs and outcomes – response to CMA provisional findings
[22] Ofwat (2022) Serious pollution incidents and discharge permit compliance common performance commitments

Table 61 – Performance Commitment Levels – BRL Discharge Permit Compliance

BRL	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	%	100.0	100.0	100.0	100.0	100.0	100.0
Standard underperformance collar	%		NA	NA	NA	NA	NA
Underperformance deadband	%		91.7	91.7	91.7	91.7	91.7
Outperformance deadband	%		NA	NA	NA	NA	NA
Standard outperformance cap	%		NA	NA	NA	NA	NA
Enhanced outperformance cap	%		NA	NA	NA	NA	NA

6.3.4 Operational greenhouse gas emissions (water and wastewater)

Ofwat has intervened to adjust the PCLs (with an accompanying base cost sector-wide net zero cost adjustment) and to set the cap and collar at 0.5% RoRE.

We are rejecting the base cost sector-wide net zero cost adjustment and therefore proposing the PCLs as per our business plan. We explain further in our representation SBBDD09_L3_Cost_and_efficiency our rationale for rejecting the base cost sector-wide cost adjustments. Our cap and collars are not set at 0.5% RoRE but reflect a view of outcomes risk 'in the round' (these are new performance commitments).

Ofwat also noted in its QAA that our plan was also unambitious for the South West area in our proposed performance target for greenhouse gas emissions from our wastewater activities. Ofwat has however not neglected to consider our bespoke ODI on embodied greenhouse gas emissions, which goes further then the common metric on operational greenhouse gas emissions. Ofwat should also consider our wastewater plans 'In the round' - our plan proposed the lowest internal sewer flooding target (at a normalised level) of all water and sewerage companies, as well as proposing one of the lowest external sewer flooding targets of all water and sewerage companies.

Our operational greenhouse gas emissions for SWB (water), SWB (waste) and BRL (water) all forecasted emissions growth between 2022/23 and 2029/30. The predicted growth in operational emissions is largely a result of additional energy consumption from new treatment processes and infrastructure planned to be deployed during AMP8 towards ensuring a resilient and regulatory compliant service. Most notably the additional energy consumption expected during AMP8 will be a result of desalination, North Devon green recovery, WRMP, DRMP and WINEP activity. The planned AMP8 investments in projects that aim to reduce emissions, including plans for energy efficiency, renewable energy, the transition to electric vehicles, and controlling process and fugitive emissions, is simply insufficient to keep pace with the additional emissions predicted to be added from the AMP8 capital investment programme.

Table 62 – Performance Commitment Levels – SWB Operational GHG Emissions (water)

SWB (water)	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e	61137	67194	65944	66042	67405	70045
Standard underperformance collar	Tonnes CO2e		70692	70692	70692	70692	70692
Underperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Outperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e		63960	63960	63960	63960	63960
Enhanced outperformance cap	Tonnes CO2e		NA	NA	NA	NA	NA

Table 63 – Performance Commitment Levels – BRL Operational GHG Emissions (water)

BRL (water)	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e	26575	30548	29985	29851	29714	29689
Standard underperformance collar	Tonnes CO2e		31455	31455	31455	31455	31455
Underperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Outperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e		28460	28460	28460	28460	28460
Enhanced outperformance cap	Tonnes CO2e		NA	NA	NA	NA	NA

Table 64 – Performance Commitment Levels – SWB Operational GHG Emissions (wastewater)

SWB (wastewater)	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e	83001	83707	82606	84377	86932	89562
Standard underperformance collar	Tonnes CO2e		89709	89709	89709	89709	89709
Underperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Outperformance deadband	Tonnes CO2e		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e		81165	81165	81165	81165	81165
Enhanced outperformance cap	Tonnes CO2e		NA	NA	NA	NA	NA

7 Bespoke Performance Commitments

7.1 Overview

Ofwat introduced an outcomes-based framework at PR14, which involved extensive customer engagement and companies setting their own outcomes, measures, targets and incentives alongside challenge from Customer Challenge Groups. PR19 reduced the freedom given to companies to develop bespoke proposals tailored to reflect customer and stakeholder needs and aspirations. However, we were still able to use the framework to meet the original objectives in other areas of performance to address our customers' preferences through bespoke PCs and through setting appropriately stretching targets. As the PR19 preview review moved through the motions, we questioned the purpose of ODIs based on where Ofwat was pushing the sector and the potential risk of pushing water companies too close to the edge.[23]

At PR24 there remains a place for well justified bespoke performance commitments in the outcomes framework. Significant value can be unlocked for customers and the region through the use of bespoke performance commitments – particularly where they relate to priorities that may not be captured within the common performance measures.

We responded to the PR24 draft methodology in September 2022, highlighting our disagreement over Ofwat's desire to set strict criteria for the inclusion of bespoke performance commitments in the outcomes framework.

On 14 April 2023 we included a number of bespoke performance commitment proposals in response to an early PR24 submission on bespoke PC definitions. We included supporting customer research for our view that customers wanted us to be able to manage uncertainty in the delivery of long term outcomes, by helping customers and communities to take steps through catchment management, community wetlands, surface water separation, meters, lead pipe replacement, preventing housing surface water run-off and sewer blockages.

Our PR24 customer research found that customers wanted an outcomes framework that included both common and bespoke PCs and that customers are strongly in favour of preventative measures as the most viable and cost-effective solutions for investment for performance commitments. We also heard that customers would like to see company activities focus on prevention of problems where possible and that they were open to new, non-traditional infrastructure ways of doing this, such as catchment management.

Our independent customer challenge group, the WaterShare+ Customer Advisory Panel supported our PR24 business plan bespoke proposals:

"We… support the company's inclusion of two bespoke performance commitments, one on embodied greenhouse gas emissions and the other associated with catchment management, as we see clear evidence that these reflect customer priorities and would appropriately best hold the company to account for delivering on these specifics… We consider there is reasonable customer evidence to support the adoption of bespoke PCs. In our view this evidence has been obtained through an appropriate and robust research methodology. The two proposed bespoke PCs are focused on local needs and do not overlap with the common PCs specified by Ofwat. We encouraged the company to propose these in its Business Plan since we believe they reflect evidenced customer priorities and as such better hold the company to account and incentivise the delivery of the priorities of customers, and customers support them."

Bespoke commitments remain a critical way of tailoring plans and we would ask that Ofwat considers:

- Allowing our proposal for the catchment management targets as per our business plan
- 'Uplifting' the catchment management ODI to reflect the downside skew in the framework in the round – we recommend this uplift as a multiplier of four based on our business plan rates
- Allowing our proposal for the embodied GHG emissions targets as per our business plan

[23] ICS Consulting and Bristol Water (2019) Will it all be upper futile in the end?

7.2 Embodied greenhouse gas emissions (bespoke)

Ofwat has intervened at the draft determination and removed the glidepath in our PCLs, introduced an underperformance deadband and changed the ODI timing from end of period to in-period. Ofwat also states that a cap and a collar are appropriate for this measure and will be set at ±0.5% of RoRE.

Ofwat has also asked for a revision definition - we have included a revised definition for this bespoke performance commitment as an appendix to this representation.

Since the publication of Ofwat's draft PR24 methodology, which encouraged companies to consider whether embodied greenhouse gas emissions could be reported "in a verifiable and robust manner", we have engaged constructively over the potential for including such a metric within the outcomes framework.

In Ofwat's assessment of bespoke performance commitment proposals, it noted that "we strongly encourage more companies to come forward with bespoke performance commitments focused on incentivising reductions in embedded GHG emissions."[24]

We welcome Ofwat's feedback in its draft determinations that our proposals are "outcomes focused, clearly defined and provides evidence on the additional benefits to customers and the environment." However, we note that the ODI timing has been revised to an in-period revenue adjustment. As this is a novel performance commitment, we did recommend in our business plan that the ODI timing and form be an end-of-period revenue adjustment. We also recommended that outperformance and underperformance payments should only apply for 2029-30 i.e. no ODI would apply for the first four years of AMP8 and the ODI would only apply to performance in 2029-30 (there would be no cumulative impact for the ODI). We reconfirmed this position in response to query OFW-OBQ-SBB-225. In response to query OFW-OBQ-SBB-015 and OFW-OBQ-SBB-245 we confirmed our adjusted Performance Commitment Levels to reflect the revised total capital delivery spend assumptions.

We do not consider it appropriate to be expected to deliver a 10% reduction from our baseline tCO2e/£m from the beginning of the next reporting period in 2025/26 and then to maintain a 10% tCO2e/£m reduction from baseline across each year of the reporting period (i.e. with no glidepath). As this is a novel metric, we consider our business plan proposal for a graduated approach, on a trajectory towards meeting a 10% tCO2e/£m reduction from the baseline by 2029/30, is more appropriate measure whilst we embed our activity-based data assessments within our internal systems and as we work with our internal colleagues and supply chain partners towards driving down emissions. The PCLs we had proposed in our business plan were stretching and ambitious due to the significant maturity required (including with supply chain partners) to ensure consistent and accurate measurement, management and reporting of 'actual emissions' on the capital programme but there can be no justification to expect an immediate reduction in embodied emissions in the first year of AMP8.

We also note that other companies with similar bespoke embodied carbon performance commitments have been granted graduated trajectories between 2025/26 and 2029/30 and would expect a parity of required action across the industry to be a more even-handed approach. For this reason, and because SWB are embedding systems internally, and whilst we continue to engage with our supply chain to deliver on our activity-based data requirements, we propose two alternative design approaches:

- Due to the immaturity of the measurement of embodied emissions globally, to revert back to our business plan approach for the timing of the incentives, namely that this should be an end-of-period ODI that only applies in the final year (in 2029/30). This allows for reporting and measurement systems to sufficiently mature and should ensure that customers would only pay for outperformance that is well-measured and understood. This is our preferred approach
- Noting Ofwat has shifted from its methodology and has now set a common performance commitment as a reputational ODI (river water quality), that the metric could be reset as reputational performance commitment only for AMP8.

[24] Ofwat (2023) PR24: Assessment of bespoke performance commitment proposals, page 7

We have tried to be as constructive as possible with our proposals, rather than simply removing the performance commitment from our outcomes framework altogether. However, we would like to stress that the metric relies upon a transitional and gradual shift away from spend-based data towards activity-based data.

Table 65 – Performance Commitment Levels – Embodied GHG Emissions (bespoke)

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2021-22	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Tonnes CO2e per £1m (tCO2e/£m)	385	382	378	362	355	347
Standard underperformance collar	Tonnes CO2e per £1m (tCO2e/£m)		NA	NA	NA	NA	356
Underperformance deadband	Tonnes CO2e per £1m (tCO2e/£m)		NA	NA	NA	NA	353
Outperformance deadband	Tonnes CO2e per £1m (tCO2e/£m)		NA	NA	NA	NA	NA
Standard outperformance cap	Tonnes CO2e per £1m (tCO2e/£m)		NA	NA	NA	NA	343
Enhanced outperformance cap	Tonnes CO2e per £1m (tCO2e/£m)		NA	NA	NA	NA	NA

7.3 Catchment management (bespoke)

Ofwat has intervened at the draft determination and removed this bespoke performance commitment.

South West Water has been leading in the area of catchment management for many years and this is critical to delivering 'nature-based' solutions. This has also leveraged significant levels of third-party sector funding through our unique partnership approach.

The performance commitment is defined as the hectares of the 'Upstream Thinking' project catchments that are under active improved catchment management as part of 'Upstream Thinking' project interventions. 'Upstream Thinking' is South West Water's catchment management programme in the major drinking water abstraction catchments of the region. It uses a range of interventions to reduce pollutant load in water sources to improve water quality or to slow water within catchment and thereby increase resilience to both drought and flood events.

Our business plan bespoke ODIs reflected local priorities - we consulted widely with customers and stakeholders, understood their priorities and identified areas not covered by common commitments where they want to see action. These were designed to complement the suite of PR24 common performance commitments. In our qualitative top-down incentives research, our customers told us that they wanted a balanced package of ODIs, including both common and bespoke performance commitments, to provide a focus on regional delivery of local customer priorities. Our customers said that catchment management is a very important issue, that it should be a top priority and that they agreed that there should be a bespoke target in this area. Customers also told us that they would like to see company activities focus on prevention of problems where possible and are open to new, non-traditional infrastructure ways of doing this, such as catchment management. This is in line with wanting to stop the issues at source instead of finding a cure afterwards, considering this more proactive rather than reactive.

The delivery of catchment management goes hand in hand with partnership working. South West Water has well established relationships with key delivery partners for our award winning Upstream Thinking Catchment Management programme. The delivery partners include Cornwall Wildlife Trust, Devon Wildlife Trust, FWAG, South West Lakes Trust and Westcountry Rivers Trust. Those partners have confirmed that they would be willing to supply new services to South West Water and have put forward proposals for delivering collaborative and nature-based solutions to meet the challenges set out in the PR24 plan.

The inclusion of catchment management in our business plan was also supported by the Watershare+ Customer Advisory Panel:

"We... support the company's inclusion of two bespoke performance commitments, one on embodied greenhouse gas emissions and the other associated with catchment management, as we see clear evidence that these reflect customer priorities and would appropriately best hold the company to account for delivering on these specifics."

Whilst we understand Ofwat's conclusions and its preference to remove catchment management from our outcomes framework, we do not accept this intervention. Ofwat's feedback notes that the metric is output-focused and that it overlaps with other common performance commitments, most notably the biodiversity performance commitment.

On the metric being output-focused, our aim is to prevent the deterioration of water quality at source. By working with those who manage the land, we can effectively manage water. This is a clear benefit to our customers with additional benefits for the wider environment. We note the eight bespoke performance commitments that Ofwat has assessed as suitable for progressing at the draft determination (including South West Water's embodied greenhouse gas emissions). Whilst we have no objections to the bespoke performance commitments that other companies are proposing, we would question whether the criticism that catchment management it too output-focused could not be applied to some of the other bespoke performance commitments, such as metrics that monitor the number of lead pipes replaced and the number of collaborative projects delivered.

On overlapping with other performance commitments, this performance commitment would not materially overlap with biodiversity, operational greenhouse gas emissions or river water quality, as it is as based on discrete projects. Whilst our work on Upstream Thinking contributes to biodiversity improvements, the biodiversity units are a negligible by-product of this work. Likewise, this metric should be incentivised, to enable us to significantly increase our activity and partnership working in the area in order to encourage everyone, not just a water company, make the environmental improvements, environmental improvements that would not be measured by the biodiversity ODI.

Table 66 – Performance Commitment Levels – SWB Catchment Management (bespoke)

SWB	Unit	Baseline forecast	Performance Commitment Level				
		2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Performance Commitment Levels	Hectare	138,000	136,500	139,000	141,500	144,000	146,500
Standard underperformance collar	Hectare		117,028	117,028	117,028	117,028	117,028
Underperformance deadband	Hectare		NA	NA	NA	NA	NA
Outperformance deadband	Hectare		NA	NA	NA	NA	NA
Standard outperformance cap	Hectare		177,028	177,028	177,028	177,028	177,028
Enhanced outperformance cap	Hectare		NA	NA	NA	NA	NA

8 Customer measures of experience

8.1 C-MeX

South West Water continues to invest in its customer services teams and expand the channels by which it can interact with and support customers. We aim to provide the best possible service to all our customers at all times.

Whilst the core principles of customer service remain the same over time, customer expectations and demands evolve. To keep customers happy and sometimes exceed their expectations, water companies need to also change. But it is disingenuous to treat water companies on par with other market services. For example, utilities offer a significantly different value proposition within UKCSI to other sectors where customers purchase a specific product or service that they want, rather than a service that they need. Our main challenge is to the use of cross-sector benchmarks within C-MeX.

We are concerned that Ofwat's proposed changes to the C-MeX measure mean that it will not meet its basic requirement of rewarding companies for improved performance, and that it will not achieve the success criteria set out in its original design, which were to:

- encourage companies to improve customer experiences and innovate;
- be simple and meaningful for companies and customers;
- be proportionate;
- be practical to implement;
- measure performance across companies consistently, reliably, and fairly; and
- reflect customer behaviour changes and market changes.

It is worth reflecting on the history of the design of the C-MeX incentive, as we do not support the inclusion of the UKCSI average benchmark.

In the PR24 methodology in December 2022, Ofwat stated its desire to increase the size of C-MeX incentives. Ofwat said that it would develop the detailed design of C-MeX, D-MeX and BR-MeX prior to the draft determinations.

In September 2023 Ofwat consulted on the high-level design of C-MeX and D-MeX. Ofwat said that its preferred option for allocating incentive payments for C-MeX was to make greater use of cross-sector benchmarks, i.e. to have a relative incentive based on how water companies compare to the wider economy. In response to the September 2023 consultation, our main challenge was over the use of cross-sector benchmarks within C-MeX. While we agreed with the principle, we raised concerns that suitable benchmarks were not available and that as a result customers would continue to find it difficult to understand why a water utility is being compared to an organisation which provides customers with a choice, such as a supermarket. We also said that Ofwat should also be mindful that incentive design at PR24 should be symmetrical, and that the design under consultation would introduce greater asymmetry than already exists.

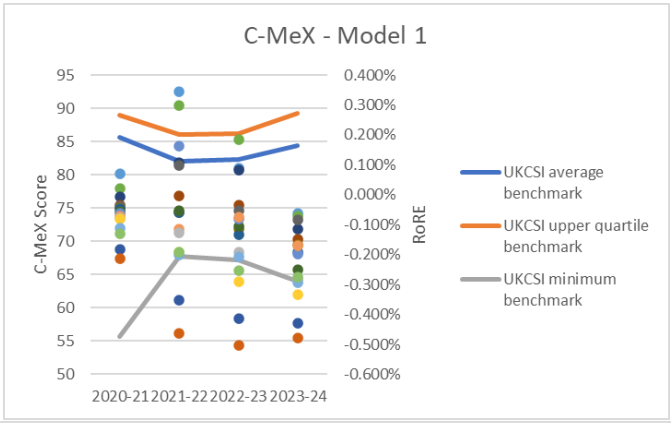
In November 2023 Ofwat hosted an industry workshop on C-MeX and specially over its proposals for cross-sector benchmarks and its formula for adjusting C-MeX scores for UKCSI performance. During the workshop Ofwat confirmed that it would publish its draft decisions and guidance for C-Mex in the period from May to July 2024 and that it would confirm its final decisions for C-MeX in December 2024.

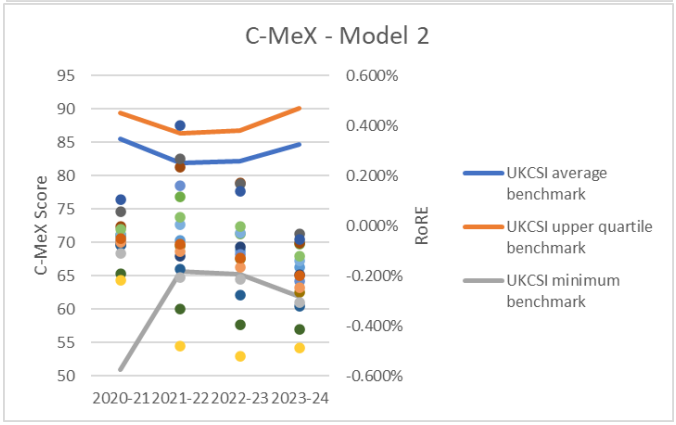
In the PR24 draft determination and an industry webinar, Ofwat highlighted its desire to include a cross-sector benchmark for outperformance payments, specifically the UKCSI average benchmark.

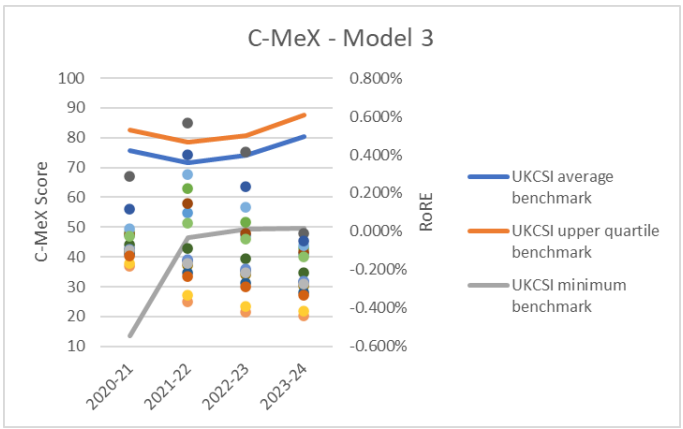
Based on the information Ofwat has published at the draft determination, we have considered four different risk models, to establish the RoRE impact based on the C-MeX incentive design. Our models considered:

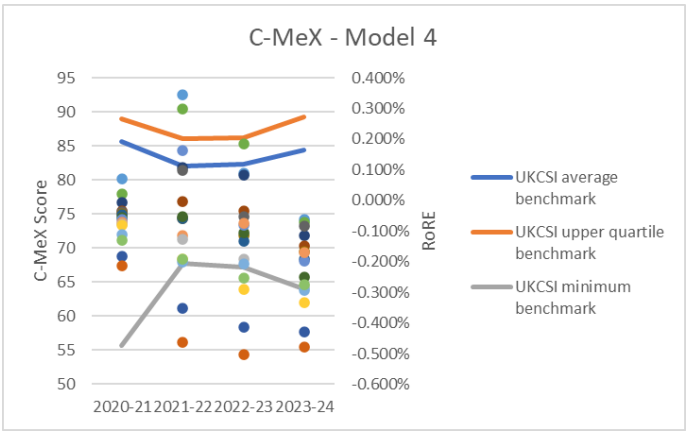
- C-Mex model 1: Existing C-MeX scores (applying C-MeX score 'as is' without any adjustments)
- C-Mex model 2: Existing C-MeX scores with survey weights adjusted to an equal 33%

- C-Mex model 3: Applying digital C-MeX (CSS) scores to reflect the change of survey method – to reflect digital scoring only with the online correction factor remove
- C-Mex model 4: As above but where a company had less than 5 digital surveys in a quarter by function applying the average digital score minus the online correction factor.









Following this analysis we conclude that:

- The survey method is not robust. Recurring questions and concerns within the industry have been raised regarding the variance in scores between digital and non-digital surveys, whether the Digital Online Correction Factor (OCF) remains appropriate, and the lack of an online Check and Challenge process. The proposed removal of both the OCF and check and challenge process alongside the move to the predominantly email and SMS CSS survey leads to a reduction in scoring, further impacting a company's ability to achieve reward against the UKCSI approach and resulting benchmark.
- The balance of the surveys (CSS versus CES) should be based on 90% CSS and 10% CES
- The use of UKCSI is not appropriate. Our modelling over the last AMP shows that the underperformance and reward has a greater correlation with the fluctuation in the all-sector average UKCSI score than it does with changes to the average industry C-MeX scores. This is driven by wider economic factors outside of the industry's control, which further challenges the appropriateness of the use of UKCSI in determining the ODI outcomes.
- There is incentive asymmetry. In each of the models, no company would have qualified for outperformance in 2023-24, meaning that the ODI is neither symmetrical nor consistent with other ODIs. Rather than act as an incentive to improve performance, this could disincentivise companies from making improvements across the industry. Whilst the UKCSI comparator has been modified to the average this would see very few if any companies achieve reward. We do not support the UKCSI average benchmark.
- The calculations required for the C-MeX incentive are complex and would not be understood by customers

Our recommendation is that Ofwat removes the cross-sector benchmark and revert back to a relative incentive approach (comparing a company's C-MeX score with other water companies), which would ensure there is consistency in how incentives for C-MeX, D-MeX and BR-MeX are calculated.

8.2 D-MeX and BR-MeX

We are supportive of Ofwat's proposals and we welcome the symmetrical incentive design.

9 Summary of Draft Determination Outcomes Interventions

We have summarised Ofwat's interventions and our observations on these interventions in the table below (this is not an exhaustive list).

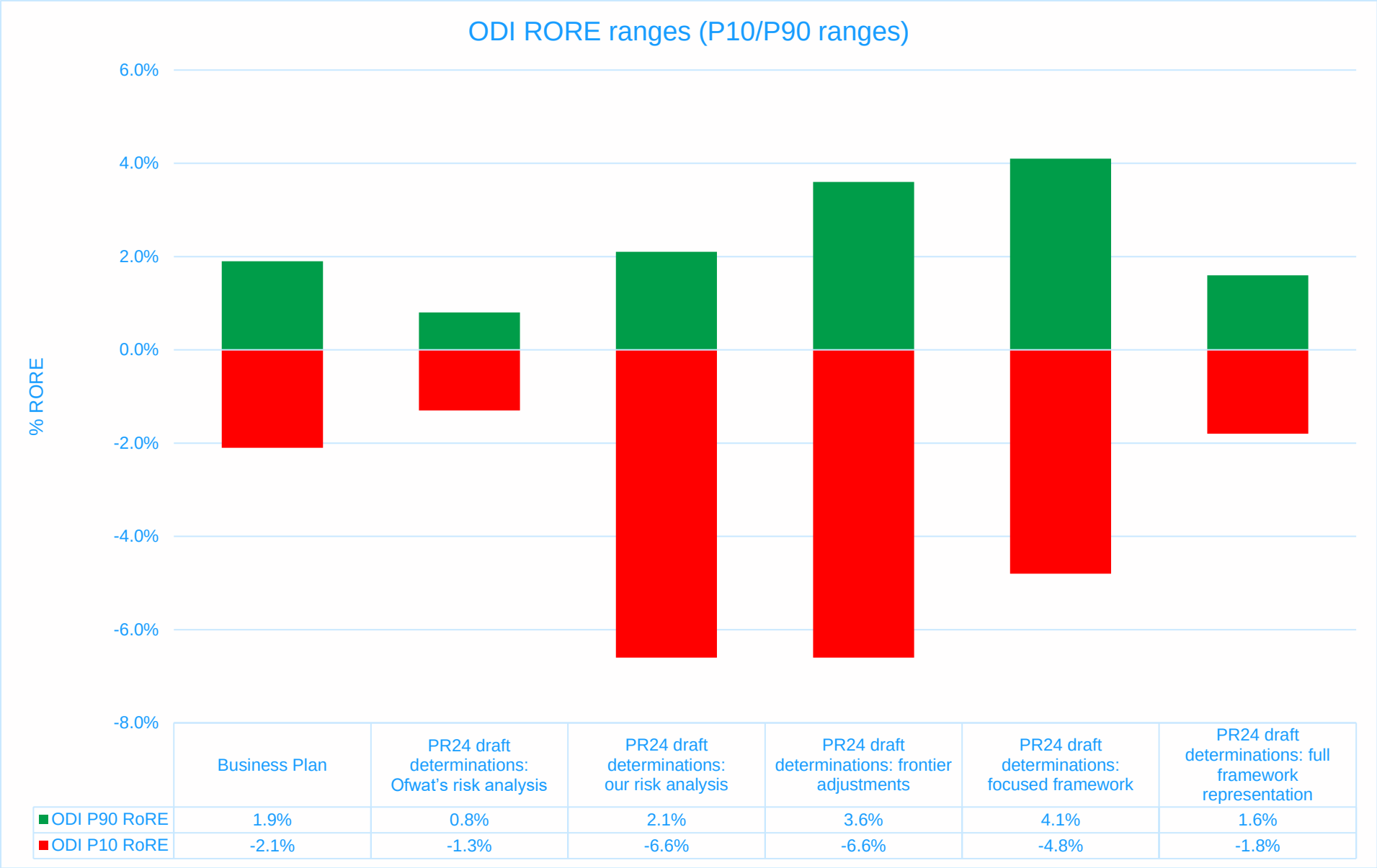
Table 67 – Summary of our response to the Draft Determination Outcomes Interventions

Ofwat Intervention		Intervention Summary	Summary Observations
In-period reporting	Financial adjustments	1% adjustment to ODI payment depending on late submissions for ODI checklists, assurance reports and/or incomplete commentary	We have objections to a mechanical adjustment – there should be a short assessment period to determine the reason for the delay.
	Early submission	ODI data to be submitted 15 June each year (not 15 July), with ODI in-period determinations extended to 15 December (from 15 November)	We disagree with the changes to the timeframe. We see no reason why Ofwat should receive performance data ahead of the 15 July and not still be able to reach determinations by 30 November each year.
Performance commitments	Common performance commitments	23 common performance commitments apply to water and sewage companies	We are disappointed that Ofwat has not reflected on definition risk in its design of outcomes risk. We accept the removal of the exclusions we had proposed for the Isles of Scilly.
	Bespoke performance commitments	Eight potential bespoke performance commitments across the industry. For South West Water, catchment management was rejected and the embodied GHG emissions targets were revised (with no glidepath) and the ODI timing was also revised	We reject the removal of the bespoke PC on catchment management. We reject Ofwat's interventions on the embodied GHG emissions PC.
ODI rates	Size of rates	Rates set using an industry-wide top-down approach, with rates that are at least as strong or stronger at PR19 across all areas. Further adjustments are made to some rates, de-linking the indicative values from customer preferences	We rejected Ofwat's indicative top-down incentive rates when we submitted our business plan. We proposed alternative top-down incentive rates, which we again propose in response to the draft determination top-down incentive rates. We have included an additional think-piece supporting the prioritisation of customer preferences in setting top-down incentives.
	Symmetry	Symmetric ODI rates except where underperformance only	Underperformance only rates must be balanced with deadbands

Ofwat Intervention		Intervention Summary	Summary Observations
			C-MeX ODI rates cannot be symmetric due to the benchmark gateway
	Financial incentives	Financial standard incentives for all but river water quality performance commitment Financial enhanced incentives removed for total pollution incidents and per capita consumption	We accept the reputational ODI for river water quality. We accept the removal of enhanced ODIs for total pollution incidents and per capita consumption (the draft determination enhanced thresholds can be found in data table OUT7 for our full framework representations)
Performance Commitment Levels	Stretch of targets	Ofwat's general view is that it has set achievable yet stretching PCLs and that these PCLs push companies to improve performance beyond PR19 levels (that were already stretching) to a stretch beyond the industry median forecasts and reflect relevant allowances to improve performance. In summary, Ofwat applies a forecast median stretch (based on cost allowances) for unplanned outage, WSI, ISF, ESF, operational GHG emissions (water and wastewater) and biodiversity. GHG emissions has an industry cost adjustment allowance For storm overflows Ofwat proposed an additional improvement of at least 5% beyond assumed baseline of 20 from base expenditure.	We consider different PCLs in our focused representation and full framework representations
	Common vs company-specific targets	In a change to the PR24 methodology, water quality contacts is now company-specific (this is good for us) Biodiversity now common (the risk is not the change in approach but the change to enhancement) Bathing water quality remains company-specific (this is bad for us)	We welcome the change in setting water quality contacts based on company-specific targets. Whilst we do not have an issue with the setting of biodiversity targets on a common basis per se, we do highlight an issue with Ofwat's modelled approach in setting the median level for the industry stretch.
Outcomes Risk and Risk Protections	Risk modelling	P50 performance is assumed to be at the new PCL and a five-year view of performance assumes a low level of performance risk	It cannot be true that the industry can have stronger incentives, but less outcomes risk. Ofwat has understated the size of underperformance ODI risk for the industry. We have included additional risk modelling evidence.

Ofwat Intervention		Intervention Summary	Summary Observations
	Caps and collars	Caps and collars applied to new and asset health performance commitments, predominantly set at ± 0.5 RoRE, with a supply interruptions collar at -1.0% RoRE.	Ofwat's caps and collars are linked to their 'stronger' incentives. By proposing our alternative top-down incentives, we had to apply different cap and collar ranges.
	Deadbands	Single deadband on compliance risk index performance commitment that has been tightened	We do not accept Ofwat's stringent application of deadbands.
	Aggregate sharing mechanism	Payment sharing threshold at ± 3% RoRE. This also applies to MeX payments (equivalent to ± 0.95 % of RoRE)	We support the aggregate sharing mechanism and the inclusion of the MeXs within the aggregate sharing mechanism.
MeXs	Cross-sector benchmark	Benchmark company C-MeX performance against the UKCSI to drive a step change in performance	C-MeX ODI rates cannot be symmetric due to the benchmark gateway.
	Size of rates	Rates set using an industry-wide top-down approach (based on RoRE)	We support setting the MeX incentives as a proportion of RoRE.

The impact of these interventions on RORE risk is materially different to our balanced business plan. We summarise the differences in the ODI risk ranges in the chart below.



	Business Plan	PR24 draft determinations: Ofwat's risk analysis	PR24 draft determinations: our risk analysis	PR24 draft determinations: frontier adjustments	PR24 draft determinations: focused framework	PR24 draft determinations: full framework representation
ODI P90 RoRE	1.9%	0.8%	2.1%	3.6%	4.1%	1.6%
ODI P10 RoRE	-2.1%	-1.3%	-6.6%	-6.6%	-4.8%	-1.8%

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11 Appendix: The Isles of Scilly

As confirmed in response to query OFW-OBQ-SBB-088, in our business plan submission we did urge that revisions to definitions reflect the status of the Isles of Scilly (Ios). In response to queries OFW-OBQ-SBB-231 and OFW-OBQ-SBB-241 we further outlined our proposals for reporting IoS performance separately for five performance commitments:

- Compliance Risk Index;
- Water quality contacts;
- Total pollution Incidents;
- Serious Pollution Incidents (water and wastewater combined); and
- Storm overflows.

We have accepted Ofwat's observations at the draft determinations and have therefore removed these performance commitments (and exemptions from the common performance commitments) from our outcomes framework.

12 Appendix: Forecast Data and 2024-25 ODI Performance Model

In Ofwat's May 2024 information notice it requested that companies confirm if the latest outturn year's performance (2023-24) is materially different to the PR24 business plan forecast value. Where this is the case, Ofwat expects companies to confirm whether performance forecasts for 2025-30 and beyond have materially changed as a result and provide updated performance forecasts in the June 2024 version of data tables.

Due to the limited timetable to respond to the draft determination, we are reporting the material changes in the tables below by exception only.

Our PCC forecasts have not been adjusted for COVID-19. This is consistent with query OFW-IBQ-SBB-022, where Ofwat has confirmed that companies should report their updated PCC 2024-25 performance forecasts in their ODI performance model and business plan table PD12 without adjusting for the impact of COVID-19. Ofwat also confirmed that companies should not adjust their forecasts based on the EE model outputs.

12.1 SWB 2023-24 Performance Outturn

The revised data below (for leakage and PCC) is showing in our 2024-25 ODI performance model (in 3F).

Table 68 - SWB 2023-24 Performance Outturn

Performance Commitment	2023-24 Business Plan Forecast	2023-24 Business Plan Reference	2023-24 Outturn	Commentary
Leakage	17.2% 105.6 (annual) 102.8 (three-year average)	OUT1.9, OUT8.3, OUT4.35 OUT4.33, CW5.35 OUT4.34	13.8% 118.5 (annual) 107.1 (three-year average)	Most companies saw an increase in annual leakage in 2022/23 reporting higher levels of bursts resulting from a hot, dry summer and the winter freeze-thaw in that year. Leakage remains challenging and subject to variation annually, partly in line with seasonal conditions.
Per capita consumption (PCC)	-1.5% 148.3 (annual) 148.2 (three-year average)	OUT1.10, OUT8.4, OUT4.49 OUT4.47 OUT4.48	-1.3% 147.3 (annual) 147.9 (three-year average)	PCC has been impacted by the higher working from home levels since COVID-19 emerged than was present in the baseline.

12.2 SWB 2024-25 Performance Forecast

As per Ofwat's response to query OFW-IBQ-SBB-022, we have also adjusted the 2024-25 ODI performance model. This is because Ofwat's response to query OFW-IBQ-SBB-022 stated:

"Companies should report their updated PCC 2024-25 performance forecasts in their ODI performance model and business plan table PD12 without adjusting for the impact of COVID-19.

"Companies should not adjust their forecasts based on the EE model outputs."

As Ofwat's published 2024-25 ODI performance models do show the impact of the adjustments, our revised 2024-25 ODI performance models show the impact of re-adjusting leakage and PCC back to our business plan forecasts. Although the 2023-24 leakage outturn results in a higher annual leakage position, the 15.0% reduction target for 2024-25 is, we believe, still achievable and therefore there is no change required to our 2024-25 forecast for SWB leakage (as a 15% reduction was included in our business plan). Likewise, there is no revision to the PCC forecast.

The revised data below is showing in our 2024-25 ODI performance model.

Table 69 - SWB 2024-25 Performance Forecast

Performance "Commitment	2024-25 Business Plan Forecast	2024-25 Business Plan Reference	2024-25 Revised Forecast	Commentary
Pollution incidents	25.8 (sewer length at 17,440) 19.5 (revised sewer length)	OUT5.43, OUT8.8	86.01 (absolute pollutions at 150)	Our pollutions performance, in particular with respect to category 3 wastewater pollution incidents remains our most challenging area. 2023 was the fifth wettest year on record and saw an increased number of storms. This contributed to operational conditions which were particularly challenging with exceptionally high groundwater levels and the sheer scale of the rainfall resulting in less time to respond to issues that arise at our wastewater treatment works and pumping stations. The challenging operational conditions from 2023 have carried on into the start of the 2024 calendar year.
EPA	4	OUT8.38	2	Partly as a result of our revised pollutions performance, we are no longer forecasting to achieve a four star rating. Companies have not historically 'jumped' from a two star to a four star rating within one year.

Taste, smell and colour contacts	1.33	OUT8.11	1.60	The consumer contact rate for taste, smell and colour contacts deteriorated slightly to 1.66 in 2023. Our general trend of improving performance, which we forecast to return to in 2024 has been achieved in part through the delivery of a number of quality schemes, including schemes to deliver improved treatment to remove dissolved metals, being delivered in the 2020-25 period, which will give benefits in taste, smell and colour performance. The longer-term benefits of our improvement schemes will however still take some time to come through, so the forecast for 2024 has been adjusted accordingly.
Biodiversity - Enhancement	124,515	OUT8.16	138,000	We are delighted to have already met our Performance Commitment Level for 2025 in respect of our original Upstream Thinking programme and are on track to delivery our Green Recovery commitments. We are on track to continue in 2024/25 to increase our activities in this area.

12.3 SWB 2025-30 Performance Forecasts

We have revised our business plan performance forecasts based on 2023-24 outturn and 2024-25 revised performance forecasts for leakage and PCC. This is to reflect the change in the three-year averages following the changes to the annual data.

In addition, we have revised our business plan performance forecasts for:

- Total pollution incidents. Looking at the top four largest water companies to achieve the EPA green status in 2023 they have to target an average of 188 category 1-3 pollutions based on the current methodology. We recommend that the smaller water companies target should be half of this at 94 category 1-3 pollutions for a 'green' status. This is our revised performance forecast.
- River water quality: we have included a new profile in data table CWW19, which now also shows in OUT5.64 and OUT5.65 for the years 2026-27 to 2030-31. This reflects our plans for the price control deliverable for Nutrients Schemes by conventional (grey) solutions.

For the other performance commitments, we are aware that Ofwat has said to another water company that "in your business plan tables, please continue to input your forecast performance for each performance commitment for 2024-25 onwards. Do not input Ofwat's expected levels set out in draft determinations." We therefore have not mechanically adjusted our forecasts for the draft determinations PCLs.

12.4 BRL 2022-23 Performance Revision

The revised data below (for leakage and PCC) is showing in our 2024-25 ODI performance model.

Table 70 - BRL 2022-23 Performance Revision

Performance Commitment	2022-23 Business Plan Forecast	2023-24 Business Plan Reference	2022-23 Revised Outturn	Commentary
Leakage	9.4%	OUT1.9, OUT4.35	8.6%	As we completed our 2023/24 review of the water balance processes and systems across the regions of South West and Bristol, we identified that the 2022/23 annual position for per capita consumption differed due to a small manual error in the underlying calculation of unmeasured household occupancy and a very small difference in the calculation of distribution operational use with regards to flushing of new mains installed. These errors are isolated in nature and represent computational errors rather than any judgemental decisions or choices. This did have an impact on the water balance, therefore resulting in an increase to the post-MLE adjusted annual leakage of 1.1Ml/d for 2022/23. There was also a reduction in the 2022/23 annual per capita consumption reported value of 148.7 l/p/d to 147.0 l/p/d.
	39.5 (annual)	OUT4.33, CW5.35	40.6 (annual)	
	36.9 (three-year average)	OUT4.34	37.2 (three-year average)	
Per capita consumption (PCC)	-4.0%	OUT1.10, OUT4.49	-3.6%	
	148.7 (annual)	OUT4.47	147.0 (annual)	
	154.9 (three-year average)	OUT4.48	154.3 (three-year average)	

12.5 BRL 2023-24 Performance Outturn

The revised data below (for leakage and PCC) is showing in our 2024-25 ODI performance model (in 3F).

Table 71 - BRL 2023-24 Performance Outturn

Performance Commitment	2023-24 Business Plan Forecast	2023-24 Business Plan Reference	2023-24 Outturn	Commentary
Leakage	11.8%	OUT1.9, OUT8.3, OUT4.35	6.1%	Although in terms of the three-year average position, leakage reduced compared to the baseline, we did not achieve the stretching target for 2023-24. Leakage on an annual basis did reduce in 2023-24 compared to the previous year.
	32.5 (annual)	OUT4.33, CW5.35	38.3 (annual)	
	35.9 (three-year average)	OUT4.34	38.2 (three-year average)	During 2023-24, Bristol significantly expanded its number of acoustic detection loggers in its network and this resulted in a reduction in the duration of leaks as we are able more quickly to identify leaks. The full year impact of the installation of these loggers should result in a further improvement in performance for 2024-25 and in particular will improve resilience in the event of severe winter weather
Per capita consumption (PCC)	-2.5%	OUT1.10, OUT8.4, OUT4.49	0.1%	BRL performance significantly improved in 2023-24 (with the three-year average equalling a 0.1% reduction compared to the baseline, rather than a -2.5% underperformance as per our business plan forecast).
	154.4 (annual)	OUT4.47	144.7 (annual)	
	152.6 (three-year average)	OUT4.48	148.8 (three-year average)	Although there were no drought restrictions in the Bristol Water area during 2023, nationwide awareness of water resource issues also has increased, and alongside increased meter penetration and a less extreme summer in 2023, contributed to this reduced per capita consumption.

12.6 BRL 2024-25 Performance Forecast

As per Ofwat's response to query OFW-IBQ-SBB-022, we have also adjusted the 2024-25 ODI performance model. This is because Ofwat's response to query OFW-IBQ-SBB-022 stated:

"Companies should report their updated PCC 2024-25 performance forecasts in their ODI performance model and business plan table PD12 without adjusting for the impact of COVID-19.

"Companies should not adjust their forecasts based on the EE model outputs."

The revised data below is showing in our 2024-25 ODI performance model.

Table 72 - BRL 2024-25 Performance Forecast

Performance Commitment	2024-25 Business Plan Forecast	2024-25 Business Plan Reference	2024-25 Revised Forecast	Commentary
Leakage	14.7% 32.1 (annual) 34.7 (three-year average)	OUT1.9, OUT8.3, OUT4.35 OUT4.33, CW5.35 OUT4.34	6.6% 35.0 (annual) 38.0 (three-year average)	BRL performance did not meet our forecasts in 2023-24 and performance in 2022-23 has been revised. Our forecast for 2024-25 reflects the performance trend in 2023-24.
Per capita consumption (PCC)	-2.1% 152.8 (annual) 152.0 (three-year average)	OUT1.10, OUT8.4, OUT4.49 OUT4.47 OUT4.48	1.9% 146.7 (annual) 146.1 (three-year average)	Our forecast for 2024-25 reflects the improvement trajectory from performance in 2023-24.

12.7 BRL 2025-30 Performance Forecasts

We have revised our business plan performance forecasts based on 2023-24 outturn and 2024-25 revised performance forecasts for leakage and PCC. This is to reflect the change in the three-year averages following the changes to the annual data.

For the other performance commitments, we are aware that Ofwat has said to another water company that "in your business plan tables, please continue to input your forecast performance for each performance commitment for 2024-25 onwards. Do not input Ofwat's expected levels set out in draft determinations." We therefore have not mechanically adjusted our forecasts for the draft determinations PCLs.

13 Appendix: Quality and Ambition Assessment

In the draft determination quality and ambition assessment (QAA), Ofwat categorised South West Water's business plan as outstanding, as it allowed the regulator to challenge the sector to deliver more for customers. We have summarised the relevant tests in the table below and provided a summary of our draft determination representations in these areas.

Table 73 – Our response to the QAA

Methodology Expectations	Business Plan	Draft Determination	Draft Determination response
Quality: Data, information and assurance			
The company provides sufficient and convincing evidence to demonstrate how its track record of performance, or lessons learnt from poor performance, support the credible delivery of the proposals in its plan.	For each performance commitment (where applicable), we included performance improvements plans. Further information on our AMP7 performance could be found in our Track Record for Delivery document.	We met Ofwat's minimum expectation. We provided sufficient and convincing evidence that we understand the drivers of our performance and we proposed credible activities to deliver our proposed performance across the South West and Bristol areas in the 2025-30 period.	We are pleased that Ofwat has recognised our delivery plans. Within this document (in the appendix on 'Forecast Data and 2024-25 ODI Performance Model') we report, by exception, where our performance forecasts have materially changed since the submission of our business plan.
Quality: Costs			
The business plan sets out the benefits of the company's proposals, specifically: • The impact on performance levels delivered through base for all performance commitments; • The impacts of enhancement expenditure on performance commitments for 2025-30 and the longer term (ie to at least 2050);	We put forward performance commitment levels that were stretching for us and tested this against wider industry performance where information was available. Most of our plan outcomes come from base expenditure, except for WRMP measures (such as leakage) and storm overflows. For each performance commitment (where applicable), we included the impact of enhancement expenditure (this was considered as part of our 'what base buys' analysis).	We met Ofwat's minimum expectation. We set out our forecast of the performance levels we considered can be delivered from base expenditure and impact of enhancement expenditure on performance commitments. Ofwat did not identify any material concerns with the data.	We have further considered the service cost relationship in setting PCL. We have recommended revisions to the following PCLs in the focused representation: • Water quality contacts (SWB only) • Total pollution incidents • Bathing water quality • Operational greenhouse gas emissions (water and wastewater) • Embodied greenhouse gas emissions (bespoke) We have recommended further revisions to the following PCLs in the full framework representation: • Mains repairs (BRL only) • Water quality contacts (SWB and BRL) • River water quality

Methodology Expectations	Business Plan	Draft Determination	Draft Determination response
			We have included Ofwat's late revision to the biodiversity PCL.
The business plan and long-term delivery strategy are consistent with the achievement of statutory requirements and relevant government targets.	Our outcomes framework (our proposed performance commitments, incentives and performance commitment levels) was fully integrated with the investment and operational initiatives for the PR24 period. For each performance commitment, we highlighted any regulatory or statutory obligations.	We met Ofwat's minimum expectation. The business plan and long-term delivery strategy were consistent with the achievement of statutory requirements and relevant government targets for operational greenhouse gas emissions (net zero) and per capita consumption. We provided sufficient and convincing evidence, specific to its own target and sites, that we will meet the 2038 Environment Act long term phosphorus targets (national target to reduce phosphorus loadings from treated wastewater by 80% by 2038 against a 2020 baseline). Ofwat did have concerns about the presented performance trends not achieving the business demand target (15% reduction by 2050) for the South West area and meeting the leakage target (50% reduction by 2050) in the Bristol area. Ofwat also had concerns with delivery of the distribution input per population target (20% reduction by 2037-38) for the Bristol area.	Our performance commitment levels for leakage, PCC and business demand reflect our WRMP assumptions. We have accepted a further stretch on storm overflows, to "*reduce the average spill frequency per storm overflow to at most 16.5 by 2030",* as per the conditions of the QAA for the outstanding status and associated reward.
		Quality: Outcomes	
For ODI rates for common PCs the company uses: • our view of indicative marginal benefits, or provides compelling evidence for any alternatives; and	We proposed alternative marginal benefits and we provided evidence	We did not meet Ofwat's minimum expectation but the impact of this on Ofwat's ability to conduct its price review was not material.	Principally we believe incentive rates should be based on marginal benefits derived from research designed to establish customers valuations where this is available.

Methodology Expectations	Business Plan	Draft Determination	Draft Determination response
• our view of indicative benefit sharing factors, or alternatives supported by sufficient and convincing evidence consistent with the considerations we have set out in our final methodology.	to justify our alternative top-down ODI rates. The adoption of these rates were necessary to ensure that the ODI framework was balanced, consistent with regulatory precedent and reflective of our customers' priorities. Ofwat's approach to setting ODI rates was revised following the publication of the PR24 methodology. Ofwat's top-down incentives were determined using RORE insights. The marginal benefits, with the assumed benefit sharing factor, were then calculated after the incentive rates. We applied the same approach to our top-down incentive rates.	We did not provide compelling evidence to support our proposals for lower incentive rates due to overexposure on risk of return. The reduction in size of incentives risks providing insufficient incentive for companies to improve performance. We proposed different ODI rates for all common performance commitments for both the South West area and Bristol area. We set out that the indicative rates represent a risk on return on regulatory equity (RoRE) greater than +1-3% when taking an additive approach. The additive approach applied is unrealistic and overestimates the risk. There is limited evidence provided regarding the rationale to target a 2% ODI return. This number is derived from customer research, which asked customers about preferred bill volatility to identify a target RoRE range. The company does not acknowledge, in interpretation of the results, the inherent complexity of the topic, with trade-offs difficult for customers to understand. We used the target 2% RoRE to allocate 0.21% RoRE per PC across both water and wastewater. The result is proposed rates that are 37 – 78% lower than Ofwat's indicative ODI rates. The lower incentive rates proposed by South West Water risk under-incentivising the company to make performance improvements.	However, we also support Ofwat's desired objective to simplify the outcomes framework. We had signalled to Ofwat, via submissions to the Future Ideas Lab and throughout the PR24 outcomes workshops and consultations, our support for top-down ODI rates, so we welcomed Ofwat's late shift from setting bottom-up to setting top-down ODIs. It is not difficult for customer to understand ODI trade-offs. As our supporting think-piece (Worthless or priceless? What is the value of listening to customers when setting Outcome Delivery Incentives?) finds: *"Evidence from across the sector shows that customers do understand these incentives if they are appropriately engaged on the subject. They understand that bills can go up and down as service varies, acknowledging that this is a common concept across many sectors. For example, in a restaurant customers expect compensation if there is a problem with their meal and can choose to tip if service expectations are exceeded...* *"Customers can also provide views on the service measures that incentives should apply to and the service areas where they feel the incentives should be stronger or weaker. Customers are able to understand that some aspects of service are fully within management control, and some are less so (e.g. sewer blockages can be caused by some customers' behaviour)...* *"The move to outcome-focussed PCs means that customers are more able to understand the impacts from changes in service level and prioritise importance of ODIs across services."* It is not true to say that we only showed ODI risk at an additive level. In addition to our additive P10/P90 range, we applied a simple probability distribution between P10 and P90 levels of performance, using 2022/23 performance between the 10th and 25% percentile and 2024/25 performance between the 25th and 40th Percentile. We also applied Monte Carlo analysis to determine an aggregated RoRE range. We have repeated the Monte-Carlo simulation elements for the DD response. We retain our view that an additive view works best.

Methodology Expectations	Business Plan	Draft Determination	Draft Determination response
			Ofwat's outcomes risk modelling assumes a company's P50 is the AMP8 PCL. This is not true for any company and neither is it true for cost-efficient companies. The +/- 2% ODI return was supported by customer research but this was not the only rationale for the adoption of that range for ODI risk. That was, and continues to be, an appropriate range given the delivery risks we face and given the fact that neither the PR24 methodology nor the PR24 draft determinations provide an appropriate balance of risk and return. Our risk testing suggests a much greater risk of significant negative returns to equity without mitigating the key risk factors, as was proposed in our plan. Even with risk mitigation, and now with a - 1.8% to +1.6% ODI return range in the full framework representation, we believe this may need Ofwat to revisit the cost of equity in order to provide sufficient returns to investors to finance the essential enhancement investment set out in our plan. In short, our +/- 2% ODI business plan return range reflected the fact that the cost of equity was not sufficient – our view remains the same based on the draft determinations. Further information on our ODI RoRE calculations are included in representation **SBBDD10_L3_Finance_risk_and_return**.
If the company's business plan includes bespoke performance commitments, the company sufficiently demonstrates how it has responded to any feedback we have provided on its bespoke performance commitment submission. The company should also provide complete, consistent and well-evidenced incentive rates for bespoke performance commitments, demonstrating how its proposals are consistent with our final methodology and any relevant guidance.	We included two bespoke performance commitments in our business plan; both of these were included in the early submission to Ofwat in April 2023.	We did not meet Ofwat's minimum expectation but the impact of this on Ofwat's ability to conduct its price review was not material. We did not sufficiently respond to Ofwat's feedback on our catchment management bespoke PC proposal. We did not sufficiently respond to Ofwat's feedback on our embodied GHG emissions bespoke PC proposal.	We have represented on Ofwat's rejection of our catchment management bespoke PC proposal in both our focused representation and our full framework representation. We have represented on Ofwat's draft determination ODI design for our embodied GHG emissions bespoke PC.

Ambition: Stretch and efficiency

Methodology Expectations	Business Plan	Draft Determination	Draft Determination response
Provide evidence demonstrating that a stretching performance from base expenditure allowances will be delivered.	The level of stretching performance from base expenditure allowances was transparently set out in our plan, based on our own operational and delivery evidence and external analysis by Oxera, developing a service-cost relationship tool we presented as part of our "performance from enhancement and base" early submissions. This tool was been further considered in establishing appropriate stretch in performance from base expenditure (particularly for data table OUT2). For some performance commitments we had to balance stretching performance from base expenditure allowances with the objective of a balanced ODI framework.	We demonstrated high ambition in our proposals to deliver stretching performance from base expenditure for the 2025-30 period. For the South West area, our plan was particularly ambitious in our proposed performance target for internal sewer flooding, proposing to maintain strong performance. We proposed the lowest internal sewer flooding target (at a normalised level) of all water and sewerage companies by 2029-30. Ofwat also said that we were ambitious in our proposed performance target for external sewer flooding, proposing one of the lowest external sewer flooding targets of all water and sewerage companies. However, for the Bristol area, Ofwat said that our plan was less ambitious for water quality contacts and per capita consumption. Ofwat also said that our plan was unambitious for the South West area for greenhouse gas emissions from wastewater activities.	We are pleased that Ofwat has recognised our high level of ambition. We prioritised improvements in serve areas to align to our customer and stakeholders' expectations. On water quality contacts, our proposals would deliver, comparatively, median levels of service and these service levels also took into account the change in reporting definition. Our PCC ambitions align to our WRMP and regional WRMP, which has been set outside of the price review process. We have proposed a new delivery profile for phosphorous removal. On greenhouse gas emissions, our business plan set out a novel approach for measuring and reducing embodied greenhouse gas emissions, which is in addition to our operational greenhouse gas emissions. Our commitment to monitoring and reducing embodied greenhouse gas emissions, a metric that many companies in the sector will not be monitoring, is more ambitious than the operational metric.

14 Appendix: Alternative Proposals for the Outcomes Framework

We do recognise that setting incentives based on top-down approaches does have drawbacks. In our business plan, in addition to exploring how top-down rates could be set, we also explored two further alternative approaches. These are explored below.

14.1 Alternative Proposals: Top-down versus bottom-up outcome delivery incentive (ODI) rates

In this section we summarise an alternative approach to incentive-setting, which was included in our business plan.

Ofwat's intention for PR24 is to set incentives that are informed by customer valuations (using the same research results applied across all companies) and to do so via simplification of the valuations calculations. Whilst we agree and champion the aim of setting incentives via customer valuations, we disagreed with the method to which Ofwat tried to achieve these ends.

Initially, Ofwat sought to 'map' 'bottom-up' valuations it sourced from its customer valuation survey, but it encountered difficulty in 'mapping' the valuations to the appropriate performance commitments. This challenge became more complex if a performance commitment could be linked to overlapping valuations i.e. one valuation did not map directly to one performance commitment.

Ofwat eventually designed a top-down approach to ODI rate setting. We retain the view that ODI rate setting would better align to a combination of triangulated bottom-up willingness-to-pay valuations (and certainly not valuations linked to a single survey as per Ofwat's original bottom-up approach) and top-down RORE allocation approaches to determining ODI rates (to ensure simplicity is addressed).

Even if we had adopted Ofwat's top-down rates, these rates are not final – they are indicative and will likely be further revised at the draft determination. This would mean that we could not accurately predict the impact of such rates on our RORE range. This is because Ofwat will test its indicative values against any rates proposed by companies in their business plans and will also consider historical performance (Ofwat wants incentives rates that "provide a strong incentive to companies to deliver good service outcomes" and so uplifts may be applied to poor performers).

Our top-down approach sought explicit customer views on our ODI allocations, instead of relying on performance ranges to justify stretch, as Ofwat proposed. Our method of calculating the resulting valuations was simple and not time-consuming. Our adoption of top-down rates (as opposed to bottom-up rates) was due to:

- Our values were intended to be a constructive, pragmatic approach in light of the later guidance and late change in Ofwat's approach to setting ODIs (moving from 'bottom-up' valuations to 'top-down) in summer 2024
- Our values more accurately aligned to our customers' preferences (compared to the method Ofwat used to determine its top-down values - the pieces of customer research Ofwat used to inform customer prioritisation were not undertaken with this use in mind and were retrospectively applied for this purpose – Ofwat was forced into this position because of the problems of its 'bottom up' valuations it sourced from its one industry-wide valuation survey)
- We still followed Ofwat's top-down guidance but we found that Ofwat's objectives of setting incentives informed by customer valuations could not be met. We still prioritised simplification of the incentive rates (as Ofwat has done so), rather than introducing further complexity
- Our values ensured a balance in risk and return was achieved
- Knowing that proposing alternative incentives would not result in being 'penalised' at the QAA (as Ofwat said companies could take this approach, so long as sufficient and convincing evidence was also included in our submission)

We have used cost benefit analysis based on triangulated customers' values to assess appropriate incentive levels across all our outcomes. We also considered the Ofwat centralised compensation based valuation research findings in our triangulation. Alongside the valuation work, independent academic expert, Professor Ken Willis reviewed, challenged and supported the triangulation process, as did the independent WaterShare+ Advisory Panel.

Those 'bottom-up' values were not included in our indicative (top-down) ODIs, but they are another source for calibrating whether top-down incentives reflect customer preferences.

We did, for example, use the same 'bottom-up' customer values to test and validate whether the 'top-down' incentives we had proposed in our plan were reflective of customers' values and trade-offs. We also directly used customer and stakeholder views to define the overall package of incentives to ensure that the balance between service and risk accurately reflected their preferences.

14.2 Alternative Proposals: Dynamic Outcomes

In this section we summarise an alternative approach to target-setting, which was included in our business plan.

Having thought carefully about the challenges to setting incentives we continue to believe that there is an alternative approach that would use dynamic incentive targets, where there are common industry metrics and expected levels of performance. Dynamic incentives help to anchor incentives around industry medians, but can create a deadband for rewards and penalties compared to industry averages.

In our business plan we proposed dynamic incentives for a number of performance commitments. This was an alternative approach to absolute/static performance for target-setting, when there is uncertainty on data or external factors that can affect industry performance. Where industry targets are being used, it is possible to use a deadband between rewards and penalties in between the actual industry median performance and the performance target assumed at the price review. Combined with the top-down ODI allocation approach we believe is required to calibrate incentives, caps and collars also ensure that incentives in circumstances is focused on normal ranges of performance, removing some of the judgement needed in calibration of ODI design. There is experience in the industry already over the design of such targets, such as for C-MeX and DMeX. The approach will be more appropriate for some incentives than others and we have identified in the following Outcomes and Priorities sections which performance commitments may be appropriate for dynamic incentives.

We recognised that this approach was not considered during the PR24 methodology consultation. We therefore set this approach out as an alternative option within our plan. We welcomed the opportunity to work with Ofwat to explore the option further and to test application as part of ODI incentives calibration during 2024.

We were disappointed that this approach was not referred to in Ofwat's draft determinations.