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Outcomes detailed commentary

PR24 Draft Determination Representations – August 2024

Outcomes Detailed Commentary

1 Summary of our Representations on outcomes

This document provides further detailed performance commitment specific commentary on issues relating to each outcome.

The table below summarises our key issues with performance commitments in the DD and our proposed remedy in the FD. It also references where the main discussion of each topic is. Cross cutting issues such as incentive rates and baselines are discussed in Chapter 12 'Our commitments to customers' of our main representations document. Where we have updated data tables we provide commentary noting the changes. The remaining issues are discussed in the detailed outcomes commentary (ANH_DD_017).

Table 1 Summary of issues and remedies for performance commitments

Significance	Topic	Issue	Proposed remedy	Reference
Very high	Performance baseline and stretch	Approach leads to significant asymmetry even for strong performers	Account for 2024/25 and reset performance expectations in light of new information on performance that has been funded historically	ANH_DD_01 Chapter 11 Our commitments to customers
Very high	Incentives	Overly powerful	Reduce intended RoRE of incentives & cap individual PCs back to intended RoRE exposure Incorporate 2024/25 data Calculate performance ranges using 2024/25 PCLs	ANH_DD_01 Chapter 11 Our commitments to customers
Very high	Total pollution incidents	Unrealistic performance expectation	Reset baseline and PCLs in light of industry performance in AMP7	ANH_DD_01 Chapter 11 Our commitments to customers
Very high	External sewer flooding	Unrealistic performance expectation	Reset baseline and PCLs in light of industry performance in AMP7	ANH_DD_01 Chapter 11 Our commitments to customers
Very high	Internal sewer flooding	Unrealistic performance expectation Tougher expectation of us due to strong historic performance despite move to common PCL	Reset baseline and PCLs in light of industry performance in AMP7	ANH_DD_01 Chapter 11 Our commitments to customers

Significance	Topic	Issue	Proposed remedy	Reference
Very high	Leakage	Overlooking of cost recovery within AMP7 ODI	Baseline performance should be our outturn given AMP7 ODI Adopt updated forecast for leakage	ANH_DD_01 Chapter 11 Our commitments to customers
High	Discharge permit compliance	Inclusion of WoCs in rate calculation leads to unintended consequences Asymmetric risk, lack of total management control and inconsistency with EPA	Remove WoCs from calculations to reduce unit rates Maintain AMP7 deadband	ANH_DD_017 Outcomes detailed commentary
High	Operational Greenhouse Gas Emissions (water recycling)	PCL ignores upwards pressure on performance Errors and double counting of benefits in setting PCL Econometric models used to benchmark performance that miss key explanatory variables	Adopt our proposed PCL	ANH_DD_017 Outcomes detailed commentary
High	Bathing water quality	PCL doesn't reflect newly designated bathing waters Ofwat interventions lead to unrealistic performance expectation Factors outside of management control impact performance (particularly with inclusion of discountable samples)	Adopt our proposed PCL which accounts for newly designated bathing waters Apply a deadband	ANH_DD_017 Outcomes detailed commentary
High	Serious pollution incidents	Inclusion of WoCs in rate setting leads to unintended consequences	Remove WoCs, adjust proxy PCL and remove double count from calculations to reduce unit rates	ANH_DD_017 Outcomes detailed commentary

Significance	Topic	Issue	Proposed remedy	Reference
Medium	Water quality contacts	Incentive rate too powerful Impact of interconnectors delivering water from new sources to customers	Reduce incentive rate significantly Apply deadband proposed in our business plan	ANH_DD_017 Outcomes detailed commentary
Medium	Compliance risk index	Deadband does not adequately reflect impact of factors outside of our control nor reasonable balance of risk	Maintain AMP7 deadband	ANH_DD_017 Outcomes detailed commentary
Medium	Biodiversity	Error in PCL Unrealistic to set a common PCL	Revert to our business plan proposals	ANH_DD_017 Outcomes detailed commentary
Medium	Mains repairs	Interaction with proactive leakage detection	Apply deadband proposed in our business plan	ANH_DD_017 Outcomes detailed commentary
Medium	Lower carbon concrete assets	Reduced incentive rate Tougher PCL	Revert to our business plan proposals	ANH_DD_017 Outcomes detailed commentary

2 Compliance risk index

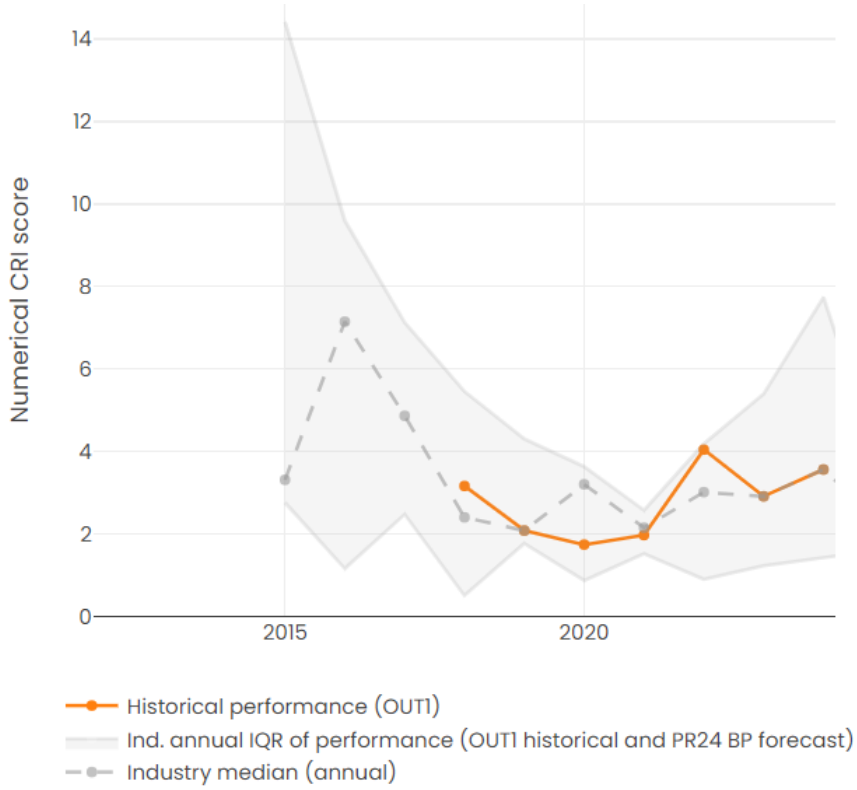
We welcome Ofwat's decision to include a deadband on CRI in AMP8 which reflects the challenges in achieving full compliance due to exogenous factors such as customers' internal pipes or fittings (which are not within statutory functions of companies). Although our aspiration remains achieving full compliance on this measure, we maintain that a deadband should be set at a score of 2 throughout AMP8. Ofwat currently proposes a deadband starting at 1.5 in Y1, reducing to 1.0 by Y5.

There is regulatory precedent established by the CMA for setting a deadband where the measure itself allows very little tolerance and companies might fail to achieve the PCL without necessarily having objectively failed in the management of the commitment.

The CRI score of two, proposed as the alternative deadband, is in line with the baseline performance expected by the DWI in the annual Chief Inspector's report. The Chief Inspector of the DWI discussed CRI at the Chief Inspector's Report launch on 11 July 2023. He recognised there is a residual risk associated with drinking water quality even when companies are providing excellent quality drinking water. Therefore, they stated it is unrealistic not to accept this residual risk at company assets and customer properties exists and a deadband remains appropriate for this measure. At the time of writing, we are not aware of any public statement from the DWI on an updated expectation of baseline performance, therefore we maintain that the current deadband score of 2 remains appropriate. We observe that this remains lower than the industry median in the last three years.

We are also concerned about the phased reduction in the deadband over AMP8. The challenges in meeting the full compliance that Ofwat set out in the Final Methodology (Appendix 8, page 68) related to customer internal pipes or fittings apply for the entirety of AMP8. These factors remain outside the statutory functions of water companies and this risk will not diminish during the AMP as the deadband implies. The factors that drive the requirement for the deadband will remain unchanged throughout the price review period, making it appropriate to maintain the deadband at the same level throughout AMP8.

Figure 1 Industry CRI performance



Our solution

We propose the deadband be set at a CRI score of 2 for each year of the AMP, consistent with the deadband for most companies in AMP7, given the information outlined above.

3 Water Quality Contacts

We are concerned that the combination of an excessively high incentive rate and stretching PCL will penalise companies who are making material investments in their networks to improve interconnection and deliver resilience for customers. This feels particularly pertinent for a measure of performance focused on aesthetics and cosmetic acceptability of water, not its safety or drinkability.

3.1 Deadband

Considering the evidence provided in our business plan (ANH07 page 23), we remain convinced that a deadband remains appropriate for this performance commitment. This is to account for the potential impact of commissioning our strategic interconnectors in addition to the further interconnector schemes proposed in AMP8. We also note more generally that increased levels of intervention on water networks and other assets in AMP8 linked to increased levels of mains renewal and other activities could impact the number of contacts companies receive. More intervention on networks means greater likelihood of contacts and performance variation. It appears perverse to penalise companies for undertaking critical improvements on their infrastructure.

There is regulatory precedent established by the CMA for setting a deadband where the measure itself allows very little tolerance and companies might 'miss' the PCL without necessarily having objectively failed in the management of the commitment. This applies in this circumstance, as we anticipate commissioning of the interconnectors will see an increase in the number of contacts on taste, odour and appearance due to customers receiving drinking water from a different source/ or mixture of sources, and therefore experiencing a change rather than a worsening of the aesthetics of their water.

We set out in our business plan (ANH07 page 24) the approximate changes in the number of customers receiving water from a particular source and the population served after delivery of interconnection; the interconnector programme will change the source supplying a significant proportion of our customer base. Although customers will eventually become used to the taste and aesthetics of water from a new source, changing where water is supplied from will likely be initially noticeable to customers.

We maintain the deadband should be set at 10% above the PCL. This is outlined in the table below.

Table 2 Our proposed deadband by year AMP8

Deadband type	2025/26	2026/27	2027/28	2028/29	2029/30
Underperformance	1.22	1.20	1.18	1.117	1.15

3.2 Incentive rate

Ofwat has now written to companies [1] outlining that this incentive rate is under review given concerns that it is too high in the DD. We note the proposed rate in the DD is 900% greater than the rate we currently face in AMP7 set at PR19 and it is also significantly higher >1,000% than our own customers valuation. A single contact above the PCL would equate to a penalty of £6,500.

In light of this, and the increased exposure companies have to this measure through the material investment in AMP8 and beyond investing in transferring existing and creating alternative sources of water, we propose significant revision is required to the calibration of this measure.

Our solution

Accept our forecast of performance to set the PCL and include our proposed deadband in the Final Determination.

Reduce the incentive rate significantly to reflect the lesser importance of cosmetic aspects of water compared to safety.

1 (20 August 2024) PR24 Outcomes - Addressing key ODI rate concerns, Outcomes Working Group

4 Internal Sewer Flooding

We have provided an updated performance commitment level and forecast in tables OUT1, 2 and 5. The rationale for this approach is discussed in Chapter 11 of our DD representation.

Our proposed PCL is based on a baseline of the industry median in the most recent three years of AMP7 (2021/22 to 2023/24) with an improving trend to the industry upper quartile in the most recent three years of AMP7 (2021/22 to 2023/24) by 2029/30.

We have reflected the funding of this performance from botex plus in the DD by updating OUT2 to align with OUT5. This means the benefit of enhancement funding is zero in our data tables and all improvements are funded by botex plus.

Our solution

Reset baseline and PCLs in light of industry performance in AMP7.

5 External Sewer Flooding

We have provided an updated performance commitment level and forecast in tables OUT1, 2 and 5. The rationale for this approach is discussed in Chapter 11 of our DD representation.

Our proposed PCL is based on a baseline of the industry median in the most recent three years of AMP7 (2021/22 to 2023/24) with an improving trend to the industry upper quartile in the most recent three years of AMP7 (2021/22 to 2023/24) by 2029/30.

We have reflected the funding of this performance from botex plus in the DD by updating OUT2 to align with OUT5. This means the benefit of enhancement funding is zero in our data tables and all improvements are funded by botex plus.

We note that our PCL in the DD is more stretching than for most companies. The latest evidence shows that Ofwat's approach to the baseline in 2024/25 is particularly penal for Anglian. In order to avoid penalty, we would need to outturn 20% fewer flooding incidents than the upper quartile company in 2023/24 to achieve the baseline. We do not consider this stretch is justified, when setting a package of PCLs across a set of common PCs, to set our PCL for external sewer flooding using a 2024/25 baselines that looks far more demanding than recent levels of upper quartile performance.

This appears to be a legacy of us having a more stretching PCL in AMP7 than most companies and appears to penalise us for historic good performance even as Ofwat moves towards a common PCL in AMP9. Ofwat should reconsider the appropriate glidepath for this performance commitment and look to make it more common across the industry to avoid penalising historically good performers.

Our solution

Reset baseline and PCLs in light of industry performance in AMP7.

6 Biodiversity

We have significant concerns about Ofwat's Draft Determination proposals for this measure.

Ofwat has stated it will correct the error relating to the double counting of performance due to units accumulating from the baseline, this correction still fails to address concerns raised (both through our own business plan, as well as through participation in the Biodiversity Task and Finish Group) that the target for biodiversity units created should be company specific.

Setting a common PCL for this performance commitment is problematic as it will not reflect the variability between companies on material factors such as the dominant habitat types and scale of landholding.

On this basis, a common PCL will therefore be inherently undeliverable for some companies - fundamentally companies defined their targets based on knowledge of the biodiversity value and potential of their landholding. Even with the error correction the target is undeliverable for us and, given the time taken for habitats to develop, would be almost entirely contingent on action taken in year one of the AMP. Ofwat has set the 2024-25 baseline at zero, which is at odds with what was agreed in Ofwat's Biodiversity Task and Finish Group that action could be started in AMP7 to realise gains early in AMP8.

The current approach will have perverse incentives for companies, encouraging companies to undertake ecologically illogical behaviour to hit specific targets (i.e. focusing on 'quick wins' in the creation of biodiversity units rather than long-term stewardship to develop more complex habitat types which require multi-AMPs for benefits to accumulate). For instance, without an appropriate company specific target, many companies will inadvertently be encouraged through the PC to seek quick interventions such as planting hedgerow over chalk steam river restoration, or scrub planting over lowland meadow creation, diverting investment away from long-term ecological decisions that will support our biodiversity more effectively.

We request that Ofwat sets company specific PCLs to ensure that this performance commitment does not place any prohibitors on us achieving this long-term aspiration or inhibit our efforts to seek and build upon real opportunities to achieve biodiversity net gain. We therefore retain our proposed PCL from our business plan.

If Ofwat wish to retain a common PCL, we request that this performance commitment is made reputational, to allow for time to work with stakeholders to ensure any future PC and ODI recommendations promote the correct ecological behaviours. This would allow time to determine if a common target should be applied for AMP9, and what specifics need to be taken into consideration to provide targets against which performance can really be compared at a company level. This could include consideration of the baseline biodiversity value of a company's landholding, what percentage is already protected or considered wildlife rich, how easily can changes to tenanted land be made, what are the appropriate land use changes in a given company area, and how can interventions add to local nature recovery plans. Consistent approaches to data and baselining could be assured, providing a more robust point from which to calibrate future incentives effectively.

We welcome further conversation on the route forward through the Biodiversity Task and Finish Group to ensure this PC is calibrated in a way that ensures the right outcome for our biodiversity.

Our solution

Ofwat adopts our forecast of performance as the PCL if it retains financial incentives for the measure; or

Makes this performance commitment reputational is retaining a common PCL.

7 Operational GHG emissions (Water Recycling)

We have serious concerns about Ofwat's approach to setting the PCL for this PC. When viewed in the round alongside enhancement allowances, it appears the companies like Anglian that showed the most ambition to improve performance with enhancement funding and the net zero challenge have been punished with the most stretching targets.

7.1 Econometric modelling

Ofwat has used an econometric model as part of assessing performance and informing its approach to setting the PCL. However this appears disconnected to the principle of having company specific PCLs for this PC on the basis that a common level of performance is not expected and is unlikely to be appropriate.

There are a number of challenges with the current model. For example, the model does not appear to include all explanatory variables that might impact energy consumption. Energy consumption drivers such as average pumping head (APH) gives insight into how much pumping is required in a companies region, which is a key driver of emissions. It is therefore anticipated that the company with the lowest average pumping head is the most efficient in the model and the company with the highest average pumped head is the least efficient.

Ofwat shared this model for review on 7 August, nearly a month after publication of the DD. Further information required to interpret and review the model was not made available until 16 August. This has meant there has been little time to review Ofwat's approach and raises process questions.

From our initial review we observe that the estimated coefficient on the scale variable in the models Ofwat draws on imply very significant economies of scale regarding emissions. In particular, model re2_all, implies that, for example, a company with 20% more load than another would, other things equal, have just 8% more emissions, and model re3_all that it would have 14% more emissions.This is a significant effect. And, given we are the fourth largest wastewater company (in terms of load) this acts to bring down, in relative terms, the modelled value of its emissions. It is not evident to us why there would be such significant scale effects at the company-level.

7.2 Calculation errors and double counting

Ofwat have made an error in their calculation of our PCL. We proposed a number of enhancement investments in our business plan and accounted for this within our data tables (OUT1 and OUT3). However in calculating our PCL Ofwat has included all of the benefits from our proposed investment in the PCL with only partial funding.

This is particularly problematic in two areas. Firstly for the nitrous oxide schemes funded in the DD we included that benefit in table OUT3. However in calculating our PCL Ofwat has included the benefit of these schemes in the difference from OUT1 to OUT2 and then accounted for them again as part of the net zero challenge. These benefits are double counted (4,287 tCO2E).

The second particular area is gas to grid investments. We are aware that some companies have funded that activity within base cost allowances in AMP7. However, our understanding is that the business case to get investment for this type of scheme requires the selling of Renewable Gas Guarantees of Origin (RGGO) to third parties. Under the PC definition it is stated that export from biomethane is only a net zero benefit if RGGOS are retained. Therefore, performance improvement associated with this would not be achievable through base. While it reduces the cost to our customers of funding the activity in this way and reduces emissions nationally, the benefit cannot be counted within the PC as currently defined and the emissions associated with this activity (for us 10,709 tCO2E over the course of the AMP) cannot be included within our PCL.

We also believe there may be some further issues in the calculation of PCLs, where companies have input negative values as the benefit of their investments.

7.3 Baseline

Ofwat's DD calls for evidence that there is upwards pressure on emissions from capital programmes. Our reported figures for 2023/24 show there clearly is an upwards trend and that our forecast for the end of AMP7 was credible.

In setting a target level form a baseline year, this does not include for the upwards pressure on emissions from operating new assets, population growth, etc which will increase emissions through AMP 8. By 2030 our forecast emissions will be 43,273 t/c02e higher than a 2024/25 baseline year. Therefore the current target setting methodology implies circa £8.1m of penalty by 2030 from business as usual activity.

Ofwat has opted to use the last year of actual performance to set their baseline for calculating the PCL. In setting the FD another year of actual performance data will be available to inform the baseline. In our case this is higher, partly due to the pressure on base emissions from the commissioning of new assets and the associated energy demand of operating them. If Ofwat continues to place no weight on company forecasts, then it should account for this new data 2023/24 as the baseline.

7.4 Updated emissions forecast

In table OUT5 we have provided our updated view of performance in AMP8 for this performance commitment. This accounts for the level of expenditure and investment in our DD representations. Our approach is the same as adopted for the business plan and described in Section 1.8 of our business plan's outcomes table commentary.[2]

Our emissions in table OUT2 are updated to reflect that moving our gas to grid investments to base, which results in a net increase in emissions as the carbon reduction benefits of these investments, will not be within scope of the definition of the performance commitment. We do reflect the emissions reductions from heavy good vehicle electrification. We also reflect upwards pressure on emissions from our larger enhancement programme in the DD representations compared to the business plan.

Our emissions in table OUT5 reflect our nine nitrous oxide investments from our business plan, the methane investments funded through the Industrial Emission Directive allowance and our additional new investments for nitrous oxide compared to our original business plan.

Our solution

Ofwat adopts our forecast performance as out PCL.

2 https://www.anglianwater.co.uk/siteassets/household/about-us/pr24/anh07-outcomes-pr24-data-table-commentary.pdf

8 Leakage

We discuss leakage in detail in Chapter 12 Our commitments to customers and we commissioned Oxera to review the DD and submit their report alongside our representations. [3]

We have updated our demand forecast for leakage, PCC and non-household demand. We have adopted the same approach as applied for the WRMP24, but using our performance in 2023/24 as the baseline rather than 2021/22. This reflects the latest information and uses the same benefits for performance improvement from the WRMP24. We provide full commentary for this update alongside table CW5. This update has been assured by our technical assurance providers Jacobs and we have updated OUT4 in AMP9 to reflect this update.

In our view Ofwat's DD overlooks important and includes perverse outcomes for shifting the frontier on this measure, such as less funding and tougher targets for the best performers. We discuss leakage in Chapter 12 of our main DD Representations.

Our solution

Baseline performance should be our outturn given AMP7 ODI and that Ofwat adopts our forecast performance as out PCL.

3 ANH_DD_065 Oxera, Review of Ofwat's PR24 DD approach to leakage

9 Per Capita Consumption

We have updated our demand forecast for leakage, PCC and non-household demand. We have adopted the same approach as applied for the WRMP24, but using our performance in 2023/24 as the baseline rather than 2021/22. This reflects the latest information and uses the same benefits for performance improvement from the WRMP24. We provide full commentary for this update alongside table CW5. This update has been assured by our technical assurance providers Jacobs and we have updated OUT4 in AMP9 to reflect this update.

Our solution

Ofwat adopts our forecast performance as out PCL.

10 Business Demand

We have updated our demand forecast for leakage, PCC and non-household demand. We have adopted the same approach as applied for the WRMP24, but using our performance in 2023/24 as the baseline rather than 2021/22. This reflects the latest information and uses the same benefits for performance improvement from the WRMP24. We provide full commentary for this update alongside table CW5. This update has been assured by our technical assurance providers Jacobs and we have updated OUT4 in AMP9 to reflect this update.

We are broadly comfortable with the changes and updates to the Business Demand PC definition. However, we seek further clarification on the following points from Ofwat prior to Final Determination.

Regarding collaboration with retailers and other third parties, we seek further clarification on what constitutes retailers meeting their 'fair share' of costs for integrated solutions delivered through partnership. We note that although retailers have a statutory duty to promote water efficiency, they do not receive any funding for this. As such, some of the smaller retailers may struggle to meet their 'fair share of the costs', dependent on what level this is set at.

Additionally, using the newly included pro forma at Annex 2, there is a requirement for retailers to effectively 'sign off' the collaborative efforts of the wholesalers, however this does not appear to work reciprocatively. It seems reasonable and justified that the wholesalers equally should be able to comment on the collaborative efforts of the retailer as this will impact the water savings the wholesaler is able to achieve in any year.

We understand that the end of period PCL adjustment mechanism (+/-3%) has been instituted in order to allow for yearly variation (and potential unforeseen growth in non-household demand). Additionally, we understand that demand management option savings included in the PR24 programme, will need to be demonstrated and verified. We therefore seek further clarity how we can demonstrate to 'Ofwat's satisfaction' that we have made all reasonable efforts to proactively engage with customers to promote water efficiency.

Regarding water saving targets, although Ofwat have broadly taken our growth protections in the WRMP into account when determining our target, where we proposed an overall saving of 9.95 MLD across the course of AMP 8, Ofwat have used a 'stretch' figure of 10.95 Ml/d. We do not believe this is appropriate and appears arbitrary.

Our solution

Ofwat adopts our forecast performance as out PCL.

11 Total Pollution incidents

We discuss this and related performance commitments in detail in Chapter 12 of ANH_DD_01_Main Representations.

We have provided an updated performance commitment level and forecast in tables OUT1, 2 and 5. This is discussed in Chapter 12 Our commitments to customers chapter of our draft determination representation. Our proposed PCL is based on a baseline of the industry median in the most recent three years of AMP7 (2021/22 to 2023/24) with an improving trend to the industry upper quartile in the most recent three years of AMP7 (2021/22 to 2023/24) by 2029/30.

Our solution

Reset baseline and PCLs in light of industry performance in AMP7.

12 Discharge Permit Compliance

We have a number of concerns with the detail of Ofwat's approach to setting ODI rates for Discharge Permit Compliance:

- The grouping of companies and combination of WaSCs and WoCs for this cross-service PC is causing distortion.
- The approach of taking a median rate is increasing the ODI rate for us significantly above the intended RoRE.
- We have concerns about the lack of a deadband for this PC due to the inherent uncertainty associated with an open biological system.

As currently calibrated, if we performed at 99% compliance every year in AMP8, we would be penalised ~£60m. This does not appear an appropriate outcome for 99% compliance across more than 1,100 treatment works.

12.1 Incentive rate

We are concerned about the scale of the incentive rate for this PC. This is driven by underlying issues with the calculation for this PC. Water only companies (WoCs) and Water and Sewerage Companies (WaSCs) are structurally different when it comes to this performance commitment. The number of discharge permits for water recycling centres far outweighs water treatment works, this means that the distribution of risk is different, as well as the optimal operational strategies to ensure compliance. For us 90% of our permits relate to water recycling centres with performance predominantly relating to water recycling compliance.

In addition to the differences between WoCs and WaSCs, the variable number of permits between WaSCs has unintended consequences with some having significantly more as a proportion of RCV than others. This bias is leading to significantly higher RoRE impacts for companies with lots of permits than the intended 0.5% of RoRE.

Ofwat appear to acknowledge some concerns with this approach in their note of 20 August. These two concerns are interlinked, and we therefore build the evidence in sequential sections below.Collectively these issues lead to an inappropriately high exposure to risk. For us, using Ofwat's data in the ODI rate model the implied level of RoRE risk is >1%. Remedying the issues can be achieved by refining the calculation of the ODI rate in a number of steps, due to the different causes (not just addressing the WoCs point).

12.1.1 Grouping of companies by RCV size is driving a bias

We recognise that the rationale for Ofwat adapting the approach to setting ODI rates for the Draft Determination by splitting the companies into groups based on RCV size is to drive more acceptable levels of risk for the smaller WoCs.

This approach, however, is driving a bias in ODI rates for WaSCs due to combining WaSCs and two of the WoCs for the cross-service PCs that cover both water and sewerage services (Serious Pollution Incidents and Discharge Permit Compliance).

To produce the Draft Determination rates Ofwat has grouped companies based on regulatory capital value (RCV) size for the ODI analysis. We are included in the large RCV company group that includes all the WaSCs excluding HDD and two WoCs (Affinity Water (AFF) and South East Water (SEW)).

Whilst this may be appropriate for water service PCs where the underlying asset base is similar, we believe this grouping is not appropriate for the purpose of setting the rate for the two cross service PCs where the impacts on the PC from water and sewerage services are inherently different.

The impact is most notable for Discharge Permit Compliance where the implied RoRE risk has increased for Anglian Water from 0.6% at business planning to 1.05% for the Draft Determination. Due to providing a water only service, WoCs have significantly fewer permits relative to their RCV size.

Here this approach is introducing a bias leading to RORE impacts significantly higher than intended upfront based on the customer priority analysis (e.g. 0.5% RoRE).

Removing Affinity and South East Water from the calculation for WaSCs for this PC reduces our rate to £10.387m (if all other assumptions are kept the same). This is equivalent to 0.85% RoRE. Whilst lower, this rate still exceeds the intended RoRE range and can therefore only represent a partial solution.

We explain in the next section why the WoCs are structurally different to the WaSCs for this PC and how this is driving this bias.

Table 3 Comparison of DD incentive rate with and without WoCs

Rate	£m
DD rate	12.854
Revised DD rate excluding WoCs from calculation	10.387

12.1.2 Impact of normalisation when estimating the median

Discharge Permit Compliance is a PC where the rate is set for a normalised unit of measurement. While this allows comparability in service performance it is distorting the ODI rate.

In this section we present evidence to demonstrate how these biases arise. First, we briefly recap on the process for setting the rate for discharge permit compliance.

- To calculate the ODI rate for PCs where there is a normalised level of service, Ofwat first converts the initial ODI rate that is calculated for each company based on the 0.5% intended rate to a rate for one incident. In the case of Discharge Permit Compliance, the rate for a 1% change in compliance is converted to a rate for a failure per permit.
- The resulting rates are used to calculate the median rate per incident (£ per permit failure) for the industry prior to renormalising the rate.

This calculation is creating a wide range of implied RoRE impacts based on the final rate multiplied by the P10 range used in setting the rates.

There are two issues underpinning this:

1. The inclusion of the structurally different WoCs in the analysis alongside WaSCs. Due to providing a water only service, WoCs have significantly fewer permits relative to their RCV size.
2. The ratio of permits to size also varies significantly across WaSCs. This is likely influenced by spatial factors in a region such as density and level of urbanisation.

The figures below demonstrate these points. They show the implied RoRE impact from the rates on the x axis compared to the ratio of permits to regulated equity on the y axis. The first graph presents the results from the Draft Determination for all of the companies in the 'Large RCV' group and therefore includes AFF and SEW due to the grouping set out by Ofwat.

The second graph presents the results with AFF and SEW removed. Here the median rate has been calculated using only the WaSC initial rates (excluding HDD). In both graphs the PC target is assumed to be 100% and the P10 range is set at 2.53% in line with the Draft Determination approach.

The first point on the structural difference between WaSCs and WoCs is illustrated by how the points for SEW and AFW sit below the WaSCs in the first graph. By removing the WoCs in the second graph the WaSCs move to sit on the trend line.

This also has the effect of narrowing the range of implied RoRE impacts. This is illustrated by the three companies in the red section in the first graph (WSH, SWB and ANH) moving into the blue section in the second graph.

The resulting range with AFF and SEW removed is now from 0.18% to 0.85% (in comparison the DD range is from 0.27% to 1.05% for the WaSCs).

The second point, on how the ratio of permits to size also varies significantly across WaSCs, is illustrated in the second graph by both the range of implied RoRE and by the difference in the ratios on the x axis. Anglian Water is an outlier (along with SWB and WSH) in that these companies have a relatively very high number of permits for their size, when size is expressed as regulated equity. We also note that some of the poorer performing WaSCs receive a lower rate.

Figure 2 Discharge Permit Compliance: Ofwat Draft Determination implied RORE impact compared to the ratio of permits to regulated equity

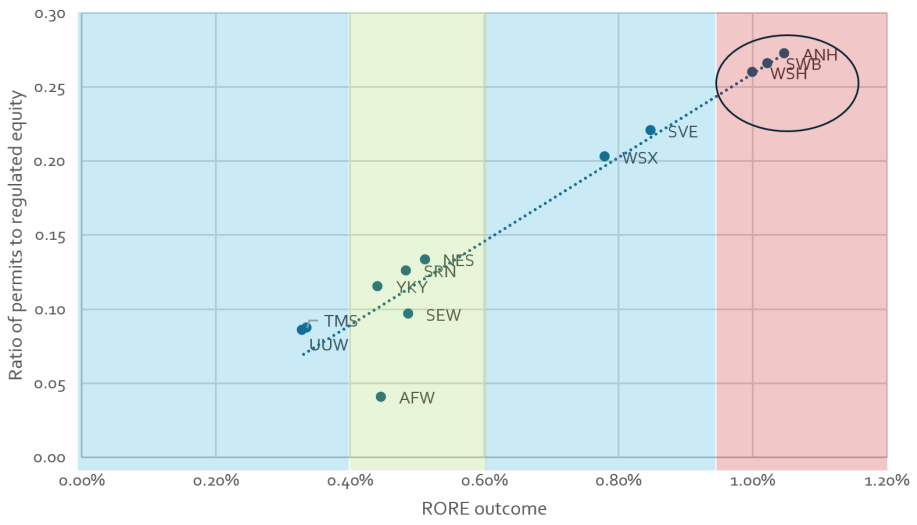
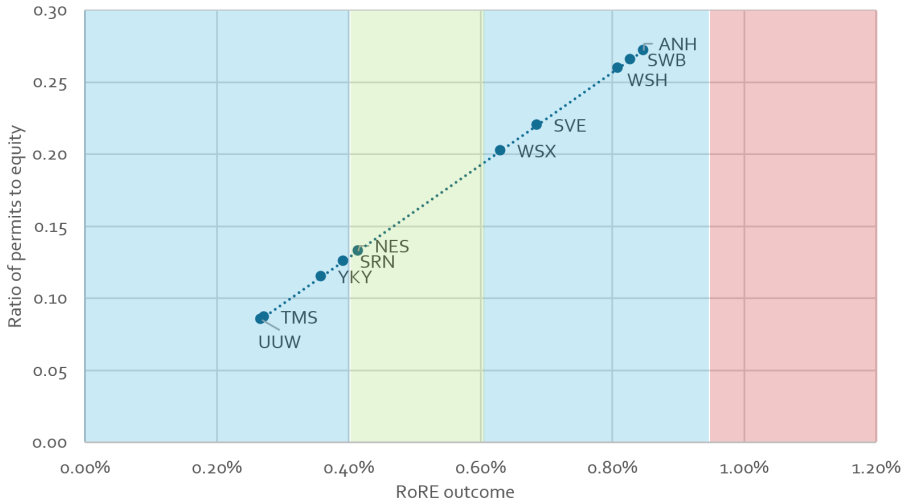


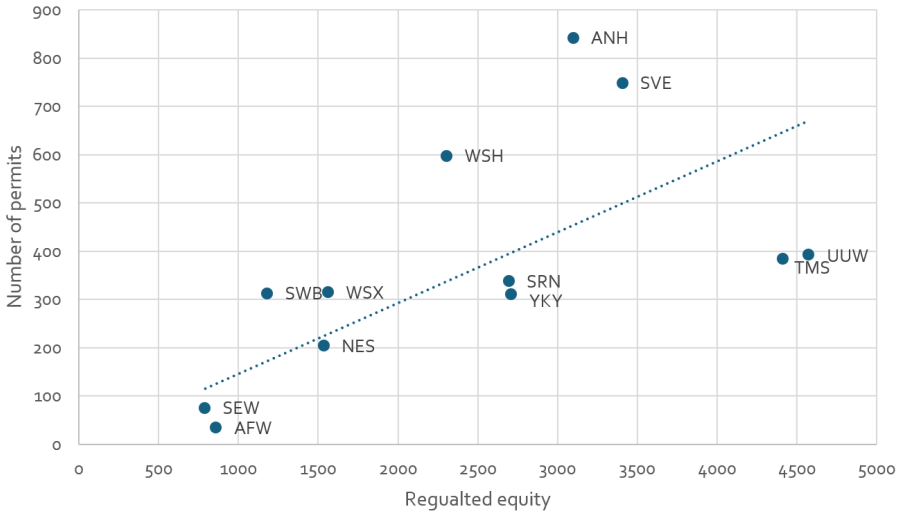
Figure 3 Discharge Permit Compliance: Implied RORE impact compared to the ratio of permits to regulated equity when WoCs are removed



Overall, this demonstrates the impact of including the WoCs within the analysis where there is a cross-service PC. Whilst removing the WoCs removes one source of bias and narrows the range of implied RoRE, the resulting range is still very varied and deviates significantly from Ofwat's intended range of 0.5%. This is due to the poor-quality relationship between the regulated equity and the unit of failure (a permit).

We also note that both Thames Water and United Utilities have a low number of permits compared to their regulated equity and this is driving a low level of RoRE risk.

Figure 4 Regulated Equity compared to number of permits



We note that Ofwat has indeed recognised the risk of arbitrary differences in incentives (as have occurred in this case) from using regulated equity in their discussion paper on ODIs from February 2022.

"There is also an inherent risk that the size of incentives and ODI rates will arbitrarily differ between companies, particularly if the top-down payments are based on a proportion of regulatory equity, which reflects the size of each company's regulatory capital value (RCV), which tends to differ between companies based on the extent of historic investments rather than number of customers."[4]

We therefore believe that in addition to excluding WoCs from the calculation of the incentive rate, Ofwat should either apply a scaling factor to reflect the ratio of permit to regulated equity (the higher the permits the lower the rate) or apply individual companies implied rates without taking the median to avoid the relationship between permits and equity biasing the calculation.

4 *Ofwat (February 2022) PR24 and beyond: a discussion paper on outcome delivery incentives, page 17*

12.2 Deadband

In addition to amending the rate, we believe this performance commitment requires a deadband in AMP8. This is on the basis that:

1. Discharge Permit Compliance is inherently uncertain due to water recycling being a biological system where risks can arise from external source and materialise in a way that management cannot reasonable gain control
2. Consistency with reporting alongside the Environment Agency's Environmental Performance Assessment (EPA)
3. Precedent from the PR19 Final Determination and the CMA's redetermination.

Introducing a deadband would also assist Ofwat in improving symmetry in incentives (an industry level).

12.2.1 Management control

The water recycling treatment process is a biological system open to the elements, as well as what household and commercial customers place into the water recycling network. There are a number of factors outside of our control that can impact performance, for example:

- Fire/unforeseen emergency - this impacted our works at Whitlingham in 2023 when a fire in an electrical transformer resulted in total loss of aeration treatment. This asset had been routinely inspected and was deemed fit to operate. While we have back-up generators on sight for resilience the Fire Brigade asked us to stop them on safety grounds. This caused an upper tier failure against the permit.
- Trade effluent discharge - this has impacted our works at Great Billing on a number of occasions, including a cyanide release which impacts the microbiological element of the treatment process.
- Theft/third party damage - this has impacted our works at Uttons Drove where electrical cables were stolen, resulting in a loss of power.

12.2.2 Consistency with the EPA

Recognising the variability around the target, the Environment Agency set a threshold of 99% compliance for their EPA assessment. This is a threshold at which companies are green on the measure and a 4 star company (i.e. a four star company can have 99% compliance).

Whilst we agree with a target of 100% compliance, this leaves the potential for companies to be subject to penalty through the ODI process and receive a green rating in the Environment Agency's assessment.

12.2.3 Regulatory precedent

There is substantial precedent for applying a deadband to discharge permit compliance. We note that the CMA supported Ofwat's decision to apply a deadband at PR19 for discharge compliance. While the role of a deadband for Discharge Permit Compliance was not disputed at PR19 the role of deadbands was a point of contention during the appeal. In their final decision the CMA disagreed with Ofwat's assessment that deadbands should only be applied in exceptional circumstances. The CMA went further and extended the use of deadbands to cover a total of four PCs .

"We consider that the circumstances in which deadbands may be appropriate are wider than Ofwat has suggested. Where delivery of the measured outcome is not wholly within companies' control, a deadband reduces the risk of penalising, or rewarding, outcomes resulting from external factors."[5]

"We believe that there are good reasons for applying deadbands to performance incentives in a price control. We understand that this is to some extent a matter of judgement; however, we were persuaded by evidence in this redetermination that a greater use of deadbands is appropriate."[6]

Given the CMA supported a deadband on this performance commitment it appears unreasonable for Ofwat to take a different approach at PR24, particularly for a full compliance measure with very little tolerance, where performance is not entirely within management control and the consistency with the EPA.

We note Ofwat's comments in the Draft Determination that some companies have achieved full compliance in the past and many have performed within the PR19 deadband of 99% which was informed by the upper quartile of the forecast deadbands. This rate was also explicitly set in line with the EPA threshold where a score above this attracts a green rating and a lower score attracts an amber rating.

We believe 99% remains an appropriate level for a deadband in AMP8 in light of the EPA threshold and that the industry median in AMP7 is below this level, showing it will incentivise industry improvement.

Our solution

5 Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations, Final report, section 7.107. page 632
6 Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations, Final report, section 7.108. page 632

To resolve issues with the incentive rate we propose that Ofwat removes WoCs from calculations to reduce unit rates and takes further action to address the unintended consequences of varying ratios of permits to regulated equity, by either applying a scaling factor for companies with more permits or using each companies own implied rate before taking the median.

To maintain consistency with the EPA, reflect that management control is not total, that small exceedances do not lead to significant harm and to reduce risk asymmetry we propose the AMP7 deadband at 99% compliance is maintained in AMP8.

13 Serious Pollution Incidents

We have a number of concerns with the detail of Ofwat's approach to setting ODI rates for serious pollution incidents:

1. The grouping of companies by RCV size is driving a bias due to combining WaSCs and WoCs for this cross-service PC.
2. The ODI rate calculation does not use variability around historic targets set by Ofwat and instead uses a proxy performance level in a way inconsistent with other PCs. This dramatically underestimates the variability (P10 position) and significantly over estimates the ODI rate.
3. The overlap between the ODI rates for serious pollution incidents and fines leads companies to be exposed to double penalties.

All these concerns lead to an inappropriate ODI rate for serious pollution incidents. Collectively these errors lead to an inappropriately high exposure to risk which drives asymmetry risk exposure as reflected in the overall balance of risk and return.

13.1 Grouping of companies by RCV size is driving a bias

In line with, and further to, the rationale we present for Discharge Permit Compliance, Ofwat's revised approach to setting ODIs at the Draft Determination is introducing bias for the two cross service PCs that cover both water and sewerage services (Serious Pollution Incidents and Discharge Permit Compliance).

To produce the Draft Determination ODI rates Ofwat has grouped companies based on RCV size for the analysis. We are included in the large RCV company group that includes all the WaSCs excluding HDD and two WoCs (Affinity Water and South East Water).

Whilst this may be appropriate for water service PCs where the underlying asset base is similar, we believe this grouping is not appropriate for the purpose of setting the rate for the two cross service PCs where there is a structural difference between the risk from water and waste water activities.

In this section we present the evidence why AFW and SEW should be excluded from the calculation for this cross-service PC. The key points are:

1. The two WoCs are clearly outliers that are influencing the median rate.
2. The two WoCs are structurally different to the WaSCs. In Ofwat's calculation the variability in the measure is calculated for WaSCs and applied to WoCs.

   By their nature, the WoCs have a different risk profile from the WaSCs for serious pollution incidents.

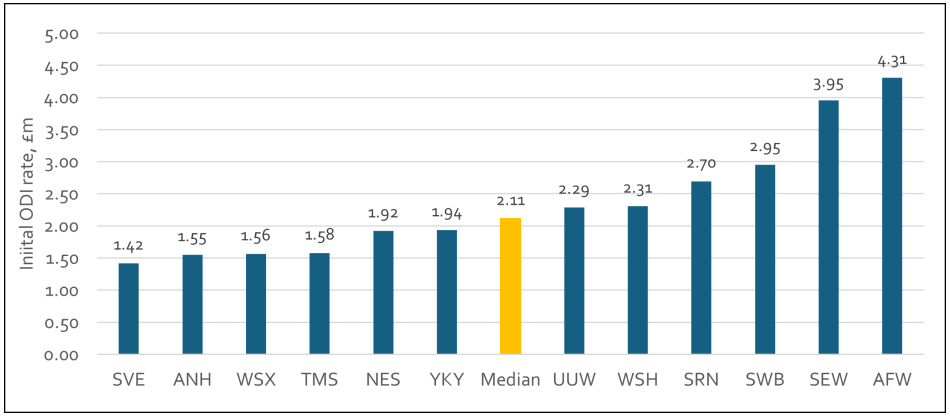
Removing Affinity and South East Water from the calculation for WaSCs for this PC reduces our rate to £1.563m from £1.747m (if all other assumptions are kept the same). This is equivalent to 0.5% RoRE.

Table 4 Comparison of DD rate and rate if WoCs excluded

Rate	£m
DD ODI rate published by Ofwat	1.747
Rate if WoCs excluded	1.563

The graph below showing the initial ODI rates per incident illustrates the first point, clearly showing that the two WOCs are outliers. These are the initial ODI rates estimated prior to the median being calculated[7]

Figure 5 Serious Pollution Incidents, initial ODI rate, £m

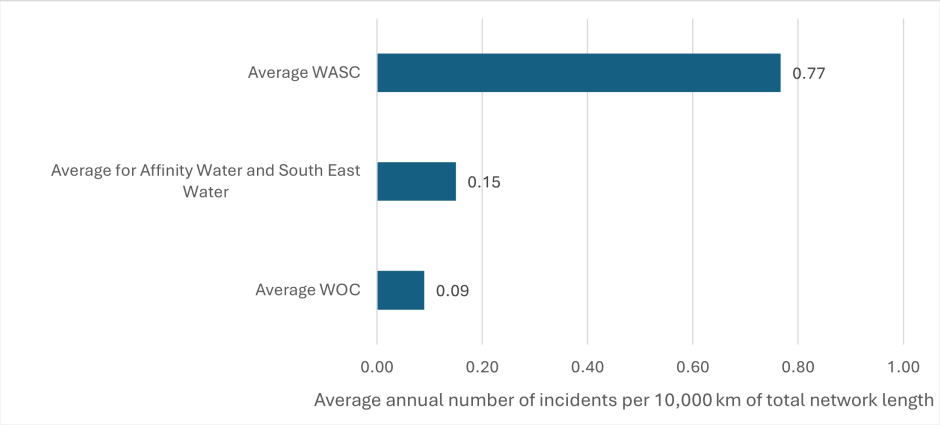


7 This is the regulated equity at risk (0.5%) divided by the Ofwat calculated P10 performance range for the company. As the ODI rates for Serious Pollution Incidents are presented as the rate per incident the analysis of the approach to normalising is not applicable like it is for Discharge Permit Compliance. Instead the P10 range applied when calculating the rates is based on a normalised variability in performance

To illustrate the second point, that WoCs are structurally different to the WaSCs we present the normalised number of pollution incidents per total network length. The data is based on 12 years of data that Ofwat use in the performance model for serious pollution incidents. We also note that in Ofwat's modelling of ODI risk in the DD, Ofwat's risk models exclude the WaSCs as part of the top-down cross check.

This shows that the rate for WaSCs is significantly higher than for WoCs:

Figure 6 Number of incidents per 10,000 km of water and sewerage network



13.2 Correcting the historical targets used in assessing performance variability

When setting the ODI rate for serious pollution incidents in the Draft Determination, Ofwat calculates variability relative to a proxy Performance Commitment Level (PCL) based on the Environment Agencies green EPA threshold for serious pollution incidents.

This variability, expressed as a percentage relative to the proxy PCL, is applied to the target for 2024-25, which is set at zero. This means that the variability is calculated relative to a historic target that is greater than zero and is applied to a target of zero.

This is not appropriate given that:

- Ofwat has historically set targets at zero incidents for serious pollution incidents and
- The rate calculation is not consistent with the other 100% compliance PCs - particularly Discharge Permit Compliance which also has an EPA threshold.
- The performance associated with serious pollution incidents remains consistent over time.

The impact of correcting the approach to be consistent with Ofwat's historical targets is significant.

13.3 Impact of correcting the historical target for serious pollution incidents

Table 5 Summary of proposed amendments to incentive rate

Rate	£m
DD ODI rate published by Ofwat (uses the EPA threshold as a proxy PCL)	1.747
Rate using historical targets set by Ofwat	0.835
Rate using historical targets set by Ofwat and removing AFF and SEW	0.748

13.3.1 Ofwat has previously set targets at zero incidents

Whilst the EPA threshold has decreased over time, Ofwat has consistently set targets at 100% compliance for serious pollution incidents. This means that the Draft Determination approach to calculating variability dramatically underestimates the variability (P10 position) and significantly over estimates the ODI rate when calculating the rate for this PC.

This is illustrated by:

1. Ofwat's final Determination for PR14 which clearly sets a target of zero incidents for 2015 to 2020. [8]
2. Ofwat setting a target of zero incidents serious pollution incidents for South West Water's bespoke PC at PR14.

The implication of underestimating the variability of for this PC is that the RoRE risk exposure for this PC is significantly underestimated in the Draft Determination.

8 Ofwat, December 2014, Setting price controls for 2015-20: Overview. Page 9

13.3.2 Consistency with the other 100% compliance PCs

Ofwat's approach to setting ODI rates is not consistent for the three PCs where 100% compliance is targeted (Compliance Risk Index, Discharge Permit Compliance and Serious Pollution Incidents).

Comparing the approach across these PCs shows inconsistencies in the approach to calculating variability as well as setting deadbands.

Comparing this approach to Discharge Permit Compliance also highlights this inconsistency. Discharge Permit Compliance is the second PC assessed within the EPA which has a green performance threshold. However, in contrast, the variability for Discharge Permit Compliance is calculated relative to the target of 100% compliance and this variability is applied to the same consistent target of 100% compliance.

Table 6 Comparison of Ofwat approach to setting ODI rates for full compliance measures

Rate	Approach to calculating variability in performance	2024-25 target variability is applied to	AMP8 PCL	Deadband applicable
CRI	Relative to 0	Zero	Zero (100% compliance)	Yes
Discharge Permit compliance	Relative to 100%	100%	100%	No
Serious Pollution Incidents	Relative to a proxy PCL based on EPA threshold	Effectively zero as uncertainty used (or min of 1 incident)	Zero (100% compliance)	No

13.4 Performance over time

Performance associated with serious pollution incidents has remained consistent over time. The graph below shows the normalised P10 performance in each year since 2011 for WaSCs (expressed as incidents per 10,00 km of sewer).

With the exception of 2011-12 the P10 for each year has remained consistent over time.

Figure 7 Serious Pollution Incidents P10 in each year over time

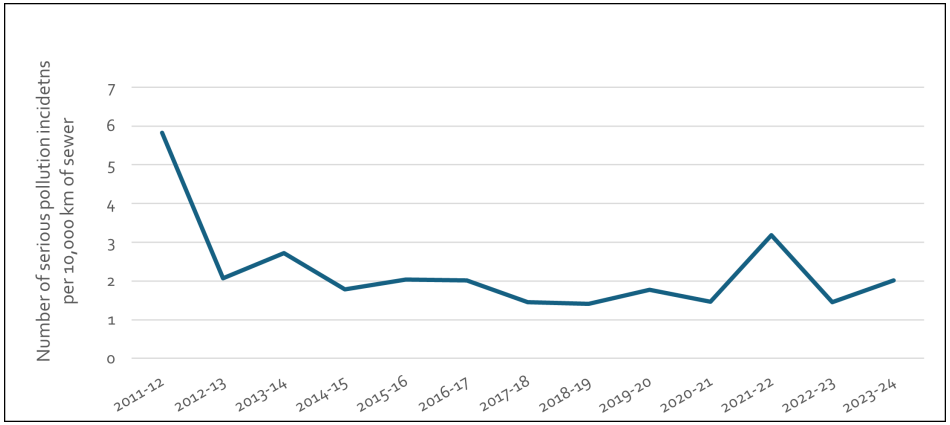
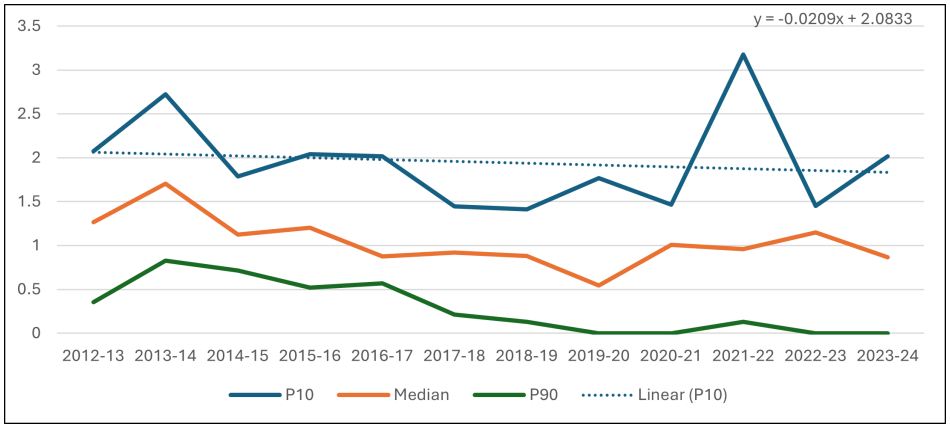


Figure 8 Serious Pollution Incidents Statistics for normalised performance over time Graph with 2011-12 removed and trend line for P10



13.5 Double counting between the ODI rates and fines.

Our final concern for serious pollution incidents is the overlap between ODI rates and potential fines.

With the increase of the civil penalty limit from £250,000 to up to £250 million the potential for fines in the future is significantly higher than in the past. [9]

The change in the Environment Agency's powers means fines are much more likely to be issued and that there will be double the penalty for any incidents.

We note that historically this overlap has been the rationale for the exclusion of financial incentives for serious pollution incidents.

At PR14 Ofwat highlighted that a key principle is that incentives should be fair and part of this is 'incentives not double-counting other incentive mechanisms'.[10]

Our solution

We propose that Ofwat should remove WoCs from the incentive rate calculation, adjust the proxy PCL to 0 and remove double count from calculations to reduce unit rates.

9 Whilst fines handed out by the courts through criminal prosecutions are unlimited, the limit for civil penalties (Variable Monetary Penalties) were constrained at £250,000 until recently
10 Ofwat, December 2014, Setting price controls for 2015-20. Final Determination page 55

14 Bathing Water Quality

14.1 Performance commitment level

Ofwat has requested that we comment on the interventions to bathing water classification and provide forecast classifications for newly designated bathing waters at the River Cam at Sheep's Green (Cambridge), Manningtree Beach (Essex) and the River Stour (Sudbury).

We have reviewed Ofwat's interventions on classifications. Ofwat made 31 interventions to our proposed classifications. We have challenged ourselves to show additional ambition for this performance commitment and have reflected on the available information for the 2024 season (noting that this is only partial). We are not making representations on 19 of the interventions. However for the remaining interventions we describe why we do not believe individually that they are appropriate. This is a combination of the impact of discountable results on historical performance and factors outside of our control which impact performance (such as diffuse pollution).

The newly designated bathing waters are all currently expected to have a poor classification (if discountable results are included).

- **Sheep Green (Cambridge)** - very poor results so far and our calculations suggest there needs to be a 65-70% reduction in bacteria before it could move towards sufficient. We have investment in the plan to improve performance and expected this to be completed by the end of AMP8, improving performance in AMP9.
- **Manningtree Beach (Essex)** - currently our sampling and available citizen science data suggest a wide variation in sample results, but is currently likely to be poor. We have investment in the plan to improve performance and expected this to be completed by the end of AMP8, improving performance in AMP9.
- **River Stour (Sudbury)** - current results indicate a poor classification. Removal of discountable samples could improve the classification but they are included within the definition of the performance commitment. We have investment in the plan to improve performance and expected this to be completed by the end of AMP8, improving performance in AMP9.

We have reflected the impact of our response to Ofwat's representations and the newly designated bathing waters both in the 'ANH backcast - WINEP' tab of the bathing water quality model and in our data tables OUT5 and OUT1. We note that the addition of new bathing waters with a poor classification reduces the total performance of the index.

14.2 Deadband

In our representation we are proposing a deadband to reflect the impact of factors outside of our control on performance. We note that the CMA's PR19 redetermination concluded that deadbands were appropriate where outcomes may not be fully in the control of management and where a company may miss a PCL without objectively failing to deliver the commitment.[11]

Bathing water quality can be impacted by a myriad of factors outside of our control, including diffuse pollution, the activity of other parties (e.g. Local Authorities jet washing sea walls) or wildlife. The classification of bathing waters includes a process for results to be discounted from the classification as a result of climatic conditions. Including these results within the performance commitment definition means that performance is even further impacted by factors outside of our control than is the case in AMP7.

We have provided additional evidence of the impacts of factors outside of our control for specific bathing waters in the table below. This shows that, between 2021 and 2024, bathing water results were identified which directly resulted in reductions in end of classifications at between 4-7 bathing waters. Our investigations found the reasons for elevated results ranged from presence of phaeocystis foam and third-party pollutions to results with no clear root cause.

11 CMA, Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations , Final Report, paragraph . 7.103

Table 7 Summary of factors outside of company control for specific bathing waters alongside yearly classifications

Bathing Water	Commentary	2019	2021	2022	2023	2024
Humberston Fitties	Extremely elevated result in 2019 (10,000 IE (intestinal enterococci)). Result occurred after a period of dry weather, no storm discharges, pollution incidents or issues relating to our WRCs. Result at nearby Cleethorpes in Excellent range. No identified root cause, suspect impact from nearby Louth Canal or pleasure boat. Result ensured Humberston Fitties highly unlikely to return to Excellent any earlier than end of 2024.					
Cleethorpes	Two extremely elevated results published in 2021 (+500 IE). No significant rainfall, no storm discharges, pollution incidents or issues relating to our WRCs. Issues reported throughout 2020 and 2021 from nearby trader with leaks from private foul system which discharged adjacent to designated sample point. Results in 2021 meant it is highly unlikely that Cleethorpes would return to Excellent before end of 2025					
Hunstanton Main	Numerous Studies carried out by us and the EA into water quality issues at Hunstanton Main. Significant impact from diffuse pollution sources include birds and dogs 19 out of 79 results between 2019-2023 exceeded 'Excellent' values. No AWS asset activity was recorded on 17 occasions, indicating that our assets are not the root cause of water quality Heavy rainfall also not a factor in around 50% of all elevated results, again indicating impact from diffuse pollution sources. Also makes improvements / predictions on what quality extremely difficult.					
Caister Point	5 miles away form the nearest network CSO. The WRC outfall is a long sea outfall considered to have no impact as most results at this beach are excellent. Elevated samples have tied in with the presence of phaeocystis foam and or decaying piles of seaweed. A CREH study carried out along the local coastline found these have high levels of Faecal Indicator Organisms that have the potential to transfer into the bathing water (please see 076_DD_ANH for details). This Bathing Water dropped classification in 2023 but this is due to the elevated results in 2022.					
Hemsby	9 miles away form the nearest network CSO. The nearest WRC outfall is a long sea outfall considered to have no impact as most results at this beach are excellent. Elevated samples have tied in with the presence of phaeocystis foam and or decaying piles of seaweed. A CREH study carried out along the local coastline found these have high levels of Faecal Indicator Organisms that have the potential to transfer into the bathing water (please see 076_DD_ANH for details).					
Sea Palling	Dropped to good on the back of some very minor elevations in IE during the 2022 season tying in with the presence of phaeocystis foam. Whilst minor elevations, the infrequent sampling of the beach by the EA (5 or 6 times per season) particularly skewed the standard deviation analysis at the 95%ile. The decline in classification cannot be due to our assets as there are no Anglian Water outfalls of any kind draining to the tidal waters in the Sea Palling catchment.					

Bathing Water	Commentary	2019	2021	2022	2023	2024
Holland	A single extremely elevated result of 5,000 no/100ml IE was recorded on the 18th July 2023. There was no significant rainfall, no storm discharges, pollution incidents or issues related to AWS WRCs in the 72 hours prior to the result. No obvious cause of the elevated result has been identified to date. Although the bathing water just retained Excellent in 2023, with an IE 95%ile of around 98 on a threshold of 100, despite the 2024 being an almost perfect season, a single elevated sample of 110 no/100ml IE means the bathing water is now expected to drop to Good at the end of 2024. If this 5,000 no/100ml result had not occurred, the bathing water would be expecting to achieve a 95%ile in the 70s and would have retained a comfortable excellent classification.					
Southend Thorpe Bay	The final sample from the 2023 season at Thorpe Bay returned an IE value of 1,100 per 100ml. There was some rainfall on the day of the sample but there were no storm discharges, pollution incidents or issues related to AWS WRCs in the 72 hours prior to this result. Prior to this result being taken, the bathing water was still on track to maintain it's Excellent classification. Further meetings with the Environment Agency have not identified a cause of this elevated result. Out of 80 samples taken between 2019-2023, only 6 samples exceeded 'Excellent' quality. Of these 6, only 2 samples had any associated activity our assets, suggesting over 60% of the elevated results are caused by external factors.					
Southend Westcliff Bay	The 2024 season has had three extremely elevated results (7,200 Ecoli, 670 Ecoli and a sample of 1,900 Ecoli and 900 IE) which is abnormal for the history of the bathing water. All of these samples are following light rainfall but there were no storm discharges, pollution incidents or issues related to AWS WRCs in the 72 hours prior to this result. Due to these 3 results, this bathing water is now trending to drop to Good at the end of the 2024 season and is likely to remain Good for multiple years.					
Impacted Classifications		2	4	5	7	5

Key

Excellent

Good

Sufficient

Poor

For example, we commissioned a study at Hemsby, Caister Point and Great Yarmouth Pier in August and September 2020, which investigated Faecal Indicator Organism (FIO) concentrations in phaeocystic algal foam and beach-cast seaweed.[12] The study showed that they should be considered as potential sources of bacteria leading to elevated sample results as they appear to provide potential reservoirs of FIOs that could impact on Bathing Water quality. Investigations of elevated samples at Hemsby, Caister Point and Sea Palling in 2021/2022/2023 showed that, on these occasions, there was no rainfall or discharges from our assets.

Not all investigations provide a root cause for elevated results; in 2023 Southend Thorpe Bay Bathing Water dropped from Excellent to Good classification following the final sample of the season returning a result of 1,100 per 100ml of intestinal enterococci. This sample was taken after light rainfall in the morning but with no associated storm discharges, pollution events or problems at the local Water Recycling Centre (WRC). A similar pattern has been identified at Southend Westcliff Bay in 2024 with 3 extremely elevated results already recorded with light rainfall, no storm discharges, pollution events or problems at the WRC. As a result, it is expected that Southend Westcliff Bay will drop to a Good classification at the end of the 2024 season.

Despite our commitment to continuing to investigate diffuse pollutions and third-party impacts, many of these factors remain outside of our control, with limited mitigation that can be put in place to reduce impacts to bathing water quality.

To mitigate this risk of we propose that Ofwat introduce a deadband for this performance commitment. The principle of this deadband applies consistently across the industry, although the specific levels may vary.

In our region between 2021 and 2024 there have been between four and seven classifications impacted by factors outside of our control. Accounting for these impacts suggests that in AMP7 we are on track to deliver our performance commitment level. To mitigate the impact of these factors that are hard to predict and outside of our control we suggest a deadband of three classifications (2.1% per year for us).

Our solution

We request that Ofwat accept our feedback on their interventions and introduce a deadband to reflect the impact of factors outside of our control on performance.

12 ANH_DD_076 CREH report on bathing water quality

15 Storm overflows

We note the proposed package in the DD in terms of funding and PCL. We believe in the round that this is appropriate.

16 Mains Repairs

In our Business Plan (ANH07 page 83), we expressed our concern at Ofwat's proposal to remove the underperformance deadband for the mains repairs PC for AMP8. We maintain, given the volatility of performance against this metric in single years due to exogenous factors, it would be appropriate to maintain a deadband on mains repairs.

Penalising companies for small changes in performance will not correlate with the underlying asset deterioration or companies' commitment to act as responsible stewards of their assets. Maintaining a deadband on this measure therefore reflects that the purpose of this performance commitment is to ensure the long-term health of assets and networks for both current and future generations, not penalising companies for temporary factors outside of their control.

As set out in our Business Plan, there is regulatory precedent for applying deadbands in this circumstance. The Competition and Markets Authority (CMA) introduced a deadband on main repairs during the PR19 Final Redetermination, stating "we consider that this small deadband maintains the disincentive to allowing asset health to deteriorate, whilst allowing for some proactive repairs and noting that poor winter weather conditions can impact on the level of repairs needed" (Final Redetermination main document, page 666).

On this basis, we maintain a deadband to be set for this performance commitment. We propose that this deadband be calibrated at 10 bursts per 1,000km water main above the PCL.

We have updated table OUT2 to reflect our representations proposal for mains renewal activity.

Our solution

Retain the deadband from PR19 as proposed in our business plan and representations.

17 Lower Carbon Concrete Assets

We have provided an updated definition as requested by Ofwat - see 'Lower carbon concrete assets definition draft determination update'.

We note that Ofwat has reduced the incentive rate and made our PCL more stretching. We also note the introduction of the deadband which does not increase the risk of penalty compared to our business plan proposals. We would like to see the incentive rate reinstated to the level proposed in our business plan and the PCL reset to align with our business plan as the additional 5% stretch appears arbitrary and applied equally to other companies' less stretching embodied / capital carbon proposals.

This performance commitment was developed as we recognised the benefits we can deliver for our customers and the environment, a point supported within the response. However the intervention in setting the ODI rate at the same level as the common performance commitment for operational greenhouse gas emissions has impacted the viability for Anglian Water to progress. In the operational greenhouse gas emissions the rate, set at £188 per tonne of carbon equivalent, will impact on a cumulative basis over a number of years e.g. an energy efficiency intervention will have a repeated benefit over a number of years as reduced energy consumption is achieved on an ongoing basis. With lower carbon concrete, the asset is delivered once and therefore the incentive or penalty has a reduced impact versus common performance greenhouse gas commitment .

We have completed the new table ADD22, reflecting our increased baseline levels of emission in the plan as our level of investment proposed in the draft determination has increased compared to our business plan. The new baseline is in ADD22E but the % reduction remains the same as our business plan (so we are hoping to remove more tonnes of carbon). The percentage increase in the baseline is similar to the percentage increase in the enhancement programme. We note that the baseline will be revisited during AMP8 as we report our performance. The approach to calculating this baseline is the same as outlined in section 1.22 of our Outcomes table commentary[13]..

Our solution

Retain our business plan PCL and incentive rate.

13 Anglian Water Outcomes PR24 Data Table Commentary, ANH07 anh07-outcomes-pr24-data-table-commentary.pdf (anglianwater.co.uk)

18 C-MeX

Our response to the draft methodology noted a number of concerns with the introduction of UKCSI to C-MeX. We understand Ofwat's rationale and agree that the industry should be incentivised to deliver excellent customer service. However the incentives must reasonably calibrated such that a good performing company can reasonably expect to earn a reward. We do not believe that the proposals in the DD reflect this.

The proposed design of the C-MeX mechanism, which now benchmarks water sector performance against the UKCSI all-sector average score and uses payments in terms of a proportion of RoRE instead of based on allowed retail revenue, causes asymmetric risk exposure for the sector and a downside in the base-case scenario.

Benchmarking to the UKCSI is challenging as it includes customer service performance of organisations operating in highly competitive sectors such as leisure, banking and retail. In these sectors, greater resources are allocated to compete on levels of customer service than in regulated utilities. There is also a more frequent direct contact with customers which contributes to the ability to shape customer views.

Based on the historical performance in PR19, only a few companies could achieve an outperformance payment, while the rest of the sector would remain in underperformance. Performance in 2023/24 would have seen all companies in the industry in penalty.

This asymmetry is shown in the 'PR24 Risk Analysis of a notional company report' by KPMG. KPMG's demonstrates that a median performer would not achieve UKCSI average score, based on the historical data, and hence would be in the penalty territory. This causes the base-case downside for the notional company and bakes in asymmetry in the expected outturn and undermining the base return.

Ofwat's own analysis shows this asymmetry (-0.3% to +0.12% of RoRE), and while Ofwat may contend that industry performance is likely to improve, we have observed worsening industry C-MeX scores in AMP7. We also note that the removal of the digital uplift would worsen this outlook and the UKCSI itself may improve.

Our solution

Given this inherent asymmetry Ofwat must either rethink the introduction of the UKCSI benchmark, adapt the implementation of the UKCSI benchmark or account of the asymmetry in the cost of capital. One option could be to include a deadband between the UKCSI upper quartile and UKCSI threshold. Another option would involve using water sector median as the benchmark.

19 D-MeX

We appreciate Ofwat's efforts to introduce D-MeX as a measure of developer services satisfaction, but have some concerns about the methodology, frequency and validity of the surveys. We would like to see the data from the survey pilots conducted in early 2024, and to understand how Ofwat will ensure a fair and representative sample of developers across different channels, regions and company types.

We also suggest Ofwat considers the value of annual surveys for large developers, who may have limited or outdated knowledge of the operational aspects of their interactions with water companies.

Our solution

We suggest that a two-survey approach, with quarterly surveys for homeowners and small developers, and annual surveys for large developers, could provide more detailed and accurate feedback on the developer experience. More frequent surveys would help provide more current information about relative performance. We track the regular information provided about our performance and other companies and use this to drive improvements, just as competitors in a market would.

We also believe Ofwat should consider how to avoid potential bias or confusion when surveying multiple companies in one survey, and ensure that each company is scored based on its own performance and not influenced by others.

20 BR-MeX

We welcome the introduction of B-MeX and R-MeX as a way to incentivise better customer service and collaboration in the business retail market. However, we have some concerns and suggestions regarding the design and implementation of these measures.

We request that a review mechanism is included for the B-MeX and R-MeX surveys to ensure that the feedback is relevant, proportionate, and based on factual evidence of the service provided by the wholesalers and retailers respectively. Through the existing R-MeX survey we have previously seen inconsistent results and feedback between surveys that is not substantiated by the scores given. For instance, MOSL has previously advised one Retailer TP that a score of 6 was an average result, however we would consider this an less than satisfied score with a negative detractor impact on our R-MeX score.

We also suggest a feedback loop, with monthly updates on the B-MeX survey performance to enable timely and effective actions to improve customer experience and meet our obligations, rather than quarterly reviews.

We are doubtful about the readiness and reliability of the MPF metrics and their inclusion in BR-MeX. We need assurance from MOSL that they will implement this change before April 2025 and clarify how it will affect the BR-MeX calculations and targets.

We are wary of the potential confusion and misattribution of service quality between wholesalers and retailers in the eyes of the NHH customers without clarity on which wholesaler/retailer they are being questioned about. We suggest clear and robust questions to differentiate the roles and responsibilities of each party and avoid unfair or inaccurate ratings. For instance, this would clarify for NHH customers who faced delays from a retailer request to exchange a meter that, if the job was completed by the Wholesalers LOS on a day the customer chose, the wholesaler should not be subject to the billing issues or dissatisfaction with the complete timescale from a potential Retailer issue.

Our solution

We suggest that a two-survey approach, with quarterly surveys for homeowners and small developers, and annual surveys for large developers, could provide more detailed and accurate feedback on the developer experience. We also believe Ofwat should consider how to avoid potential bias or confusion when surveying multiple companies in one survey, and ensure that each company is scored based on its own performance and not influenced by others.

We also suggest a feedback loop, with monthly updates on the B-MeX survey performance to enable timely and effective actions to improve customer experience and meet our obligations, rather than quarterly reviews.

We suggest clear and robust questions to differentiate the roles and responsibilities of each party and avoid unfair or inaccurate ratings.

21 Overview of changes to Outcomes tables

We have updated our data tables to reflect our Draft Determination Representations in accordance with Ofwat requirements, including updating 2023-24 forecasts with actuals for both APR aligned and non-APR aligned data.

We have provided commentary on material changes made to the data in the tables. Please refer to our original data table commentary (ANH07 to ANH18) if more information is required.

We have made changes to the following Outcomes tables since submitting the version of our data tables that our Draft Determination is based on (ANH03 Data tables - March 2024 update). Please see the Change Log in ANH_DD_004 - v7 Main data tables for a more detailed summary and the individual tables themselves for changes in red font:

- OUT2
- OUT4
- OUT5
- OUT6
- OUT8

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