WSX-O02 – Price Control Deliverables

Response to Ofwat's PR24 draft determination

Wessex Water
YTL GROUP

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1. Summary

As explained in our PR24 business plan and response to Ofwat's Draft PR24 Methodology, we support the principle of PCDs where they promote an outcomes-based approach and do not lead to more input/output-based measures in place of performance commitments. In this context, we have the following concerns with Ofwat's proposed PCD framework and the way in which it has proposed to introduce PCDs in specific areas of companies' investment programmes.

- It is somewhat **at odds with Ofwat's totex and outcomes framework** which was introduced to allow "*companies more flexibility to deliver customer outcomes in the most efficient way*". In that it removes this flexibility and restricts companies' abilities to make efficient trade-offs.

- The **scope** of the PCD framework duplicates existing mechanisms by introducing further penalties where customers are already protected from the consequences of non-delivery. There is also some duplication within Ofwat's PCD package that would lead to companies potentially being penalised twice for non-delivery of the same outputs.

- Ofwat's approach to PCDs introduces **further downside skew** into the package. PCDs are punitive by design. Introducing the possibility of a small timing reward at draft determination does not address this.

- The **design** of specific PCDs does not reflect the degree of uncertainty and potential for change during AMP8, and the resulting need for flexibility to pursue optimal solutions as companies' investment programmes are delivered during the AMP. This creates a major risk that companies will be forced to make investments that are inefficient and / or not in the interests of customers and wider society. This is a major issue particularly for two PCDs (storm overflows and STW growth) that we ask Ofwat to address in its Final Determination.

- Similarly, the overly restrictive nature of PCDs will have practical implications for the **new Government's ability to effectively deliver legislative change and reform.** For example, such change could lead to companies facing penalties under the current design.

- The calibration of PCD **payment rates** requires further consideration to ensure that they result in the correct adjustment at PR29, and that they do not reinforce any perverse outcomes.

In addition, we also have some specific concerns with the way in which some individual PCDs have been set.

Unless these issues are addressed, the implementation of Ofwat's PCDs would continue to create a material downside risk for companies. We have set out the implications for our RoRE risk range, as well as the impact of our proposed changes, in this representation.

While we ask that Ofwat addresses the issues set out in this representation, we note this would still not provide companies with a balanced risk profile. As such, we also ask that Ofwat recognises the impact of PCDs on companies' overall balance of risk and return. This is discussed in more detail in representation WSX-R01.

1.1. Changes requested

We request that Ofwat makes the following changes to its PCD framework:

- Reconsider the **scope** of its PCDs and only apply them where there is a clear absence of existing customer protection for non-delivery.

- Allow for **greater changes** to PCD deliverables to ensure that companies can continue to deliver the outcomes that matter to customers and the environment, in the most efficient way. This is most evident for scheme-level PCDs including storm overflows and STW growth. It must also ensure the framework allows for changes brought about due to legislative change and reform such that companies will not be penalised for the impacts this may have on their delivery programmes.
- Amend its **delivery profiles** for three PCDs subject to time-incentive payments (should these continue to be used), recognising that it is for companies to determine the most feasible programme of delivery to meet its regulatory obligations and WINEP dates.
- Set an **output band** within which time-incentive payments would not apply.
- Reconsider the application of **non-delivery payments** in circumstances where PCD outputs are in the process of being delivered, and the expenditure has been incurred, but there may be a delay to completing these outputs of more than a few months. This is most relevant for discrete investments such as nutrient upgrades and IED schemes.
- Review its **reporting and assurance requirements** to ensure these are proportionate. We have proposed a simpler form of reporting and assurance, more closely aligned to the existing Annual Performance Reporting process.

In respect of the latter two points, our proposed changes are consistent with Ofgem's Price Control Deliverable framework.

Besides these broader changes to the PCD framework, we ask Ofwat to make changes to individual PCDs set out in Table 1.

Table 1 – Changes to Ofwat's PCD framework

PCD	Change required
Smart metering	Amend recording and transmission thresholds for delivery of a meter
Water supply*	Set delivery output as completion of option feasibility and design rather than WAFU benefit
Lead pipe replacement	Amend scope of PCD to exclude external supply pipes
Raw water quality	Amend scope of PCD to exclude DWI lead strategy
Storm overflows (grey-hybrid solution)	Amend conditions such that grey-hybrid solutions can be substituted with green solutions. Amend delivery profile for time-incentive payment to align with latest company views of realistic delivery profile
P-removal	Amend delivery profile for time-incentive payment to align with latest company views of realistic delivery profile. Adjust non-delivery payment to recognise progress with completion of works
N-removal	Adjust non-delivery payment to recognise progress with completion of works
STW growth	Amend PCD output and associated non-delivery payment rate to be based on cumulative PE delivered rather than scheme-level outputs.

	Allow for changes to scope or substituting a scheme based on need rather than DWF permit changes.
PR19 Outcome Delivery Incentive PCD - Avonmouth	Remove PCD (if approach to funding revised scope of programme is not amended as per our separate request)
IED	Remove PCD for Taunton Amend PCD delivery date to 31 March 2030 for all other IED sites Adjust non-delivery payment to recognise progress with completion of works
Mains renewals	Amend PCD target from 0.48% of mains to 0.4% of mains length (or 0.24% if no further adjustments to base cost allowance) Consider setting separate rates for trunk mains and distribution mains reflecting the different costs for each activity.
Investigations (water and wastewater)	Aligns delivery dates for wastewater investigations with water investigations (March 2030); or remove the PCD condition around EA confirmation. Review disaggregation of payment rates particularly for storm overflow investigations
PR19 WINEP carryover - Blagdon	Remove time-incentive PCD penalty

*If included at Final Determination stage.

The rest of this representation sets out our reasoning for these changes. This should be read in conjunction with our summary document which sets out our proposed uncertainty mechanism (see representation WSX-M07). We consider this mechanism could also help to mitigate some of the issues with Ofwat's PCD framework discussed here.

We also set out our views on Ofwat's proposed Delayed Delivery Clawback Mechanism (DDCM).

1.2. Further engagement

In addition to the points raised in this representation, we remain concerned with the degree of uncertainty that still exists for large parts of the PCD framework, and the absence of engagement Ofwat have offered in the interim between submitting our business plan and the draft determination. PCDs are an entirely new mechanism being introduced for AMP8 and this is the first opportunity that we have had to comment on Ofwat's full PCD proposals.

We are concerned that the PCD (and DDCM) framework is not sufficiently mature, and that Ofwat should consider delaying the introduction of PCDs or only introducing them for certain areas while it continues to work through the issues raised in this document with industry. We would welcome further engagement on this during the rest of the PR24 process.

2. Our concerns with Ofwat's PCD framework

This section sets out in more detail our views on the scope, design, and calibration of PCDs, as well as on the proposed reporting and assurance framework.

In general, we consider that a key weakness in Ofwat's PCD framework is that it does not recognise the distinction between:

- 'mechanistic' PCDs, where work can be clearly defined *ex-ante* and is measured by volumes or numbers; and
- 'evaluative' PCDs where there is greater uncertainty over the scope of works, costs, solution type and other external factors.

It is our view that where Ofwat applies PCDs it should reflect this distinction in its design and payment calibration. This is explicitly recognised in Ofgem's Price Control Deliverable framework and, as set out above, we would encourage Ofwat to apply the lessons from that regime to ensure its own framework is workable. We have highlighted specific areas where Ofgem's approach can be easily incorporated into the PCD framework to provide a fairer and more practicable approach.

2.1. Scope of PCDs

Ofwat sets out in its PR24 Draft Determination that it wishes to avoid duplicating existing incentives in its regulatory framework, and that PCDs should be used where the benefits of the investment are not linked to, or fully protected by, performance commitments and outcome delivery incentives (ODIs).

To do this, Ofwat has assessed the relationship between enhancement expenditure and ODIs to identify the protection that ODIs may already provide. Ofwat says its analysis – based on information provided by companies in business plan tables CW15 and CWW15 – suggests a very low level of protection for most enhancement areas.

It is unclear how Ofwat has arrived at this conclusion; however, we do not consider this will capture the full extent of the protection provided by ODIs. For example:

- Ofwat states that 1.6% of the storm overflows programme expenditure is protected by ODIs. However, as set out in our business plan, we cannot achieve our forecast step change in improvement for this performance commitment unless we deliver our enhancement programme in full.
- Likewise, for smart metering, Ofwat states that 3.6% of programme expenditure is protected by ODIs. We are forecasting that 37% of our leakage improvements will be derived from smart metering rollout. If we fail to deliver 20% of our smart metering programme, all other things equal, we would expect to miss our leakage target by 0.4% by 2030, which is equivalent to a performance commitment penalty of £0.9 million.

In these areas, the existing outcomes framework incentives us appropriately to deliver our enhancement programmes (i.e. through PCLs and ODIs), as we would be expected to underperform against our performance commitment target if our enhancement programme does not deliver. This means that the consequences of delays in delivery will be captured through two separate mechanisms, significantly increasing the delivery risk to companies across the bulk of their enhancement programme.

To restore an appropriate balance of risk for companies, we ask Ofwat to reconsider the scope of its PCDs and only apply them to enhancement areas where non-delivery would not affect a company's performance against existing performance commitments. Alternatively, as we proposed in our PR24 business plan submission, Ofwat could net off ODI payments against any PCD payment.

2.2. Design of PCDs

2.2.1. Dealing with change

We are concerned that Ofwat's PCD framework is insufficiently flexible to allow companies to deliver in the best possible way for customers and the environment. This is because of the way in which Ofwat has specified PCD deliverables, many of which are output-based, and placed restrictions on the extent to which these delivery outputs can be changed during AMP8 to reflect changing circumstances or a better understanding of requirements / solutions.

This is at odds with one of Ofwat's design principles, which is that PCDs should cover outcomes over outputs / inputs. It is also at odds with Ofwat's totex and outcomes framework. Ofwat sets out that: "the totex approach went hand in hand with the move from outputs to outcomes, as it allowed companies more flexibility to deliver customer outcomes in the most efficient way".[1] As set out below, we are concerned that this creates a risk that companies may be required to continuing pursuing a particular course of action in order to meet a PCD, rather than delivering in ways that are more efficient and more aligned to customer interests.

Delivering customer outcomes in the most efficient way

Ofwat's PCD rules risk restricting our ability to optimise our delivery programmes. For instance, these rules will require us to continue building a grey storage solution to address a storm overflow, even if future design and investigation work reveals a green solution is more effective. It is not clear why Ofwat would seek to prevent greater use of nature-based solutions if companies subsequently identify that they can address the harm arising from a storm overflow and reduce average spill count either for the same or a lower cost.

This lack of flexibility also applies *between* PCDs. Our smart metering and water efficiency programmes both contribute to our performance commitment to reduce per capita consumption, which ultimately supports the aim of sustainable abstraction (the outcome that ultimately matters to customers and the environment). Our proposed programmes are based on our best view about the optimal mix of smart metering and water efficiency activities to deliver the greatest benefits, while also reflecting deliverability considerations for each programme. However, it is entirely possible that this may change in future as we progress our rollout of smart meters and water efficiency activities during the AMP and gather more information about the observed benefits (and potential challenges) with each programme. This is especially true given that smart meters are a new area of investment for us. In the absence of PCDs, we would be able to review our balance of activities within the AMP. This could lead us, for instance, to undertake more water efficiency activities instead of smart metering if the evidence suggests this is more cost-beneficial, or if deliverability constraints have tightened / relaxed over time. However, the presence of prescriptive PCDs will prevent us from doing this. We cannot therefore capitalise on the potential for more effective methods of delivering long-term outcomes within a price review period.

Ofwat explicitly says that it does not want provisions in the PCD framework 'to distract companies….by engaging in significant programme re-optimisation during the initial years of the regulatory period'. Programme re-optimisation is by definition a good thing that allows companies to identify and capitalise on more efficient solutions that may emerge due to design and development work, or investigations that complete during the AMP. The benefits of this approach are shared by customers through the cost-sharing process and more broadly by revealing better solutions for future periods. We cannot understand why Ofwat would seek to prevent this, and we consider this reflects the drawbacks of setting PCD deliverables in an output-based fashion.

[1] PR14_Review_Paper_Jan_2022.pdf (ofwat.gov.uk), page 50.

Incentivising the completion of investments that customers and society may no longer value

Changing circumstances during an AMP also mean that some investments may be no longer required, or may not be value for money. Ofwat does recognise the risk that companies will be disincentivised from stopping investments even where this would benefit customers. To address this, Ofwat proposes to allow companies to retain 6% of their allowance where they can demonstrate that under-delivery is due to an investment no longer being required – on the basis that 6% is the same rate used to set development allowances for DPC and major projects. However, this may not be sufficient to address such risks in circumstances where the next phase of work has already begun.

Ofgem's PCD framework addresses this issue by applying a qualitative assessment of non-delivered projects that are cancelled due to changing circumstances, rather than applying a bright-line threshold. Ofgem states that it will determine adjustments to allowance taking account of "all relevant information provided by licensees and other stakeholders", and it sets out examples which show that if a licensee can demonstrate that expenditure was efficient and necessary, the licensee would retain all efficient costs incurred in undertaking those activities. We consider that this is a more appropriate approach than capping any retained cost at 6%, as it will incentivise companies to make correct investments rather than continuing to complete an investment purely to avoid a punitive PCD penalty.

Flexibility to changes made outside our control

We are also concerned the restrictive nature of PCDs may have practical implications for the new Government's ability to effectively deliver legislative change and reform, if such change were to lead to companies facing PCD penalties. It is important that any such changes can be accommodated within the framework, and that the interaction with PCDs does not create an unnecessary friction that serves to frustrate the objectives of reform.

2.2.2. Delivery profiles

We have significant concerns with the delivery profiles that have been proposed for two of the PCDs subject to a time incentives PCD: Storm overflows and P-removal[2]. These profiles do not account for

- The delay between expenditure being incurred and outputs being delivered. Ofwat has set its delivery profile based on the proportion of expenditure incurred, but this does not reflect the fact that many schemes will be undertaken simultaneously and then complete towards the ends of the AMP. This is consistent with our AMP7 delivery programme.

- Company-specific circumstances. All companies will have slightly different enhancement programmes reflecting their individual WINEPs. For instance, our P-removal programme is much larger than other companies and we have several very large upgrade schemes, accounting for a large proportion of total PE served, that we cannot complete until the final year of AMP8. This means that a larger proportion of our nutrients programme will be delivered towards the end of the AMP. We forecast that Ofwat's proposed profile will result in us incurring a time incentive penalty of **£15 million** for the P-removal PCD even if we deliver our programme according to our internal planning, which has been developed to meet WINEP regulatory dates.

We do not consider it appropriate for Ofwat to intervene to effectively determine companies' delivery programmes when they have already been developed and optimised to meet relevant regulatory and statutory deadlines; Ofwat's PCD profiles effectively compel companies to deliver some schemes in advance of when the EA considers they need to be delivered. This is particularly the case given that expediting elements of our programme is not possible due to deliverability constraints.

[2] As discussed in Section 3, we also disagree with the level of output that has been set for the mains renewals PCD.

We consider that time incentive PCDs, where these are considered necessary, should be set based on companies' internal delivery profiles that have been developed to meet relevant regulatory dates. It is for companies to determine how best to optimise their programmes to ensure efficient delivery, recognising that they will be subject to enforcement action and non-delivery PCD payments should the overall programme not be completed by the end of AMP8 or when EA regulatory dates occur. We have set out our latest view of these profiles for each relevant PCD in Section 3 of this representation.

We note that Ofwat also requires companies to set interim milestones for other areas that are not subject to a time incentives PCD. It is unclear what how Ofwat will use this information, and we would welcome further guidance from Ofwat on this.

2.3. Calibration of PCD payment rates

2.3.1. Two-way incentive payment

As set out above, we do not agree that Ofwat should intervene to set delivery profiles for companies that supersede companies' own regulatory and statutory deadlines. This makes it harder for companies to manage programme delivery risks across the period to ensure efficient delivery of all outputs by the end of the AMP.

In this context, applying an outperformance payment for delivering outputs according to a specified delivery profile is a somewhat artificial way to partly (though not fully) redress the balance of risk in companies' settlements. This introduces further regulatory complexity to the regime and is only necessary because of the asymmetry that has been introduced to the regulatory framework through the design of PCDs. We consider that this reflects the need to address the broader issues with the PCD framework and with Ofwat's overall package of risk and return.

However, in the absence of any other changes to the PCD framework, we would support the introduction of a two-way incentive. We set out our views on specific implementation issues below.

Implementing a two-way incentive

We consider Option 2 (where companies can face both underperformance and outperformance payments in each year) is more appropriate than Option 1. As Ofwat notes, this provides stronger incentives to deliver outputs where a company faces delivery challenges beyond its immediate control. It also provides for a more balanced risk and return package than Option 1.

We also consider that this would be improved by setting an output band within which underperformance or outperformance payments would not apply. This would further redress the balance of risk by giving companies some protection against financial penalties resulting from delivery challenges which are beyond their immediate control. In our view, applying a deadband is a far better way to achieve this than arbitrarily amending the timing and / or level of outperformance payments. It would also allow for some further flexibility in re-optimising programme delivery requirements as necessary. All other things equal, and notwithstanding our broader concerns, we therefore consider this would improve the current set of proposals.

Underperformance rate

We consider Option 1 (WACC multiplied by the protected totex) is more appropriate than Option 2 (WACC plus run-off rate, multiplied by the protected totex). Ofwat says it is concerned that Option 1 this may not provide sufficient incentive for companies to deliver in a timely manner. We disagree with this, for the following reasons:

- Firstly, as discussed above, companies already have strong incentives to deliver these PCD outputs because they will not achieve performance commitment targets without doing so. The ODI regime covers storm overflows, river water quality (phosphorus) and leakage and fulfilling these performance commitments rely on at least one PCD subject to a time-incentive payment. This is bolstered by the reputational consequences of failing to deliver PCD deliverables that contribute to these outcomes (e.g. leakage).

- Secondly, two PCDs subject to this incentive payment (P-removal and storm overflows) have regulatory output dates and companies are therefore further incentivised to deliver by the prospect of enforcement action for missing these dates. Even where these regulatory dates are set at the end of the AMP, companies must achieve consistent progress across the AMP to deliver their programmes in full by 2030.

- Thirdly, as set out elsewhere in our representations, we consider that Ofwat's proposed WACC is too low. Adjusting its WACC appropriately would increase the level of payments for late delivery.

In our view, the existing regulatory framework therefore provides clear incentives for companies to deliver these PCD outputs in a timely fashion.

Ofwat says it would welcome additional evidence on the relative risk impacts of setting underperformance rates based on Option 2 compared to Option 1. Based on Ofwat's suggested approach, Option 2 would more than double two-way incentive payments rates (8% of protected totex rather than 3.66%). Table 2 below sets out the impact on expected payments in AMP8. We have based estimated payments using Ofwat's four-to-one ratio for outperformance to underperformance (e.g. a central case of 80% of outputs delivered in a given year) but based on our expected delivery profiles. All profiles assume we are funded for the proposed cost allowances set out elsewhere in our draft determination response.

Table 2 – Comparison of impacts of setting underperformance rates

PCD	Expected time-incentive payment under Option 1	Expected time-incentive payment under Option 2
Metering	£0	-£0.7 million
P-removal	-£15.8 million	-£41.8 million
Storm overflows	-£1.6 million	£-8.4 million
Mains renewals	-£1.5 million	-£5.2 million

As Table 2 shows, Option 2 would further skew companies' RoRE range which, as set out in WSX-R01 and WSX-R02, already has a significant downside skew. This would require Ofwat to make additional adjustments elsewhere to maintain a balanced package of risk and return. For the reasons set out above, we do not consider this is necessary or desirable.

Application of payment rates

Ofwat has not clarified whether time-incentive payments will be applied in-AMP i.e. by adjusting companies' revenue allowances in subsequent years, as with ODI payments, or if these payments will also form part of the PR29 reconciliation process. We would welcome further clarity on this point in advance of the final determination. We note that that an in-period adjustment could be considered alongside our proposed uncertainty framework which sets out the potential for in-period adjustments to reflect wider uncertainties in the PR24 framework.

2.3.2. Non-delivery payments

We have significant concerns with the calculation and application of non-delivery payments for scheme-level PCDs. There is a material risk that companies could be compelled to return a penalty for not delivering a scheme which is significantly in excess of the efficient costs that would be incurred for that scheme. For discrete, lumpy investments, companies could also be compelled to make a non-delivery payment even when that scheme is near completion and will shortly be completed. These issues are explained below.

Use of cost benchmarking to set payment rates for scheme-level PCDs.

Non-delivery payment rates have been set by way of reference to the modelled allowances in Ofwat's econometric models. This places huge reliance on the robustness of those models. It is one thing to use such models to set companies' overall allowances for investment programmes; but in linking non-delivery payment rates specifically to the results of these models, Ofwat must be confident that it can predict the efficient cost of individual schemes.

To do this, it is essential that Ofwat's scheme-level econometric benchmarking is highly robust and captures all the key cost drivers determining scheme-level costs. We discuss the reliability of Ofwat's cost benchmarking in more detail in WSX-C02 and other enhancement cost representations. However, by way of illustration, Ofwat's benchmarking model for storm overflow grey-hybrid solutions has an adjusted R squared value between 0.596 and 0.666. This means that Ofwat's model is explaining around two thirds of the variation in the costs of delivering a grey-hybrid scheme. While some of the residual variation may be expected to average out for companies at programme level, an individual grey-hybrid scheme could easily cost as much as 50% less than Ofwat's model – and non-delivery payment rate – implies.

This means that non-delivery payment rates set at scheme level may be far higher than the efficient cost of delivering that individual scheme. Furthermore, as discussed below, non-delivery is in practice far more likely to be due to be delays and overruns which prevent completion by the end of, or shortly after, AMP8. A company could therefore be forced to return more than the actual cost of delivering a scheme, having already spent the majority of this actual cost to progress the scheme through to near completion.

The additional risk that this creates for companies – exacerbated by the risks of inaccurate payment rates – does not appear to have been considered in Ofwat's Draft Determination. To address this, we ask Ofwat either demonstrate that its cost benchmarking is sufficiently reliable to calibrate individual non-delivery payment rates, or else reconsider its approach to setting payment rates e.g. by basing payments on the total amount of output delivered (such as PE served or equivalent storage) to partly mitigate this risk.

Investment which is slightly late but on track to be delivered early in PR24.

We welcome Ofwat's consideration of circumstances where companies fail to deliver PCD outputs by the end of the control period but are still on track to deliver early in the following control period. We agree that, in such circumstances, non-delivery payments should not be applied.

For smaller, continuous PCD outputs such as lead pipe replacement (e.g. those defined by Ofgem as 'mechanistic'), we consider this approach works well. We welcome further clarity from Ofwat on how many months into the 2030-35 period it considers this would apply for.

However, for larger, lumpier investments such as nutrients upgrade schemes, this means that companies could still be required to return the total funding for a scheme even where they are a substantial way through the construction of that scheme and will continue to take the scheme through to completion in the early part of AMP9.

We do not consider this is consistent with the intent of PCDs, which is to protect customers from non-delivery of enhancement-funded programmes of work. In these circumstances, companies will still be completing the schemes (in line with regulatory requirements) and so customers will still benefit, albeit later than March 2030; to impose the full non-delivery payment for a delay which may be less than one year (e.g. slightly longer than Ofwat's interpretation of 'a few months into AMP9') is punitive. **We consider a non-delivery penalty should be reserved for instances where companies completely fail to deliver a proportion of its funded enhancement programme.**

To address this, we propose that Ofwat could continue to apply a time-incentive payment for all schemes which are still due to complete at some point in AMP9 (whether or not this falls within a few months of AMP9), so long as there is a clear timescale for delivery at some points in AMP9. This is consistent with the approach taken by Ofgem in applying its evaluative PCDs, which explicitly recognises that evaluative PCDs can be partially delivered (not just delivered or not delivered) and adjustments to price control allowances are made accordingly. It is also more

consistent with the principles of Ofwat's proposed Delayed Delivery Cashflow Mechanism (DDCM), which recognises that delayed delivery (whether during or between control periods) is primarily a cashflow-related issue[3].

A hypothetical example of this alternative approach is set out below[4].

Example of approach to partially delivered PCD.

Defined PCD: £30 million allowed to deliver phosphorus removal at WRC 1 (based on p-removal model)

Scenario: By March 2030, £24 million has been spent with 80% construction complete. Company demonstrates construction will be completed with EA confirmation in a year's time.

Ofwat proposed approach: PCD penalty of £30 million applied as output not delivered within a few months of AMP8. Adjustment of £30 million applied to PR29 settlement (on top of the efficient delivery costs which have been incurred up to that point, net of any cost sharing)

Alternative approach: Seek further report after scheme completion. Where there is evidence of a reduction in consumer outcome due to the delay, reprofile allowances to match the profile of the actual delivery of work or expenditure. PR29 allowed revenue adjusted by NPV of delayed customer benefit accruing from phosphorus-removal benefits beginning in March 2031 rather than March 2030.

We consider this would apply at a minimum to those investment areas with the largest discrete PCD outputs, including: P-removal; N-removal; and IED upgrades. These PCDs have the clearest characteristics of an evaluative PCD as defined by Ofgem.

We consider this strikes a much better balance between retaining customer protection for non-delivery or late delivery of funded schemes, while still incentivising companies to complete late schemes in a timely fashion. It is also aligned with existing regulatory precedent.

Interaction with cost sharing mechanism

PCD payments also need to reflect the impact of non-delivery under the cost sharing mechanism. Ofwat has proposed that non-delivery PCD payments are reconciled first and allowances are adjusted accordingly, before cost sharing is then reconciled based on the adjusted allowances.

We have set out in Table 3 our understanding of Ofwat's proposal, using three purely illustrative scenarios and comparing the impacts of both approaches (i.e. adjusting and not adjusting PCD payment rates for cost sharing). We believe that the two approaches are broadly equivalent, when assuming a 50:50 totex sharing rate and revised allowances are set (for cost sharing purposes) which take account of companies' PCD payments. This ensures that the existing cost sharing protections, and balance of risk, are preserved on the elements that companies have delivered, while correctly remunerating customers for the value of the work that has not been delivered.

[3] We have concerns with the specific implementation of the DDCM in-period. These are set out in Section 4.
[4] This is based on applying Hypothetical example 1a in Ofgem's Price Control Deliverable Reporting Requirements and Methodology Document.

Table 3 – Illustration of approaches to managing interactions with cost sharing

	PCD payments adjusted for cost sharing rate			PCD payments not adjusted for cost sharing rate		
	Scenario 1	Scenario 2	Scenario 3	Scenario 1	Scenario 2	Scenario 3
Allowance	1000	1000	1000	1000	1000	1000
Company spends	0	1000	1500	0	1000	1500
Target delivery	100	100	100	100	100	100
Company delivers	0	50	50	0	50	50
Cost sharing rate	50%	50%	50%	50%	50%	50%
PCD payment per unit	5	5	5	10	10	10
Total PCD Penalty	-500	-250	-250	-1000	-500	-500
Total cost sharing	-500	0	250	0	250	500
Net company position	0	-250	-500	0	-250	-500

We would welcome confirmation from Ofwat that this understanding is correct. We would not support any proposal that is implemented in such a way that it undermines the existing cost sharing mechanism on work that has been delivered (for instance by not adjusting cost sharing allowances). This would represent a transfer of risk that would be at odds with the wider allocation of risk in the totex framework.

Under either implementation approach, we consider companies are sufficiently incentivised to deliver the funded improvements. This is because (i) companies would not be better off under either approach by not delivering schemes i.e. there is no incentive to underdeliver even if PCD payments are adjusted for cost sharing and (ii) as set out above, there already exists strong incentives (outside of the PCD framework) to deliver enhancements in a timely manner, including regulatory enforcement.

Application of payment rates

Ofwat has provided limited detail as to how PCD penalties would be factored into companies' PR29 settlements. In our business plan, we proposed to set PCDs based on the difference between: (a) the revenue and RCV additions received by a company based on its *ex-ante* totex allowance; and (b) the hypothetical revenue and RCV additions that the company would have received if the *ex-ante* totex allowances were re-profiled so that they are in line with out-turn PCD delivery. The payment rate is then calculated as the sum of the revenue adjustment and the RCV adjustment needed at the start of PR29. We consider this is a more accurate way to apply a penalty, distinguishing between capex-funded and opex-funded PCDs, in a way that is consistent with Ofwat's stated policy intent from the PR24 final methodology.

Ofwat's Draft Determination does not set out its view on this proposal. Ofwat has subsequently clarified that it is still considering how PCD payments will be reconciled at the end of the period and intend to consult on this at an

appropriate point in the future[5]. This is very important given the scale of potential penalties that may arise under the current framework, and the lack of clarity in this area is increasing companies' uncertainty about the overall implications of PCDs. As part of its final determination, we ask Ofwat set out how it intends to apply penalties as part of PR29, and, if only being applied to companies' allowed revenues, explain why that is deemed appropriate and will not distort companies' financial settlements for the next price review period.

2.4. Impact on balance of risk and return

Ofwat has presented its analysis of PCD risk ranges as a percentage of regulated equity. It makes the following assumptions:

- Firstly, it excludes the impact of any non-delivery payments. This is on the basis that a company incurring significant abortive costs, that cannot be considered as design work for future improvements, should not be a material risk for an efficient company.
- Secondly, it calculates a range for time-incentive payments based on two scenarios: a potential downside scenario where a company does not deliver 35% of projects on time, with a one-year delay on average; and a potential upside where a company does not deliver 5% of projects on time, with a one-year delay on average. Ofwat said these scenarios are based on the rate of delivery of projects in WINEP for 2020-25. Ofwat says a calculation of the impact based on this period, where restrictions arising from COVID-19 may have led to project delays, is likely to represent an upper bound estimate of impacts.

Based on this, Ofwat estimates a PCD risk range for Wessex Water of around +/- 0.32% of regulatory equity.

We consider this analysis overlooks two important factors.

- Firstly, Ofwat ignores the fact that its own PCD framework is likely to lead to significant non-delivery payments not just due to abortive costs (which it says is within a company's control) but because some discrete, lumpy investments may be delayed by more than a few months into AMP9. As explained above, this creates a major risk that companies pay penalties for PCD outputs that they have already spent the majority of allowances on. This is not the same thing as an abortive cost and the risk of this should not be allocated entirely to companies, particularly given the scale involved and the impact on delivery programmes of factors outside companies' control.
- Secondly, Ofwat's claim that time-incentive payments are broadly balanced requires that delivery profiles are set correctly[6]. As discussed above, for two PCDs subject to time-incentive payments (storm overflows and P-removal), this is not the case. Furthermore, as discussed in our separate representation WSX-C20 (Cost adjustment claims), the total deliverable for the mains renewal PCD is also higher than we would expect to deliver each year. This means that companies would be expected to incur more in the way of underperformance payments than overperformance payments *ex-ante* under the proposed framework.

We have amended Ofwat's RoRE analysis by factoring in these two important points, to reflect a fuller set of risks introduced by PCDs under the current framework. The resulting PCD risk ranges are set out in Table 3 below. This demonstrates that we face a very significant negative RoRE skew due to PCDs. This is driven primarily by three

[5] QA-Price-control-deliverables-PCDs.pdf (ofwat.gov.uk)

[6] It also relies on Ofwat's view that a company would deliver 80% of schemes on time at P50 levels. The basis for this is an analysis of approximately eleven thousand PR19 WINEP schemes, but this sample will be heavily weighted towards smaller schemes such as investigations and is unlikely to be representative of the larger schemes that are subject to time incentive PCDs. We have not adjusted for this in our RoRE analysis as we do not have available data from other companies, but we consider that Ofwat should take account of this in its final analysis.

factors: (i) the incorrectly specified delivery profile for P-removal (which means we would expect negative time-incentive payments even in the upside scenario); (ii) the unachievable target for mains renewals (which means we would expect significant time-incentive and non-delivery penalties for this PCD under both scenarios); and (iii) the risk of non-delivery penalties for major P-removal and N-removal schemes which are under construction but which may be delayed by more than a few months into AMP9.[7]

We have then undertaken a separate RoRE analysis by amending the following aspects of Ofwat's PCD framework to present a more appropriate and balanced package:

- We have excluded those PCDs which we consider should be out of scope of the framework. These are: Avonmouth FFT; PR19 WINEP carryover; and smart metering (due to overlaps with the leakage performance commitment)[8]. We consider there is a case for reducing the scope of PCDs further due to overlaps with the ODI regime, but we have not excluded any more PCDs from this analysis.
- We have aligned the delivery profiles for storm overflows and P-removal to our latest delivery forecasts, and the mains renewal PCD to our expected renewal rate (based on funding requested in our business plan).
- We have adjusted the end-of-AMP payments for two PCDs (P-removal and N-removal) such that, where major schemes are delayed beyond a few months into AMP9, a time-incentive payment would continue to apply rather than the full non-delivery payment on the basis that these schemes will still be completed and so should not attract a full non-delivery payment. As noted above, this is more consistent with how Ofgem approaches partial delivery for evaluative PCDs.

The resulting PCD risks ranges are also set out in Table 4. This demonstrates that implementing our proposed changes to the PCD framework would significantly improve the balance of risk and return from PCDs. Nevertheless, there is still a negative skew. This is unsurprising given that for the majority of PCDs there is only a risk of underperformance, and so the framework itself is asymmetric.

Table 4 – Updated PCD risk ranges for RoRE

	Existing PCD framework		Amended PCD framework	
	Downside scenario	Upside scenario	Downside scenario	Upside scenario
Time-incentive payments	-0.83%	-0.48%	-0.25%	0.25%
Non-delivery payments	-4.73%	-1.16%	-0.17%	-0.02%
Total	**-5.56%**	**-1.64%**	**-0.43%**	**0.23%**

The analysis presented above is intended to demonstrate the impact of amending some of the most significant issues with Ofwat's current PCD framework. It does not capture the full set of risks introduced by PCDs. In particular:

[7] We have captured this by using Ofwat's delay profiles of 35% and 5% under the downside and upside scenarios, and applying those to the largest P-removal and N-removal schemes. We have not included any impacts from the IED PCD, given the uncertainty over delivery dates highlighted in this document, but doing so would significantly increase the negative skew presented in Table 3.

[8] Excluding the Avonmouth FFT PCD has no impact in practice on the analysis as we conservatively assume a 0% chance of non-delivery for this PCD.

- The time-incentive range does not reflect the potential issues with Ofwat's underperformance and outperformance ratio set out in footnote 6. Doing so would skew this range further towards the downside unless payment rates are also adjusted commensurately.

- The non-delivery range conservatively assumes a likelihood of non-delivery of 0% under both upside and downside scenarios for all other PCDs besides those highlighted above – reflecting our very strong track record of delivery. However, in practice, there is a risk that factors outside of our control may lead to non-delivery of a small proportion of other enhancement programmes, but we will still be required to spend full allowances. In these circumstances, the PCD risk range would be skewed even further towards the downside.

It is also not an exhaustive list of the changes to the PCD framework that Ofwat should make; other changes set out elsewhere in this representation (e.g. allowing greater flexibility to substitute different schemes) are also needed to ensure the overall framework is fit for purpose. However, this captures the impact of some of the most quantifiable changes in respect of RoRE modelling.

2.5. Reporting and assurance requirements

Ofwat requires companies to report on progress against our PCD delivery plan on a six-monthly basis in the months of October/November and April/May of each year. Companies need to provide independent third-party assurance on the April/May report and publish this assured report in July of each year alongside the Annual Performance Report.

We set out our broader views on Ofwat's reporting and assurance requirements in our separate representation in WSX-O04 – Ofwat's reporting and assurance proposals. While we fully support the need for clear reporting on our enhancement delivery programme, we have some concerns about the cost and burden of these requirements and the potential for them to introduce duplication in respect of reporting of delivery outcomes to the different economic and environmental regulators.

In respect of PCDs specifically:

- We consider that, particularly for those PCDs without time-based incentive payments where delivery is only required by 2030, it is necessary to report on progress against milestones twice-yearly. At a minimum, **we propose that the autumn report is confined to those PCDs with time-based incentive payments**. We understand that Ofgem's PCD reporting framework consists of a single annual progress report, with further reporting when a PCD delivery date has passed.

  Additionally, as set out in Section 2.2 above, we would welcome further guidance from Ofwat on how it expects to use the information on interim milestones provided by companies for reporting purposes.

- The overlap between the overall PCD assurance report and individual PCD assurance reports is unclear. We also request further clarity for individual reports on the structured interviews with individuals from the company responsible for producing the data that is used to complete the APR PCD submission tables and review of data files and records. We are not aware of similar requirements for our performance commitment or other reporting undertaken as part of the APR, and Ofwat has not stated exactly what this should involve and why it is considered necessary.

- We note that, in addition to twice-yearly reporting and assurance, companies must report any PCD scheme substitutions "in a timely manner", including the scheme that is being substituted, rationale for substitution and amount of storage of substitute scheme. Ofwat does not define what is meant by a timely manner. We propose that the most proportionate approach would be for companies to report any substitutions as part of the next annual (or six-monthly) reporting cycle. Further reporting outside of this cycle would add additional burden both to companies and to Ofwat, given the clear potential for significant changes to the WINEP and scheme swaps in

AMP8 (reflecting the amount of uncertainty that persists). There is also no clear benefit to this information being reported sooner than the next milestone report.

We note that Ofwat has subsequently clarified that it is still developing its approach to how we will monitor PCDs and that it will set out further guidance on PCD reporting in due course. We would welcome this, and we request that Ofwat provides this sufficiently in advance of the start of AMP8 so that we can prepare internal reporting systems well in advance of when the first report is due.

3. Concerns with individual PCDs

In this section, we set out our concerns with the calibration of specific PCDs, over and above our concerns with Ofwat's broader PCD framework as described above. This includes one PCD which Ofwat has not imposed as part of its Draft Determination, but for which we would meet the materiality threshold if Ofwat accepts our requested enhancement cost allowances set out elsewhere in our representations.

3.1. Water enhancement PCDs

3.1.1. Smart metering

Our response is consistent with Ofwat's proposed trajectory for the smart metering PCD as far as it relates to numbers of smart meters installed.

However, we have concerns with the definition of the deliverable proposed by Ofwat. For a meter to be counted as part of this PCD, Ofwat states that it must:

- Measure and record water consumption data at least once an hour with a 95% or higher success rate.
- Transmit the recorded consumption data to the smart infrastructural network at least once every 24 hours with a 95% or higher success rate.

If an installed meter does not achieve either the data recording or transmission thresholds, it should not be reported as delivered in the PCD until it does achieve these requirements.

Ofwat has subsequently clarified that its 95% connectivity and data completeness thresholds are based on discussions with several companies and suppliers, which indicate that levels higher than 95% can be achieved so consider this a reasonable expectation at this stage[9].

Connectivity and data threshold

We disagree that 95% connectivity and data completeness on a per meter basis across 100% of smart meters installed is achievable or reflective of current performance being achieved by companies with mature smart metering programmes. This relies on 100% of meters connecting 95% of the time. Our market engagement with suppliers to date defines connectivity SLAs based on a percentage connectivity of the whole smart meter estate.

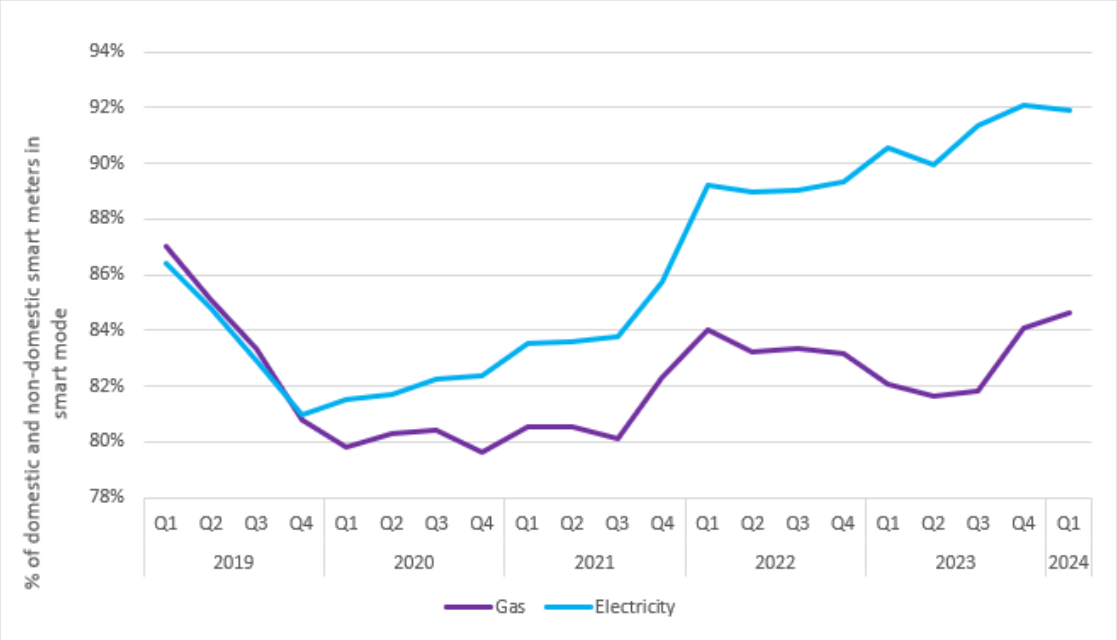
✂

There are multiple factors that can impact connectivity of smart water meters, including meter depth, chamber construction, chamber lid material, flooded chambers, obstruction of the meter chamber by a car/skip etc., new buildings/development and tree growth. Whilst there is mitigation possible for most of these scenarios, achieving 100% connectivity across a meter estate upwards of 230,000 meters by the end of the AMP would be unachievable. Mitigation measures to maximise connectivity would add additional unfunded expense to the programme and may negatively impact the battery life of meters that have to attempt to connect to the network more often, reducing the efficiency of future meter renewal programmes. Reducing battery life of meters from 15 years would also significantly impact companies cost models linked to asset life of the smart meter unit.

[9] QA-Price-control-deliverables-PCDs.pdf (ofwat.gov.uk)

As shown in Figure 1 below, at the end of Q1 this year 92% of electricity smart meters and 85% of gas smart meters operated by large energy suppliers were operating in smart mode, but this percentage has varied significantly since 2019. The challenges around connectivity of energy smart meters are different to water smart meters but generally energy meters are considered easier to connect due to not being underground or at risk of being flooded. Furthermore, electricity smart meters are powered from mains electricity supplies, so they are not constrained by battery life to the number of connections attempted per day as water meters are. While we strive as a sector to build on lessons learnt from the rollout of energy smart meters, we believe the experience from the energy sector indicates that these connectivity levels are not achievable particularly at the outset of a smart metering rollout programme.

Figure 1. Percentage of energy smart meters operating in smart mode since 2019[10]



Achieving this high level of connectivity within current cost allowances could also incentivise companies to install meters in urban areas where connectivity is generally better, rather than areas where the demand management benefits are most needed as per companies' WRMPs. Furthermore, adherence to higher connectivity standards than are generally available would also drive up the overall cost of metering programmes without any clear evidence that this would deliver improved outcomes, which would be to the detriment of customers.

Overall, while we recognise the need for Ofwat to ensure companies install smart meters that function as smart meters, we consider the proposed connectivity and data completeness targets do not reflect the available evidence on meter performance and could lead to poorer outcomes.

We encourage Ofwat to review their proposed connectivity and data completeness thresholds in light of evidence provided here and the data available to them from across the industry and other sectors. ✂, we would suggest that 90% is considered as a maximum threshold.

[10] DESNZ- Smart meters in Great Britain, quarterly update March 2024: data tables. https://www.gov.uk/government/statistics/smart-meters-in-great-britain-quarterly-update-march-2024

Application of non-delivery payment

Further to this, we also consider it disproportionate for a PCD non-delivery payment to apply in circumstances where a meter has been installed but may have a connectivity and data completeness 1% less on average over the period its installed, compared to a target. One way to address this would be to separate out the PCD target into meter installations on a per meter basis and connectivity and data completeness as an average across the installed smart meter estate, as per our example below.

The example payment rate for new meters is based on the unit cost allocation for a new meter install minus the cost allocation for a smart meter upgrade (for Wessex Water, £364.91 - £76.3). Meter upgrade costs are accounted for in the connectivity and data completeness target, for example if Wessex Water have a target to install 237,301 meters in AMP8, non-delivery against this target at the end of the AMP would incur a penalty of £181k per percentage below target level (1% of 237,301 x £76.3).

Table 5 – Example of alternative smart meter PCD

PCD Output	Delivery test	Example payment rate
New installation meter	AMI smart capable meter installed	£288.6 / meter
Meter replacements	AMI smart capable meter installed	£125.0 / meter
Connectivity level and data completeness	On average throughout that stated period, 90% of smart enabled meters transmit data once every 24 hours **and** data is 90% complete across the meter estate.	£X / % below target (based on company target installs)

This proposed approach assumes that, if an AMI meter failed to meet the given standards in a subsequent year after installation, it would not attract a time-incentive payment in that year because it could exceed the success rates in subsequent years and so still meet the requirement to achieve success rates on average until the end of the reporting period 31 March 2030. We would welcome further clarity from Ofwat on this matter.

Common standards agreement

Finally, Ofwat also states that companies should engage and collaborate with other water companies, meter suppliers and other stakeholders across the sector to agree on common standards relating to the data collected from smart meters to ensure data interoperability across the sector. Although we agree with the requirement for common data standards to be agreed across the industry, we don't believe this condition should form part of each companies' PCD as a specific condition that must be met within a defined timeframe. This could create a risk that water companies could incur a penalty if they were to engage on this, but other companies did not, as the actions of other companies and suppliers are not within individual company control. It would seem more appropriate for data standardisation to be driven by the regulator, for example through the Ofwat Water Efficiency fund as has been previously proposed.

3.1.2. Water supply schemes (excl. interconnectors)

Ofwat has not set a PCD for water supply schemes. This is because Ofwat's proposed cost allowance did not meet the materiality threshold. As set out in our separate representation WSX-08 (Enhancement costs – supply schemes), we have removed the delivery costs from the last two years of the AMP, reprofiled to reflect WRMP changes. However, based on our revised cost allowance proposal, this PCD would still apply to our enhancement programme.

On this basis, we disagree with the defined deliverable for this PCD. This output is defined as the WAFU benefit to the supply demand balance in £m per ML/d, scaled by complexity of scheme. However, the schemes we are taking

forward in AMP8 relate to supply-demand balance improvements delivering benefits starting from 2031. We will be completing design and development work on the following options for WRMP29. As such, the WAFU benefit associated with these schemes does not become fully realised until the next price review period, and only then if the scheme is selected as part of our WRMP29. We are not being funded in AMP8 to deliver WAFU benefits through any of these schemes within AMP8.

This output would therefore be inappropriate as a PCD deliverable for our AMP8 supply scheme programme.

In our business plan, we proposed that this PCD output should be defined as the completion of option feasibility and design reports, and the resulting outcome of WRMP decisions. This reflects what we are being funded to deliver in AMP8 – the design and development work required to take forward various supply-side options to inform the next round of WRMP planning. Our view remains that this is the most appropriate deliverable for this PCD. Independent third-party assessment and assurance of progress could be provided each year, and on completion of the feasibility studies, as part of the APR process. The PCD penalty would then be calculated as the total value of our AMP8 supply enhancement funding allowance divided by the number of individual schemes being taken forward, to be paid for each report that is not delivered at the end AMP8 or in time to inform our WRMP29 planning round.

3.1.3. Lead pipe replacement / Raw water deterioration and taste odour & colour

We accept Ofwat's proposed trajectory for the lead PCD. However, we consider the scope of this PCD should be limited to the number of communication pipes replaced. This is because the replacement of external supply pipes is much more uncertain and relies on customers giving their consent. To encourage replacement, we plan to offer a grant to customers for whom we cannot replace their external supply pipe. Nevertheless, as this remains largely outside of our control, we do not consider that we should incur a penalty if we cannot achieve our target for the replacement and relining of external supply pipes. At a minimum, we consider the PCD should be set to cover both communication pipes and external supply pipes under a single target, so that we have the flexibility to exceed our target for communication pipe replacement if customer engagement prevents us from achieving our target for external supply pipes.

We also note there is overlap between this PCD and the separate PCD covering raw water deterioration and taste odour & colour. This PCD includes as an output the DWI's lead strategy legal instrument, which underpins our lead pipe replacement programme. This creates a risk that non-delivery of a portion of our lead replacement scheme will result in two separate penalties through two different PCDs, effectively double-counting the intended penalty. Ofwat appears to justify its approach on the basis that not all companies have PCDs for lead replacement; this clearly does not mean those companies who *do* have this PCD should be exposed to the risk of being penalised twice.

To address this overlap, the PCD on raw water quality should exclude the DWI lead strategy legal instrument and be confined to other DWI legal instruments. This would also ensure that the penalty for the PCD on raw water quality is linked more closely to the funding allowance that we have been given in this area.

3.2. Wastewater enhancement PCDs

3.2.1. Continuous water quality monitoring

We did not propose a PCD for continuous river water quality monitoring in our PR24 business plan, due to late confirmation of EA guidance in this area. Ofwat has now proposed PCD for this investment area for all companies which meet the materiality threshold.

We agree with the proposed delivery profile and output specified by Ofwat for this PCD. We are still intending to deliver 470 monitors in AMP8 to meet Environment Agency targets to monitor 25% of (non-exempt) outfalls by 2030. We note that companies are expected to deliver the funded solutions at the specific sites identified and any substitutions must be approved by the Environment Agency. We welcome this flexibility, and we expect this is likely

to be needed in AMP8 as the programme develops. Our views on communicating this to Ofwat are set out in Section 2.5 of this representation.

We also note that Defra's technical guidance for companies on implementing their continuous water quality monitoring remains subject to change. Any changes to this guidance that affects the PCD should be reflected in Ofwat's final PCD set at final determination. As explained above, any further changes during AMP8 would also need to be reflected in PCD rules.

Finally, we also accept the proposed non-delivery payment rate. Since submitting our business plan, we have reviewed the forecast costs of this programme supported by supplier and regulatory engagement. This has led us to refine our view of the costs of this programme. The main reason for this is that we have significantly revised our assumption on land purchase requirements and associated costs, in light of further review of Defra's guidance. On this basis, we consider the proposed non-delivery payment rate is appropriate.

3.2.2. Storm overflows (grey-hybrid solutions)

We have concerns with the design of Ofwat's PCD for storm overflows, in particular: the potential for changes to companies' storm overflows programmes to deliver the best possible solutions for customers and the environment; and the delivery profile used to set time-incentive payments.

Flexibility to deliver solutions.

Ofwat says that its PCD will not allow substitution from grey and grey-hybrid to 'green only' solutions (although companies can deliver more green storage as part of a grey-hybrid scheme). It is not clear whether Ofwat classifies wetlands schemes as a green-only solution, but, as they are covered by another PCD, we assume that it would not be permissible to do so. This is disappointing. We are committed to making greater use of nature-based solutions across our investment programme. We have identified 36 schemes where a wetland can be used to address the harm caused by storm overflow improvements. However, as our investigations and design work progress during the rest of AMP7 and early in AMP8, we will continue to look for opportunities to make greater use of these or other green solutions which are more environmentally friendly than traditional grey storage solutions. Ofwat's PCD framework would prevent us from capitalising on such opportunities.

Ofwat justifies this approach on the basis that it has allowed a higher unit allowance for green solution types compared to grey and grey-hybrid solutions. We do not understand why this should prevent a company from making greater use of green solutions (including wetlands) using the storm overflow enhancement allowance that is set. If a company can achieve SODRP requirements and deliver the same environmental outcome through these solutions using the same funding, this is demonstrably a good thing for the environment and Ofwat's PCD framework must be sufficiently flexible to ensure these benefits can be realised. We request that Ofwat amends the conditions for this PCD to allow for greater use of green solutions (including wetlands schemes) by allowing substituting these for grey-only schemes, where there is EA agreement that this change would be beneficial for the environment.

Ofwat also states that companies can change storm overflow location provided that it addresses all high priority sites and secures approval from Environment Agency. There may be circumstances in which it is beneficial to replace a storm overflow at a high priority site with one at a different sensitive location. We consider that it should be for the EA to determine whether a change to the list of storm overflow improvements in a company's WINEP is beneficial, rather than imposing an additional constraint which limits the EA's ability to make judgements about WINEP changes during AMP8. The PCD framework must be designed to accommodate agreements between companies and the EA, otherwise it risks prohibiting changes which are in the interests of customers, the environment and wider society.

Delivery profile

As set out in Section 2, we disagree with Ofwat's proposed delivery profile used to determine time-incentive payments for this PCD. We do not consider it appropriate for Ofwat to intervene to effectively determine companies' delivery programmes when they have already been developed and optimised to meet relevant regulatory and statutory deadlines. For storm overflows, we will be progressing many grey storage schemes simultaneously during AMP8 due to the significant lead times involved in detailed design and construction work, and so we expect the majority of outputs to be completed towards the end of the AMP. We are not currently forecasting any outputs to be completed during year 1 of AMP8 as this is when we will be continuing detailed design, land purchase and other preparatory work continues from initial work carried out as part of AMP8 transition.

We consider that time incentive PCDs, where these are considered necessary, should be set based on companies' internal delivery profiles that have been developed to meet relevant regulatory dates.

We set out our proposed delivery profile for all 128 storm overflow improvements in our PR24 business plan PCD proposal (Table 22), which states that we are not planning to deliver any schemes by 2026/27:

Table 6 - Number of storm overflow improvements per year of AMP8 (taken from our PR24 plan table 22):

	2025-26	2026-27	2027-28	2028-29	2029-30
Number all SO improvements schemes delivered in PR24 plan	0	15	28	39	46

Table 7 below set out the equivalent profile for the grey and grey-hybrid only storm overflow improvements in our plan, i.e. excluding wetlands schemes which are not covered by this PCD. It also sets out the volumes of equivalent storage delivered.

This has been informed in part by the experience of AMP7. We have a target of delivering 13 storm overflow improvements under the U_IMP driver. We started designing the schemes before 2020, but delivery has been backend loaded due to the time it takes to design and build these schemes. We delivered the first two schemes in 2023/23 (year 3 of AMP7) and another scheme in 2023/24. We are delivering the remaining 10 schemes in 2024/25. This shows how challenging it is to deliver schemes in less than 3 years. While we are already progressing schemes, we do not therefore expect to deliver equivalent storage volumes until year 2 of AMP8 at the earliest, due to these lead times.

Table 7 – Proposed storm overflow (grey-hybrid solutions) delivery profile

	2025-26	2026-27	2027-28	2028-29	2029-30
Number of Grey and Grey-hybrid schemes	0	10	20	28	34
Volume of equivalent storage delivered	0%	10%	22%	30%	38%
Number of Grey and Grey-hybrid schemes (cumulative)	0	10	30	58	92

Volume of equivalent storage delivered (cumulative)	0%	10%	32%	62%	100%

Overall, we consider this profile is extremely challenging particularly as the storm overflows programme is affected by many factors outside our control. We request that Ofwat amends its delivery profile to align with this.

Exclusion of late schemes added to WINEP

We note that Table 5 excludes the storm overflow improvements that we have added to our business plan since October 2023, specifically to address new inland bathing water designations and improvements at Poole Harbour shellfish waters. These are new requirements and have recently been added to the WINEP as holding lines. While we have included our best view of the required solutions in these areas, as requested by Ofwat, there is significant uncertainty about these as we have not undertaken detailed modelling work. We also expect there to be further changes in this area including on regulatory dates, pending further discussions with the EA. In light of this uncertainty caused by this very late addition to the WINEP, we consider these specific improvements should not be included in a PCD.

All other things equal, the inclusion of these improvements would make the profile in Table 5 even more challenging as the preparatory work for these improvements is less-well progressed.

Measurement of equivalent storage

Ofwat proposes that companies should measure equivalent storage as the volume of storage required to meet the target spill frequency set by the Storm Overflow Discharge Reduction Plan. The model used to assess equivalent storage should be fit for purpose and constructed in accordance with the Code of Practice for the Hydraulic Modelling of Urban Drainage Systems, CIWEM UDG, 2017.

Ofwat seeks views on further assumptions that should be defined to ensure consistency, such as whether the default assessment should be based on offline tanks; whether there is a need to define when tanks should begin to drain down or define return pump rates, as we are aware that these could significantly influence storage volume. We do not propose any further levels of complexity are necessary.

For some schemes in sensitive environments, we have assumed a higher level of performance than minimum requirement in the SODRP of 10 discharges per year. If the ‘no harm’ investigation (due in 2027) relaxes the performance requirement, then we may deliver lower volumes to meet the required performance whilst ensuring best value investment.

3.2.3. Storm overflows (wetlands)

Ofwat has proposed a separate storm overflow PCD to cover our wetlands programme, for delivery by 2030.

Ofwat states that if wetlands are determined not to be a suitable storm overflow spill reduction solution by reference to the Urban Wastewater Treatment (England and Wales) Regulations, companies must deliver an alternative solution to meet their legal obligations and the targets of the Storm Overflows Reduction Plan and either provide the required spill reduction solution using an alternative scheme or consider delivering solutions at alternative sites.

We welcome the flexibility afforded by this approach. As set out in our PR24 business plan, we are continuing to work with Defra and the Environment Agency to determine whether wetlands could be used as storm overflow solutions primarily at groundwater-induced overflows. This is the subject of ongoing discussions. We are committed to making use of nature-based solutions such as these to address the harm caused by storm overflows and we will continue to engage constructively with regulators on the benefits of this approach during the rest of AMP7.

However, should we not be able to obtain agreement on this approach, we will substitute schemes for storage solutions, which we recognise will be assessed through the grey hybrid equivalent storage model.

We consider this is consistent with the SODRP which states that: *'We are aware that green infrastructure enhancements often have longer delivery timelines than traditional concrete solutions and may therefore be seen as riskier investments by water companies. For that reason, the Environment Agency and Ofwat will work to ensure assessment processes promote and incentivise the use of nature-based solution in favour of more carbon intensive alternatives. To promote sustainable solutions, green infrastructure projects started before 2027 and delivered as quickly as possible will count towards completion of the targets, subject to review".'*

More detail is provided in document WSX-C11 - Enhancement costs - storm overflows. We note that, as set out in WSX-C11, since our original business plan submission, we have slightly revised our forecast wetland area (from 32.4 to 30.0 hectares) to be delivered in AMP8.

3.2.4. Phosphorus removal

We have significant concerns with the design of Ofwat's PCD for P-removal, particularly the delivery profile that is being used to set time-incentive payments. This is set out in more detail below.

Delivery profile

As set out in Section 2, we disagree with Ofwat's proposed delivery profile used to determine time-incentive payments. We do not consider it appropriate for Ofwat to intervene to effectively determine companies' delivery programmes when they have already been developed and optimised to meet relevant regulatory and statutory deadlines.

We will be progressing many P-removal schemes simultaneously during AMP8 due to the significant lead times involved in detailed design and construction work, and so we expect the majority of outputs to be completed towards the end of the AMP. Ofwat recognises the relatively longer lead time required to design and deliver phosphorus removal upgrades, and states that it has amended its delivery profile accordingly. However, a 'one-size-fits all' approach to setting delivery profiles is not appropriate for an investment programme such as P-removal, where there is major variation in companies' programmes.

- Our P-removal programme is one of the largest programmes of all companies – covering around 130 separate schemes and over £900 million in investment. In contrast, Northumbrian Water has requested just £25 million for a P-removal programme covering 6 schemes. Moreover, the profile of schemes within each company's programme is different. The delivery profiles for programmes of such varying size and scope would not be expected to be common.
- Our P-removal programme includes twelve major schemes that together account for more than 35% of total PE served – with the combined PE at our largest three P removal sites delivering in AMP8 (Poole, Taunton and Salisbury) being 366,536, or 26% of total PE. These schemes all face significant lead times including land purchase requirements, and the lead times involved mean there is no prospect of delivering these schemes earlier in AMP8. This means that purely based on these schemes alone, the proposed delivery profile is not achievable or realistic.

For these reasons, we consider that time incentive PCDs, where these are considered necessary, should be set based on companies' internal delivery profiles that have been developed to meet relevant regulatory dates, reflecting company-specific circumstances. It is not realistic to expect all companies to have delivered the same proportion of cumulative PE delivered at a given point in AMP8, nor is it necessary to ensure customers are protected from non-delivery as all companies will be subject to non-delivery penalties at the end of AMP8.

This is a very material issue because of the scale of the time-incentive penalties that could arise. As set out in Section 2, we forecast that the proposed profile will result in us incurring a time incentive penalty of **£15 million** for

the P-removal PCD even if we deliver our programme according to our internal planning, which has been developed and optimised to meet WINEP regulatory dates. In other words, we would be expecting a penalty of this magnitude even if we deliver our entire programme over the course of AMP8 by the EA's specified dates.

Our latest delivery profile, reflecting the changes to our nutrients programme made since business plan submission, is set out in Table 8 below. For the purposes of completing this table, we have used the average forecast served PE (2025/26 - 2029/30), irrespective of delivery year[11].

We request that Ofwat amends its delivery profile to align with this. This reflects the specific nature of our nutrients upgrade and our view on the optimal delivery programme.

Table 8 – Proposed P-removal delivery profile

	2025-26	2026-27	2027-28	2028-29	2029-30
Cumulative Number of schemes	0	7	21	29	124
Cumulative PE ('000s)	0	11,300	35,855	112,057	1,384,260
Proportion of PE served	0%	0.8%	2.6%	8.1%	100%

Non-delivery penalties for investment which is slightly late in AMP9.

Our P-removal programme consists of several major projects along with a large number of smaller upgrades. As set out above, we have undertaken major work to assess and refine our deliverability programmes for the largest schemes. However, the lead times involved mean there is no prospect of delivering these schemes earlier in AMP8, and there remains a risk that one or more of these schemes may not be fully operational by the end of AMP8.

As explained above, in such circumstances where external constraints could impact delivery, we do not consider these schemes should incur a non-delivery penalty. We consider a non-delivery penalty should be reserved for instances where companies completely fail to deliver a proportion of its funded enhancement programme, rather than for delays impacting a live delivery programme, taking it into AMP9.

To address this, we propose that Ofwat could continue to apply a time-incentive payment for all P-removal schemes which are still due to complete at some point in AMP9 (whether or not this falls within a few months of AMP9).

Exclusion of schemes with completion dates beyond AMP8

As described in all relevant PR24 documents, the PR24 phosphorus removal scheme at Holdenhurst WRC (08WW102049) has a WINEP completion date of 31/03/2033, as agreed with the Environment Agency. In the development of the WINEP with the Environment Agency we agreed to provide additional treatment at nearby Corfe Mullen WRC (08WW102045) beyond that required to meet localised water quality objectives, to allow for the

[11] For PCD profiling, Ofwat have used "PE served", although do not provide the underlying calculation of how they have derived these values. We believe it to be the average of our provided 5-year forecasts (2025/26 thru 2029/30), although are unable to exactly reconcile with Ofwat's number.

Holdenhurst scheme to have a 2033 completion date. This was also in recognition of the complexity of the scheme and that Holdenhurst was being upgraded in AMP7 for phosphorus removal.

The phosphorus removal PCD for Holdenhurst WRC (08WW102049) therefore needs to be amended. We acknowledge the complexities of overlap schemes and would seek to work with Ofwat in agreeing an appropriate PCD for Holdenhurst, if necessary, e.g. with an AMP8 expenditure target, to ensure customers are not paying twice when we request additional funds to complete the scheme through PR29.

3.2.5. Nitrogen removal

As with P-removal, and given the major, lumpy nature of this investment, we propose that the non-delivery payment for N-removal schemes should not be applied where schemes are in progress. Instead, Ofwat could continue to apply a time-incentive payment for all N-removal schemes which are still due to complete at some point in AMP9 (whether or not this falls within a few months of AMP9).

3.2.6. Growth at STWs

We have concerns with the design of Ofwat's PCD for growth at STWs, which is highly prescriptive and does not reflect the potential for changes to companies' growth programmes to deliver the best possible solutions for customers and the environment.

Companies' STW growth programmes, while comprised of individual schemes, are (and always have been) a programme of works that is based on funding, risk and prioritisation at a point in time. This includes alignment of schemes alongside quality enhancement to drive cost efficiencies.

The sites and growth proposals included in our business plan were our latest view at time of submission in October 2023. Since preparing the business plan, we were subsequently made aware of localised growth pressures in several catchments – linked with specific developments (housing and/or commercial) or trader expansions – that is placing emergent compliance risk on our treatment works. For this reason, we included in a subsequent submission to Ofwat a further 16 'at risk' sites that may require growth enhancement in the short/medium term, be it capacity and/or dry weather flow related.

Consistent with Ofwat's guidance, we have since made further changes to our programme in our revised business plan data tables as part of our draft determination response. This reflects the latest available information and reflects an updated view of requirements as of July 2024.

This illustrates that companies' STW growth programme are regularly evolving to meet the latest requirements. We will continue to assess and monitor these STWs and prioritise based on compliance risk in the AMP cycle. The need to enhance some of the originally included sites has been reduced or re-prioritised, based on any updated view on funding, risk and prioritisation, while other STWs may need to come into the programme.

In light of this, we have significant concerns that Ofwat's PCD will prevent us from optimising our STW programme. Our concerns can be summarised as follows:

- Ofwat has said it will allow companies to change the scope or substitute a scheme due to changing population growth forecasts in their service areas. We welcome this; for the reasons set out above we would expect this to be necessary during AMP8. However, Ofwat also states that companies should inform Ofwat of any substitution in a timely manner, including third party assurance, and it will approve changes in schemes in the PR24 end-of-period reconciliation.
    - The requirement for third party assurance has the potential to be onerous for companies, given the extent of changes that are likely to be seen in AMP8. In AMP7, for instance, 48% of WRCs with growth investment in AMP7 were not listed in our PR19 business plan (7 WRCs were reprioritised while a further 12 sites have come into the delivery programme), reflecting the likely extent of changes as

companies optimise their programme in light of the latest information. It also creates a risk of delays to programme changes, which do not neatly align with reporting cycles and would affect companies' ability to deliver on their overall programme by the end of AMP8.

- This approach also leaves companies open to risk that Ofwat will not approve some changes as part of its reconciliation exercise. This could deter companies from making such changes even where they are driven by clear changes in local population trends and therefore in the best interests of customers.

- Ofwat also states that companies cannot substitute in a scheme that has a change in the flow-to-full treatment (FFT) permit level without a corresponding change in the dry weather flow (DWF) permit level, or schemes that address previous non-compliance with DWF or FFT permit levels. This approach may discourage companies from addressing DWF issues by alternative means if they are then restricted to re-prioritise schemes in the most efficient manner. Historical FFT or DWF issues are not in any way reflective of future growth in the catchment and therefore should not limit a company's ability to address future needs.

Furthermore, Ofwat's approach to dealing with change may disincentive companies from making necessary changes to STW growth programmes. Ofwat proposes to allow companies to retain 6% of the allowance where they demonstrate that under-delivery is due to an investment no longer being required. There are likely to be circumstances where growth requirements change after a company has spent more than 6% of allowances on detailed design and preparatory work. Under this mechanism, companies may still be incentivised to complete the scheme to avoid a scheme-level PCD penalty. Rather than holding companies to the delivery of this scheme-based output, we consider it would be better if companies were able to allocate its overall STW growth allowance to redirect investment towards others alternative STW upgrades to meet its cumulative PE target by the end of AMP8.

These examples demonstrate that Ofwat's PCD design could produce adverse consequences that would worsen the efficiency of STW growth programmes, which in turn could hinder future housing and other development if STWs are not expanded in a timely manner.

We note that if the predicted growth for a site with an allowance is not likely to occur in the 2025-30 period as expected, but the company assesses that growth (and associated permit changes) will proceed in the 2030-35 period, Ofwat intends not to apply non-delivery payments in the PR24 end-of-period reconciliation. We welcome this proposal as it could partly mitigate the issues described above. However, we do not consider it fully addresses all the potential unintended consequences set out above. It is essential that companies are given the flexibility to optimise their growth programmes and are not disincentivised or restricted from re-optimising their programmes during AMP8 as need arise and circumstances change.

In light of this, we consider it would be more appropriate for the PCD to be based entirely on cumulative PE served. This would allow companies the flexibility to deliver the best possible growth programme during AMP8, taking account of changing requirements during the AMP, while still protecting customers by ensuring that the overall capacity improvements funded at PR24 are delivered (or penalties would apply if not). This consistent with our PR24 business plan proposal (see tables 31 and 32), and would strike a much more appropriate balance between Ofwat's objectives. It would also lower the regulatory burden for companies and Ofwat by removing the need for companies to report and agree each and every change to their growth programmes.

3.2.7. PR19 WINEP carry-over – Avonmouth FFT

Ofwat has proposed a PCD for the completion of our Avonmouth FFT scheme by March 2028.

We consider the approach Ofwat has taken here is inconsistent with its approach to assessing our enhancement cost allowance for this scheme. Ofwat's PR24 final methodology sets out that the purpose of PCDs is to protect customers against under or non-delivery of *funded* enhancements. Ofwat also recognises that this enhancement scheme has a revised full flow to treatment requirement of 5,300 litres per second, and a revised completion date, as required by the Environment Agency. However, Ofwat has not allowed any enhancement funding for the revised scope of this scheme in AMP8.

It is inconsistent to apply a PCD for this scheme without providing commensurate funding against which to protect consumers from non-delivery. This approach does not reflect the underlying purpose of PCDs and is tantamount to introducing a retrospective regulatory mechanism for the PR19 period.

If Ofwat accepts our request for enhancement funding in PR24 to deliver the revised scope of the Avonmouth FFT project (as set out in our separate representation WSX-C09), then this PCD can be set in accordance with Ofwat's PCD framework i.e. by linking to the PR24 enhancement funding allowance. If it does not, we should not be subject to a PR24 PCD for this investment area.

3.2.8. Bioresources - IED

Ofwat has proposed a PCD for the completion of IED upgrades at relevant sties. We have 5 such sites – at Poole, Trowbridge, Berry Hill, Taunton and Avonmouth.

Due to site rationalisation to maintain efficiency in bioresources, we will be closing the anaerobic digestion (AD) plant at Taunton. We will be decommissioning the AD plant in 2025-26 and converting the site to lime treatment. We will be surrendering the IED permit after the AD plant is decommissioned. As Taunton will not be an IED site in AMP8, we request that the PCD for Taunton is removed as well[12].

We also ask Ofwat to provide clarity on the deadline for the delivery of this PCD outputs. We will be engaging with the EA to agree an alternative IED delivery programme based on the best endeavours approach, but we are unlikely to have revised compliance dates agreed with the EA within the Draft Determination timeframe. While we acknowledge that Ofwat's proposed PCD delivery date of 31 March 2025 is to align with EA guidelines and timescales, we do not agree that this delivery date is reasonable because 100% compliance is not feasible by this date, due to the following reasons:

- We have not received all our IED permits from the EA,
- The EA has not confirmed the full scope of IED compliance (see WSX-C18 Section 7 on IED uncertainties),
- The scale of capital works in the IED programme.

Until we receive an agreed revised delivery date from the EA based on the best endeavours approach, we propose that the PCD delivery date to be revised to 31 March 2030 for all our IED sites. We understand from Ofwat that any non-delivery payments would apply at the end of AMP8, so we consider that aligning the delivery date with this date would ensure consistency.[13]

Finally, as with P-removal, and given the major, lumpy nature of this investment, we propose that the non-delivery payment for IED sites should not be applied where schemes are in progress. Instead, Ofwat could continue to apply a time-incentive payment for all IED schemes which are still due to complete.

[12] We have included the cost of decommissioning Taunton's AD plant as IED enhancement expenditure because the rationalisation is driven by IED compliance. As Taunton is removed as an IED site, we have allocated this cost in the IED enhancement expenditure for our IED sites.
[13] Question 15, QA-Price-control-deliverables-PCDs.pdf (ofwat.gov.uk).

3.3. Other PCDs

3.3.1. Mains renewals

Ofwat has proposed a PCD for all companies covering mains renewals activity. This is based on Ofwat's view of the base renewal rate which companies should be achieving. For Wessex Water, this is 0.48% per AMP – equivalent to 58.41kms of mains renewals per year.

Delivery target

We strongly disagree with Ofwat's target for mains renewal. We have long supported the water sector's ambition to move towards a sustainable mains replacement rate to maintain and improve asset health. One of the reasons why this is necessary is because the industry has historically received inadequate funding for capital maintenance. In our PR24 business plan, we submitted a cost adjustment claim to allow us to achieve a 0.4% rate of mains renewals. We consider this should increase further to 0.6% per annum in AMP9 with the long-term sustainable level likely to be between 0.8% and 1.0%. However, Ofwat has not upheld our cost adjustment claim.

We set out our views on base cost requirements in more detail in representation WSX-C01. This includes further evidence as to why a step change in capital maintenance funding is required to increase our level of mains renewals. In summary:

- Under Ofwat's Draft Determination proposal for base costs, we can only achieve a mains renewal rate of 0.24%. A renewal rate of 0.48% rate is not achievable.
- The delivery target for this PCD must therefore be amended accordingly to reflect the level of base funding that we receive in AMP8. If Ofwat amends our base cost allowance accordingly, in line with our request, the PCD target should be set at 0.4%. This is equivalent to around 48 kms per year. If there is no change to base cost allowances at Final Determination, this PCD target should be reduced to 0.24% per year.

We also note that the PCD is based on all mains renewals and does not distinguish between different parts of the network. This could disincentivise companies from undertaking trunk mains renewals as it is likely to be easier to deliver Ofwat's PCD target by renewing distribution mains. This could distort companies' asset replacement programmes in AMP8 away from the optimal mix of replacements, which is based on underlying asset condition and expected performance improvement. To address this, if this PCD is retained, Ofwat should consider setting separate rates for trunk mains and distribution mains reflecting the different costs for each activity.

Delivery profile

Ofwat has proposed a flat delivery profile for this PCD, but it has asked companies to submit a reprofile for consideration at final determination. We consider that a flat profile is reasonable when the target is adjusted appropriately as discussed above.

Table 9 – Proposed mains renewals delivery profile

	2025-26	2026-27	2027-28	2028-29	2029-30
Base wholesale water model funded renewals (kms)	48.7	48.7	48.7	48.7	48.7

3.3.2. Investigations (water and wastewater)

We note Ofwat's PCD proposals in respect of water and wastewater WINEP investigations. In particular, we note that Ofwat will review this PCD between draft and final determinations to reflect any changes in the number, categorisation or completion date of investigations made by the Environment Agency. We welcome this – in particular, our wastewater investigations programme has changed since our business plan submission. This is discussed in more detail in our representation WSX-C16 and reflected in our revised data tables (table CWW20).

Regarding the PCD deliverable, Ofwat states that companies must secure confirmation from the Environment Agency that investigations have been satisfactorily completed in accordance with WINEP obligations. In our PR24 business plan, we proposed that the PCD deliverable should be claimed when the relevant report is sent to the Environment Agency. This is to mitigate the risk that a company could incur a PCD penalty for reasons outside of its control, i.e. due to delays on the part of the EA. We remain of the view that this is a more appropriate delivery output. We also note that there appears to be an inconsistency in Ofwat's approach to setting the PCD output – water investigations are due at the end of AMP8, whereas wastewater investigations are due in year 3 of AMP8. We request that Ofwat either aligns its delivery dates for wastewater with water, which would mitigate the non-controllable risk to meeting this PCD created by potential EA delays in reviewing investigations, or it removes the PCD condition around EA confirmation.

Regarding the PCD payment rate, Ofwat has proposed two payment rates; one for simple / desk-based investigations (£0.0728m) and one for more complex investigations (£0.8175m) investigations. Ofwat has said where unit rates are higher for desk-based and simple investigations than complex investigations, the aggregated unit rate would be used – but this will be revisited for final determinations.

Given the variety in the type and nature of investigations, we agree with the need to distinguish between different investigations when setting payment rates. Otherwise, the payment rate could be significantly different to the true cost that should be returned to customers in the event of non-delivery of an investigation. However, we consider that within Ofwat's simple / desk-based category, there is still likely to be significant variation as this is a very broad class that covers two of Ofwat's original categories. Furthermore, the inclusion of storm overflow investigations – which have specific characteristics – is likely to increase the degree of averaging in this category. While we agree there is a balance to be struck here, if these investigations are included within the scope of a PCD, we suggest that Ofwat could look to disaggregate payment rates further e.g. by setting a specific rate for storm overflow investigations, or grouping by WINEP driver.

We note that for water investigations, payment rates have been set specifically for each individual WINEP investigation.

3.3.3. WINEP carryover PCD (Blagdon STW – Phosphorus removal)

Ofwat has proposed a PCD for PR19 WINEP actions that are unlikely to be delivered before the end of the 2020-25 period but are still required to be completed. One such PCD has been proposed for our PR19 programme – the phosphorus removal scheme at Blagdon STW.

This PCD would include a time incentive payment applied monthly from April 2025. Ofwat said this is because these actions should have been completed in PR19 and companies need to deliver them. Ofwat has also confirmed that it proposes to apply a late delivery PCD payment whether an alteration to the original PR19 WINEP date has been approved by the Environment Agency or not.

We disagree that time incentive PCDs should be applied in these circumstances. Where the Environment Agency has explicitly consented to a change to the delivery date for a scheme, recognising factors outside our control, the scheme has not been delivered late and so we are unclear as to why a late delivery PCD payment is applicable. In this case, the Blagdon scheme was subjected to significant delay due to third-party issues outside the control of Wessex Water, including: a change in Environmental Impact Assessment determination, land acquisition, and the

provision of new power supply and overhead HV diversion, involving protracted liaison with various stakeholders. This resulted in the EA changing the WINEP date for this scheme.

We also question whether Ofwat can retrospectively introduce a mechanism without prior warning which, as currently stated, relates to the completion of upgrades set during AMP7. This PCD was not in place when we secured approval from the relevant body to extend the WINEP date for this scheme, nor was there any suggestion that it would be introduced.

For these reasons, we request that Ofwat restricts this PCD to a non-delivery penalty that is applicable if the scheme has not completed by the revised WINEP data confirmed by the EA.

4. Delayed Delivery Clawback Mechanism

Ofwat has proposed to introduce a Delayed Delivery Clawback Mechanism (DDCM) for PR24. This would claw-back a proportion of revenue associated with unspent wholesale expenditure allowances if companies are behind in delivery. This sets out that a portion of revenues would be withheld if cumulative expenditure is less than 50% by end of year 2 of the allowance to March 2027, or 65% by end of year 3 of the allowance to March 2028. Any foregone revenues would be reinstated through reconciliations in PR29 if companies subsequently catch up their enhancement programmes.

We have concerns with this proposed mechanism. Our main concerns are as follows.

- It weakens incentive for companies to outperform if this meant they would significantly underspend FD allowances. Equally, it could force inefficient use of investment in order to not trigger this clawback. Judging from the QAA assessments on cost, 7 out of the 10 WaSCs had underspent relative to their allowances by the end of year 3 (March 2023) by 30% or more and yet still anticipate delivering their programmes on time overall. Setting an allowance in AMP8 at 65% would potentially trigger clawback for all 7 of these companies if the same conditions as in PR19 occurred in PR24.

- It removes the accountability from management to adjust the timing of investments resulting from significant shocks or stresses. In the PR19 period is entirely possible that in certain areas the expenditure profile will be considerably different to that in the PR19 final determination, for instance due to COVID-19. It also does not recognise the dynamic nature of delivering stretching targets while managing shocks and stresses from the outside world that mean programmes of work can materially vary at certain points in the AMP without necessarily impacting overall delivery.

- It adds another layer of regulatory complexity introduced at a late stage with no prior consultation.

It is important the executive and Boards are held to account for their company's performance and progress, and a key facet in delivering stretching performance at efficient cost is how to mitigate risks. As currently proposed, we consider this mechanism could create tension with this principle and we request that pauses any implementation of this until it has considered these issues and engaged further with industry.

To this end, we consider that our proposed uncertainty mechanism is an alternative way to provide customer protection against unspent revenues, while avoiding the need to set an arbitrary threshold for clawback, as it ensures that companies are funded upfront for areas where there is sufficient certainty over investment requirements. Our full proposal for this mechanism is set out in WSC-M07. We would welcome further engagement on these issues to ensure the best balance is struck for AMP8.

5. Responses to Ofwat's Draft Determination actions

For completeness, we set out in Table 10 where our responses to Ofwat's specific Draft Determination actions can be found.

Table 10 – Ofwat Draft Determination proforma – PCD actions

Area	Action	Response
Storm overflows	We welcome views on further assumptions that should be defined in order to ensure consistency, such as whether the default assessment should be based on offline tanks; whether there is a need to define when tanks should begin to drain down or define return pump rates, as we are aware that these could significantly influence storage volume.	We do not propose any further levels of complexity are necessary.
WINEP flow and monitoring PCDs	As the WINEP/NEP completion date is at the end of 2025-2030 period, we are not proposing to set a profile for these PCDs, but we welcome the company profiling of expenditure and delivery over the regulatory period.	We intend to revise the profiles for these PCDs set out in our business plan, as part of the first reporting requirement in autumn 2025. Expenditure profiles are captured in our data tables.
Mains renewal	We are introducing a mains replacement price control deliverable (PCD) for all water companies to ensure the sector prioritises asset health over the 2025-30 period and replaces the water mains it is funded to deliver. For draft determinations, we have applied a flat profile of renewals across the period for each company. We welcome companies to submit a reprofile for consideration at final determination.	Please see Section 3.3.1 for our proposed profile for this PCD, should a time-incentive payment continue to apply.
Time-based incentive payments	We considered whether a higher rate based on WACC plus run-off rate (Option 2) would be more appropriate. For draft determination we have used option 1 to inform our proposed PCDs but we will review this for final determination based on evidence on whether this provides sufficient inventive for timely delivery.	We consider Option 1 (WACC multiplied by the protected totex) is more appropriate than Option 2 (WACC plus run-off rate, multiplied by the protected totex). See Section 2.3.1 for further details.
	Alternatively, we could set an output band (say +/-20%) within which we would not apply either underperformance or outperformance payments. This would mitigate the risks for companies and customers but would dampen the incentives for timely delivery within the output band. We are keen to explore this alternative approach further and welcome stakeholder views on this alternative approach.	Notwithstanding our broader concerns with time-incentive payments, we consider Ofwat's framework would be improved by setting an output band within which underperformance or outperformance payments would not apply. See Section 2.3.1 for further details.
DDCM	Do you agree with the proposed 'Delayed Delivery Cashflow Mechanism'? If not, please indicate where you provide evidence in support of your response.	Please see Section 4 for our views on this question.