Consultation on regulatory reporting for the 2020-21 reporting year

Response on behalf of Severn Trent Water & Hafren Dyfrdwy

24 August 2020

WONDERFUL ON TAP

SEVERN TRENT

HAFREN DYFRDWY

Consultation on regulatory reporting for the 2020-21 reporting year

This response is provided on behalf of both Severn Trent Water and Hafren Dyfrdwy. In the document, references to “we” or “our” should be read as referring to both companies. Where necessary we have referenced the individual companies within our response to make clear where the response is not relevant to both companies.

Summary Response

We welcome this opportunity to comment on Ofwat’s proposals for regulatory reporting for 2020-21 and have set out our responses below.

Overall, we consider that the proposals will result in more consistent and transparent reporting across the sector, and we welcome the opportunity to provide feedback for potential future reporting requirements. We believe that the proposals strike an appropriate balance between achieving consistency of reporting between companies whilst allowing them the flexibility to ensure that their reports are relevant to their stakeholders and appropriately reflect their performance.

We are supportive of the move to 9 sections, promoting increased transparency of the price controls, and the updates to the RAGs, in particular, the streamlining of commentary requirements into RAG3. Where we have feedback or areas that require additional clarification, we have outlined these in this document.

If you have any queries or wish to discuss the response in more detail, please do not hesitate to contact me.

Rob McPheely
Group Financial Controller

Q1. What are your views on the proposed changes to the APR tables in Appendix 1?

We have included our response in Appendix A using the prescribed template. We would like to draw attention to our feedback on table 4H, line 5 on page22.

Q2. Do you think that the tables allow a comparison of performance to the PR19 business plan tables? Are there areas where this could be improved? Are there areas where we should consider deviating from the business plan formats?

In general, we think that the proposals allow a good comparison to the PR19 data tables.

As noted in our commentary for table 2C in Q1, at PR19 the retail control was changed to a uniform cost to serve applied across all types of customer. We think Ofwat should therefore consider whether collecting the information for all customer types is necessary given it is not required for comparing performance against the PR19 FD assumptions.

Q3. Do you think that the transactions between the price control units, in particular for the sludge liquors which Network+ treats on behalf of Bioresources, are sufficiently transparent? If not, please give examples as to how this could be improved.

A clear framework of how to charge for sludge liquors being returned is required to ensure all companies are transparent and consistent. However, there are concerns that increasing sludge liquor charges for sites where there is existing capacity to treat those liquors in WWR may lead to further investment in Bioresources – an inefficiency given current site infrastructure. We should consider liquor treatment in the round for the company and understand how the flow of value transfers to WWR or Bioresources if the investment is made in either price control. There are also concerns on the accuracy of the data available for any recharge mechanism as in line logging is not currently possible for return liquors.

We welcome further investigation into this topic and industry wide discussion.

Q4. Are there any practical presentational issues we should consider e.g. do any tables have too many lines to publish easily? Do you have any preference for landscape versus portrait format?

There are no new tables that have practical presentational issues. The most challenging existing tables we have been reporting on this AMP, namely 4L and 4M, we have developed solutions for. We have chosen to use landscape format in AMP6, and do not see that the revised tables would change this.

Q5. We are considering moving the 15 July deadline for the APR publication earlier in July so that we can more easily accommodate the in-period determinations. Would it be practical to implement such a change?

We believe the 15 July reporting date has worked well over AMP6, which, whilst challenging, has given enough time for us to complete our robust assurance processes. However, we believe that, with enough notice, it could be possible to bring this date forward to accommodate in-period determinations.

The main practical challenges to an amendment in this date are:

- We operate a rigorous governance process for the review and approval of our APRs involving, inter alia, our Boards and Audit Committee. These meetings are set more than 12 months in advance to ensure availability of our non-executive directors and the meetings for the FY21 reporting season have already been arranged. If we had to change these dates to accommodate an earlier reporting deadline we may not be able to find alternative dates when all the required participants would be available.
- The additional reporting requirements arising from this consultation will result in an increased workload that will fall on the same teams as those who prepare the existing reporting requirements. Any acceleration of the reporting deadline would require additional resource to be deployed to meet it, which would need to be considered.

Q6. Do you agree that we should embed the ODI performance model within the annual performance reporting tables?

Yes, we agree that it is sensible to embed the ODI performance model within the APR tables. We have no specific comments on the structure of the table and think it sensible to align reporting of common measures and that Ofwat should clearly identify sections that are not applicable to water only companies.

We note two further comments on table 3A:

Management override of ODI calculations

Severn Trent's experiences as one of only three companies operating in-period ODIs during AMP6 exposed that, on occasion, our management took decisions in customers' interest to vary the mechanistic ODI calculation. This may have been to claim less than the full outperformance payment earned, or to pay additional penalties. This was easier to demonstrate through reporting of the formula driven ODI value in table 3A, than explaining the variances in both the commentary and our in-period ODI model submission in the September.

Our recommendation would be to report the formula driven ODI calculation within table 3A as it is currently structured. An additional column should be added that requires companies to report the ODI value to be passed through to bills which would ensure transparency of any management decisions taken to override the calculation.

Cumulative ODI forecasts

We see little benefit in providing the full AMP forecast information. We note that these columns were included in the AMP6 version of table 3A; we did not provide these forecasts as the information is considered market sensitive.

We would further note that the experience of providing the measure specific forecasts for 2019/20 as part of PR19 and the subsequent reconciliation demonstrates that it is extremely difficult to forecast with accuracy at such a detailed level. This is exacerbated further when trying to forecast multiple years into the future. We further expect that there would need to be a detailed reconciliation between any forecasts provided and the actual performance

delivered which is likely to add a significant reporting burden to companies and reduce the transparency of information provided.

If these columns are retained for AMP7 then we expect to continue to provide a nil-return for both Severn Trent Water and Hafren Dyfrdwy.

Instead we would be supportive of using these columns to show the cumulative ODI position based on actual performance across AMP7. This would be a useful way of understanding how companies are balancing their performance across measures.

We note here that there is no specific question on the information included in table 3B. We have the following comments:

1. Table 3B significantly increases the level of information sought on a number of performance commitments and we would question the benefit of supplying this. Our assumption is that the intention is to ensure correct calculation of the outturn performance reported on table 3A. If so, we would question the need given the significant effort and expense incurred by companies to undertake a robust assurance programme including review by independent, technical assurance partners. Reporting this further level of data will inevitably drive an increase in our assurance requirements and cost.
2. However, if the information is required, we believe there are ways to simplify the process and reduce the number of input values. Much of the information needed in the normalisation of measures is included elsewhere within the APR data suite. Wherever possible the data required for table 3B should be linked to relevant cells in other tables to automatically copy the information and reduce number of input fields (e.g. length of sewer).
3. Similarly, the final column on table 3B should include the formula to calculate the outturn performance commitment value to further reduce the number of input fields.
4. Given the standardised structure of table 3A we would suggest that column 6 of table 3A could also be linked to the relevant cell on table 3B to auto-populate the actual performance and again reduce the number of input cells.

Q7. Do you agree that companies should report performance against the PR19 asset health long list on table 3E?
If so, should information be restricted to water companies and regulators or made publicly available?

We do not agree that it is appropriate to collect information on the asset health long list in table 3E. Firstly, by not mandating that all companies include all measures on the asset health long list gave the industry freedom to explore new and innovative ways of measuring performance; agreeing with our customers and stakeholders how we should do this. Requiring all companies to report on this information will undermine the trust in the outcomes framework moving forward.

We agree in principle that table 3E should exist to collect information on future common measure once they have been confirmed as part of the PR24 programme, but until such time it is not appropriate to collect any information on table 3E.

Our specific comments by measure are:
Properties at risk of low pressure – Severn Trent has worked hard to develop a new, innovative way to consider low pressure risk that will fundamentally change how we consider pressure issues. The asset health measure is

not a true view of risk, it is a lag measure of what is essentially properties that are disproportionately expensive to remove with traditional solutions. By requiring us to report the measure in a different format will add regulatory burden for no customer benefit. Furthermore, the asset health measure reflects only the properties on the register on 31 March of each year which does not demonstrate the significant change in the register during the year as properties breach the pressure limits and solutions are put in place to fix the issues. We would note that Hafren Dyfrdwy is using the asset health measure and, therefore, reporting it on table 3E is a duplication.

Sewer blockages – this information is already collected in table 7C, line 5 so including here is a duplication.

External sewer flooding – Hafren Dyfrdwy agreed with its customers that it would not include this measure as part of the AMP7 suite of performance commitments. By including it here it will increase the regulatory burden for no customer benefit. For Severn Trent Water this would be a duplication of information reported on table 3A.

Non-infra maintenance – as a company we are evolving our approach to asset health to consider overall operational effectiveness. This approach, used extensively outside of the water industry, considers asset availability, productivity and quality at any time to ensure our assets are working at optimal level and any deterioration is identified and corrected. Requiring us to report on a historic approach to maintenance will increase the regulatory burden and reduce the freedom we have as a company to explore new and innovative ways to measure asset health.

If Ofwat does mandate this information, then we see no reason why it should not be publicly available. We would, however, suggest that the data requests are added to other tables in the APR (sections 5 to 8) to keep the purity of table 3E for such time that an AMP8 priority is confirmed as part of the PR24 process.

Q8. Developer services are open to competition. Most site-specific services are contestable and can be provided by an undertaker (incumbent company or NAV), self-lay provider (SLP) or (primarily in the case of sewers) developers.
We are introducing a new table 2N for developer services to measure the level of third-party activity in areas served by incumbent companies. This should enable us to measure that activity in a way that ensures the information is insightful and consistent. It will provide an insight on how competition in developer services is evolving over time.
We have also added granularity for our cost information for growth-related expenditure in tables 4L and 4M. We propose a re-definition of our cost lines to capture the main elements of growth activities, and to capture specific on-site and off-site costs separately.
We welcome comments and views on our proposed approach.

Given the way in which it was regulated in PR19, we understand the need and rationale to gain a greater understanding of the developer services market. Therefore, the activity and cost information proposed in Tables 2N, 4L and 4M appears a sensible progression.

Based on our experiences from PR19, there is a high likelihood that companies consider some of the definitions relating to developer services activities in slightly different ways. Therefore, we suggest that line definitions / table guidance should be tightened up to improve the likelihood the data will be reported in a consistent manner.

We make the following observations where the proposed data lines might lead to ambiguity and therefore, should be considered further.

2N.1-3 and 2N.5-10 (Definitions for new connections and new properties): Based on analysis of PR19 data submissions, it appears that companies might consider the specific definitions for new properties and new connections in different ways. Therefore, it would be helpful if the table guidance / line definitions were more explicit.

We consider that a new connection in this context is a physical connection between a new property (or properties), and a new or existing water main / sewer. We consider that a new property in this context is a new future billed property, i.e. residential apartments will likely deliver multiple new properties derived from one new connection. Note that, depending on the specific definition, this may lead to variances with property data reported elsewhere in the APR.

It would also be helpful to clarify that 'source of water connections' (i.e. a connection between an existing main and a new requisition main on a development site) should not be counted here.

2N.4 & 12 (SLP new connections activity): The proposed data line seeks the number of new connections (and properties) where self-lay providers completed the service connections. We assume that you require the activities of both SLPs and developers to be reported against this line.

It would also be helpful to clarify the activities that are to be considered as relating to the 'service connection', and whether this should be interpreted as the SLP / developer completing all aspects, or some aspects, of the activity.

For water, we consider that new connections activity could include: Laying of service / supply / communication pipe; Installation of meter and stop tap; and Physical connection with existing / requisition main.
For wastewater, we consider that new connections activity could include: Laying of lateral drain; physical connection with existing / requisition sewer; and sewer adoption activities.

2N.11 (Total new properties): It would be helpful to clarify how this should interact with data elsewhere in the APR. e.g. Should properties reported here relate to the new connections made in the year rather than the new properties billed in the year? Note also that change in billed properties should be a function of new properties billed (rather than connected), change in void properties and disconnections/demolitions completed.

2N.13 & 14 (Length of requisition mains): The table does not currently require data on the length of new development related sewers (either delivered by the company or the SLP/developer). Note that the proportion of new development related sewer laying work undertaken by appointees and SLP/developers is likely to be materially different to water.

4L.2 (New mains): For clarity, the line and definition should refer to requisition mains.

4L.3 (Other on-site costs): To aid clarity, the line definition should set out that 'source of water' connections expenditure should be included here. This would make sure that this expenditure does not dilute any new property connections unit cost analysis that might be undertaken.

4L.5 (other off-site costs): It is not clear what expenditure is expected on this line. Expenditure relating to upsizing of existing network assets should be recorded in 4L.4. Is the intention that this should relate to new infrastructure

activity where the development site is not directly adjacent to a development site? Further guidance would be helpful.

4L.7-12, 4M.7-12 (growth operating expenditure): We consider that the disaggregation of growth opex may be disproportionate. Resource costs relating to specific growth activities are likely to be capitalised and opex costs relating the management or development applications are not likely to be generic to all of the activities.

4M.1 (On-site costs): The line definition should state that all on-site activity completed by the appointee should be included in this line. We consider that this could include: laying of lateral drains and new sewers; physical connection with existing / requisition sewer; and sewer adoption activities.

4M.3 (Other off-site costs): It is not clear what expenditure is expected on this line. Expenditure relating to upsizing of existing network assets should be recorded in 4M.2. Is the intention that this should relate to new infrastructure activity where the development site is not directly adjacent to a development site? Further guidance would be helpful.
We note that 4M.4 states that growth related expenditure at sludge treatment facilities should be included in 4M.3. Accepting the comments above, it would be clearer to explicitly state that in the definition for 4M.4, or change the title of the line to 'Growth at Sludge Treatment facilities".

4M.6 (total growth expenditure): We understand that Sewage Treatment Growth and Sewer flooding activity are both indirectly impacted by new development activity and that the costs were modelled together with new development during PR19. However, we suggest that it might be confusing to show them as part of a growth expenditure total. These costs do not relate to the activities of developers, are not contestable and have no direct influence on developer services charges.

Q9. We currently calculate the reconciliation in table 2K using infrastructure charges before any efficiency discounts. We are aware of some views that this should be changed to use infrastructure charges after discounts. What are your views on this?

We do not believe that the current approach requires changing.

Q10. Is there scope to rationalise the number of areas where we ask for specific assurance?

We believe that the Company Monitoring Framework provided a sound framework to enable companies to deliver data and information that is clear, transparent and accurate. We recognise that Ofwat needs to set an outline framework and expectation for assurance to protect customers while balancing that with the ability for Boards to make the decisions on the way that they deliver the assurance. The principle of the Company Monitoring Framework largely allowed those decisions to be made.

As a Listed company we already do more than the minimum requirements of assurance. We believe the intent of the requirements for assurance prescribed by Ofwat are at the correct level, however there are examples of where less specificity of assurance requirements would allow companies to meet the intent of the Ofwat request with less conflict with other requirements; as an example, table 1F has caused issues as to what our Auditor can provide consistent with its own compliance with the request of Ofwat. A more pragmatic approach to meeting the overall

assurance of the APR chapters 1 and 2 would enable us to satisfy the requirements of assurance in these areas and meet the intent of Ofwat's requirement without providing the exact specificity.

As outlined in our PR19 plan, our intent will be to continue to carry out assurance activities in line with our established risk based three lines of assurance. The non-prescriptive approach to enable our Board to make additional statements relating to information published is welcomed, to enable us to target our activities and associated assurance according to business need.

We are likely to continue with the spirit of a number of the CMF mechanisms in order to ensure that we continue to listen to customers and wider stakeholders and use their views to improve our practices.

Q11. We currently collect information on property and customer numbers, including voids etc, in various places in the APR. We could move all of this information into a single table – what are your views on this?
Are there any other useful metrics for property and customer numbers which we should specify?

Yes, we agree with the proposal to collect all property and customer numbers in a single table. There are no further metrics that we would propose.

Q12. Table 4U line 23: Total volume of network storage.
We are aware that companies have had difficulties completing this item and are concerned that this may mean there could be inconsistencies across the industry.
How might this definition be improved to avoid ambiguity and improve consistency of reporting?

We believe that the inconsistency related to reporting Line 4U23 is related to the impact of the potentially different assumptions made by companies due to missing data (e.g. pipe size, pipe shape) rather than any ambiguity of the definition. Our recommendation would be to have guidance on the methodology that should be used where infilling missing data.

Q13. Strategic water resources – we have included more granular information on bulk supplies revenues and volumes in our proposed table 4A in order to promote trading activity. Currently, for cost information, we have a single line for third party costs, of which bulk supplies is a constituent. We asked companies to forecast individual costs for new bulk supplies in their PR19 business plans. Is it practical to disclose granular cost information for bulk supplies?

Based on the proposed table 4A, it should be possible to disclose cost information for bulk supplies.

Q14. Social tariffs – we have proposed additional information to table 2F. Is this sufficient to provide a view of company activities in this area? What additional information should we consider adding to this table?

We are not sure that Table 2F is the best place to capture information on social tariffs and cross-subsidy. While it may be convenient to insert extra columns into an existing table, we do not see the need to analyse this additional information between single and dual service customers within Ofwat's regulatory framework.

Q11 asks whether information on property numbers should be moved to a single table rather than being collected in several parts of the APR. We think that it should. If the property numbers from 2F were placed in another table, Ofwat should consider streamlining this table to look at household revenue split between wholesale, retail, water and waste; possibly also the split between measured and unmeasured. We do not think the additional split of revenue between single and dual service customers serves any purpose within Ofwat's price control framework.

At PR19, the retail control was changed to provide a uniform correction to retail price limits, irrespective of the type of customer. We can see that there is still a requirement for the numbers of customers and an analysis of retail costs on this basis (Table 2C), because this information is used in Ofwat econometric modelling. But given the changes made for AMP7, Ofwat should consider whether collecting revenue information in this format is necessary.

The industry worked with Ofwat on an appropriate format for social tariffs in response to the recent information request. This included the following items, which would fit better in a separate table:

	Item		Water	Wastewater
1	Customers on social tariff	Nr		
2	Discount per customer receiving	£ 2dp		
	Customers on other subsidised tariffs	*Nr*		
3	Household customers not in receipt of subsidy	Nr		
4	Company funded subsidy	£m		
5	Social tariff cross-subsidy per customer	£/customer		
6	Level of support reflected in business plan	£/customer		
7	Maximum contribution supported by engagement	£/customer		
8	Revenue sacrifice per customer	£/customer		

We would add the line in italics – *customers on other subsidised tariffs* - to the Ofwat format to take account of WaterSure or any other subsidies that companies are providing. This enables a correct calculation of line 3 (customers not in receipt of subsidy) and ensures that the figures can be reconciled with total household numbers captured elsewhere.

This would be a reasonable format for reporting social tariff information - the draft for Table 2F does not capture the customer-funded element of the subsidy. The format is not perfect, because it only captures company support to customers through revenue sacrifice. Severn Trent provides support through a company trust fund, which is an operating cost rather than a reduction in revenue and this would not be included in the table; we would have to report this within the commentary.

Q15. We currently have a source type for direct effluent reuse. This is where treated effluent is diverted to network plus price control activities (either via a raw water transport asset, raw water storage asset or to a water treatment works for further treatment and treated water distribution). We define direct reuse as when the effluent does not return to the environment or to the water resources price control activities (abstraction asset before entering the water treatment works).
Although we consider indirect effluent reuse as being where an effluent discharge is diverted to a location (environment or water company water resource asset) purely for the purposes of abstraction for treatment and treated water distribution, we do not include this currently in the reporting of costs or sources.
Where do you currently report these sources and costs? If we were to introduce an indirect reuse source category do you agree with our definition above?

We do not currently have any sources that we classify as "direct effluent reuse", given the definition provided we also do not currently have any sources that we would in the future classify as "indirect effluent reuse" .
We agree that the definition of "indirect effluent reuse" is reasonable as it will only take into account effluent reuse where the effluent has been redirected specifically for reuse purposes.

Q16. In section 8 we have included new data requirements for Bioresources. Should we collect more data to support the Bioresources market?

We welcome the additional data requests and believe these are heading in the right direction for a more transparent industry.

As highlighted in #3, the data requested for sludge liquors will require significant estimation given logging of such material is not currently possible and requires manual samples to be taken that will be extrapolated for any calculations.

With regards to the energy incentives, we would suggest that further data be included such that the end date of specific incentives is more transparent. This will allow visibility of future changes in incentive income driven by the specific incentive conditions (such as RHI that is specific to site and commissioning date of the plant). Note that this final point references the updated data tables that were circulated by Ofwat following the Bioresources workshop.

Q17. We are introducing a new table 9A for the reporting of issues relating to the innovation competition. This is to collect the information required for the 'PR19 Innovation funding reconciliation model' in a format that will also provide stakeholders with relevant information to monitor how the company is performing against its allocated innovation competition fund price control revenue. We propose in section 3.16 of RAG 3.12 that companies provide commentary on its innovation competition spend.
Do the proposed new table, line definitions and commentary requirements capture the required information to support the reconciliation process? What additional information should we consider adding to this table?

We are supportive of the table 9A proposed by Ofwat and believe it will allow for transparent reporting of innovation expenditure. We think that the proposed lines are sufficient to support the reconciliation process.

We note that there is "Expenditure on innovation projects funded by shareholders", and there is no similar table for projects covered by company borrowing. It may be that a less granular view would be sufficient in this instance, and a potential solution could be to have a simpler table "Expenditure on innovation projects funded by company".

Q18. We propose new reporting requirements for small companies:
a. Customer-focused performance summary,
b. Per capita consumption (PCC),
c. Leakage; and,
d. Financial security.
What are your views on these proposals?

Not applicable to Severn Trent Water or Hafren Dyfrdwy.

Q19. What are your views on how we should collect the information to calculate the bilateral entry adjustment?

We think the main information required in order to calculate any Bilateral Entry Adjustment (BEA) would be:

- The volume of water that has been supplied, together with the volumes (or capacity) which the new entrant has agreed to supply in subsequent years.
- The Water Resource Zone (WRZ) where the supply is being made.
- The Annualised Unit Cost (AUC) of schemes in the company's Water Resource Management Plan that have been displaced as a result of bilateral entry.
- The value of equalisation payments made to the entrant (and also the expected values, based on the volumes the bilateral entrant has agreed to provide for the remainder of AMP7).
- The AUC of alternative schemes required as a result of bilateral entry.

As we noted in our response to the PR19 rule book, it is important that any "equalisation payment" to any new entrant is taken into account when calculating the BEA. The Equalisation Payment is supposed to bridge the difference between the company's average unit cost and the cost of developing incremental capacity; the

incumbent gives this to a new entrant so that it can compete. But this is the same value that the BEA returns to all customers (in the draft versions of the BEA adjustment model).

A company should not lose funding for new investment twice if there is bilateral entry, so any BEA should be calculated on the basis of displaced AUC less the equalisation payment. These may net to zero, but it is possible that bilateral entry might displace a scheme that was funded at PR19 without providing the full capacity that the original option would have delivered.

For example, if a WRZ had a single scheme which should have reduced its deficit by 10 Ml/a and a bilateral entrant provided only half of this, it might make the original solution uneconomic. The company might then need to find an alternative way of providing the additional 5 Ml/a; these costs should also be deducted from the net BEA that should apply to the incumbent.

Q20. We highlight proposals for Greenhouse gas emission reporting in section 4 'Future developments in performance reporting'. To what extent do you agree or disagree with these proposals and why? Could companies publish annual gross and net greenhouse gas emissions (in tCO2e) for both water and wastewater? Could this be done for both operational and embedded emissions?

Greenhouse gas emissions must be reduced and we welcome Ofwat's desire to consider how best to drive further reduction of direct and indirect emissions in our sector. This aligns well with the commitments that Severn Trent plc has made, as set out in our most recent statutory annual report and our sustainability report.

We have made stretching commitments on carbon

In addition to supporting the Water UK public interest commitment on carbon, in 2019 we made a specific 'triple pledge' commitment. This is to achieve by 2030:

- Net zero operational emissions
- 100% Electric or alternative fuel vehicles; and
- 100% of our electricity generated or sourced from renewable sources.

This pledge built on our carbon performance commitments for AMP6 and our 2020 target to generate the equivalent of 50% of our electricity use from renewable sources, which we met.

We were also the first water company to commit to setting and following science-based targets, which includes requirements to report and reduce indirect supply chain emissions, capital carbon and biogenic emissions.

We already report on our carbon footprint and the scope of reporting has increased

At a group level (Severn Trent Water, Hafren Dyfrdwy and our non-regulated activities) we already report our operational emissions publicly in our annual report and we have reported to the Carbon Disclosure Project (CDP) every year since 2006. We also report on our wider climate change risks and management in our sustainability report, which we are aligning to the guidelines of the Taskforce on Climate-related Financial Disclosure. From the end of the 2020-21 financial year we will also be reporting emissions under the science-based targets initiative.

Any additional reporting requirement from Ofwat would need to be weighed against the costs and benefits – particularly if the definitions mean different results to those currently published. However, we support more reporting if it will help promote lower-carbon options in the future.

Further reporting of emissions against a different regulatory boundary would add to regulatory burden and it is not apparent what benefit this would deliver. Values would also necessarily vary from our group reported values, which we believe may be confusing for customers.

However, we also recognise that Ofwat plays a critical role in unlocking further improvements in the journey to net zero. This is particularly the case for emissions in our sector which are unlikely to be sensitive to economy-wide policy incentives and so it is difficult to justify investment to reduce emissions from a pure cost benefit analysis.

A good example of the above are 'fugitive' emissions from our waste and bioresources treatment processes, which now make up around half of our total operational carbon emissions. The activated sludge process which we have deployed across the industry to effectively treat wastewater is effective but it results in emissions of nitrous oxide, a greenhouse gas. We know that our current optimisation of the aeration processes reduces these emissions to an extent, but it cannot reduce them to zero. The only solution to that would be to deploy new treatment processes which are less well developed or install some form of gas capture. Both solutions would require significant investment above and beyond what we would otherwise make to deliver the required customer and local environmental outcomes.

Similarly, across our sector we collect and digest sludge and subsequently combust millions of cubic metres of methane to generate renewable energy in our bioresources processes. This process generates renewable gas, heat and electricity and results in fewer emissions than alternative disposal routes such as incineration. However, emissions of methane still arise from sewers and from locations where we store sludge and dispose of biosolids.

We are already conducting research into how we can reduce emissions in these areas, along with other water companies. However, we believe the solutions required would be complex and costly and it's not apparent that the current framework makes provision for the investment which might be necessary to reduce these emissions to zero. Consequently, we think further regulatory focus and the associated reporting could be an important step in valuing these emissions and improving customer outcomes (ie, through innovative regulatory mechanisms to reveal the value and drive an economic case for substantive management of these emissions in the future).

We have mature operational carbon reporting and we think CO_2e is the best unit measure to use.

For operational carbon, we have sufficient maturity in our reporting to provide information at an appropriate level of robustness. We currently report internally on our water and waste emissions, in scope 1, 2 and some categories of scope 3 emissions and we can report both gross and net emissions. We think that CO_2 equivalent (CO_2e) is an appropriate and well understood total metric, so we do not see much value in reporting against separate greenhouse gasses.

Any further reporting should follow the international greenhouse gas protocol, in particular splitting emissions reporting into scopes 1, 2 and 3 and including the reporting of both market-based and location-based scope 2 emissions.

If appropriate guidance and definitions were developed, comparative information sufficient to baseline performance between companies might be possible within the identified 2020-2025 period. However, a reintroduction of regulatory emissions reporting would need to be closely reviewed to make sure that it aligns

closely to the latest international GHG protocol emissions reporting guidelines. An example of this is the need to follow the industry standard approach to accounting for scope 2 emissions. This requires the parallel reporting of grid electricity emissions against:

- Location based emissions intensity (i.e the emissions intensity of the UK energy grid); and
- Market based emissions intensity (i.e. the emissions intensity of the energy procured from your specific suppliers).

Ofwat's previous reporting of Greenhouse Gas emissions in Table 42 of the June Return[1] would be an appropriate starting point for a sensible level of reporting granularity but does need to be updated. This included the following breakdown:

Total gross emissions:
Scope 1

- Direct emissions from fossil fuel consumption;
- Process / Fugitive emissions from company assets; and
- Company owned transport emissions.

Scope 2 (purchased electricity)
Scope 3 (subset)

- Business travel on public transport; and
- Outsourced activities

Total net emissions:

- Total gross emissions (as above);
- Carbon benefit of renewable energy exports;
- Green energy procured (following the latest accounting standards this could be reflected through the market based emissions intensity of scope 2 emissions); and
- Carbon value of any offsets procured.

We have committed to begin reporting scope 3 emissions, including 'embedded' or 'capital' carbon but this area will require time to mature and will remain less comparable and controllable than operational emissions.
We have limited control over some of our most important scope 3 emissions and this should be carefully considered in any reporting or regulatory mechanisms being proposed. Before any reporting is introduced, consideration should be given to the full range of both upstream and downstream scope 3 emissions in the water sector. 'Embedded' emissions associated with capital interventions are only one type of scope 3 emission. Using the science-based targets initiative definitions, there are fifteen overall categories of relevant scope 3 emissions, within which there may be many hundreds of different suppliers responsible. These include areas like employee commuting, emissions from the manufacture of pipes and chemicals; construction companies disposal methods and water usage in the home, to name a few. All scope 3 emissions are owned by other bodies or companies and whilst we know can influence these areas, for example through design choices or selecting different suppliers, they are the ultimate responsibility of other stakeholders.

For example, energy use and carbon emissions from the use of water in homes and businesses is likely to far exceed our own operational emissions to abstract and treat that water. We have some influence over this with our water efficiency activity but as the Public Accounts Committee recently observed in its July report on water, Government must play a larger role in this area to effect any tangible change on water use behaviour in the home.

[1] (June Return 2011 reporting requirements: https://webarchive.nationalarchives.gov.uk/20150604004611/http://www.ofwat.gov.uk/content?id=07f6e8a1-2ef2-11e0-805b-21f1b94cbce2)

Regarding 'embedded' emissions specifically, we do not yet have the capability to measure the company wide emissions of our current programme in a bottom up way. Therefore, any estimates would require sizeable assumptions and estimates and we believe this remains the case for even companies who have been calculating these figures for some time. As part of our commitment to insourcing of our capital design functions, we are currently developing and testing a carbon tool which will reveal the carbon impacts of different capital interventions and enable us to better manage down embedded emissions throughout a project design and construction lifecycle. We are looking forward to seeing how we can evolve the tool, improving its robustness and effectiveness in capital decision making.

We acknowledge the breadth and potential materiality of scope 3 emissions, and the likely lack of comparative data that could be robustly benchmarked. We cannot currently report on embedded carbon emissions, but this might be feasible in AMP7 – potentially for 2022/23. A sensible intermediate step could be for companies to provide commentary on how scope 3 emissions are being considered, integrated into decision making and the most material barriers to their effective management. This could be through the APR process or as part of companies' wider corporate reporting (as is currently the case in our sustainability report).

Q21. We highlight proposals for nature-based solutions reporting in section 4 'Future developments in performance reporting'.

• To what extent do you agree or disagree with these proposals and why?

• Which type of nature-based solutions do you think should be included in any reporting, and how could they be reported against?

• What work do you think is required to establish relevant baselines?

We are supportive of Ofwat's intention to encourage the sector to increase its use of nature-based solutions. This correlates well with our own future aspirations as set out in our sustainability report.
As stated in the consultation document, nature-based solutions can take many forms and are likely to vary between companies depending on their local environments and the stakeholders working in their regions. Consequently, regulatory attention will also need to reflect and not stifle this diversity.

We consider that, over the longer term, the key to making material improvements in this area is to better reflect the value of natural capital when determining the efficiency of company business plans, and by the setting positive economic incentives as part of the price setting process. We would encourage Ofwat to have this in mind when exploring potential regulatory reporting options.

We consider that there are three broad approaches that Ofwat could follow with respect to developing reporting on the use of nature based solutions: reporting on activity delivered or indicators of expected longer term benefit; reporting on expenditure incurred; reporting on the benefits derived. All three have attendant strengths and weaknesses. They would all require careful development and clear guidance if they were to provide data of appropriate robustness and consistency. Some initial high level thinking is set out in the table below:

Potential Examples	Potential benefits	Potential issues
Reporting on activity delivered		
• Number of schemes (e.g. SUDS, Low carbon sewage treatment)	• In most cases, can be objectively measured and verified	• Type and scale of activity and will vary dramatically between companies depending on the landscape of the region. Reporting of activity will require

Potential Examples	Potential benefits	Potential issues
• Number of farm visits or number of farms implementing infrastructure improvements (e.g. catchment management) • Level of collaboration e.g. amount of match funding (amount of work with external stakeholders) • Biodiversity delivered (trees planted, hectares / km of watercourse improved	• Simple and of limited regulatory burden.	boundaries, effectively limiting the extent of nature-based solutions to those that are currently widely used across all companies. • Accounting for collaborative activity may be ambiguous. • The right type of activity needs to be measured to ensure that it represents and drives the right long term outcome.
Reporting on expenditure incurred (could be incremental or total expenditure)		
• Catchment management • SUDs • Low carbon sewage treatment / river basin management (reed beds, lagoons, wetland creation) • Biodiversity / habitat improvement	• Can be objectively measured and verified • Could be the basis of a comparative benchmark relative to total capital expenditure	• Difficult to disentangle volume delivered and efficiency of delivery. • Solutions can often be delivered collaboratively (total expenditure or expenditure contribution, could lead to spurious unit costs) • Would likely require a boundary to be set limiting the extent of nature based solutions to those that are currently widely used across all companies. • Incremental cost relative to traditional solution might be more appropriate for base interventions but not enhancement interventions. Added complexity.
Reporting on the benefits derived		
• Long term financial savings • Carbon abatement • Reduction in energy / carbon intensity (e.g. treatment CO_2e/ML/d) • Valuation of natural capital benefits delivered (measurement of economic externalities).	• Purist form of measuring comparative activity. • Does not require a boundary to be drawn around a set of nature based solutions. • Will help to reveal natural capital benefits not currently being considered in economic appraisal. Starting point for integration into regulatory price setting framework	• Usually requires consideration of the counterfactual. This is likely to be judgemental and difficult to compare / validate. • Requires robust valuation methodology. • Likely to require complex guidance and assurance. Therefore, could lead to a material increase in regulatory burden.

Q22. We highlight proposals for household bills reporting in section 4 'Household bills'.

• To what extent do you agree or disagree with these proposals and why?

• What additional information on household bills do you think should be included in the APR?

Publication of average bills

Ofwat already collects data on average bills in January each year. We supply the total household revenue for each service, the number of residential customers billed and the proforma calculates the average charge. At the point that charges are set for the coming year, the average bill is based on a forecast – in successive years, the values are updated becoming "provisional" and then "actual" once we have firmer information.

These are straightforward calculations; the combined bill is the sum of the two services. We do not think that the APR should attempt to replicate the combined bill calculation that Ofwat used in its financial model, which is much more complex and less transparent. The model has different approaches being used for retail and wholesale, and (for WaSCs) does not calculate water and sewerage bills that include retail. If it did so, the sum of these two parts would not add to the combined WaSC bill.

Average bills on the conventional basis (i.e. using the calculation method from the January proforma) have been collected in a continuous series since privatisation. If an alternative approach was adopted in the APR, this would be different from all historic bill figures that have been published. It would also be at odds with some charging requirements. For example WaterSure customers are required to have a bill that is capped at the average – the Ofwat PR19 calculation of combined bills does not meet the meet the definition of an "average" in the normal sense of the word. If alternative figures were published in the APR, WaterSure customers might ask why this was different from the amount they were being charged.

The data required to calculate the "actual" average bill is already captured within the APR: the number of residential customers and retail revenue (metered and unmetered) for each service can be calculated from the information in Table 2F. Therefore, if Ofwat was to include average bills in the APR, this should be a calculated table, applying the same method as the proforma that companies supply in January.

For ease of reference, we could also supply the forecast bill for the current year (this would be the same value as supplied in January). While it would be possible to update this to a provisional value we think this would have limited value - by the time the APR is prepared we will only be reaching the end of Q1, and the provisional figure would be updated again in January.

Statistical deciles for household bills

There are different ways in which customers could be classified by decile. We take this to mean deciles of bill size, which would mean the charges paid by the lowest 10% of households followed by each successive 10%. There are other ways in which we could segment the household base – for example, by income decile – but since we do not hold this information on our customers there would be a high level of extrapolation based on other data sources. For example, we could apply ONS information about socio-demographic bandings to our region of service, but we could not attribute bill values to these cohorts. From the information we do hold, the relationship between income and bill size is weak.

In principle, it should be possible to segment by bill size. By itself, this would represent a large increase in the reporting requirement – around 120 data items (numbers of customers and bills in 10 groups for each service and combined, measured and unmeasured). However, we could extract this type of data from our billing system. Where other companies supply water and bill sewerage on our behalf, it would require a significant amount of co-ordination with bordering companies.

Mapping customers in arears against these categories is also feasible, although it would add a further level of complexity; in deciles for water, waste and combined, measured and unmeasured this would represent another 240 data items. If we are not certain that there is a relationship between bill size and the likelihood of customers getting into debt this seems a large requirement to build into the APR.

It is more likely that households will struggle to pay if bills are significant relative to their income (especially disposable income). The data would not show this if the deciles are organised by bill size, and (as noted above) we do not hold income data for our whole customer base. When we are actively managing customers in debt they may provide this information so that we can assist with payment plans or other measures, but we do not have a right to collect it as a matter of course. In addition, since this data is volunteered (and sometimes relayed through third parties such this Citizens Advice), this information could not be verified to a reportable standard.

The industry has previously reported the age of outstanding debt as part of the old June return. A possible way forward would be to report the number of customers in arrears, together with the value of the debt in the age cohort. A simple calculation of the average amount per household in debt could then be built into the APR proforma if this is required.

Appendix 1

Table recommendations in response to Question 1

Table	Line	Issue
1F	2	A minor point but the line description should be labelled as "Actual performance adjustment 2015-20" (rather than 2010-15) as the adjustments relate to the period covered by PR14 not PR09
1F	5	With the introduction of allowed returns on a RPI/CPIH basis at PR19, we think it is important for Ofwat to be specific on which allowed real cost of debt that companies should use in the gearing calculation – i.e. cost of debt (CPIH stripped) or cost of debt (blend of RPI and CPIH stripped).
1F	7	As the intention of this line is to show the variation in the tax charge to the tax allowance in price limits, we think Ofwat should align the definition of this line with the Current tax reconciliation section (4.6.2) in RAG 3.12. This would ensure the financial flows analysis fully reflects the impact of all significant variations between the appointed current tax charge and the FD tax allowance.
1F	9	See comments on 4H.5 below
1F	9	There is a typo in the description for the line as the guidance states that the cost of debt (unadjusted for hedging instruments) should be less Financing total (line 1F.11) rather than Hedging instruments (1F.10)
1F	11	We do not think it is correct to add line 1F.3 Adjusted return on regulatory equity to the financing total as the base return (line 1F.3) is not a component of financing performance
2A	7-10	Principal Use recharges have been updated, which we welcome, but feel there could be further improvements to aid transparency and consistent reporting between companies: • For 2A it states, "It is assumed in this table principal user charges are included in the costs disclosed for each price control". We believe for reporting to be consistent it should be explicit whether these costs are being reported within operating expenditure (included in totex) or depreciation (excluded from totex). • For retail (table 2C) lines 2C.13-2C.17 explicitly set out the recharges. A similar approach for 2B (Wholesale), by adding in 2 or 4 lines (it may be beneficial to have pre/post 2015 split), would likely lead to move consistent reporting. • Additionally, table 2A could be reported as it has in AMP6, outside of operating expenditure. Then, there could be visible reconciliations between the recharges in tables 2B and 2C and table 2A.
2C	All	We note that the changes proposed for table 2C include an analysis of retail costs based on household customer type. At PR19, the retail control was changed to a uniform cost to serve applied across all customer types. We think Ofwat should therefore consider whether collecting the information in this format is necessary given the analysis is not required for comparing performance against PR19 FD assumptions
2C	12	We do not think that the 3 way split (pre 2015/2015-2020/post2020) is required. This was introduced as pre-2015 assets were retained in the Wholesale RCV, and therefore no charge should be included in retail when comparing to the final determination. The additional split adds a level of complexity which is not required. However, we do believe that whichever split is applied to depreciation should also be applied to amortisation.

Table	Line	Issue
2E	10	We welcome the changes that have been made to table 2E. Based on the proposals, we would recommend an update to the definition of line 2E.10 to explicitly state "this does not include any income offset" in RAG4.
2E	23	Similar to 2E.10, we would recommend an update to the definition of line 2E.10 to explicitly state "this does not include any income offset" in RAG4.
2F	All	Our feedback on this table is included in our response to question 14.
2I	All	We believe that it would be aid consistency of reporting across the industry if Ofwat were to provide clarification in the RAGs on how companies are expected to report actual revenues.
2N	All	This table should be moved to section 4 of the APR. If it remains in section 2, then it would be subject to audit opinion by a financial auditor, which we do not think is appropriate. Our feedback on the lines in this table has been included in our response to question 8.
2O	All	We think it may be easier to move this table next to table 2D, or to potentially combine them into a single table.
3A	All	Our feedback on this table is in our response to question 6.
3B	All	Our feedback on this table is in our response to question 6.
3D	All	Confirmation that the D-MeX final positions will not be provided until June presents us with two concerns explained below. To overcome these issues, we would seek clarity that the final D-MeX position will be provided in line with the timetable agreed for C-MeX: • Severn Trent Water's ODI outturn for the year forms a key part of Severn Trent Plc's results announcement in May of each year. The range of possible outcomes for the D-Mex ODI is £9 million and if this outcome is not known there could be significant uncertainty in the overall ODI result for the year. • Secondly, provision of the D-MeX data in June would then impact on our governance timetables to complete final assurance, production and sign-off of documents in time for the accelerated submission date proposed in question 5.
4A	Column 2	We believe that this data may be commercially sensitive.
4C	18	We agree that it does make sense to merge the current table 4B and 4C as both tables perform the same underlying cost performance calculations. However, further adjustments are required to the calculations in the table to ensure the projected shadow RCV calculated in line 4C.23 is on the correct basis. We think these are as follows: • The calculation of total company share of totex over/underspend (4C.18) includes an adjustment for the variance on timing (4C.4). Whilst an adjustment for timing is required in totex performance reported in financial flows (table 1F) and RoRE (table 4H), there should be no adjustment for timing in the shadow RCV. We think a simply way round this is for Ofwat to add a new line in the table, which calculates the company share of totex over/underspend without an adjustment for the variance of timing. • Totex underspend in RoRE and financial flows is reported as outperformance (i.e. shown as a positive value). The adjustment to the RCV for totex underspend deducted is a reduction to the RCV rather than than a positive adjustment. The signage (or calculation) of the company share of totex over/underspend should therefore be the inverse in the shadow RCV calculation.

Table	Line	Issue
		• As the FD RCV reported in table 4C is in nominal year end prices, the company share of totex over/underspend should also be converted from financial year average prices to financial year end prices for the reporting year. Given the complexity of the additional calculations required to calculate the shadow RCV, we think the table would benefit from being split into two sections – Section A Cost performance and Section B Impact on Shadow RCV.
4C	20	There is an error in the guidance for the calculation of the RCV element of cumulative totex over/underspend as the guidance states that total company share of totex over/underspend should be multiplied by the PAYG rate. Applying the PAYG rate results in calculating the revenue element of cumulative totex spend and not the RCV element. The correct calculation would be to multiply by (1 – PAYG rate).
4C	22	We think the guidance for this line should clarify that the FD RCV should be inflated to financial year end prices for the reporting year.
4H	5	Historically Ofwat has set fixed allowances for embedded debt and new debt. At PR19, a new approach has been adopted based on a gradual build-up of new debt and conversely an offsetting reduction in embedded debt. This creates a challenge in how annual financing performance should be measured in AMP7, as the new debt element is no longer a fixed allowance (unlike over AMP6) and is subject to a reconciliation mechanism at PR24. The allowed cost of debt therefore can no longer be assumed to be the same (or fixed) each year. Given the complexity of the above issues, we think Ofwat needs to find a simple approach for calculating AMP7 financing performance but one that seeks to address the methodological changes. We think an approach that Ofwat could adopt is using an allowed cost of debt which is based on Ofwat's estimate of the proportion of each type of debt over 2020-25. This approach would result in a different weighted average cost of new and embedded debt in each year but which would more closely align to how debt costs would evolve over the AMP.
4H	5	The line references to table 1F for the components of RoRE are incorrect as for example totex performance is referenced as line 1F.13, whereas in table 1F totex performance is in line 1F.12. The same issue applies to ODI performance, retail performance and other factors.
4H	5	We note that performance on C-Mex and D-Mex has been included in table 1F for reporting in subsequent years. It would be useful if Ofwat clarified how C-Mex and D-Mex should also be reported in RoRE in subsequent years.
4L/M	Growth [4L.1-4L.6; 4M.1-4M.6]	In table 4L, separating growth from enhancement is good, as it gives clear visibility of the subcategories, which were potentially not reported consistently by all companies in AMP6. The drivers proposed for growth in waste are not necessarily all driven by growth, for example, reducing flooding risk. If this category is for purely growth-related activity, then it may be inappropriate to include 4M.5, and it should be returned to the main body of the table.