

Comments to consultation

British Water Member 1

Outcomes

Q1. Do you agree with our proposals for common and bespoke performance commitments?

Not really - PR19 appears to be more heavily regulated than PR14, which given that Ofwat wants companies to take ownership of their Business Plans, imposing uniformity for the sake of comparability risks stifling innovation and ownership by over regulation.

We believe that ambition and innovation needs clearer definition and greater focus on 'sector improvement' rather than 'peer comparison' in order to achieve the ambition to make the step change identified.

Q2. Do you agree with our proposals on setting performance commitment levels?

No – to quote your document - *"We have decided that companies' performance commitments for 2020-25 should be supported by long-term projections for at least a further ten years. These projections will encourage companies to consider their long-term ambitions and will help customers and stakeholders engage on longer-term issues (as identified in PR14 Lessons Learned)."*

When looking at asset failure, surely a set of commitments should be judged over 10 years not 5? Asset renewal and maintenance is not a 5 year process. Why can't this element of the determination be broken out so that capital and asset maintenance can be managed over a 10 year cycle, or longer, this could potentially allow companies to work with the supply chain to develop work programmes that avoid the 5 year boom and bust cycle. This would help the industry maintain and recruit skills and skilled people, allow a sustainable supply chain which will generate programme efficiencies associated with steady state operation and innovation in delivery methodology.

Moving the performance and measurement goalposts every 5 years creates confusion, uncertainty, reactive, rather than proactive behaviours and stifles innovation and risk taking.

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?

There seems to be too little focus on the supply chain and no real ambition to address the damaging boom and bust cycle and the resultant skills shortage, job losses and obstacles to investment it creates. There is almost a sense that OFWAT feel it's 'inevitable' and there is little they can do to prevent it. If OFWAT believe that it comes down to water companies behaviours then perhaps an ODI is needed which recognises and rewards companies which demonstrate consistent spend across the 5 year AMP period?

The aim to improve the uniformity and consistency of TOTEX is good. Our experience is that it is currently very fragmented which can lead to confusion within the context of a 5 year investment cycle.

Resilience

Q1. Do you agree with our resilience planning principles?

Yes, but how will operational resilience be incentivised? E.g. preventive maintenance plans for existing assets.

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?

Yes this is positive, but will flexibility be allowed within water companies business plans to allow for additional spend, as the condition of assets become known during the AMP period?

Wholesale controls

Q5. Do you agree with our proposals for the form of control for bioresources as set out in the 'Wholesale controls' chapter and appendix 6, 'Bioresources control'?

No – The correct long term decision will not be made unless water companies can genuinely make asset lifetime decisions.

It is unrealistic to expect any business to 'set out a long-term bioresources strategy' and then measure them on 'efficient Totex during the 2020-25 period.

How can a business invest for the long term and make the correct Totex decisions which are effectively based on 'Totex is simply a 5 year WLC'. We assume this cannot be the intention?

At the same time double guessing the 5 year game is time consuming and damaging to all concerned.

Inter-company sludge trading with revenues based on volumes treated seems logical. However, there is some suggestion that bioresource asset investment will have a shorter depreciation compared to water asset investment. Is there a danger this will this disincentivise capital investment?

Direct procurement

Q1. Do you agree with our draft guidance that appointees should focus on projects likely to deliver the greatest customer value for DPC at PR19? (We ask that appointees provide a list and description of which projects, based on our guidance, they consider would be in scope at PR19.)

Possibly, but why restrict it to new assets – surely there is scope to bundle existing assets and genuinely undertake Totex DPCs to improve quality and reduce cost over a 20 -25 year period.

Q3. What are your views on the overall commercial and regulatory model, including our draft procurement and contract principles set out in appendix 10, 'Direct procurement for customers' ?

This seems over complicated and meddling. Once the DPC has been agreed and assuming that the evaluation is undertaken on the whole life cost – let the undertaker get on with it. As long as they meet the quality and volume outputs why would Ofwat interfere? This should be a means to reducing the cost of complying with regulation.

Cost assessment

Q7. Do you agree with our proposals for the transition programme?

A Tier 2 supplier, disappointingly we didn't see any benefit of transitional spend. However, we strongly agree with the principle and we think it should be a measure of efficiency and Totex. Our concern is that with reviews every 5 years and new levels of efficiency demands and the other complex changes to the regulatory regime we will continue to see spend dry up between the AMPs – leading to inefficiency, redundancy and skills loss. Depleting the industry of the ability to operate efficiently – certainly from a capital delivery perspective.

Your laudable ambitions for long term planning, transition spending and Totex appear at odds with your behaviour every 5 years where you burden the industry with change to the extent that it becomes paralysed to act in a coherent, efficient and effective manner. For example, the large cost burden for the industry of supplying and re-scoping numerous times for the same scheme is inefficient and a burden the industry just doesn't need.

The initial assessment of business plans: securing high quality, ambition and innovation

Q1. Do you agree with our proposed approach to the initial assessment of business plans?

• Q1a: In terms of the nine test areas?

It isn't clear how the 9 test areas will be weighted, and consequently what impact this will have.

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?

PR19's aim that innovation becomes an integral part of the business plan should encourage innovation. However, the ability to make the initial investment in innovation (in order to reap the longer term benefits) is extremely difficult to achieve within the current 5 year investment cycle.

British Water Member 2

Section 4 : Delivering Outcomes for Customers

Q1: Do you agree with our proposals for common and bespoke performance commitments?

In principle we agree with the proposals for both common and bespoke performance commitments. From a supply chain perspective, common measures across the Water Companies enables us to focus how to solve industry wide challenges in the most efficient manner with greater sector consistency. The bespoke element enables specific customer issues to be addressed on a local basis. However, one concern we have is the potential for contradictory drivers between performance commitments leading to delivery delays while these complexities are understood, contributing the cyclicity in the Supply Chain; An example being the complexities surrounding

Water Mains Asset Health, Mains Rehabilitation Meterage Targets and Leakage Reduction. These performance commitments / outcome complexities are then further compounded by the drive for TOTEX solution selection in a commercial environment where a significant element of the market is driven by CAPEX.

Q3: Do you agree with our proposals for strengthening outcome delivery incentives? In principle we agree with the proposal to strengthen the outcome delivery incentives. As a supply chain partner there are 2 aspects which we would seek to address. The first is the cyclical nature of work in the Water Industry supply chain, which is impacted by the uncertainty caused by a change in performance metrics in each regulatory cycle. The second is the impact that increased risks (potentially balanced by the opportunity for increased rewards) may have on risk/reward balance with the supply chain and the negative impact this may have on the improvements in collaborative working which have been achieved between the Water Companies and their Supply Chain in AMP6.

Section 5: Securing long term resilience.

Q1: Do you agree with our resilience planning principles?

In principle we agree with the principles for resilience planning. As a supply chain partner principle 5 “Delivering best value solutions for customers” is key to TOTEX efficiency. The principle states “Companies plans should consider the best value solutions for customers in the long term, which may involve long run solutions”. Is the intention that these are only considered as part of a selection process or is the intention more definitive that the best value solution for customers in the long term is OFWATs preferred outcome. If the best value solution for the long term is preferred, how will the solution selected be balanced where there is a gap between longer term solutions and customers willingness to pay today? Do you intend to apply a standard method for calculating the whole life cost or allow each Company to select its own metrics appropriate to its specific situation?

Q2: Do you agree with our approach to assessing resilience in the initial assessment of business plans

In principle we agree the assessment approach. We are pleased to note the specific reference on pg102 with regards to addressing possible skills gaps and welcome engaging with all parties on how to address this in the round as well as providing tools and techniques (such as transition funding) to minimise the impact of cyclical nature in the Water Sector and encourage new recruits into the sector while retaining the skill set we already have.

Section 7: Targeted controls, markets and innovation: direct procurement for customers.

Q2. What are your views on the type of tender model (i.e. an early or late tender model) appointees should use? Do you have any views on whether or not we need to specify a tender model companies should use?

While the intent to remove barriers that prevent innovation in the sector are positive, we do not agree that OFWAT should specify the tender model companies should use. Greatest value will be achieved by having the flexibility to select the tender model that reflects the risks and opportunities associated with delivering the outcome sought. We welcome the references in Section 7 to further consultation and engagement with stakeholders between the end of this consultation period and

issuing the Final Methodology in December 2017 and look forward to contributing to these forums.

We note your reference on pg. 146 proposing to allow “appointees to recover costs they incur while developing and tendering projects as part of totex allowances for PR19 (that is, under the same price control). This would include all pre-construction costs, as well as tender and procurement costs”. How far into the supply chain do you propose this recovery of costs will flow and what measures will be applied to assess the process for this particular aspect has met OFWATs principles?

Section 9: Securing Cost Efficiency

Q7. Do you agree with our proposals for the transition programme?

We are grateful that OFWAT responded to the challenge of cyclicity in the Water Sector by enabling the transition programme. As a supply chain partner the funds referenced on pg188 did reduce the cyclicity between AMP5 and AMP6. It is good that this remains available as a tool in PR19. As PR19 strives to embed the good behaviours and outcomes of PR14 while also enhancing the areas where better outcomes can be achieved, we think that cyclicity is still a factor that affects skills shortage and supply chain efficiency. The reference on pg. 188 that “there should be less need for a prescribed transitional mechanism” may be more relevant to the transition to AMP8. It is our expectation that cyclicity will remain between AMP6 and AMP7 and we would request that OFWAT assesses how the Water Companies propose to minimise the impact on the supply chain. Increasing stability in the supply chain will be a contributory factor to achieving the ambitious goals OFWAT is setting in this methodology.

Section 14: The initial assessment of business plans: securing high quality, ambition and innovation.

Q2: Do you agree with what we will look for in terms of high quality, ambition and innovation?

We are pleased to note the references in this document relating to the value that the supply chain can bring with regards to changing the culture and focus (pg11), solution innovation via direct procurement (pg. 139), TOTEX and outcome cost efficiency (pg. 164) and increasing collaboration to drive innovation and result in benefits for customers, companies and the environment and better management of the risks and opportunities (pg. 266). It is also pleasing to note the business plans will be assessed on their demonstration of how their plans are high quality, ambitious and innovative. We are pleased that these assessments will include not only what will be done but also how it will be achieved while also making it clear that the Water Companies own their plans. To be able to realise these ambitious objectives, as a supply chain partner, it is important that the sector is attractive so that it retains the talent we already have and attracts the best new recruits to fill the skills gap already identified. This can be achieved in a market that not only values high quality, ambition and innovation but also one that is stable and takes a long term view. While the proposed methodology builds on PR14, we would seek that minimising the impact of cyclicity is a consideration in the scoring process and that collaborative working through balanced risk and reward models is encouraged.