

December 2019

PR19 final determinations

**UK Government priorities and our
2019 price review final determinations**



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1. Introduction

The 2019 price review (PR19) plays an important role in delivering the UK Government's strategic priorities and objectives.

The UK Government has set out [strategic priorities and objectives](#) for us,¹ which came into effect in November 2017. We are required to act in accordance with these priorities and objectives when carrying out our relevant functions relating wholly or mainly to England. In this document, we discuss how the PR19 final determinations for 'English companies' (companies whose areas are wholly or mainly in England) support the achievement of those priorities and objectives (which we refer to as the UK Government's 'strategic policy statement').

The UK Government has set priorities and objectives for Ofwat and the water industry in relation to three themes:

- securing long-term resilience;
- protecting customers; and
- making markets work.

These themes, and the priorities and objectives that underpin them, have played an important role in shaping the decisions we have made throughout the price review process. When we published our final [PR19 methodology](#), we set out how that methodology would contribute to the delivery of the UK Government's strategic priorities and objectives. Our initial assessment of business plans then evaluated company plans against that methodology.

When we made our [draft determinations](#) in July, we set out how those determinations supported the priorities and objectives of the UK Government. This document outlines how our price review final determinations support the achievement of the priorities and objectives of the UK Government. We address each of the above themes in turn, setting out the UK Government's priorities and objectives, and how we, and the sector in England, have responded.

¹ It has done so under section 2A of the Water Industry Act 1991, as amended by section 24 of the Water Act 2014.

2. Securing long term resilience

Customers expect reliable water and wastewater services that can avoid, cope with and recover from disruption, as well as protect the natural environment. To make decisions about their operations, maintenance and investment in the short and long term, water companies need the right information, systems, processes, governance, capabilities, and finances.

They need to have operational, financial and corporate resilience: to be ‘resilient in the round’.

This is a key priority for the UK Government and us, and long-term resilience has been one of the key themes for PR19.

Priority

Ofwat should challenge the water sector to plan, invest and operate to meet the needs of current and future customers, in a way which offers best value for money over the long term.

Resilience is vital to current and future customers. The water sector faces serious resilience challenges including climate change and population growth, which present real threats to the resilience of assets, water resources and services to customers. The combination of these threats and changes in people’s expectations – including about how we treat the environment itself – makes tackling these resilience challenges vital.

We expect companies to carefully identify risks to their resilience, and to consider a full range of measures to manage those risks over the next five years and the long term. Companies need to show a good understanding of the condition of their systems, assets and finances, and the key risks they face. We also expect companies to demonstrate that they have robust plans in place to mitigate and manage those risks.

Based on our assessment of company draft water resources management plans, the supply infrastructure requirements highlighted by the National Infrastructure Commission (NIC), and our own focus on resilience, we have assessed company plans, and subsequent representations, in this area, in particular, with the growing challenges of drought risk in mind. In our final determination, we provide funding to

enhance drought resilience and improve the water supply-demand balance over 2020-25 and the long term.

We challenge companies to meet a stretching but achievable set of performance commitments to improve the resilience of their systems and services. These commitments are also designed to incentivise companies to improve asset health by, for example, maintaining pipes so they don't burst. We have made sure that these performance commitments are backed by financial incentives.

It is important that company proposals to spend customers' money to improve resilience are grounded in an understanding of the risks to resilience and how these can be best mitigated.

We require companies to be innovative and rigorous in how they manage and address risks, for example, by:

- choosing the best option for consumers and environment;
- exploiting opportunities to use existing resources better to address future challenges;
- exploiting opportunities to collaborate with third parties and other water companies; and
- better integrating water and wastewater resources.

We expect companies to identify and act on the risks of flooding, including the additional challenges created by climate change, and to make sure these are reflected in their investment and delivery plans. Integrated approaches to wastewater flooding are supported by the development of drainage and wastewater management plans.

In our final determinations, we challenge the water sector to plan on a long-term basis that meets the needs of, and provides good value for, both current and future customers, through:



New investment to improve resilience and meet the needs of future customers: Our final determinations allow English companies and competitively appointed providers to invest £2.6 billion in protecting customers and the environment from the risks of extreme weather conditions (such as drought and floods) and critical asset failures. The determinations also require English companies to use their existing resources better to deliver further resilience.



Engaging customers on long term issues: In developing their plans, we expected companies to engage their customers on longer-term issues, such as resilience, and take into account the needs and requirements of future customers. This included, but was not limited to:

- gathering independent evidence from their customer challenge groups on the quality of engagement; and
- the extent to which customer views were reflected in company plans.



Delivering excellent experience for current customers: We incentivise companies to deliver excellent service to their current customers through our new customer measure of experience (C-MeX) and developer services customer measure of experience (D-MeX).



Providing a better service for current customers: By taking forward a wide range of measures to boost resilience, English companies are set to deliver significant improvements in service quality. On average, over 25% fewer properties should experience low water pressure, and all companies are being required to meet our stretching targets for resolving water supply interruptions over 3 hours.



Making sure investment delivers value for money: Our assessment process benchmarks company costs to make sure customers only pay for efficient company costs. For areas where there are no appropriate benchmarks we evaluate the evidence companies provide for a scheme's investment need, best options for customers, cost efficiency and customer protection. All of these aspects help make sure that, overall, the allowed investment represents value for money and so ensure that the investment has the maximum impact on maintaining and improving resilience over the long term. Throughout the price control we have put a strong emphasis on companies planning for the long-term, both in terms of their goals and their customers' bills.



Incentivising companies to invest in their assets: Asset health² is an important element of operational resilience and central to the long term delivery of services to customers. We require all companies to adopt our common asset health performance commitments, as well as making sure that they have bespoke asset health performance commitments. We have also made sure that asset health performance commitments are backed by appropriate financial incentives. This will help ensure that companies are incentivised to invest in and maintain their assets so that they will be able to provide services now and into the future, which is what matters to customers.



Making sure our final determinations are financeable: Water companies must be able to finance the required enhancements to the asset base and replace existing debt as it matures. It is important that companies are able to access finance on reasonable terms if they are to meet their obligations and commitments to customers. Our allowed return on capital will provide debt and equity investors with a reasonable return: one that is commensurate with the low level of risk in the sector. Our determinations advance revenues where needed to ensure efficient companies can continue to access finance on reasonable terms. However, companies are responsible for their choice of capital and financing structure; our determinations for certain companies highlight a need to for them to accelerate plans or take additional action to improve financial resilience of their actual financial structure.

² The maintenance of physical items, such as pipes and sewers, that allow companies to provide water and wastewater services.

Objective

Ofwat should further a reduction in the long-term risk to water supply resilience from drought and other factors, including through new supply solutions, demand management and increased water trading.

Our PR19 final determinations aim to reduce the long-term risk to water supply resilience from drought and other factors.

In line with the UK Government's objectives, we are pushing companies to take a 'twin track' approach to improving resilience, with investment in new water supplies complementing measures to reduce the demand for water.

In our final methodology, we expected companies to consider a wide range of options to achieve long-term resilience in water supply, including:

- investing in new supplies;
- managing customer demand;
- reducing leakage;
- water trading; and
- solutions provided by third-parties that extend beyond traditional water company boundaries.

We have worked closely with Defra, the Environment Agency and other regulators during the consultation and assessment of companies' water resources management plans. Water resources management plans set out the likely range of interventions that companies plan to make sure that there are secure, sustainable and affordable supplies of water over at least the next 25 years. This collaboration aimed to make sure that the investment identified through the water resources management plans meet the needs of the environment, accounting for climate change, as well as the expectations of customers for best value resilience.

A water resources management plan is an important process that helps to inform a water company's business plan. In assessing companies' proposals, we have aimed to make sure that companies invest efficiently so that water is available in both the short term and the longer-term (i.e. beyond the 2025 horizon of our current price control). We have tested their choice of options and the robustness of evidence put forward to justify the proposals. This includes water transfer solutions and those provided by third-parties, such as the Canal & River Trust, which have the potential for additional environmental and social benefits. Where appropriate, we allow

funding for water resources solutions that may not deliver benefits straight away but are important for long term drought resilience. We have intervened in company plans to encourage companies to develop strategic national and regional solutions, where company water resources management plans had fallen short by focusing too narrowly on company specific approaches to improving drought resilience.

The water resources management plans, even once published, do not provide a static plan for delivering water security. Companies keep these as live documents that change as information about demand and supply projections and relative costs and benefits of options become clearer and evolve. These changes are reported through the annual review process with only material changes requiring a formal update to the final water resources management plan. The draft water resources management plans, which we provided our statutory consultation responses for, hold only limited information on the costs and benefits of specific solutions. These costs and benefits subsequently change during the iteration of the water resources management plans process up to publication of the final plan and in the business plan submissions. The evidence we were presented with in the companies' business plans represented further evolution of this assessment. We have stress-tested this assessment further through our PR19 process.

The strategic policy statement expects us to recognise the need for investment to balance supply and demand and achieve the level of service set out in the final water resources management plans. In our assessment of business plans for final determinations, we accept the need to invest to address the water resources management plan supply deficits. We also continue to challenge companies to meet that need in a way that represents the best value for money over the long term, namely, challenging scope, efficiency and optioneering. Where investment in solutions is in addition to the requirements to meet the supply-demand balance, we assess these for robust evidence of need for investment and cost efficiency.

Our final determinations reduce the long-term risks to our water supply and help meet the twin challenges of climate change and population growth, through:



Investing in drought resilience: During the 2020-25 period, investment by English companies in supply-side solutions should support 400 million litres per day of additional water being made available during droughts, helping to maintain or improve supply resilience. Addressing the longer term challenges, investment in supplies over the next five years is set to deliver an additional 420 million litres per day in England after 2025. This is supplemented by companies investing to interconnect their areas to better use both existing sources and those newly developed, delivering 450 million litres per day of additional capacity improving connectivity and flexibility of their networks. In addition, we are allowing development funding for strategic regional water resource solutions that will potentially deliver a further 1,500 million litres per day by the 2030s. In 2018, the NIC highlighted a requirement for an additional 3,000 million litres per day by 2050 to maintain drought resilience, of which, 1,300 million litres per day is needed from new supply solutions by the 2030s. The combination of investments allows the efficient delivery of capacity which, in total, by far exceeds the capacity needs identified by the NIC.



Reducing water leakage: All English companies have met our challenge on leakage to deliver at least a 15% reduction in annual average leakage from 2019-20 levels over the 2020-25 period. This reduction will save 469 million litres of water per day in England during the period.



Reducing consumption of water: English companies are also set to take forward a range of measures to reduce overall use of water by customers. Companies plan to help their customers to use water more efficiently to reduce water consumption by 517 million litres per day over the 2020-25 period. This should further reduce the burden on water supplies. Companies also plan to invest £650 million, installing at least 2 million new water meters over the 2020-25 period to help customers reduce consumption. Smart meter installations should provide more insight into consumer demands and help identify leaks.



Innovative solutions to meet supply challenges: We are allocating funding of up to £469 million to facilitate the development of strategic regional water resource solutions to help solve the drought resilience challenges in the south-east. This includes potential major new water resources, including reservoirs in the south and south-east of England and transfers of water from the north-west to the south-east of England. This will enable companies to jointly evaluate multiple solutions in more depth and to make sure that appropriate regional solutions are taken forward in future investment plans. We are also proposing a separate ten year price control to fund the construction of the Havant Thicket reservoir, which is being developed by Portsmouth Water to help meet the water resources needs of Southern Water's customers through water trading.



Making sure that long term water resources meet the needs of customers and the environment:

We have established the Regulatory Alliance for Progressing Infrastructure Development (RAPID), bringing together Ofwat, the Environment Agency and Drinking Water Inspectorate to ensure that we have the frameworks to deliver water resources that meet the long term needs of customers and the environment. RAPID has started to work with the water industry to help develop the 17 strategic solutions identified and funded by Ofwat, which aim to address the forecast water resources issues. Funding decisions will be made during a series of regular gateways. RAPID has been working with water companies to engage with stakeholders, timetable the gates, specify the inputs and develop the assessment criteria. We have established strong relationships with the water resources regional planning coordination groups and the water resources national framework so that our work supports one another to deliver water resources in line with national interests and policies.



Reducing the impact of droughts on customers:

The common drought performance commitment measures the percentage of the customer population at risk of experiencing severe restrictions (e.g. standpipes or rota cuts as part of Emergency Drought Orders) in a 1-in-200 year drought, on average, over 25 years. To calculate this performance commitment, companies have to really understand the impact a 1-in-200 year drought will have on their customers, including by considering the impacts of climate change more generally. To achieve this, companies will have to consider the supply-demand balance of their water resource zones. To improve performance on this measure, companies must either increase supply or reduce demand by, for example, reducing leakage and per capita consumption.



Challenging companies to set ambitious flood resilience performance commitments:

We require companies to measure the percentage of population in their area that is at risk of having sewer flooding in an extreme 50 year rainfall event or storm. This metric aims to foster a common way of assessing risk across the industry. It also encourages companies to improve their understanding of their regions and the risk of sewer flooding in a storm by developing models. Companies can improve performance by developing a model where previously there wasn't one since this improves understanding of the region and is more accurate in assessing risk for customers. Companies can also increase performance by making changes to, for example, surface water drainage.

Objective

Ofwat should challenge water companies to improve planning and investment to meet the wastewater needs of current and future customers.

Our final determinations challenge water companies to improve planning and investment to meet the wastewater needs of current and future customers. As set out in our final methodology, we expected companies to assess a wide range of options to mitigate the risks to operational resilience for wastewater, with support from customers.

We have also set four common performance commitments relating to wastewater services, each of which will motivate companies to identify and mitigate risks to these services.

We also required companies to provide a detailed work programme to assure us that they will deliver appropriate drainage and wastewater management plans to inform their PR24 business plans.

Our final determinations further wastewater resilience now and in the future, through:



Incentivising companies to plan and invest to prevent pollution and sewer flooding incidents: English companies are committing to a 30% reduction in pollution incidents by 2024-25, as well as a 41% and 21% reduction in internal and external sewer flooding incidents respectively.



A new focus on long term wastewater planning: Our final determination allows for the full scope of the Environment Agency's Water Industry National Environment Plan (WINEP) that is based on long-term planning principles. As a part of our initial assessment of companies' business plans for PR19, we required relevant companies to deliver appropriate and timely plans for their drainage and wastewater management plans. We asked companies to make sure that they can prepare and consult on their first drainage and wastewater management plan no later than the summer of 2022. This deadline enables companies to prepare revised plans in early 2023 to inform their PR24 business plans. We asked companies to produce a detailed work programme before the end of August 2019. All companies have submitted work programme plans that meet the requirement.



Promoting more sustainable solutions: Our final determination includes a separate control for bioresources: wastewater sludge transport, treatment, recycling and disposal. This control is designed to encourage management focus on bioresources activities and so encourage companies to use and trade this resource in a more efficient and sustainable way to the benefit of customers and the environment, such as by increasing the transformation of waste to energy.

Objective

Ofwat should challenge water companies to make sure that they assess the resilience of their system and infrastructure against the full range of potential hazards and threats and take proportionate steps to improve resilience where required.

In line with our resilience planning principles, we expected companies to consider ‘resilience in the round’, taking an objective and comprehensive view of the risks they face. In our initial assessment of business plans, we considered whether companies had taken a systematic and integrated approach to identifying and assessing all of the diverse risks to the resilience of systems and services across the entire business.

We also expected companies to apply a robust, objective, comprehensive and well evidenced assessment of priority risks to the delivery of the services their customers depend on, over the next five years and over the longer term. This assessment was required to include the consideration of risks to infrastructure, systems, processes and people. They were also required to consider hazards and threats, such as physical and cyber-attacks, extreme flood events, and disruptions to energy supplies.

While some of these individual aspects were considered by companies’ plans, they needed to do more to make sure that ‘resilience in the round’ is firmly embedded across the whole of the business. As a result, we asked companies to provide resilience action plans by 22 August 2019, to demonstrate that they have put tangible measures in place to implement their resilience frameworks promptly and to provide confidence that frameworks are applied in practice. The action plans should build on the companies’ revised business plans and provide a set of actions that address key elements of our feedback.

All companies have now submitted an action plan. In general, the action plans suggest that most companies have further to go in developing a systems based approach to resilience. While we will not be providing further specific actions to companies to develop their action plans, we expect to engage the sector further through the implementation of our strategy. This will encourage further shared learning and development of resilience approaches, to accelerate best practice across the industry. We may consider the progress companies have made in this area as part of assessing company business plans in the 2024 price review.

We are encouraging all companies to improve the health of their assets over the next five years and beyond, pushing the worst performers to close the gap between them and the rest by facing higher penalties for underperformance if they fail to catch up. We are also encouraging companies to work together to develop forward-looking asset health metrics. This will improve their understanding of asset health and the risks affecting it. Companies can then target investment to have the greatest positive impact on services for customers and the environment.

As well as operational resilience, we want companies to improve their financial resilience. We assess our determinations to be financeable for companies that are efficient. However, each company is responsible for making sure that its financial structure will be resilient for 2020-25 and for the long term.

Some companies have already taken steps to improve financial resilience and reduce gearing levels (measured by debt as a proportion of regulatory capital value) by restricting dividend payments or injecting equity into the company. However the allowed return on capital in our determinations, which is low by historical standards and lower than our draft determinations, means that some companies with more risky financial structures may need to bring forward their plans to improve financial resilience in 2020-25.

We are requiring companies with high levels of gearing to share some of the benefits with customers through a gearing outperformance mechanism, which we amend from our draft determination to include a glidepath that provides companies time to adapt. We are intervening to introduce our default gearing outperformance mechanism where arrangements proposed by companies do not provide equivalent benefits for customers in the round to our glidepath mechanism. We will continue to monitor each company's assessment of its financial resilience through the long term viability statements in its annual performance reports and to monitor progress on issues, such as gearing reduction.

We have also set out that we expect companies to demonstrate how their dividend policies and performance related executive pay policies for 2020-25 are stretching and substantially linked to delivery for customers. We have set out our assessment of company policies in the company specific appendix that accompanies each determination. All companies have taken steps to demonstrate that they are moving towards meeting our expectations, though some companies have more to do than others. We expect companies to continue to take steps to improve legitimacy by applying dividend and performance related executive pay policies that clearly align incentives with the customer interest.

Our final determinations push companies to take a ‘resilience in the round’ approach, through:



Security funding: We are providing funding of £64 million to protect against physical and cyber threats in England. This builds on the physical security funding provided during the 2015-2020 period to make sure that companies comply with the Security and Emergency Measures Direction (SEMD). Our allowance for cyber security aims to make sure that companies comply with the Security of Network and Information Systems (NIS) Directive.



Forward looking resilience performance commitments: We have required companies to propose new performance commitments to provide forward looking measures of resilience of water and wastewater services. These new metrics will help to identify risks to resilience and encourage companies to develop a deeper understanding and more robust data on the resilience of their systems and services.

Objective

Ofwat should challenge companies to further the resilience of ecosystems that underpin water and wastewater systems, by encouraging the sustainable use of natural capital, and by encouraging water companies to have appropriate regard to the wider costs and benefits to the economy, society and the environment.

The UK Government’s strategic priority statement recognises the importance of sustainably managed natural resources and a resilient ecosystem. This has been further emphasised in the government’s [25 Year Environment Plan](#), which aims to leave the environment in a better state than it was found. We recognise we have a role to play in this, working with others, including the Environment Agency and Natural England.

Our final determinations allow companies the costs required to deliver the Environment Agency's Water Industry National Environment Plan (WINEP) efficiently. They also include stretching performance commitments that push companies to go even further on important environmental outcomes, such as reducing pollution.

Our final determinations further the resilience of our natural ecosystems, through:



Major investment to protect and enhance the natural environment: In our final determinations we have allowed £4.6 billion for WINEP relating to water and wastewater systems in England. This funding will increase the quality of wastewater effluent and see improved watercourses throughout England, bringing benefits to biodiversity and habitats.



Promoting a sustainable approach: Companies have committed to increasing the number of catchment management schemes related to WINEP in England by two-thirds, totalling more than 370 schemes.



Reducing water consumption: Water consumption in England is set to be reduced to, on average, 131 litres per person, per day, as a result of further investment in customer metering, water efficiency activities and educational campaigns.



Reducing strain on watercourses: Companies plan to reduce abstraction from the environment as a result of investment in customer demand activities, metering and leakage reduction. All English companies have adopted the abstraction incentive mechanism (AIM) to reduce abstractions at environmentally sensitive sites during times of low flow.

3. Protecting customers

Throughout the PR19 process, we have pushed companies to do more to protect customers by better understanding the issues they face and delivering real improvements to the service they receive. To support this, companies have gone further than ever before to engage their customers: a record one and a half million customers shared their views as water companies in England developed their plans.

In particular, we expect companies to do more than ever before to protect customers who are struggling to afford their bills, or who are in other circumstances that make them vulnerable.

Priority

Ofwat should challenge the water sector to go further to identify and meet the needs of customers who are struggling to afford their charges.

Affordability is one of the key themes of PR19, and we are going further than any previous price review to make sure that customers are suitably protected, particularly those who struggle to, or cannot pay their bills.

In our final methodology for PR19, we set out the five principles against which we assess companies' plans on affordability:

- customer engagement;
- customer support;
- effectiveness;
- efficiency; and
- accessibility for customers who are struggling to pay.

Our final determinations improve outcomes for customers struggling to pay, through:



A 12% fall in bills before inflation for customers in England:

By reducing the average bill, we are making water more affordable for customers, including those struggling to pay. This is driven by our record low cost of capital for the sector and our efficiency challenge. Our efficiency challenge aims to make sure that customers – especially those struggling to pay – do not pay any more than they should. We develop our view of the efficient total expenditure (totex) allowance by benchmarking water companies to the most efficient companies within the sector. We have challenged companies' investment proposals to make sure customers pay only for efficient investment and that they are protected if that investment is not delivered. At PR19, we are setting a high bar of efficiency for companies, by considering wider evidence of efficiency gains and frontier shift, to drive a step change in efficiency across the sector.



Additional support measures for those who find their bills unaffordable:

All English companies have engaged their customers on the benefits of social tariffs and have obtained sufficient support to increase the amount they levy to give discounted bills to those who cannot afford to pay. By 2025, 1.3 million customers in England should receive help through social tariffs and WaterSure, a statutory scheme that caps bills for certain customers with a water meter. Four companies in England, South West Water, Yorkshire Water, United Utilities and SES Water, have pledged to partly self-fund their social tariff schemes using shareholder money.

Objective

Ofwat should challenge companies to improve the availability, quality, promotion and uptake of support to low income and other vulnerable household customers.

At PR19, we are, for the first time, putting a specific focus on how companies deliver non-financial support for customers in circumstances that make them vulnerable. We have assessed the extent to which companies provide sensitive, well-designed and flexible support and services for customers in circumstances that make them vulnerable. This includes customers who are at risk of entering vulnerable circumstances.

Our final determinations increase support for customers in circumstances which make them vulnerable, financially or otherwise, through:



Increased take-up of priority service register support: We have introduced a common performance commitment on priority service registers (a record of consumers who have expressed a need for specific help or service). This commitment incentivises companies to make sure that:

- at least 7% of its customers are on the priority service register by 2025; and
- the register is accurate and up to date.

As a result of our actions, the number of customers of English companies registered for priority services will increase by 2 million in the 2020-25 period.



Additional support measures to help customers in vulnerable circumstances: In addition to increasing the reach of priority services, a large number of companies have committed to improving customer satisfaction with the services offered. Nearly every company has a performance commitment relating to the satisfaction of vulnerable customers. In addition, eight companies are to adopt the British Standards Institution (BSI) standard on Accessible Services, which should further improve the quality of service that companies provide to help customers in vulnerable circumstances.



New approaches to dealing with problem debt: In relation to dealing with debt, ten English companies report they will offer 'payment matching', whereby the company forgoes debt for customers who make regular payments. A number of companies, including United Utilities and Severn Trent, offer customers payment holidays to help people avoid getting into debt.

Objective

Ofwat should promote an enhanced focus by water companies on the needs of small business customers that may struggle to access the best deals.

The business, charity and public sector retail market in England opened to competition in April 2017. Water companies can exit the business retail market by transferring their business retail operations to either an associated retailer (a company in the same group), or a third party retailer.

Following Yorkshire Water's exit on 1 October 2019, none of the English wholesale companies remain active in the business retail market. Our final determinations, therefore, do not include a price control for any non-household businesses.

4. Making markets work

Priority	<p>Priority: Ofwat should promote markets to drive innovation and achieve efficiencies in a way that takes account of the need to further:</p> <ul style="list-style-type: none">• the long-term resilience of water and wastewater systems and services; and / or• the protection of vulnerable customers.
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In our approach to PR19, we have promoted markets, where appropriate, to achieve our PR19 themes of:

- great customer service;
- affordable bills;
- long-term resilience; and
- innovation.

Markets can help to support progress across the UK government's other strategic priorities, including building resilience and protecting vulnerable customers (as noted above).

Our final determinations will promote markets in England, to drive innovation and achieve efficiencies through:



Developing markets for ecosystems services: Our total expenditure (totex) approach and outcomes framework incentivises companies to come up with innovative approaches to using markets to improve the natural environment. A good example of this kind of innovation is Wessex Water's scheme for creating an online reverse auction³ for pesticide reduction from farming (EnTrade), which several companies are now rolling out. This is an industry-leading innovation and Wessex Water demonstrates cost savings and environmental benefits from using these natural solutions, compared with engineered solutions.



Markets as drivers for improving water resource management: Companies are using new markets in water resources to reduce abstraction in sensitive areas and improve the natural environment. For example, South West Water has developed demand-side schemes provided by third-parties. To improve water efficiency, the company collaborates with organisations such as Greenredeem and Advizzo to develop schemes that reduce the consumption of water. We continue to encourage the water resources bidding market through the water resources market information and water trading incentives.

³ Online Reverse Auctions are electronically managed auctions, typically hosted by a third party service provider or via leased software systems. During the event, multiple prospective suppliers bid against each other to see who is willing to offer the lowest price point for their good or service.



Creating new markets in bioresources: By helping companies to procure bioresources services from a range of suppliers, we can unlock efficiencies that can be reinvested in the areas that customers value most. For example, Yorkshire Water has conducted market testing of bioresources services and has identified potential savings of around £100 million over the period of the 2020-25 period from market-based approaches.



Implementing our new framework for direct procurement: We are encouraging water companies to competitively tender for the financing, design, build, and operation of large projects. This can reduce the costs customers pay for the largest or most expensive new assets, by increasing competitive pressure on project and financing costs, and driving innovation through greater choice.

In our final determinations, we have identified 5 schemes in England that offer best value for money for customers under a 'direct procurement for customers' approach. We expect the expenditure on these schemes to be approximately £700m in the period 2020-25 and £640m in the period 2025-30. We expect further schemes in the future, including the strategic solutions, which could potentially spend over £3bn in the period 2025-35.



Driving Innovation: Our outcomes and total expenditure approach helps companies to innovate by giving them the flexibility and freedom to deliver services by innovative means. We are promoting innovation by setting stretching outcome performance commitments and by setting other performance commitments and the cost efficiency challenge, where we measure companies' efficiency against the performance of leading companies. Our outcome delivery incentives approach encourages companies to look for innovative ways of delivering better services to customers and improving the environment.



Going further: We have been considering how we can stimulate innovation more widely in the sector and encourage collaborative innovation initiatives. In our new strategy [consultation](#), we explored options for customer-funded interventions designed to drive innovation to benefit customers in the longer-term. Having reviewed the responses to the consultation, we are publishing our decision alongside the PR19 final determinations. In this decision, we confirm that we are making up to £200m available for innovation activities for the period 2020-25 through the introduction of an innovation competition. We will work together with companies and other stakeholders in the sector to set up a competition, which will effectively drive innovation in the sector to the benefit of customers across England and Wales.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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