

**PR24 and beyond: Our reflections
on lessons learnt from PR19
– Executive summary**

improve affordability of bills. And water companies have committed to providing further support for those struggling to pay.

The package includes more expenditure on resilience than ever before, including £1 billion to reduce the impact of flooding on communities across England and Wales, and we intervened to allow an additional £469 million to address long-term drought resilience. We introduced measures to support innovation including the £200 million [innovation fund](#), enhanced outcome delivery incentives, direct procurement for customers and funding for investigating potential future water resource schemes. And we are supporting the environment, for example by allowing £4.8 billion of expenditure for the Water Industry National Environment Programme (WINEP) in England and the National Environment Programme (NEP) in Wales.

Creating the space to learn

We want to continue to improve and evolve our approach to future price reviews. We have therefore conducted a significant lessons learnt exercise. This involved engaging with external and internal stakeholders. Our aim was to understand what people thought worked well and what could have worked better about PR19. We spoke with UK and Welsh governments, sector regulators, CCW, water companies' regulatory teams and their CEOs. We also sought the views of wider sector stakeholders including business retailers, Customer Challenge Group (CCG) members and environmental groups.

The timing and execution of this exercise had to be substantially adapted following the impact of Covid-19. We are grateful to our stakeholders for embracing new ways of working to engage with us virtually, particularly when they were having to juggle competing priorities.

What we heard from our external engagement added to the knowledge we had collected from the lessons learnt exercises we have run internally throughout the design and delivery phases of the price review. We talked to people across all areas of Ofwat, our delivery partners and our Board to understand the impact of the price review.

Lessons from PR19

This document explores what we have heard and our own reflections on lessons we have learnt from PR19. We summarise our key learnings here.

PR19 was a much better process than PR14. This was achieved by Ofwat setting out a clear timetable in advance and delivering to it, while retaining flexibility to respond to emerging issues. The PR19 plan has enabled significant changes to occur smoothly, such as the development of 15 common performance commitments, the introduction of direct procurement for customers for large schemes, a regional approach to water resources and a fairer balance of risk and return. And having that clear plan helped us to deliver effectively while remaining agile, for example by enabling us to introduce additional funding for strategic water resources. But it was still a challenging process for many people,

both in Ofwat and water companies. We will consider how we can further improve future processes.

The initial assessment of plans (IAP) encouraged a number of companies to challenge themselves to stretch further for customers and improve efficiency. It was also effective as a feedback mechanism to highlight where companies' plans needed to improve. We will consider how we can learn from this experience to ensure that all companies have strong incentives to produce their best business plans first time.

PR19 was more sophisticated and covered more issues than previous reviews – but was consequently more complex. We will consider what opportunities exist to simplify future price reviews while continuing to deliver the same or greater benefits for customers and the environment. For example, we will examine whether we could deliver some elements through our other regulatory tools outside of the price review.

Effectively challenging companies promoted improved service and efficiency. An important element of the price review is to challenge monopoly water companies to improve service and efficiency and to provide a framework to enable high quality decisions on new investment. At PR19, a number of companies challenged themselves to improve service and efficiency. In other cases, we used evidence from the leading performers in the sector to require companies to improve. We approved major new investment to protect the environment and deliver better service. In several cases, we protected customers' interests by intervening to increase company investment levels to improve operational resilience. There was considerable support for the approach to cost assessment including the transparent and collaborative development of cost models. The challenge to improve service was based on both historical data and evidence in company business plans. Some companies questioned whether the expected level of service improvements could be delivered without additional funding. We consider that the cost allowances were consistent with evidence of historical and forecast service improvement within base cost allowances. We will consider how we can most effectively challenge cost and service quality in future price reviews.

Lower bills were driven by lower returns for investors. The impact on bills is the net result of the decisions made across the price control framework. Contrary to the views of some stakeholders, we did not and do not aim for a particular bill level. We set lower shareholder returns – reflecting prevailing market conditions – and stretching but achievable cost efficiency challenges. The bill reductions are the result of a package that includes significant investment in improving resilience and protecting the environment alongside delivering improvements in outcomes over 2020–25 and beyond. In setting the overall package we took into account affordability overall and also the support available to customers who are struggling to pay and those in circumstances that make them vulnerable. These issues are increasingly important during the Covid-19 pandemic and we would expect to retain a focus on them in the next review period. We also considered bill profiles over the long term, including evidence on customer preferences for smooth bill profiles and the need for an efficient company to finance its activities. In a number of cases we intervened to reduce bills in the longer term at the expense of smaller reductions in 2020–25. Looking ahead, there may not be the same scope for falling returns to support lower bills in future.

Consequently we may face more pressure on bills and affordability from rising cost pressures to improve resilience and the environment.

We were pleased to see a step change in the level of customer engagement at PR19, both in terms of the number of customers engaged and the approaches to engagement. There were however issues with large variances in customer valuations for the same service across companies. The variances appear to a significant extent to have been driven by differences in the methodologies used by the different companies and their research firms. We have started considering the role which customers and customer engagement will play in future price reviews, and have published '[PR24 and beyond: Reflecting customer preferences in future price reviews – a discussion paper](#)' outlining our initial thoughts on this and inviting views. We recognise the importance of providing an early steer on this so water companies can develop their engagement approach for the next price review alongside their continuous customer engagement.

We consider that water companies do not yet have a full understanding of their own resilience, particularly in the longer term. There is more for us and the sector to do to build that understanding to ensure customers and the environment are sufficiently protected. We have allowed more expenditure than ever before on resilience, and asked companies to develop resilience action plans. We intervened in companies' business plans to provide an additional £469 million to develop long term regional and national solutions to improve drought resilience, and £480 million of gated funding for Thames Water to improve services to Londoners. Some stakeholders consider that there was a missed opportunity for further resilience expenditure, but we do not consider that there was sufficient evidence to justify it; we allowed enhancement costs for resilience where it was sufficiently evidenced, and funded resilience through base costs where appropriate. We consider that we and the sector need to work together ahead of the next price review, to build our and the sector's understanding of what is needed to keep the sector resilient over the long term, and to better reflect what resilience expenditure is already funded through base costs.

Our data and IT systems are key to the successful delivery of price reviews. Large scale document production and complex modelling require robust and reliable systems. While our systems for PR19 worked well, we recognise that we need to continue to improve our technical capability, and we are developing our data strategy to enable us to make better use of data and run a smoother process in future.

PR24 and beyond

Looking forward to the next price review and beyond, we will seek to build on these lessons, and any further lessons arising from the CMA redeterminations, to help to deliver our strategy: '[Time to act, together](#)'.

We aim to work collaboratively with stakeholders to develop our approach to future price reviews. We have published our first papers to launch the development of the next price review – ‘[PR24 and beyond: Future challenges and opportunities for the water sector](#)’ and ‘[PR24 and beyond: Reflecting customer preferences in future price reviews – a discussion paper](#)’ and will engage with stakeholders on these over the coming months. We are also launching the ‘[Future ideas lab](#)’ – a collaborative space that we hope will be used to generate ideas and discussion on PR24 and beyond, as the ‘[Marketplace for ideas](#)’ did for PR19.

In spring 2021 we will launch a consultation on the development of future price reviews, looking ahead to PR24, PR29 and the long term. This will consider:

- the key challenges, ambitions and the implications of our strategy for future price reviews;
- high level design of future price reviews, including initial thinking on scope, structure and form of price controls;
- key issues for the high level approach to outcomes, cost assessment and the balance of risk and return;
- embedding longer term approaches into price reviews;
- the approach to customer engagement, taking account responses received on our discussion paper; and
- the timetable for PR24.

We explore the issues covered here in ‘[PR24 and beyond: Our reflections on lessons learnt from PR19](#)’.

**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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