Ofwat and PR24 - Future Ideas Lab – CIWEM Water Resources Panel Submission

Background to CIWEM

CIWEM is the leading independent Chartered body for water and environmental professionals, promoting excellence within the sector. The institution provides independent commentary on a wide range of issues related to water and environmental management, environmental resilience, and sustainable development.

CIWEM is pleased that Ofwat is engaging widely on their approach to PR24 in order to inform the development of their future approaches, which we understand will be further consulted upon in May. The Ofwat consultation is broad, including many questions and is open in nature; so our response has targeted specific questions where we had substantive comment to make with reference to water resources (in line with the remit of CIWEM's Water Resources Panel).

We have presented these as far as possible against the relevant Ofwat question areas. In particular, noting recent publications such as *"PR24 and beyond: Reflecting customer preferences in future price reviews – a discussion paper"* related to Question 6, we provide specific further thoughts on engaging on water resources topics and issues.

In drafting this response, we received input from our Water Resources specialist panel.

Response to consultation questions

1. What could the water sector look like in 2040, and how can Ofwat and water companies work towards that vision?

- Given the inherently long-term and complex planning questions for water resources that impact society as a whole, the water sector should strive to be nationally recognised as a leader in planning for investment driven not just by shorter-term performance considerations, but in ensuring sustained best-value for customers and society.
- We anticipate a future water sector that is increasingly outward looking in a drive to innovate within the sector, and whose planning is an exemplar of system-thinking, harnessing long-term best-value, and collaborating with other sectors. This will evolve from the approaches such as natural capital and best-value planning that are currently evolving across the industry.
- The regulatory system should support both the water sector, and wider society in meeting the climate and ecological emergency. As recognised in Ofwat's recent documentation, the water sector has a duty not just through the lens of 'customers', but to citizens. We know that water is the medium through which many of the impacts of climate change will be felt (drought, flooding, pollution, environmental health).

- To achieve such aims, it is critical that government and regulators give strong, early policy steers and mechanisms to achieve goals, that are backed up with realistic investment propositions to meet these. Companies are most likely best placed to determine the most cost-effective way to deliver ambitions, but where long-term investment needs run against shorter-term affordability drivers these need to be fully supported by the regulatory framework. This might include policy changes on issues such as water labelling (which is long overdue and has been on the government agenda for some time), metering and building standards, building upon previous consultations.

2. How do we best regulate to help companies to achieve long term goals such as adapting to climate change, reducing leakage, improving water efficiency and delivery of net zero?

- It is important to recognise that for water resources challenges in particular, that the planning and investment takes place against long-term 'deep uncertainty'. When balanced against shorter-term pressures such as customer affordability, there is a risk that investments in these areas lose out to shorter-term drivers. There should be sufficient counterbalances to ensure that long-term value is not lost due to short-term 'efficiency' savings.
- Investment in these areas requires strong regulatory frameworks and endorsement, as customers may not always see direct or immediate personal benefits to individual customers.
- We hope to see a shift in the balance of economic regulation so that it gives greater weight to investments and actions, such as demand management, that address the climate and ecological emergencies.
- Recognising that the water resources planning process should consider all options, and that the scale of the national challenge requires supply side solutions, this also applies to potential supply-side options that potentially offer better long-term solutions. The progress made and emphasis upon multi-AMP planning such as via the WRMPs should be maintained. The RAPID process is a good example of where there has been regulatory commitment to explore options with long-term potential and national benefit to overcome and tackle long-term challenges and barriers.
- Ofwat should consider whether performance measurement and incentives are suitably balanced between shorter-term, easily tracked metrics (which may not adequately track underlying value or benefits, especially for low likelihood, high consequence risks), and more sophisticated measures of risk or underlying value that equip the industry for the future. Without progress in being able to more consistently demonstrate performance relating to long-term goals, it is likely that they will always lose out to shorter-term drivers in day-to-day decision-making.
- Tracking performance on water resources considerations often relies upon metrics that may be influence by a range of external factors such as the weather; consideration should be given as to whether the data capture and analysis of such metrics allows for year-to-year comparison of performance, or whether further

exploration and innovation in this area should be promoted to enable more sophisticated metrics. This is particularly important for demand side metrics.

- Regulators have the benefit in some cases of a 'helicopter view' across segments of the industry. There should be regular review of the business planning framework, in terms of the effectiveness that this links to regional and Company WRMPs, but also as to how these processes interact with other aspects of planning as they mature (e.g. DWMPs), so that shared opportunities are realised.
- The incorporation of customer valuation into cost-benefit analysis is longstanding, although Ofwat should ensure clarity and support to the incorporation of wider societal or value into decision-making as part of the price review process, e.g. natural capital. It should add increasing weight and expectation of this wider long-term value to be presented in the Business Plan process over time.

4. How can we encourage companies to innovate and to take advantage of technological change to increase productivity, reduce costs and improve resilience, service and the environment?

- It is important to promote and foster the fact that strategic and business planning activities, whether that be customer engagement or water resources planning assessment, have benefits beyond their initial target purpose related to the business plans.
- Huge strides in the sophistication of modelling, analysis and risk-based planning have been made in the field of water resources over the last 5-10 years. This has resulted in the development of stochastic hydrological data for the assessment of drought resilience, companies to develop more sophisticated weather-demand models, and consider a range of other metrics or valuations as part of defining a best-value plan (i.e. other than simply meeting a supply-demand balance in a least-cost manner).
- Many of the aforementioned new tools and approaches have the potential to harness significant future operational efficiency and/or resilience benefits, including better accounting for customer and/or environmental consequences as part of decision-making. This might be a useful area to foster shared research and collaboration.
- Ofwat could assist the industry in learning the lessons from other industries, such as in terms of the smart metering roll-out in the energy sector, leveraging specific insights from their counterparts in other industries.
- The industry is becoming increasingly data rich, and the ability to create data often has the potential to outstrip the ability of users to analyse / apply it. Consideration should be given as to what role 'big data' approaches and partnerships may bring to areas such as demand management, and what barriers and incentives the regulatory environment might have to increasing the level of innovation in this area.

6. How can we encourage companies to best take account of customer needs and priorities, while ensuring services are comparable across companies?

- As described earlier, water resources planning problems are subject to long-term 'deep uncertainty' driven by factors such as climate change, and are often inherently

complex due to the risk-based nature of decisions and the number of influences & interdependencies in systems or catchments.

- Ofwat should continue to support adaptive planning processes that take account of uncertainties around central planning estimates/assumptions (e.g. population or property growth being lower than local authority aspirations, greater impacts of climate change etc.), to ensure that plan interventions are appropriate across a range of potential futures.
- As Ofwat's recent customer engagement focussed literature states that "*most customers deem the following areas to be least appropriate for consumer research: business plan inputs where the relevance of the subject matter is: tenuous to consumers; so technical to require expertise to understand; relates to very long-term planning…".*
- Much of the above could be seen as closely describing many of the attributes of water resources planning, particularly around risk and resilience choices. However, over time water resources decisions have potentially high investment levels attached to them, so customer engagement and support does not feel something that should be avoided. Given the importance of tackling the future climate and environment challenges, we believe that it is critical that we both promote water resources investment with customers, but also test plan choices with them.
- As with performance metrics used to monitor and incentivise the industry, conventional research techniques are likely to be insufficient to explore the longer-term, more complex questions related to water resources value. The types of techniques used to explore day to day aspects of company performance may be limited when exploring low likelihood, high consequence risks (such as those relating to drought).
    - As Ofwat's recent customer engagement discussion paper states: *Perhaps most importantly, it challenges the idea that conventional research techniques can be reliably applied to all aspects of water services. For example, the study highlights that most market research which uses probabilities tends to run into difficulties, which may have implications for the extent to which stated preference methods can be relied upon when trying to understand customers' views on resilience issues.*
- Whilst theme-specific research has the potential to overvalue customer WtP (for a specific service area) than research conducted across themes, specific research should be supported for strategic water resources themes such as national drought resilience and water transfers. This might involve the use of immersive WtP techniques or online programme choice experiments or games to make the subject matter more accessible. This is important to bring the 'consequences' to the fore (even if the likelihood is perceived to be relatively low), whether from an economic, customer or environmental perspective. It may also be useful to help contextualise water resources event probabilities against those for wider societal events. Ofwat should showcase exemplars from the previous planning round in this area.
- With this in mind, we are supportive of Ofwat's consideration of some common national level of research (even though Companies should ultimately own the end

delivery of engagement with their customers), which would allow 'legitimacy' to the research, and allow greater understanding of national and regional customer opinions related to water resources. Such insights could also be used to help increase the utility of customer campaigns around water usage (e.g. countering the perceptions of lack of water need due to the UK being 'wet').

- However, we feel that it is important that the local and regional implementation of such research is retained. The process should allow for specific in-area questions to be explored, and companies should be fully able to build upon (and triangulate to) this wider scale research. It is important that material used in research has a suitable in-area 'legitimacy', recognising that there are already potential criticisms of wide-scale customer research from those in rural or environmental sensitive areas where it may be felt that their voice is outweighed 'by the masses'. Environmental considerations should be brought to the fore across a range of scales.
- Therefore, a hybrid approach is likely the most effective, with wider scale national research taking place with a set of common questions being applied across areas, but supplemented by regionally or locally relevant material and/or specific tests or questions (and built upon as required at Company level).
- Recognising that customers are also citizens, and the increasing cross-sector planning currently being advocated through the regional water resources plans, Ofwat could consider how such engagement on water resources challenges could benefit from some pooling of research with other sectors or organisations.

7. What, if any, could the role of the price review be in encouraging or incentivising companies to better deliver public value?

- As outlined earlier, consideration should be given as to whether the current range of performance metrics used in the industry is sufficiently supporting long-term considerations that drive value for society in the long-term, on the big themes that relate to water resources such as climate change, the environment and net zero carbon.

11. How do we encourage companies to collaborate and work in partnership with others, such as on nature-based solutions, to better achieve outcomes for customers and the environment?

- Strides are already being made in regional water resources planning in widening the focus of companies to work in partnership with other sectors and organisations, building on the work done in WRMPs. However, careful review of the outcome of the process should be completed upon delivery of the plans in this cycle to consider how this may be improved upon in future AMPs.
- Continuing to promote the integration of natural capital-based approaches into the options appraisal / decision-making processes is key, such that there are suitable planning processes to recognise the value of collaborative and partnership working in plans (and of solutions that deliver for the environment).
- Regulators should also play an increasing role in facilitating or supporting the activity of companies by working with their government or regulatory counterparts to

promote processes such as the regional water resources plans and their benefits, and so that the funding mechanisms for other sectors function in tandem with those used by the water industry. Ofwat may be able to provide greater clarity and a framework to support cross-sector or organisation investment, which may not always interface well with the 5-year planning cycles of the water industry.