2nd August 2021

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Please ask for Steve Morley
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Dear Sir or Madam,

PR24 Consultation

Thank you for the opportunity to respond to this consultation and for granting the short extension of time for what is for us an extremely important exercise. Whilst we are supportive of many of the proposals Ofwat has made, in particular the emphasis on a long term view, we have listed below our main concerns at this early stage in the process:

1. We are conscious that there are many challenges facing our industry which could result in upward pressures on prices and this is an especially acute issue for us as the company with the lowest charges in the sector by some margin. Upward inflationary trends (potentially followed by increases in interest rates), the cost of de-carbonisation, investment in improvements in regional resilience, removal of lead pipes, expansion of metering coverage through compulsory metering and the bow wave of much needed investment in infrastructure renewal are but some of the factors contributing to these upward pressures. Whilst investment priority and timing choices will need to be made, we believe the net result will be an increase in spending requirements and therefore prices and, whist nature based solutions have an important role to play, there is still a huge need for much 'conventional' investment in many areas. Clearly, strong support for vulnerable customers needs to be in place but to adopt a general policy of flat or reducing prices in real terms (as has been the case in the last two price reviews) will undoubtedly result in the deferment again of a big chunk of much needed investment, most of which we believe will be strongly supported by customers. This is a major concern for us.

2. Momentum is building rapidly around the issues of improving river water quality and dealing with the legacy of CSO's. These areas are not within Portsmouth Water's scope of operations and whilst we fully support the need for improvements to be made, we are concerned that the agenda for PR24 may be impacted in a way that disadvantages us.

3. Portsmouth Water is a small water company in UK terms and the PR process has a disproportionate impact on the smaller companies – in many ways, the effort needed is the same irrespective of scale and smaller companies carry a heavier burden. We appreciate Ofwat's previous comments regarding consideration of a simplified process for Water Only Companies

and look forward to engaging further on this matter. This does not mean that we do not appreciate the need to evolve our approach to running the business in line with the future challenges we face, but believe this needs to be in a way that aligns with our scale and builds on our historic experiences, capability and knowledge.

4. We welcome the emphasis on the long term and are highly supportive of this. In enabling this long term view, we recognise the importance of clear and well aligned long term strategic priorities from across the industry's regulators. We feel that Ofwat has a strong leadership role to play in this. Finally, we believe that a long term, predictable and transparent regulatory regime should enable a long term approach to be taken by the industry. There is limited information in the consultation as to the regulatory framework beyond PR24 and we look forward to understanding the proposals in more detail as they evolve.

5. We support Ofwat's proposals for a more centralized and standardized approach to customer consultation although we also feel this should be combined with a limited degree of local consultation on local issues, particularly for smaller community orientated companies such as ourselves.

We have structured our response in sections aligned to the structure of the consultation document and have restated the questions at the start of each section for ease of reference.

Finally, thank you once again for granting us an extension to this response. This has allowed a thorough discussion of the issues at our July Board meeting. We would be very happy to discuss any points of interest in further detail should you wish to do so.

Yours faithfully

[redacted]

C R TAYLOR
Chief Executive Officer

Consultation response

Ambitions for PR24	Q2.1: Do you agree that the themes we have suggested for PR24 are appropriate for England and for Wales?
	Q2.2: Do you have comments on the considerations we've identified as relevant to the design of PR24?
	Q2.3: How should we evaluate our progress, and how can we best develop or use appropriate metrics to do so?

Q2.1
We feel that overall the themes suggested for PR24 are appropriate and consistent with our views on areas of strategic importance for the industry.

In particular we support the emphasis on a "long term" view and have previously highlighted our view that too much emphasis on 5 year cycles has been detrimental to the industry. As Ofwat has highlighted the ability to take a longer term view will need increasing certainty for regulators, Companies and Investors, into periods beyond PR24 – we recognise that this could be the key challenge. We also see that future challenges around, for example, resilience, water resources and net carbon zero could result in significant upward bill pressure. Having a long term view and increasing certainty on future determinations may allow us to smooth this impact thereby eliminating significant bill variances from AMP to AMP.

In relation to environmental and social responsibilities we note the challenges of delivering the net carbon zero ambition and would value an early view on the balance of funding for this area.

As noted in our introduction, we would be very supportive of a simplified and streamlined process which could, in part, be a risk based review informed by historic company performance.

In environmental terms we recognise the regionally significant issue in relation to the impact of abstraction on chalk streams. We note that the Havant Thicket Winter Storage Reservoir (HTWSR) is a programme designed to reduce chalk stream abstraction – but recognise the need for companies in the region to go much further. The recent re-designation of our area of supply as "seriously water stressed" will be instrumental in allowing us to commence a universal metering programme aimed at reducing Per Capita Consumption. However, investment of this nature and extent is also likely to cause significant upward bill pressure.

We very much support the focus on customers and communities and, as a small, city centric, 160 year old company we have a long-standing customer and community focus. We are also very supportive of the proposed national customer engagement activity but have concerns about the cost impact, as a small Company, of raising the bar further on customer engagement. We will be seeking ways to manage our programme within an appropriate efficiency envelope.

Finally, we are supportive of the continued focus on innovation and efficiency but question whether there is really a level playing field in this area across the industry; in particular there is a need to promote/support innovation in smaller companies. Efficiency assessments and cost modelling also need to recognise where step changes in levels of performance are needed.

Q2.2
We broadly agree with the considerations identified in terms of the design of PR24. We would welcome clarity around how the price reviews will be undertaken in the longer term as we feel greater predictability and transparency here would both support good long term decision making and maintain and attract investment into the sector.

Streamlining of the price review process is a significant theme for us. The PR19 process felt more complex than ever and we would challenge whether any proposed streamlining and simplification could go further for small companies For example could a more risk based approach, that reflects historic performance and applies a light touch to certain aspects of the review be effected for small companies?

Finally we feel it is important to recognise "local diversity" of companies and ensure that the design of the PR24 process allows for this. Therefore, whilst employing an overall national strategy there needs to be sufficient flexibility to deliver on (and finance) local issues (e.g. chalk streams, universal metering) and consider local customer priorities.

Q2.3
We feel that evaluating progress could, in part at least, use relevant stakeholder groups and other regulators' views. Indicators should be aligned to Outcomes (considering a longer term glide path).

How we regulate	Q3.1: How can we best regulate the water sector to deliver value for customers, communities and the environment? Do you agree, or have comments on, our suggestion to maintain our 'building block' approach based on outcomes, costs and risk and return?
	Q3.2: To what extent is greater co-ordination required across the sector? In what ways might we promote better co-ordination across companies and with other sectors, and how might this benefit customers?

Q3.1
We support the proposal to maintain the "Building Block" approach based on Outcomes, costs and risk & return.

Above all regulation needs to be balanced and proportionate. It is critical to get good value for money for customers. However, the industry also needs sufficient long term investment for the future – accordingly we welcome the signalling of a longer term approach to regulation. We feel that the 5 year cycle has created too much emphasis on the short term and there needs to be a re-balancing to ensure sufficient investment for the future – particularly to tackle nationally important aspects such as climate change, resilience and net carbon zero.

We have, however, previously flagged our concern that PR19 pushed the balance of risk and return too far towards the downside – particularly in relation to Outcome Deliver Incentives (ODIs).

We feel that the use of Outcomes has been very effective but, as noted above, have concerns about the down-side skew – particularly for WoCs. We also have concerns about the relative fairness of the position of WOC's and WASC's on ODI's – with WASC's having the overall benefit of more achievable wastewater Outcomes.   We support an overall reduction in number of Outcomes and support plans to publish Performance Commitment Levels (PCLs) corresponding to base costs.

We would like to see more commonality of Outcomes and greater linkage to key strategic objectives for the sector. In particular we challenge whether Outcomes are sufficiently well aligned to the strategy of all key regulators involved in the industry and wider government policy.

Q3.2
As noted above we feel that Outcomes have been effective but need to re-balance the approach between risk and return; additionally we would welcome more commonality and greater read-through to key strategic objectives. We challenge whether Outcomes are currently sufficiently well aligned to the strategy of all key regulators involved in the industry and wider government policy.

We believe it is critical that the Industry is actively influencing government policy to ensure strategies are congruent e.g. water efficiency is aligned to policies on building regulations, the adoption of national water efficiency rating for appliances and water efficiency grant schemes.

Increasing focus on the long term	Q4.1: What are your views on the need for greater focus in companies' regulatory business plans on how they will deliver for the long term?
	Q4.2: What should long-term strategies seek to cover and what details should we expect companies to set out in business plans? Would common requirements help us and other stakeholders to understand each company's approach?
	Q4.3: How would this build on the work completed in strategic planning frameworks?
	Q4.4: How can we allow such strategies and plans to adapt to new information at future reviews while continuing to hold companies to account to deliver expected benefits into the future?
	Q4.5: Would providing our views on comparable aspects of companies' plans in advance of business plan submission streamline the price review process?
	Q4.6: Should we adopt a collaborative approach to developing Welsh companies' plans at PR24? If so, how should we go about doing this?
	Q4.7: What are your views on how we could provide clarity over the long-term regulatory framework?
	Q4.8: Are there barriers to water companies changing how they deliver their core functions to deliver greater environmental and social value? How can we address any barriers?
	Q4.9: Do you have any further suggestions for increasing the focus on the long term? If so, what are these?

Q4.1
We strongly support the need to take a longer term view and have been advocates for a move away from a short term 5 year cycle to one which supports greater certainty over long term issues. We feel this could be supported in a number of ways including;

- Better clarity and explanation of how Company Business Plans fit into their long term business strategies.
- Greater transparency and future certainty of regulation in relation to agreed long term programmes/objectives
- Better alignment between different regulators and UK Government in respect of long term objectives for the industry and how this is congruent with the long term strategies of stakeholders
- Outcomes & incentives appropriately linked to long term objectives with indicative glide paths for performance (from Companies and Ofwat)

Q4.2
With this change in emphasis, it will clearly be important for companies to articulate how Business Plans support their long term strategies. To this extent we feel that guidance on ***thematic*** commonality would help comparability and understandability. However, we caution a too specific or highly mandated approach which could become over burdensome.

A framework setting out the industry's long term objectives would be helpful in order that companies can articulate how their Business Plans and longer term strategy support those objectives. Companies could set out their strategy in relation to such objectives broadly in 5 year blocks with indicative "glide path" for performance.

If thematic guidance is provided then companies should be in a position to articulate how they will address the thematic areas. These could include strategic long term themes such as net carbon zero, water scarcity, resilience and water poverty. Such categories need to be sufficiently broad to allow companies to make their own specific circumstances and issues clear whilst allowing Ofwat to draw comparison between companies. We would caution about including too much complexity. This should also be aligned to Ofwat's thinking around common Outcomes and related incentives (over the longer term).

Q4.3
This approach would be aligned and complimentary to work undertaken in strategic planning frameworks.

Q4.4
It is inevitable that all strategies will need to evolve over time. In order to allow appropriate flexibility but retain accountability we feel that a key enabler is for the Industry to have clarity in relation to Regulators' key strategic objectives (which could be articulated through a framework as set out above).

Within such a framework it then would be possible to have companies track against long term objectives - setting out performance against a longer time glide path.

Where changes are needed to overall objectives or timelines it should be transparent how delivery glide paths have been revised – e.g. plotting against a fan diagram showing tram lines against "original" and "new" performance objectives.

Q4.5
We are not clear that Ofwat providing views on comparable aspects of companies' plans in advance of Business Plan submission would necessarily streamline the process but feel it would provide helpful insights and food for further thought.

Q4.6
We feel that a collaborative approach would deliver best for customers.

Q4.7
We see this question as being the one of the most challenging aspects of delivering a longer term approach for the industry. Companies and Investors want certainty and predictability yet we recognise that Regulators do not want to "fetter their future discretion".

We feel that a key enabler here would first be to have a longer term view on combined Regulator's strategic priorities (Ofwat/DWI/EA/CCW etc.). We feel that Ofwat could take the lead here and we recognise the work already ongoing with the EA.

In concert with this a longer term view from Ofwat on related objectives (Outcomes) including publication of longer term indicative glide paths would improve certainty over the long term regulatory framework. Like-wise indicative incentive rates for the longer term would enable improved cost/benefit analysis of longer term programmes.

A move away from a (short term) focus on low bill levels to ensure sufficient investment for the future is also a key enabler, as is certainty on funding of long term programmes (where these cannot easily be changed once committed to).

Q4.8
We see the primary barrier to water companies changing how they deliver their core functions (to deliver greater environmental and social value) as being mainly the incremental cost of additional responsibilities and how this is funded. Customers need to be charged for the efficient cost of delivering our services but where those are expanded beyond the base function (and efficiently delivered), this should be recognised in prices.

Q4.9
The development of the RAPID alliance of regulators has been an important first step in developing a longer term consistent framework for the industry. However, the further ahead we plan, the more certain we can be that the decisions we need to take today will be the right ones for the future.

We therefore encourage all regulators to understand that a lowest cost solution may not always be appropriate and that a “least regrets” approach may be more appropriate if we are truly to support a long term vision. This approach would be based on a good understanding of the scale of uncertainty around the issue being addressed and detailed consideration of all options (and costs) able to solve any challenge.

At each stage the objective should be to make decisions which do not necessarily “lock” the business into a given solution until it is needed. We have developed this approach at Water Resources South East (WRSE), where the planning horizon is 80 years and, we believe, there are merits in it be applied more widely to benefit our business and the industry.

Strengthening incentives	Q5.1: Should we undertake an initial assessment of plans at PR24? If so, what areas should we focus on in this assessment?
	Q5.2: Should we consider adopting a more light touch approach at PR24 for companies with a strong track record of delivery during the PR19 price review period? If so, what factors should we consider in our assessment and why?
	Q5.3: Should we streamline the price review by combining different steps in the process? If so, which of the three options outlined in this paper should we consider? And are there other options we can usefully consider?
	Q5.4: Is a different approach needed for the initial business plan assessment for companies in England and in Wales?
	Q5.5: What incentives should we provide for high quality plans at PR24? If we don’t make use of early draft determinations, how else might we strengthen incentives to table high quality plans on first submission?
	Q5.6: How might we set cost sharing rates at PR24? Should we consider an approach based on our ability to monitor companies’ asset health status?
	Q5.7: Which areas should we be considering targeted challenges for at PR24, and why?
	Q5.8: Should we use innovation specific incentive mechanisms at PR24? If so what would these be, and what would they add in addition to the other mechanisms outlined in this chapter?
	Q5.9: In what ways might we promote the themes of EBR through PR24?

Q5.1
At PR19 the Initial Assessment of Plans (IAPs) helpfully provided detailed Ofwat feedback (and clarification) on its expectations. If this guidance had been provided earlier in the process (and before Business Plans were submitted) it would have been very helpful and in some cases may have avoided significant re-work in the period following the IAP.

Assuming guidance is clear we would support the publication of the Draft Determination at the same time as IAP.

Q5.2
We welcome that Ofwat are considering a streamlined process for companies with strong track records. We consider that we would be included in this category, given our Totex and service performance in particular.

Furthermore, in terms of risk (to customers) the fact that we have by far the lowest bills in combination with industry leading ODIs should also be part of this consideration. If our plan has something significantly new / novel / innovative, relative to issues that others in the industry may have already addressed then the price review process should undertake a 'deep dive'.

At PR19 we considered the impact of meeting Ofwat's expectations of being a fast tracked company, but the Board considered the prize (in terms of reputation and additional rewards) was not great enough given the significant down-side (reputational and financial) risk involved.

We do not believe the concept of developing a prize for the "best" plan is particularly helpful. The key issue in terms of credibility should not be what is written in a plan but what has been delivered for customers.

Q5.3
As noted in our response to Q5.1, assuming guidance is clear we would support the publication of the Draft Determination at the same time as IAP.

Q5.4
The Initial Assessment of Plans was very detailed on many key parts of the plan. On occasions it felt as though Ofwat were "telling us" what the answer would be and therefore what we needed to justify. For example we had 50 challenges relating to ODIs, categorised into definition, targets, incentive rates and timing. Ofwat clearly had an explicit set of criteria in determining the appropriateness of the ODI package. If at PR24 we are building on the PR19 methodology, there should not be significant challenge from Ofwat on this issue. In addition, our expectation is that the customer research, to some extent undertaken across the nation, will provide extra data which will feed into the incentive rates.

Therefore, the volume of work that is generated from the IAP is related to the quality of guidance / instruction provided by Ofwat in advance of any business plan decisions. It would also support the decisions made by Ofwat in the Draft Determination.

Q5.5
Our fundamental position is that the industry should not receive financial or other incentives to ensure we provide good quality Business Plans. As noted above the Company did consider the PR19 requirements to achieve "fast track" status but concluded that the incentives were not sufficient relative to the risk being built into the plan and our ability to absorb shocks. We believe that the reputational incentives with stakeholders in particular, provide a strong incentive to all companies.

Q5.6
The current cost sharing rates reward those whose plans out-perform the Ofwat expectation and conversely for those who do not meet expectations. We think this is a reasonable approach. We agree that the Asset Health Assessment should in some-way be included in this assessment, given it is this which is the driver of capital maintenance plan in total. The Asset Maintenance Maturity Assessment work stream currently being undertaken by Ofwat is looking at this issue, and it is recognised that forward looking indicators of performance should be considered in addition to the current econometric approach (which is backward looking) to determine the appropriate level of spend for the next AMP period.

Q5.7
We believe that the two areas of per capita consumption and wastewater discharge you have highlighted for step changes on delivery are sensible candidates. We are clearly only involved in delivering the former. We would however caution over-emphasis on this one metric. The key measure (in terms of water demand and therefore abstraction from the environment) should reflect total demand, including non-household demand and leakage, not just household demand.

Q5.8
The introduction of the Innovation Fund was a significant new development at PR24. We agree with Ofwat that it is currently too early to assess its effectiveness but consider it to be different to the standard price setting process methodology – and something that should be considered for longer term challenges.

Q5.9
We would consider that we do operate our business consistent with the principles of an Ethical Business. We believe that any regulation of the industry should be built on foundations of collaboration and trust for all parties involved. Whilst this is generally true for us, we consider that there are judgements Ofwat have made at PR19 which run counter to that position. Furthermore, the fact that 4 companies chose to appeal their Final Determination would indicate that collaboration and trust was not achieved. We support the overall aspiration but believe it is very difficult to start afresh on this issue, given recent past issues.

Reflecting customers' preferences	Q6.1: What are your views on the merits of our proposals for a collaborative approach to standardised and/or nationwide customer research to inform company business plans and our determinations?
	Q6.2: Do you have any suggestions for how we best implement the collaborative approach to customer research for the price review?
	Q6.3: Are there aspects of negotiated settlements that could be reflected in our price review framework?
	Q6.4: What are your views on our proposals for customer challenge of business plans and assurance of customer engagement?
	Q6.5: What are your views on whether we should develop minimum standards or provide guidance in other areas?
	Q6.6: How well does our proposed approach to customer engagement take appropriate account of the different regulatory frameworks in England and Wales?

Q6.1
We strongly support the development of a collaborative approach to national customer research. We recognise that the standardised approach may allow companies greater flexibility in how they approach their research, but we would question if such flexibility is more desirable than consistency of results gleaned at the same point in time using the same methodology nationwide?

A key issue at previous reviews has been the inconsistency between different companies' results, which we do not think is adequately explained by differences in the customer base, but by the methodology by which the research was undertaken. We are already involved in the on-going discussion but wish to highlight that the timescales are tight to deliver this given the issues being addressed.

At this stage, we are not able to quantify the cost of the national exercise for us and, therefore, whether it will impact affordability of other customer engagement activities we believe we will need to do. We believe local engagement will be needed to focus on local issues.

We would encourage Ofwat to accelerate this initiative as soon as possible.

Q6.2
We would suggest a small steering group is required to ensure the scope is clear and delivery is achieved as follows:-

- Ofwat, representing all regulators including Defra, EA and DWI
- One member of the industry, perhaps WaterUK, representing each of the water suppliers
- CCW, given their experience of significant research programmes in the past.
- The research organisation – an experienced independent third party

Both Ofwat and the Industry representative would need to be able to communicate quickly with those they represent and speak on their behalf.

Similar approaches were applied successfully at PR04 and PR09 when we tested acceptability of plans and price changes. The key area to focus on initially would be ODIs, both the level of the performance commitment and the incentive rates.

Q6.3
We agree with Ofwat that to move to negotiated settlements will be a challenge for PR24. We do not know who we would be negotiating with as such a legal entity does not currently exist with the responsibility to set water prices. Indeed this responsibility sits very clearly with Ofwat.

Of all of the issues we need to address at any price review, it would seem that ODIs could be the topic of any negotiated settlement. That said the general move to greater common ODIs between companies will reduce the scope of any negotiation.

Q6.4
We consider that our CCG did play an important role in the PR19 process, challenging our plan, bringing a strong local focus and making sure it was consistent with the results of our research programme.

We note Ofwat will still require challenge and assurance of our engagement process and this in part is a reason why we support the nationwide research programme.

We do not currently have a proposal on how we will assure our overall engagement plan but will discuss this with our Board and CCG in due course.

Q6.5
We understand the importance of appropriate challenge and assurance for customer engagement. However, we are concerned that these may be a complex series of requirements where a "one size fits all" approach which may not be achievable for smaller companies like ourselves.

Q6.6
We have little experience of the detail of the regulatory framework in Wales and so have no comment on this issue.

Planning together for PR24	Q7.1: How can we ensure that companies bring together the outputs of the strategic planning frameworks in the most coherent and effective way for business plans?
	Q7.2: What are your views of our thinking on our and companies' roles in engaging with other regulators between business plan submission and our issuing of the final determinations?
	Q7.3: How could we best involve a 'PR24 Challenge Panel' in the price review process to help ensure that our decisions best reflect the interests of customers, communities and the environment?

Q7.1
We support the important concept of ensuring that the industry as a whole and Ofwat in the context of the regulatory determination has a transparent and shared understanding of the strategic objectives of the key (national) regulators for the industry. Companies or groups of regional companies should work on a shared view of the framework in relation to regional priorities and strategies.

We will need to retain an element of flexibility in order to capture the effects of changes in emerging government policy.

This joined up approach with regulators is even more important given the focus on delivering long term strategies and the "flight path" needed to determine the appropriate steps over a number of price review periods.

Ofwat could take a lead role in coordinating a shared understanding of key strategic objectives across the regulators and we are pleased to see the work already underway with the EA and through RAPID. However, companies have ultimate responsibility for ensuring that submitted plans meet the expectation of other regulators.

Historically our Water Resources Management Plan has always underpinned our Business Plan to Ofwat. We welcome the fact that Ofwat recognised its importance at WRMP19 and actively engaged with the plans during the process. This needs to continue for WRMP24 as the potential impact of abstraction reductions from chalk rivers will have a significant impact on our supply demand balance and ability to provide bulk supplies to Southern Water. Further, the recent decision to classify the Company as Water Scarce means we will be able to install meters at all domestic properties in the future. Both of these issues will be significant areas of focus for PR24.

We suggest companies could also produce a "top ten issues" list – from other strategic planning frameworks and ensure Ofwat has these at the front of their minds in advance of any review of Business Plans.

Q7.2
We recognise the need for ongoing engagement with other regulators. Companies and other regulators should be responsible for liaising to determine/assess that business plans meet the needs and expectations of other regulators including any changes/challenges that emerge during the regulatory process.

However, we firmly believe that the foundation to success is for the industry to have a clear and mutual understanding of the objectives (medium and longer term) of key regulators at the outset of the process to avoid late changes which may be difficult to accommodate in the business plan process.

We agree with Ofwat that we need to challenge the expectations of the other regulators to ensure ultimately that our plan is appropriate for our customers. Our experience is that some detail of the WINEP for example is not provided until later in the process, sometimes after we have submitted our Business Plan. We have quarterly liaison meetings with EA and will make sure they understand when we need to know their expectations and ensure we understand and challenge any of their proposals. We welcome Ofwat's work already to take a lead on this cross regulator liaison area.

Q7.3
Whilst recognising the role that a challenge panel could fulfill, we are somewhat unclear about the specifics of the role and how this would interplay with customer and stakeholder engagement work.

We also have a concern about how regional objectives and differences would be recognised through this process. The key to ensuring plans best reflect the "local" customer base, its communities and environment is to understand the detail of plan and why it has been proposed. We would suggest this will be a significant task for one group to deliver. Our local CCGs performed this function at PR19.

Design and implementation of price controls	Q8.1: Do you agree with, or have any comments on, our general approach to the design and implementation of controls, i.e. to retain separate controls with the same broad structure as at PR19, but with improvements to our implementation?
	Q8.2: Do you agree with, or have any comments on, our proposals for specific parts of the value chain, i.e. for water resources, developer services, residential retail and business retail in Wales?
	Q8.3: Do you agree with, or have any comments on, our proposals spanning multiple parts of the value chain, i.e. for major projects and future reconciliations?

Q8.1
We broadly support the proposal to retain the current separate price controls as structured at PR19 but with improvements in implementation. However, we would suggest that revising the current water resources control to include water treatment would be sensible. As noted in the consultation many of our water sources combine both water resource and water treatment, so we have created an artificial boundary for regulatory purposes. Whilst we understand the aspiration of developing a market for raw water nationally, this is highly unlikely in the South East of England, give the aquifer and chalk streams are already over utilised. We do not therefore find it surprising that the market has not developed as Ofwat had hoped. For the purpose of water resource planning, we place greater weight on the collaborative exercises being undertaken by the regional water resources forums (eg WRSE) as opposed to market solutions.

Q8.2
We are generally supportive of the proposals for specific parts of the value chain. We would suggest wholesale could be split into three business units:-

- Resources and treatment
- Networks
- Developer Services

We are participating in the current review of developer services. In recent years there has been a significant number of changes to the pricing rules and the current review is proposing to take this further. A related issue for us with the current tariff setting process is the adoption of the single till approach. It does not seem logical to treat all income equally when setting charges for domestic customers and developers. We would prefer to keep the two "tills" separate, to ensure that over / under recovery from developers does not impact other customers. We appreciate this would impact different components of the price review process, for example the comparative efficiency assessment, but it should be easy enough to carve out the developer data from the general Totex spend proposed by the Company.

Finally, we suggest household retail remains as a unit in its own right. However, the current approach is to determine the revenue we are allowed being set as a fixed unit cost per customer, which is currently £15. We would suggest reverting to the pre PR19 approach of having a separate price for metered and unmetered accounts, say £18 and £12 respectively, given the cost to serve is clearly greater for measured customers.

Q8.3
We support the need for future major projects to potentially span multiple parts of the value chain and feel this is in keeping with the emphasis on long term planning.

We would like to see further work done to look at how DPC arrangements can be standardized and simplified to reduce transaction costs as we see this as a barrier for smaller projects/smaller companies to successfully use DPC arrangements. In addition, DPC projects take longer to mobilise adding to the overall project timetable. Looking at ways to meet these two challenges may improve the viability of DPC.

We would support simplification of future reconciliation processes as these are frequently complex and often lack transparency – particularly when considered from a risk perspective in terms of financing and ratings impact.

Outcomes	Q9.1: What kinds of performance commitments should we include in the price review? What outcomes require financial incentives for all companies for the foreseeable future?
	Q9.2: How do you think we should monitor outputs that are not clearly linked to the outcomes incentivised in the price control? Would it help to distinguish between PCs that monitor outcomes and PCDs that monitor outputs? What other options could we consider?
	Q9.3: Do you consider there are aspects of company performance where it would be better not to set expectations as part of the price control? What approaches should we consider in these cases, so that companies act in the
	Q9.4: What should be our aim in setting the levels of performance commitments? Do you agree with the proposal that performance commitment levels should be set, as a starting point, at what can be achieved by an efficient company with base costs and that deviations from this are proposed in company business plans? If not what alternative proposals should we consider?
	Q9.5: What approach should we take to setting ODIs? How should we take account of marginal costs and marginal benefits in setting ODI rates? What are the risks and benefits of the approaches that we set out, or any others that you propose?

Q9.1
We agree that ODIs in the industry are too many and too varied and would like to see further simplification and standardisation. We currently have 9 common ODIs and 15 bespoke ODIs, many of which were in response to customer and stakeholder feedback, especially on environmental issues. We would generally like to see these reduce further in number particularly the bespoke ODIs.

Having reviewed our current ODIs we feel that 4 of the reputational ODIs could be dropped, given the focus on outcomes.

This would include:

- Avoidance of restrictions – as this is a legitimate action as part of our WRMP planning;
- WINEP delivery – as there is a second WINEP ODI relating to delivery on time, which has a financial incentive;
- RoSPA accreditation – which although important and unique to us, does not really fit in this framework – indeed should health and safety performance be measured across the industry?
- Resilience Schemes – the delivery of 3 capital schemes.

Consideration should also be given to the reasonable expectation of stakeholders to report against Environmental /Social /Governance performance.

If asset health measures are included in the ODI package, we would caution against reliance on financial incentives. These measures, such as mains repairs, can be heavily influenced by the weather and annual performance may not be a reflection of the health of the asset but more so the operating environment.

We recognise the importance of alignment of the Performance Commitments to longer term objectives and agree with the proposals for the three categories of "enduring outcomes".

We believe that there should be a clear read through to service levels and cost allowances particularly where step change in level of performance is needed.

Finally, we support a simplified approach to setting incentive rates. We feel this is an area where national customer research could be employed. However, in saying this we need to be mindful of how incentive rates are scaled relative to bill levels.

Q9.2

Overall, we see “outcomes” as being more effective than “outputs”, but recognise that some outcomes can be difficult to measure and therefore there can be a place for output measures or other indicators of success.

Generally, we would welcome the introduction of Price Control Deliverables to compliment ODIs. An example would be the installation of domestic meters, which play a key role in reducing per capita consumption and identifying leakage.

If the latter is not realised it is still be important to demonstrate to stakeholders that we have delivered against our plans and installed the agreed number of meters in the year.

However, we do have some concerns that this could result in a “two tier” system which could split management focus.

Q9.3

We can see that there could be some merit in this approach and feel that the examples given by Ofwat are appropriate. It is always likely that issues arise within the price review period which need to be addressed and agreed with companies. The two examples given relating to affordability and vulnerability are two such issues.

The regime should not be so rigid as to not be able to accommodate significant changes in circumstances.

Q9.4

We feel that Ofwat need to consider the setting of the performance commitment level carefully – particularly recognising the individual company circumstances. This assessment should also ensure cost required to deliver is recognised.

By way of illustration:-

- Interruptions to supply targets should recognise the circumstances the company operates in; rural companies are less likely than urban companies to achieve a set target given the time it will take to locate and repair a burst main, for example.
- Per capita consumption targets – should recognise the meter penetration of the business and indeed the level of the bill the customer faces. Low prices as in our case do not send strong signals to save water.
- Leakage targets – should recognise the current performance of the Company and not be set as a blanket percentage reduction

We also welcome the introduction of three year rolling averages for PCC and leakage, recognising these metrics can be heavily influenced by the weather.

Q9.5

We struggled at PR19 to determine relevant customer benefits to determine the incentive rates in accordance with economic theory. Ultimately Ofwat determined rates for each of our ODIs based on industry comparisons.

We would hope that the national research programme would address this issue in particular but note that incentive rates should be set relative to the size of the bill.

We would caution against the use of financial incentives for asset health measures, as noted above in Q9.1.

We would welcome the early publication of on incentive rates ahead of any business plan being submitted.

Cost assessment	Q10.1: What should be the priorities for improving our approach to cost modelling and assessment?
	Q10.2: In what areas (both historical water sector and external) can we improve the range of benchmarks we use in cost assessment?
	Q10.3: How can we take account of longer term ambitions such as delivering net zero and increasing public value in our approach to assessing costs?
	Q10.4: Do we need to amend our cost assessment approach to take account of nature based solutions?
	Q10.5: Where can we enhance our evidence base on the relationship between costs and service?
	Q10.6: What mechanisms should we consider for the efficient funding of performance levels, set in a long-term context, that vary from those an efficient company would deliver through its base allowance?
	Q10.7 – Is there more that we need to do to reflect future pressure on operational resilience in our approach to cost assessment?
	Q10.8: Are the most significant challenges to the operational resilience of the sector adequately captured within current strategic planning frameworks?
	Q10.9: How can we strengthen incentives for long-term operational resilience and improve the assessment of resilience enhancement expenditure while continuing to protect customers' interests?

Q10.1
The approach to cost assessment has been reviewed as part of the CMA process and the recommendations from their review should be considered as key pieces of work to be undertaken by Ofwat in collaboration with the industry.

We generally supported the PR19 models; they were relatively simple and easy to explain internally and to stakeholders.

The issue of growth in new connections was not assessed satisfactorily at PR19 and needs to be considered further. We recognise that the assessment of enhancement costs is not straight forward, but should be developed further in collaboration with the industry.

Finally we feel strongly that there should be clear linkage between cost allowances and levels of performance – particularly where a step change is required.

Q10.2
We note and support the discussion on developing external benchmarks in the consultation and also the difficulty in determining relevant external benchmarks.

Ofwat could consider discussing the issue of pipe laying costs with either self-lay providers or NAVs, given the volume of work both are winning in the market place at this time.

Q10.3
The issue of the cost associated with net zero (carbon) will be an ongoing and evolving issue as we prepare for PR24. At the end of July all companies will have published a road map of the activities they will undertake to deliver the commitment by 2030. We would hope that we can then discuss the cost / benefit implications of the plan with Ofwat in some detail.

As noted early in the context of the setting of performance commitments, Ofwat will need to look at each strategy in turn. It is unlikely that any two companies will be starting from the same position or indeed have the same cost of delivery for any given activity – this will need to be taken into consideration along with the specific difference between WoCs and WaSCs as a result of the WaSC access to bio-resources.

Q10.4
Yes, we feel this is an important consideration. We did propose a nature based solution at PR19, our catchment management programme, and we were pleased that this was fully recognised by Ofwat in the Final Determination.

We do not therefore, necessarily concur with the conclusion that the uncertainty of allowances for more than 5 years will discourage their development. However, we recognise that as the level of nature based programmes develops the level of future certainty will become more critical.

We will present our plans for AMP8 as a development of the agreed AMP7 programme and have no reason to assume it will not be recognised at PR24.

Q10.5
The link between service and cost is a very important issue and one recognised by the CMA in the context of delivering the 15% reductions in leakage at PR19. That said, unless the required change in service level is significant, it is unlikely that costs of improvement can be determined with any confidence.

We would suggest companies are asked to provide scenarios of how much it would cost to deliver significant step changes in the key ODIs, leakage, PCC, interruptions to supply for example.

This is not an easy exercise and again very much depends on the current operating performance of the business.

Q10.6
When we look at how costs are remunerated at any price review, we would argue that any step change in level of service is enhancement expenditure, assuming it is fully supported by the customer base. This will move into base expenditure in subsequent AMPs, either opex or capital maintenance spend.

We have not determined any other approach to funding a step change in service.

Q10.7
The current Ofwat work streams on Asset Maintenance Maturity Assessment and Cost Assessment have both discussed the issue of appropriate future funding based on leading indicators.

However, we have yet to conclude discussions on the issue.

What we have agreed thus far is that any assessment of cost should be take into account:-

- The econometric assessment of past expenditure
- The impact of any additional spend required as per the forward looking indicators
- A reflection of the Company's understanding of its asset health / maturity

We also believe that any approach to asset maintenance spend should take into account the performance of the assets and the quality of service delivery to customers.

Q10.8
We believe the issues, which impact operational resilience, are well understood and covered in the strategic planning frameworks.

All of the following issues impact our operational resilience:-

- climate change,
- population growth,
- environmental pressures on abstraction,
- changing demand from customers,
- the condition of the asset base,
- raw water quality and other local environmental impacts

We will work collaboratively with all stakeholders to develop our understanding further and, as noted previously, feel that Ofwat also has an important role to play in this process.

Q10.9
We look forward to the forthcoming paper from Ofwat on the issue of funding for long term operational resilience. We are not aware of any approaches to funding such programmes which do not result in an impact on our customers' bills.

Risk and return	Q11.1: Are there areas of our risk allocation framework where mechanisms could be added, simplified or removed in a way which would benefit customers?
	Q11.2: How should we improve our use of RoRE risk ranges to provide insights into the balance of risk and reward, and improve comparability across companies?
	Q11.3: Should we index the allowed return on equity, and if so, how ought this to be implemented?
	Q11.4: To what extent should we place weight on a) balance sheet data; and b) index data when setting the allowed return on debt?
	Q11.5: Should we allow adjustments to the sector allowed return based on company size - and how should this be assessed?
	Q11.6: Should we make different assumptions for the PR24 notional structure compared to PR19, and how should such a change be implemented?
	Q11.7: Do you have any suggestions for mechanisms which could incentivise financial resilience within the price control process?
	Q11.8: To what extent should we further increase the share of the notional company RCV which is indexed to CPIH in our assumptions for the period 2025-30, and how should this be implemented?

Q11.1

We recognise the importance of getting the right overall balance of risk and return. We would support simplification of processes and mechanisms- particularly the number of reconciliations. We would also ask Ofwat to reflect whether any further simplification could be applied to the small WoCs.

We would re-iterate our PR14 and PR19 feedback that the balance of service incentives was too skewed to the downside. We feel that this was particularly evidenced, in terms of the downward outturn seen for WoCs versus the Water and Sewerage companies (WASCs). This may be due to the relative fairness/achievability of water ODI's relative to wastewater.

Q11.2

In relation to the allocation and quantification of risks (through the Return on Regulated Equity (RoRE) process) we recognise that that can be undertaken in a number of different ways and it will be difficult to find a practical approach that suits all companies.

We are concerned that small companies may be required to undertake complex (and costly) Monte Carlo analysis which still may not result in the level of comparability that Ofwat seeks. This is because even within a Monte Carlo approach there will be a range of judgements (e.g. in relation to the risk distribution) and this is also very dependent upon the quality of the data.

We do support the challenge that risks should be well understood and transparently presented and this is consistent with continued developments in Corporate Governance.

Q11.3

We would support an indexation mechanism.

Q11.4
As previously highlighted, we remain concerned that the process of setting the allowed return on debt continues to disadvantage small companies, which tend to have much smaller financing programmes and will generally not have a rolling program similar to the largest companies. This results in WoCs being, generally, further away from the average debt profile used and therefore puts small WoCs at a disadvantage.

We would ask Ofwat to consider making a *further* company specific adjustment which takes account of significant variances from the index/benchmark that small companies may suffer due to having significantly different historic debt profiles.

Q11.5
Yes, we strongly support the continuation of a company specific premium to recognise the fact that the cost of financing for small companies is higher due to the semi fixed cost of raising finance and view that smaller companies have a higher risk profile.

We note that this is a separate issue to our response above (11.4) with respect to variances in the historic debt profile of small companies relative to the average index.

We suggest that the application of the company specific premium should be linked to a "customer benefits test".

Q11.6
We support the CMA's position on the gearing out-performance sharing mechanism.

We continue to have concerns about a notional gearing which diverges significantly from market levels (in both Water and other infrastructure-heavy industries). There will be significant tension (and pressure on financeability) if there is an expectation that companies will both reduce gearing and increase investment for the long term, in the next AMP.

Q11.7
We support the CMA's (& rating agency view) that changes to PAYG should not be used to address financeability constraint as we see this as undermining future financeability. Our view is that this approach is not consistent with the principles of a long term financial resilience.

Q11.8
Although not particularly palatable for us, due to the significant portion of RPI linked debt that we carry, we recognise the practical and reputational impact of the need to continue CPIH transition. However this will cause upward bill pressure and, if combined with other bill pressures such as Net Carbon Zero and further long term/resilience investment, this could put too much upward pressure on bills.

Next steps for PR24	Q12.1 - What are your views on the draft timetable for PR24?

Q12.1
The draft timetable appears similar to that of PR19, although noting draft determinations will be earlier. This would be a good step if the IAP and Draft Determinations are combined.

All we wish to state at this stage is that we have a relatively small team engaged in preparing the plan and during April/May/June these staff are heavily involved in the APR process. We are aware that the larger companies have similar challenges at this time.

It will be critical that relevant PR24 guidance is published with sufficient lead time (12 months at least) to allow Boards adequate time to prepare and develop their PR24 strategies and approach. We also flag the importance of timely output from the combined customer research/engagement activity.

Appendix - Examining the boundary of the targeted control for water resources	Q14.1 - How can costs and incentives for the existing water resources control be targeted more effectively?
	Q14.2 - Would amending the boundary to include raw water distribution or to extend it further to include water treatment improve the operation of the control? What are the issues involved?

Q14.1
We do not think greater targeting of the water resources control is beneficial, given the nature of our system and the need to allocate costs across water resources and treatment to determine these unit costs separately. The overall objective in establishing the Water Resources business unit was to identify the cost of existing water resources and create a market for "new" water.

The cost of any new water will need to include the capital costs of construction. This cost has already been incurred by the Company for its existing sources and it is therefore unlikely that any new source will have a lower unit cost than existing sources. This issue needs to be kept under review, given the inherent quality of the water may change overtime and the need for (additional) treatment may be greater than any "new" sources of water. In any case, in the water stressed South East, the only genuinely 'new' sources of water are from desalination or water recycling.

Q14.2
We discussed this issue in response to Q8.1. We do not have any raw water assets. We would suggest that revising the current water resources control to include water treatment would be sensible. However, we note that if there is truly a wish to simplify PR24 it should be considered whether or not there is significant regulatory benefit from making this change.

As noted in the consultation many of our water sources combine both water resources and water treatment infrastructure, so we have created an artificial boundary for regulatory purposes. From an accounting point of view (and therefore an understanding of the costs) this would give Ofwat a good benchmark of the cost of treatment by treatment type.