

Ofwat consultation: 'PR24 and beyond: Creating tomorrow, together.'

Blueprint for Water response: July 2021

Wildlife and Countryside Link is a coalition of 60 organisations working for the protection of nature. Together we have the support of over eight million people in the UK and directly protect over 750,000 hectares of land and 800 miles of coastline.

Blueprint for Water, part of Wildlife and Countryside Link, is a unique coalition of environmental, water efficiency, fisheries and recreational organisations that come together to form a powerful joint voice across a range of water-based issues.

This response is supported by the following Link members:

- Amphibian and Reptile Conservation
- Angling Trust
- British Canoeing
- Institute of Fisheries Management
- Marine Conservation Society
- National Trust
- RSPB
- Salmon and Trout Conservation
- The Rivers Trust
- The Wildlife Trusts
- Waterwise
- Wildfowl and Wetlands Trust

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Ellie Ward Policy and Information Coordinator

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Blueprint for Water welcome the opportunity to contribute our views on the framework for PR24 and future price reviews. We welcome the recognition that greater focus on long term priorities will be valuable to drive action, providing a strategic steer to companies and ensuring that delivery in each AMP makes an appropriate contribution to long-term goals. This will be particularly important in delivering environmental outcomes, as sustained focus will be required to deliver on many of the things that the environment requires, and customers expect.

Our response sets out some of our environmental ambitions for PR24, and we would welcome the opportunity to discuss these in more detail.

Ambitions for PR24

Q2.1: Do you agree that the themes we have suggested for PR24 are appropriate for England and for Wales?

- We agree with the greater focus on the long term, including by drawing together Water Resources Management Plans (WRMPs), Drainage and Wastewater Management Plans (DWMPs) and other statutory plans, & by taking account of Government ambition – or going beyond it. Within this, a strengthened approach to resilience must include environmental and not just business / systems resilience.
- We agree with the need to deliver greater environmental and social value, & welcome recognition of the need to work on how these aspects feature in decision-making. We welcome consideration of how to incentivise nature-based solutions (NbS) & opex-based solutions, and greater partnership working.

Q2.2: Do you have comments on the considerations we've identified as relevant to the design of PR24?

- We welcome the greater clarity of approach, and the maintained focus on outcomes.
- We support a greater element of centralised comparative customer research where aspects are common across companies, and welcome suggestion that companies consider more 'day to day' engagement, not just during a Price Review (PR).
- We welcome a focus on efficiency and innovation; although it will be important that proposed 'targeted challenges' are used to drive innovation in areas that may otherwise be disadvantaged by uncertainty, for example, the use of NbS.
- We welcome the recognition of climate change as the 'first and foremost' challenge facing the sector, and society. It is important that companies are supported to implement solutions that not only provide resilience against climate change, but that do not exacerbate either the climate or biodiversity crises.
- On affordability issues in a post-Covid society, we note that it will be important to harness best value solutions, not just lowest cost options (although in some cases these will be one and the same, especially when non-financial value is considered). To fail to do this is short-sighted as when wider costs and benefits are taken into account, 'lowest cost' approaches are typically more costly overall.

Q2.3: How should we evaluate our progress, and how can we best develop or use appropriate metrics to do so?

- Ofwat need to significantly improve visibility and transparency of in-AMP progress against expectations. Too often, significant customer engagement and public discussion of plans and progress happens only during the PR period. This could be achieved through evolving the Discover Water website, or by production of a new performance dashboard by Ofwat.
- Any metrics or measures used to assess progress do however need to be adaptable, to take into account things that may affect performance, such as Covid. This will be increasingly

relevant as water companies work more and more in partnership with others, as aspects such as partner capacity will be outside of the control of the sector.

- When considering in-AMP progress, we would also like to see greater use of mechanisms that allow for companies to move from investigations to delivering improvements within the same AMP, where feasible. The Water Industry Green Recovery funding programme has shown that companies can move more rapidly on such elements where funding frameworks support this.

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?

- We support the outcomes framework element of the current approach. Main Performance commitment (PCs) have worked well overall, but reputational PCs have not been a success, with limited reporting against them, and a lack of evidence they are driving progress.
- We accept the principles behind Ofwat's preference for Common PCs over Bespoke, but must first explore whether this would disadvantage environmental commitments as these may be linked to differing local / regional customer priorities. For example, where there is customer support for investment in restoring chalkstreams, or upland habitats, these may be more suited to bespoke PCs. Alternatively, any CPCs would need to be sufficiently broad so as to allow for all interests, so for example a CPC on 'Biodiversity delivery', which could use standardised measures such as hectares of land enhanced, with local priorities then determining *where* that work is delivered.)
- We support further work to ensure that cost efficiency isn't achieved at the expense of service levels and environmental delivery. This could be achieved via a focus on best value rather than lowest cost, as discussed above.
- We support ongoing efforts to ensure the system does not unduly favour capex solutions and allows companies to develop nature-based solutions that have less certainty but greater benefits.

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?

- We welcome the regional and stakeholder engagement approaches delivered through Regional Water Resources Planning and suggest that Ofwat consider what can be learnt from this approach to inform the development of DWMPs. As with water resources, drainage and wastewater are not solely within the responsibility or control of water companies, meaning that the early engagement of stakeholders such as Local Authorities and Catchment Partnerships will be of benefit during plan development.

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?

- We support a greater focus in the investment plans on delivering what society needs in the longer term as well as the short term. Ofwat providing clarity on expectations for future PRs would facilitate this.
- Greater clarity on what is considered base vs enhancement expenditure would also be welcome; the CMA challenges to Ofwat's PR19 Price Determinations demonstrated that companies' expectations on this differed from Ofwat's.
- We welcome the idea of 'PRs as staging posts within a long-term context', and agree that it is best *not* to achieve a long-term focus by significantly lengthening PR periods, as this may limit the scope of plans to be responsive to changing circumstances and priorities.
- We note that Strategic Direction Statements previously produced were separate to companies' 5-year Business Plans (BPs) and there was often not a clear line of sight between the two. We welcome the suggestion that that companies 'place their delivery plans for the price review period clearly in the context of long-term strategies' and suggest that companies integrate these into a single business plan that looks at both the short term and at longer term strategy, connecting the two things more explicitly within the plan. This may help to identify more easily where short-term (ST) delivery proposals do not match up to long-term (LT) ambition.

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?

- LT strategies would be welcome and, yes, some common requirements would help stakeholders understand each company's approach. These could include a company's 'pathway to Net Zero' building on the Industry's 2030 route map (and incorporating wider emissions, as a contribution to the UK 2050 target). There is a similar need against other ST and LT Government priorities, for example, halting and reversing the decline in nature by 2030, and delivery of targets being developed under the Environment Bill target-setting framework. We agree that a LT view will also help to tackle under-investment in asset maintenance.
- BPs should identify activity for the coming 5yr period as well as activities that could helpfully be brought forward from subsequent periods if opportunities emerge.

Q4.3: How would this build on the work completed in strategic planning frameworks?

- Recognising that these include both industry plans such as WRMPs, and external strategic plans such as River Basin Management Plans, this will help to translate long term policy into a long-term investment plan, and ensure integration of areas where there is crossover (e.g., between water resources and wastewater), rather than siloed approaches.

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?

- We accept that plans will need to adapt, as we can't precisely predict the future. But we suggest that an audit trail process is employed to capture what has changed in terms of

policy or local priorities, and what has been done to reflect or adapt to these changes. The use of graphed trajectories may be a good way to present this to stakeholders and customers, and will be important in providing confidence in the planning process.

- We can draw here from the WRMP process as an existing example of a LT plan which is updated on a rolling basis.

Q4.5: Would providing our views on comparable aspects of companies' plans in advance of business plan submission streamline the price review process?

- Yes. It would also be very useful to stakeholders as highlighted above.

Q4.7: What are your views on how we could provide clarity over the long-term regulatory framework?

- We agree with the suggestion to indicate which areas will be retained over several cycles as long-term priorities, as this will give companies certainty in direction of travel.
- We agree that there may be value in ensuring that outperformance and underperformance incentives and penalties could be more strongly linked to sustained performance levels. As it currently stands payments for some Outcome Delivery Incentives (ODIs) such as sewer flooding, Per Capita Consumption and supply interruptions can be heavily influenced by externalities such as weather or Covid. On the other hand, there is no incentive for companies who benefitted from outperformance payments for successful delivery during one AMP to continue to maintain progress in those areas in subsequent AMPs, meaning that customers may not receive best value for money in the long term.

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?

- Mainstreaming the use of Nature-based Solutions (NbS) is a key shift which could help to deliver greater environmental and social value; this could be supported by Natural Capital accounting approaches, as discussed under Q10.4, and by ensuring that there are no barriers to companies opting to implement NbS. For example, companies have suggested that clearer guidance / processes would be welcome to reduce uncertainty, such as around where the balance of risk sits if a NbS fails to perform as hoped.

Q4.9: Do you have any further suggestions for increasing the focus on the long term? If so, what are these?

- The adoption of agreed principles, metrics or targets relating to areas that undoubtedly require investment over the longer term, such as sustainable abstraction and environmental resilience, would be a valuable signal, giving companies the confidence to invest in delivery that will help to achieve these LT aspirations.

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?

- Yes, but we agree that the Initial Assessment (IA) should take greater account in PR24 of how the plan delivers environmental and social value in both the short and long term. In PR19, the environmental value in particular was not well covered in the IA process.

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?

- Yes, track record should be important but should sit alongside forward ambition.

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?

- We do not support Option 1 as it limits opportunities for dialogue and feedback, and does not leave sufficient scope for companies to adapt and improve their plans. Options 2 and 3 avoid this; option 3 allows for the procedural incentive of early draft determinations (as provided previously for ‘fast-track’ companies), which could again be employed if experience from PR19 shows that this did not result in under-scrutiny, or any other perverse consequences.
- However, noting that during PR19 Ofwat observed limited movement between IAP and Draft Determinations, the IA process could more usefully target the specific areas likely to be in need of resolution, e.g., the ‘totex gap’.

Q5.4: Is a different approach needed for the initial business plan assessment for companies in England and in Wales?

- Unless Ofwat become directly involved in the development of Welsh plans (under the proposed “collaborative approach to developing Welsh companies’ plans”) we do not see the need for a different approach in Wales per se, but note that assessment criteria should reflect any legislative or policy differences, e.g., plans must reflect the LT policy goals of the relevant administrations. If Ofwat are involved in plan development, IAP for Welsh plans could be delivered by different officers for objectivity.

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?

- We do not see the benefit of developing any incentive or penalty regime for draft submissions beyond the reputational and procedural incentives already established. High-quality submissions could be further supported by ensuring that expectations for the draft plans are clearly set out.

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?

- Noting that high cost-sharing rates might “incentivise companies to cut back on asset health, to benefit from savings”, we suggest that a lower cost-sharing rate for underspend compared to overspend could be considered, perhaps 50:50. A rate skewed more than this in customers' favour, however, could also disincentivise genuine cost reductions, and therefore savings for customers.

Q5.7: Which areas should we be considering targeted challenges for at PR24, and why?

- Targeted challenges are useful in giving a clear signal on where action is needed, and in spurring innovation; we agree that the leakage challenge resulted in a marked improvement in ambition and performance.
- We would welcome targeted challenges around the two areas proposed by Ofwat; water efficiency, and the harm caused by wastewater discharges.

Water Efficiency

- Progress in reducing personal consumption has been challenging in AMP7 and has been impacted by delays in supportive policy from the government (water labelling, metering, building regulations) and COVID.
- We do need to be careful with regards to the choice of metric given recent experience with PCC during Covid. A % reduction in distribution input may be an alternative option and map across to the water demand reduction approach being considered in the Environment Bill.
- Recognising that targeted challenges can be seen as arbitrary since they are applied uniformly across all companies, an alternative approach might be to propose that all companies plan to at least double their planned AMP7 spend on water efficiency (or allocate above a minimum % on planned WRMP24 investment). This step change in funding could be linked to more thorough requirements for companies to collaborate and to share evidence of progress plus include reporting into the new Senior Water Demand Steering Group.

Harm caused by wastewater discharges

- We agree that harm from wastewater discharges would be another area which could benefit from the certainty provided by a targeted challenge.
- We suggest that a target for zero pollution incidents (all categories) by 2030 should be set; although challenging, we do not believe that companies should be *planning* to achieve anything less than this.
- In light of significant public interest, a target on Storm Overflows would also help to reassure those concerned that political interest may not necessarily translate into improvements on the ground. We suggest that targets for bringing CSOs up to standard (asset health), and taking action to deal with the most significant spillers, should be set, in the context of a long-term aspiration to progressively reduce reliance on Storm Overflows altogether. The DWMP framework will help to prioritise delivery, and identify options for reducing overflow operation, including by tackling customer-driven events (sewer misuse) and by reducing surface water ingress to the sewer system, including through the use of NbS.

Other areas

- There is growing recognition that we are experiencing a biodiversity crisis as well as a climate crisis. In light of this, and given the significant scope for the sector to contribute to the decline (or the recovery) of biodiversity, we suggest that biodiversity delivery would be an appropriate targeted challenge. The Environment Bill will bring in the requirement to meet the Biodiversity Gain Objective by delivering a minimum of 10% Biodiversity Net Gain on schemes requiring planning permission; given the importance of the environment in underpinning companies' business models, we suggest a figure of 20% would be appropriate for the water sector, going beyond just legal compliance and showing leadership. We suggest that such a target would align with the sector's Public Interest commitment.

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?

- Innovation to encourage use and monitoring of key NbS would be useful, providing an incentive where other drivers may be a deterrent, e.g., penalties for underperformance may deter novel approaches with less certain outcomes.

Q5.9: In what ways might we promote the themes of EBR through PR24?

- We do have a concern that in effectively taking Customer Challenge Groups (CCGs) out of the PR24 process Ofwat are losing a key element of plan scrutiny from local stakeholders covering social and environmental perspectives. Companies must clearly set out how they will be able to demonstrate high-quality engagement with stakeholders if not maintaining their CCGs.
- Moving to a more 'trust-based system' of regulation is (currently, at least) unlikely to draw support from the many community and environmental stakeholders with concerns around sewage pollution for example; this is pertinent since it is a complex issue of potential non-compliance, underinvestment, and 'external' factors such as customer behaviour; a move towards EBR via trust-based regulation may be more acceptable over a period of several PRs, as companies improve / gain customer trust over time.

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?

- We support it. The lack of any visible comparators of customer feedback and willingness to pay (WTP) across companies was raised by eNGOs in the run up to PR19 as a weakness in the process. An enhanced process with some centralised elements will be helpful in determining whether any reported differences in WTP are genuine, or are a factor of differing methodologies / quality of approaches adopted by different companies. It must also however be sophisticated enough take account of any genuine differences, such as in WTP for environmental enhancements; for example, customers in the SW may prioritise bathing waters and the SE, chalkstreams. Differences which are a genuine reflection of local ambition must not be watered down by a centralised process.

Q6.4: What are your views on our proposals for customer challenge of business plans and assurance of customer engagement?

- We are concerned that proposals for a single national group (a PR24 Challenge Panel), if it is the sole approach taken, would weaken the part of the assurance process that considers whether local circumstances and priorities have been sufficiently incorporated. We suggest that local stakeholders are better placed to provide this scrutiny. We also note that it is a big ask of participants to review and scrutinise the BPs of all companies; establishment of a national group would therefore need in particular to consider the capacity of its members to properly participate.

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?

- We suggest that a spatial element may be one of the most effective ways of identifying where the outputs of different strategic plans best align. This could be achieved using GIS, and would be a useful method of generating a public-facing overview of proposed delivery and of enabling stakeholders to identify opportunities for collaboration.
- It would also help to demonstrate how delivery is contributing to overarching aspirations or delivery programmes such as the WINEP, and as a 'live' system could also be used in progress-reporting to regulators and stakeholders.
- The development of Local Nature Recovery Strategies will provide a further framework that plans should take account of, and again, GIS will facilitate this. For example, it could identify where the use of NbS could make a wider contribution to LNRS ambitions.
- There should also be an expectation that water companies will provide appropriate input into relevant external plans, such as Local Authority-led place-based plans. A GIS-based approach is likely to be the most streamlined way of achieving this.
- However, we recognise that where it is beneficial for water companies to take account of externally-owned strategic plans within their *own* planning processes, this will rely on the capacity of those external partners to engage / provide data; expectations here should not be placed solely upon water companies. A map-based system could nevertheless be of use in allowing the owners of those external plans to understand water company proposals, even if they do not have capacity to contribute their own data to it.
- In terms of ensuring coherence of environmental goals, and that plans contribute to overarching environmental targets and ambition, Strategic Environmental Assessment can play a key role here.

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?

- We are pleased to see Ofwat committing to ensure it is "joined up" in its regulatory approach to PR24 with other relevant regulators, including Natural England and the Environment Agency. This was a criticism from environmental NGOs in PR19 especially in relation to the IAP process and criteria.

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?

- As outlined in our response to Q6.4, a PR24 challenge panel could be a positive step enabling Ofwat to tap into a broader range of expertise and perspectives than those held in-house. However, the time commitment could be significant and participants will need to have their costs covered where appropriate. It does also not completely remove the need for local input to the scrutiny process.

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?

- We support Ofwat continuing to use a number of common performance commitments. We agree that they should be focussed on issues and outcomes of enduring interest and importance for society, customers and the environment. We have already noted that reputational commitments appear to have been of limited value given limited publicity / visibility, and suggest that only a small number of these be permitted if this type of commitment is used again.
- Blueprint for Water support proposals put forward on water efficiency by Waterwise, with the overarching objective of reducing the amount of water that needs to be put into supply / taken from the environment.
- We also consider that PCs around wastewater will be important; these could include pollution incidents, use of nature-based solutions, and action on Storm Overflows.
- Blueprint will shortly be publishing an Environmental Manifesto for PR24; we would welcome the opportunity to discuss with Ofwat our priorities for the Price Review, and where PCs may support the achievement of these.

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?

- The proposed approach is sensible in principle, provided that it does not 'reward' inefficient companies for previous under-investment, and that the levels at which penalties and incentives are set do not create perverse outcomes, such as it being cheaper overall to accept a penalty than to invest in delivering an outcome.

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?

- Ensuring that long-term aspirations are appropriately factored in to cost assessments will be particularly important; in the absence of this, short-term delivery priorities could result in investment that undermines long-term goals. For example, solutions in the WINEP could be very carbon-heavy if contributions to UK net zero goals are not considered. A natural capital

accounting approach could facilitate this, as could considering the long-term costs (to companies, customers and society) of not acting. In terms of demonstrating public value, transparency is key, so that customers can make informed choices; currently issues and investment are not always aligned.

Q10.4: Do we need to amend our cost assessment approach to take account of nature-based solutions?

- Yes, we suggest that Ofwat consider natural capital assessments as a framework by which nature-based solutions can be assessed, to account for the wider benefits that they provide to customers, society and the environment. This should be based on net present value rather than just in-AMP investment. To facilitate the mainstreaming of NbS, Ofwat should encourage and promote consistent approaches to natural capital assessments across the industry.
- Ofwat should consider a cost assessment process that addresses nature-based solutions - that deliver value beyond regulatory or statutory requirements - in the same way as capital solutions are addressed. Disincentives to investment in NbS, such as the lack of allowance for future maintenance costs, must be tackled.