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<u>Additional document – BRL responses to the questions for stakeholders in PR24 and beyond: Creating tomorrow, together</u>

Our responses to the 'questions for stakeholders' can be found in the pages overleaf.

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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?

We are supportive of the themes suggested for PR24. We were pleased to see the wider context framing – such as the level of emissions, threats to biodiversity, changing customer expectations and Covid-19 and the issue of affordability – as these areas of public concern align to the concerns of our customers and local stakeholders.

We also strongly welcome Ofwat's focus on public value, but we question the narrowness of its interpretation, particularly the framing that focuses on statutory obligations for price reviews and public value as how these are delivered. Our social contract provides a clearer framing of how a focus on public value can improve long-term planning and resilience for the water sector[1]. It is Bristol Water's 175th anniversary this year and trust and public value is enshrined in our social purpose statement – "Our purpose is to have a positive impact on the lives of our customers, our communities, our colleagues, and on the environment beyond the delivery of pure and reliable water". We therefore welcome the recognition of the importance of purposeful companies and public value (which we support) but we question why Ofwat does not see a stronger link between these principles and the importance of building consensus and trust through engagement around what the water sector is delivering for society, to guide the trade-off judgements Ofwat must make, when faced with uncertainty and inevitably imperfect information, at PR24. We explore this dichotomy further in Appendix 1 and in response to question 5.9.

We do question the reliance on sector-wide targets. As an illustration, we have provided in the table below the relative pressures and Bristol Water's position based on the examples of long-term targets as stated in figure 2.1 on page 13 of the discussion paper. A fuller exploration of the balance of local and sector-wide issues is shown in Appendix 7.

Area	Year stated in consultation	Bristol Water position	Other considerations
Serious pollution incidents	2025 (EA target)	Not applicable	Not applicable
Eradicate water poverty	2030 (Water UK commitment)	Achieved in 2019/20 but marginally not in 2020/21	The CCW affordability proposals and

[1] https://f.hubspotusercontent30.net/hubfs/7850638/Site%20Assets/Offline%20docs/A-Guide-to-Our-Social-Contract.pdf

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Area	Year stated in consultation	Bristol Water position	Other considerations
			analysis may result in us not meeting our target through standardisation , with a higher cost to customers.
1-in-500 year drought resilience standard	2039 (water resources Planning Guideline)	Not in an area of serious water stress, or with clear need for significant abstraction reductions	New water resources may be required, within regional and national frameworks
throu50% reduction in leakage from 2017-18 levels	2050 (Water UK commitment)	Lowest leakage in industry – meeting 50% reduction will require step change in customer supply pipe losses	Target reflected sector not individual company – as companies with higher leakage and bigger water resource stress should be able to efficiently make higher adjustments.
UK net zero carbon emissions	2050 (UK government target)	Net zero carbon route map consultation will be published at the end of July 2021	Water sector net zero carbon emissions by 2030 (Water UK commitment)
110 l/p/d per capita consumption	2050 (initial planning assumption by national framework for wate resources steering group	We share this long term ambition, but as an area not in serious water stress building standards for new properties will less support it than areas in serious water stress	We continue to work cross sector to deliver resource efficiency support and messages – scaling this up requires cross-sector funding and Government support so water is seen as much a priority as energy use for consumers.

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Our overriding concern is that without a local framework and context informing Ofwat's PR24 trade-off decisions, or a process that supports understanding of these issues, the focus on the long-term will reduce compared to PR09, PR14 or PR19. Even if the framework does focus on the long-term at a national level, customers and stakeholders care most about the local environment, and need local action to help translate priorities such as net zero to everyday lives. Water companies have a key role in this, but can only achieve this if the decision making framework for the water sector actively understands and explains decisions against what it means for local customers.

In terms of measuring progress, our greatest concern is that regulation should be demonstrated to be proportionate and risk based, and does not crowd out company ownership of business plans. A number of review criteria and objectives for balancing regulatory burden with meeting objectives were developed alongside the Gray review in 2011. Alongside measures of customer, local stakeholder and investor satisfaction with the water industry, including trust, and for investors and informed stakeholders specifically with Ofwat's regulatory approach, impact assessments on the regulatory burden have a role to play as metrics of success in a balanced scorecard for Ofwat. Even something as simple as the balance of what Ofwat is spending its time on (forward looking engagement and policy development vs backwards looking data analysis and enforcement), split across areas of activity, would be helpful. Illustrations of where Ofwat works with others (perhaps using a capitals or the UN SDG principles to illustrate) rather than through formal regulation could be a way of engaging on why the balance of Ofwat's time is what it is, and how this may change depending on the success of the strategy.

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?

Generally, we think the building block approach of outcomes, costs and risk and return works well, and will continue to do so. We think the challenge is more around:

- The clarity of how individual assessments and methodologies are considered in the round, rather than as individual areas.
- How we avoid "one size fits all" approaches that, at an individual minor level are sensible from a regulatory efficiency perspective for delivering a price review in the round, but are so substantial in combination that the principle of a coherent plan from a company for its customers and stakeholders ends up being undermined and not in their interests.
- How we communicate these trade-off decisions which Ofwat inevitably has to make.

Therefore, whilst we agree Ofwat should explore all of the totex, outcome and risk and return ideas set out in the consultation, whether they should be applied and the clarity of the

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overall approach, is our main concern. We set out our views in our covering letter with support analysis appendices. In particular we suggest a price review process in **Appendix 2** and an approach to risk and return in appendix 5 that would help to achieve this objective, and help to guide the overall framework beyond the detail of the individual regulatory assessments and incentives.

On totex, the consultation raises concerns that the industry inherently focuses too heavily on capital intensive solutions and less so on encouraging nature-based solutions. We do not see this as an issue, or one of reducing influence, if the principles of the PR14 totex and outcomes approach are maintained. Where this becomes a bigger issue is where top-down decisions and analysis (whether standardised outcomes or through enhancement or capital schemes or maintenance assessments) end up with silos of regulatory incentives. There were some examples of this at PR19, particularly with ODIs but also with a few cost elements such as leakage, which the CMA noted in its subsequent review. With the PR24 methodology as it appears to be developing, there appear to be greater risk of separate assessments of costs that may overlap, and less link to the outcomes that most companies are delivering. We do not think that "Price Control Deliverables " (PCDs) which may accommodate some non-model elements will be better than bespoke outcomes. The reason is that Ofwat will only be able to assess them for a limited number of special factors or PCDs, but ultimately a plan for a company, its customers and local stakeholders needs to be considered holistically, because that is the basis of the statutory duties on both companies and Ofwat. More importantly as we shown in **Appendix 7**, it is what the future challenges appear to require us to consider.

Nature-based solutions do not necessarily mean that they are completely opex driven. The assumption that the totex framework is encouraging capital intensive solutions is only a problem if you assume a specific cost assessment and efficiency measurement approach. We question what examples are there of capital-intensive solutions, which are currently being promoted instead of nature-based solutions? In our case, such solutions are embedded in our statutory obligations, and with bespoke ODIs for biodiversity and raw water quality that goes beyond the minimum. This will only change if the statutory obligations require a fixed time or greater certainty – it comes back to any number of individual risk and return trade-offs (to the environment as well as just financial) that need to be aggregated bottom up, rather than just considered top down. If done top down, this is where capital-intensive solutions will be encouraged at the potential expense of public value.

Is the issue perhaps the penalty regime and the risks associated with nature-based solutions – these are better for managing emerging risks but not for immediate quality concerns that regulation forces water companies to remove? It may be regulation that is the issue, as it always was originally in preventing water companies contributing to third party nature-based solutions or flood defences, even if it was more cost beneficial to society, or had a

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water pay back period longer than 5 years, as was the case up to PR09? We do not believe regulation was the main issue at PR14, and not in the main at PR19, but Ofwat's direction of travel gives us some potential concerns.

On operational resilience, we see a disconnect between the PR19 approach to encourage systems thinking through Resilience Action Plans, and the potentially narrower focus on operational resilience from the perspective of asset management maturity assessments. We set out our preferred approach to strengthening operational resilience in Appendix 6.

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 would agree that as far as it is possible, it is better to co-ordinate the roles of Ofwat, EA and DWI in reviewing and regulating relevant aspects of companies' plans. We see it as sub-optimal if investments are required by quality regulators but then not fully considered (and appropriately financed and incentivised) through the price control, so would suggest reaching earlier alignment on requirements and associated costs would provide greater certainty to business plans.

We believe that the process would benefit from consideration of a number of scenarios, and attempting to reach consensus on the right balance of service, cost and risk allocation, prior to finalisation of plans. We would see other regulators and CCW as being a key part of that consensus building. We set out a process and timetable aimed at this in Appendix 2.

On co-ordination with other companies, we would support this where it can be shown to be in the interests of our customers, but in general we prefer a local approach which reflects that co-ordination with other businesses, sectors and organisations is also important. We want our plan to be based on the preferences of our customers, reflecting our local circumstances and ambitions. We do support regional resource development, as demonstrated through our leadership of "Resource West", and co-ordinate with Wessex Water and other local utilities on areas such as support for vulnerable customers through the Priority Services Register. Similarly, West Country Water Resources builds on the type of co-ordination which in the past has naturally taken place with the organisations involved. We can therefore support the recognition of such co-ordination in the regulatory processes. Their effectiveness relies on the regulators ensuring that there is flexibility in the way national policies and objectives are applied and delivered, which requires a strategic dialogue to support this. This will avoid gaps between the best value plans for individual companies' customers and stakeholders, whilst still explaining the contribution of these plans, outside of area, to wider policies and objectives – this is the new requirement which requires us all to give it sufficient focus.

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Increasing focus on the long term

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
Companies more clearly positioning their five year business plans in the context of long-term strategies. In Wales, we are exploring whether these strategies could be developed collaboratively with Welsh stakeholders	Harder to assess and incentivise delivery if over a longer period	Allows more adaptation to short term issues, and optimisation of solutions	As we did at PR19 in "Bristol Water...Clearly", we will explore a number of pathways and influences on long term objectives to set the scene for engaging, researching and developing our five-year plan. We believe that local stakeholder engagement is not an add-on for Wales, but is also necessary in England.
Setting out information on base costs, initial views of the service levels that base costs could provide, appropriate incentive rates and financing costs before business plans are submitted. This could help streamline the price review process, allowing companies to focus their business plans on the long-term enhancements needed over and above this.	Companies don't stretch themselves as far on efficiency – using the Ofwat figures as the basis for their costs. Loss of local/customer focus on levels of	Greater certainty, more likelihood that plans will reflect Ofwat expectations	If information on base costs and service levels can assist the process, and be certain enough it doesn't become deterministic of customer needs and wants, then the risks can be minimised. We

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Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
	service required.		suggest a process that helps to minimise this risk (Appendix 2)
Providing additional clarity on our expectations for future price reviews, to allow companies to deliver more robust long-term strategies and allow us to be clearer about whether companies have met our expectations in future reviews. This could include approaches to the delivery of environmental benefits delivered as part of companies' core functions	May limit opportunities to adapt and evolve the framework in future	Greater certainty may support longer term planning	As above – adaptive planning for the long term, with engagement on what is valued, certain and uncertain, should be supported by a process that specifically considers this end.

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?

This proposal aligns to the approach we took at PR19. We published in advance our future strategy document "Bristol Water … Clearly" which set out our long-term ambitions. Our business plan was then able to focus on the first steps of delivery of those ambitions in the five year period.

We have set out in our proposal (Appendix 2) that the process would benefit from consideration of a range of scenarios, and attempting exploring consensus on the best approach prior to finalisation of plans. We very much see those scenarios as being part of a long-term framework, and whilst they will have implications for expenditure, delivery and risk and return in the shorter term, they would form part of a longer-term plan. We illustrate one of way of summarising the balance of local / national and short/long term issues in Appendix 7.

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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?

We would expect long term strategies to consider:

a) A range of long-term factors that would have implications for water supplies and companies' continued service delivery
b) Customers' and stakeholders' expectations for trends in service and performance
c) Investment needs over the longer term to maintain and improve performance
d) The long term balance of risk, return and the management of uncertainty.

We would not expect overly prescriptive regulatory guidance on the form of the long-term strategies as these should be a matter for companies and produced to allow meaningful engagement with stakeholders. However, we would have no objection to a summary template containing key details to simplify Ofwat's comparisons across companies. We set out one approach in Appendix 7, but our strong recommendation is that it is the strategic dialogue that is more important than a summary template, and this was the main gap at PR19 that could improve the decision-making process (in how we describe assumptions and trade-offs in a language non-economists can engage with, as much as the decisions themselves).

On risk and return, we need to be able to describe the role of investors and be clear about their contribution to sector long-term planning in a positive way, to balance the short term financial consequences of the application of incentives on customers and investors, whether positive or negative adjustments from investor point of view (i.e. the service as well as bill impact from a customer perspective from the regulatory framework requires some consensus on how we talk about the regulatory framework in non-technical language).

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

In our view, this can only be through a price review planning process that requires engagement and local differentiation to be recognised where it should divert from national frameworks and assumptions. The process we suggest, including a wide range of national, regional and local stakeholder engagement is set out in **Appendix 2**.

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?

Ofwat has signalled that five-year price control periods remains its preference, and so this will naturally allow for refinements in future to take into account updated information. Risks and challenges will change over time and it is right that plans should be adapted for these.

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Therefore, we suggest a process that places plans within a set of long-term scenarios, so that as information changes we understand the impact this should have on plans, targets and ultimately risk and return incentives. Whilst Price Control Deliverables, notified items and other regulatory tools can support the process (and mean not everything has to be defined, cost assessed and incentivised as part of the five year price review) these decisions need a clear benchmark that affects the price review itself – we suggest a process and approach to risk and return that should provide this type of coherence.

We suggest the balance is that whilst plans and targets should be set with a long-term perspective, it is right to continue monitoring performance and delivery in the shorter term, and Ofwat can continue to use its regulatory framework to achieve this. In our experience, company ownership of long-term planning has developed through bespoke outcomes, and that should be the default position from the grounds of innovation. This has in some cases allowed for the development of common ODIs, but as we observe in **Appendix 9** using the case of affordability, standardisation where there is an existing planning approach may not always be an improvement. The important thing to consider is how customer or stakeholder impacts can be mitigated, where there is a wider sector interest in standardisation.

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

In the narrow sense of "streamlining" then, yes, this would be the case. Ofwat would probably find that many companies adopted Ofwat's suggested figures into their plans, which would reduce the scope for disagreement and challenge in the later stages of the process.

However, whilst this might make life easier for regulatory teams, we do not believe that such an approach would produce optimal outcomes for customers or stakeholders. The important point to consider is whether such early certainty is a) sustainable through the price review process and b) the degree to which we can depart for specific customer plans, for the benefits of customers and stakeholders. We have weighed these pros and cons in our covering letter, in thinking through the price review objectives and process as a whole, rather than seeing streamlining as a specific objective.

Early visibility of the likely cost efficiency challenge creates the risk that companies focus their plans on the outputs of the model, rather than on what their customers want. As the experience of PR19 shows, updated data can make a significant difference to what is considered efficient levels of expenditure, and it would be wrong to close down that assessment too early.

Similarly on performance, we prefer that targets are set based on local preferences and willingness to pay for improvements, rather than in a uniform national approach. So whilst some information will be useful, it should not prevent companies from "breaking" from the approach and justifying why they have done so. Up front information is likely to be subject to a significant degree of interpretation, so Ofwat will also need to consider the clarity and certainty of what is provided.

On cost of capital, early sight of Ofwat's indicative calculation forms a useful planning assumption for testing plans, but experience of PR19 shows that again this is subject to later movements in the evidence base so should not be assumed to be final. In some ways this is not really a significant change to previous reviews, as the degree to which certainty can be provided is then mitigated by company specific factors. We note the consultation mentions that symmetrical adjustments should be considered for these, which has been considered at PR14 and PR19 but not applied in practice based on the evidence and the uncertainty this creates in the 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?

Whilst this is primarily a matter for the companies operating in Wales, we do agree with much of the approach that Ofwat is proposing to adopt for Welsh companies, as it more closely reflects the proposals for collaboration and consensus building that we set out in "Regulating for consensus and trust". We believe that, notwithstanding the different governmental structure, it should be possible to use this approach in England as well, developing consensus at a local level between companies, their customers and stakeholders, and the government and regulators. The question if Ofwat do not allow for similar stakeholder engagement in England may end up being "why not?". Whilst the Welsh policy framework clearly adds necessity in terms of the Welsh Government's expectations of Ofwat, we believe that collaborative planning with specific company plans is needed in England in any case.

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

We think the question is more whether Ofwat needs to provide this clarity at this point. Regulation will continue to evolve, future challenges will change, and new solutions will emerge. We think that is right that regulation and companies' plans are set in a long-term context and focus on long-term ambitions, but do not see that this means that the regulatory framework needs to be set or fixed in the long-term in a way that might deny it the flexibility to adapt in the future. Exploring long-term scenarios, and with Ofwat engaging (or at least listening) to what is expected of the water sector, and how the regulatory framework and other frameworks (whether external to the water sector or self-defined by companies) can support the delivery of stakeholder expectations.

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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?

At PR19 we introduced our “social contract” to allow us to deliver greater environmental and social value. We did not find there to be regulatory barriers to doing that, as it largely sits outside the regulatory framework, although we introduced our “Local Community Satisfaction” performance commitment so that customers and stakeholders could have confidence we are delivering in the right ways for them.

The main barrier that we see is therefore the adaptability of regulation to changes that society expects in water companies. There is a balance between national regulation, and the burden of focus of our company on this, and our accountability to customers and stakeholders. Having built a social contract that we saw as going beyond a risk based regulatory framework that left the narrative of how companies delivered, and was open to local adjustments to minimum expectations (and even well-made cases for reshaping timing of meeting those expectations), the direction of travel of regulation towards more centralisation of decision making and away from the “PR14” model post the David Gray review inevitably concerns us. It could, at some point in the near future, be that economic regulation becomes the main barrier for delivering for society, when the sector and Ofwat had worked very hard after PR04 to change water regulation to avoid this risk. We also recognise that not everyone shares our perspective. As we set out in Refcat, the principles of economic regulation should be revisited because of public value, and the economic theories that underpin this, rather than overlaying public value on top of the current market proxy basis.

On the one hand, most customers and stakeholders trust the water sector and its regulators as the experts in its areas of focus, and in water supply and quality this appears generally to be the case. What tends to undermine trust is systemic failure, either in one companies’ delivery over an extended period of time, or in the sector to adjust to stakeholder or customer changing expectations. What we do with our social contract is try to balance what national regulation should do, with those expectations and learning for long term planning that matter more locally. Our plan as a company should expose the tensions and trade-offs, in a way that maintains trust, because not everyone will be happy with every decision. This ownership of the solution requires some reflection in price reviews, as the things in a social contract engage more with the stakeholders that directly experience our services than statutory obligations generally do. Equally though, we have to act in context of the national regulation and statutory obligations we face, but we see our role to act as a conduit to aligning local and national issues, and being seen as responsible for this. This informs both innovation and better long-term planning.

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So, we think the main way to address this barrier is to keep some flexibility in approach, and explore this topic before we bake-in a burden or centralisation of regulation that we may ultimately regret. Our only observation is it will be very hard to rebuild local trust in company owned business plans and delivery of them once it is lost, and that there is not a single issue in the water sector which demands such an approach (noting the different challenges in the water and wastewater sectors). As we suggest in our process comments , we wonder whether some distinction between different sector objectives in terms of approach is required, beyond the target challenge or market regulatory tools, which often overlap and add complexity for third parties who often see the water sector as a relatively simple public service, if it is noticed at all.

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

Our suggestions are set out most clearly in our covering letter and appendices. We summarise our assessment in the table below.

Strengthening incentives (Getting more for customers, communities and the Environment)

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
Continuing to use business plan incentives, as we did with the 'initial assessment of plans' (or 'IAP') at PR19, to encourage companies to provide stretching, well-evidenced plans that are in line with customers' interests, with a particular focus on how well companies have set these plans in a long-term context	Plans too focused on regulatory requirements rather than customer expectations	Likely to drive plans to meet regulatory expectations	We suggest PR24 starts with a long term context and engagement on key themes – Appendix 2
Reducing the number of stages in the price review process to enable a greater focus on the long term, potentially by merging the initial business plan assessment and draft determinations stages together	Fewer opportunities for engagement on issues and reaching consensus – risk that some issues not resolved by FD	Allows more time for engagement and discussion of evidence, rather than focus on reproducing plan after IAP	We agree with the principle of less stages, as long as there is strategic dialogue on scenarios – Appendix 2 and

			"Regulating for Consensus and Trust"
Retaining cost sharing to ensure that risks are allocated appropriately	May need different cost sharing rates depending on risk allocation – can add complexity	Evidence generally that this benefits companies and customers	We suggest considering as part of a wider review of risk and return – Appendix 5
Making use of targeted challenges to focus minds on areas where the sector needs to step up	Wrong areas targeted leading to sub-optimal investment. Can be one size fits all	Can signal a step change to reflect sector recognises and acts on stakeholder concerns	Suggest use sparingly where the sector message cannot be achieved any other way. We suggest considering through explicit risk and return scenarios – Appendix 5

Q5.1: Should we undertake an initial assessment of plans at PR24? If so, what areas should we focus on in this assessment?

Please refer to our response to question 12.1.

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?

PR19 delivery should give Ofwat confidence that those companies are capable of delivering the performance levels and investments that they propose in their PR24 plans. We would not expect this to translate into automatic acceptance of PR24 proposals, but may reduce the depth of deep dives, or imposition of arbitrary efficiency challenges to enhancement

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schemes. Whilst light touch approaches should be part of the procedural incentives for a track record of delivery for customers, the correct framing at a price review should be the confidence that performance gives (or otherwise) in a proposed plan. Clearly where companies are able to describe their past performance and transformation in a way that inspires confidence, Ofwat can consider less intervention still than where a company doesn't present a credible plan of improvement.

A high-level comparison of PR19 delivery may reflect historic positions, fortunate circumstances for well performing companies or factors outside of short term control for less-well performing companies. Judgement is required, and it is probably sensible for Ofwat to consider this in the round, in the light of the future plan of the company, whilst still challenging companies as to how well they are meeting obligations and targeting intervention on a risk-based basis as part of on-going regulation. It may be that the balance to what Ofwat does on an ongoing basis and at price reviews can be revisited, and we support Ofwat's intention to do this, including the value obtained from formal assurance as opposed to other forms of engagement and dialogue. As at the price review, the main gap we see, that surprises those not involved in the water sector, is the limited direct engagement particularly at Board and executive level between companies and Ofwat. This should be considered as part of the process for PR19.

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 would urge caution against streamlining the process as an end in itself. The options could lead to fewer opportunities for companies to set out and justify their view of what the 'right' plan for the future is.

More fundamentally, there appears to be no meaningful simplification of the price review framework, beyond some outcomes rationalisation, which itself could prevent innovation due to the desire to limit bespoke performance commitments.

In our view the process at PR19 (figure 5.1) worked relatively well. But what was missing at PR19 was the dialogue about company strategy (feedback does not just have to be formal) and any real understanding about what types of plan adjustments should be made. Perhaps there were few adjustments to most plans because they reflected customer-led preferences.

We do not particularly object to the consolidation of the IAP and DD stages, as we feel the focus at that point should be on meaningful engagement between the company and the regulator to resolve outstanding issues, rather than repeated rounds of refinements to plans, which at PR19 resulted in two short response times, which did not in many cases allow for much research or reconsideration, other than for clear cut issues.

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Our proposal, as set out in Appendix 2 is for the introduction of an earlier production of a strategy document with various scenarios, allowing for engagement and consensus building on the best approach for 2025-30. This will help to support the consolidation of IAP and DD.

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

This may depend on the extent to which Ofwat is able to apply the concept of consensus building in Wales, and whether it is able to adopt a similar arrangement in England. The Welsh companies are relevant comparators for English companies and we would expect the approach for IAPs/Draft Determinations to be the same to allow comparison of information and decisions.

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 come back to the need for a long-term focus on what the sector is being asked to achieve, and how economic regulation can absorb this information from a wide range of sources to inform trade-offs in how long-term goals can be delivered effectively and efficiently. The key success factor is not likely to be in the incentives, but to how trusted companies are in the communities and by their customers. Ofwat could use this as a key aspect for the price review process, and in doing so building trust in the process. Ofwat has to balance this with calls from companies to simplify the task (we think short-sightedly) and to be seen to meet national policy accountability, which is entirely appropriate. We think the approach we suggest will provide Ofwat sufficient tools to achieve this, with the advantages of a more agile sector that focuses on delivering outcomes and promises it owns, a less technical debate on when intervention and incentives have to be applied with full power, as well as a lower regulatory burden.

We would caution against the desire to mimic Ofgem's RIIO-2 controls, which would signal a step towards an outputs framework, with multiple layered and complex incentives. This includes a mechanical reward and penalty framework as part of incentivising business plans – this appears to have resulted in disputes in both the concept and how these plan incentives have been calculated.

Clearly Ofwat will need to have a range of procedural and financial incentives. It may be appropriate to limit these to the very best and very worst plans, as this is likely to retain incentive properties. For instance, it was quite clear at PR19 that a slow track was an appropriate categorisation for the Bristol Water plan, because it reflected a significant

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turnaround of performance and transformation compared to the previous position, which in part reflected disagreement at the previous price review. We believe though Ofwat recognised the strengths of the plan and its high quality elements, and those where Ofwat raised questions needed exploration of whether they mattered or needed specific customer protections. A financial penalty for slow track would not have supported this process, and we expect this would apply to many of the plans Ofwat were faced with.

We think it could be a sign of maturity and evolution of the regulatory framework to consider the plan confidence and incentives within the risk and return framework, although this would dependent on the process (appendix 2) and risk and return (appendix 5) proposals we would like to explore in more depth with Ofwat.

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?

We do not believe that asset health status, as described through the asset management maturity assessment, is likely to help in setting cost sharing rates at PR24. As Ofwat is already aware, it is far from clear to us how the asset management maturity assessment could inform this decision, based on the approach taken to date. We recognise that Ofwat will publish observations on this assessment after this consultation has closed, and that little detail was included in the consultation to allow for a fully considered response. Our main challenge is that the purpose and appropriateness of the maturity assessment has not been clarified – for instance the Ofwat annual report records that you *"Published our Asset management maturity assessment questionnaire in March 2021 which aims to build on existing frameworks to ensure that companies have the tools to address resilience needs including the impact of climate change and that assets are being managed appropriately for the long-term."*

One emerging conclusion may be that what is appropriate in terms of asset management maturity will vary across the industry. Similarly, any judgement on maturity would seem to depend not just on a standalone assessment, but a wide range of other risk factors, efficiency assessments and service levels in a plan. We would caution Ofwat to consider carefully how many company-specific judgements the regulator makes which, when seen as a whole, could result in disputes. Also consider the complexity of such assessments, and the impact of then assessing such disputes in the context of other plan adjustments. Ofwat should also consider why the sector and its regulation moved away from such assessments, before reintroducing them.

The discussion document appears to suggest that high cost sharing rates may be a problem in terms of asset health. The exact same statement could apply to low cost sharing rates – companies cutting back on maintenance spend if costs increase because they will carry more of the overspend (rather than underspending because of the benefit of the savings). Using asymmetric cost sharing rates also is not a panacea, as the CMA found.

We reflect further on this in Appendix 6, and consider that cost sharing rates should be considered as part of risk and return, as we propose in Appendix 5.

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

We note on page 50 of the discussion paper the reference to the desire to explore water efficiency "*since step-changes will be needed… in the coming years*" and that this may include a specific focus on business customers in the non-household sector. We would be grateful for further details over this proposal, and whether it would apply to wholesale companies. It would appear to undermine the logic of the business retail market, and may be a less effective way of supporting this market than other measures, such as R-MEX, or developing the bilateral trading market that Ofwat suggest postpone further development to PR29 elsewhere in the consultation. It may be there are better examples of a targeted challenge that raises less questions given the potential consequences. If the question was about balancing per capita consumption which only covers households, given the impact of COVID showed some of the risks from targeted challenges rather than balanced incentives based on local needs or historical performance levels, that is a different question. The solution, consistent with WRMPs, may be to focus on distribution input, rather than separate incentives that cut across the several other aspects of regulation.

Whilst there may be a role for targeted challenges, they should be used carefully and coherently, which we believe the leakage challenge at PR19 had a clear rationale, but had an impact on the industry cost base which needed to be considered consistently across the price review. In our view, any targeted challenge should consider the full pros and cons on cost and risk and return, and compared to the use of other regulatory tools. We suggest a way the process for PR24 could explore scenarios at an early stage to understand the impact of these type of regulatory incentive decisions.

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?

We do not think any further specific incentives are required. Whilst we have a view that innovation funding should evolve so that each company has the opportunity to develop collaborations, we recognise Ofwat will need to assess the impact of the first two innovation fund rounds before refining and developing further proposals.

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Our main concern is whether the regulatory framework, and risk and return approaches including locally defined outcomes, continue to encourage innovation and regulatory reform. Existing incentives around cost allowances and performance levels ought to promote innovative solutions. It may be that some innovations are more minor or only applicable to particular companies, there is a risk that in trying to create mechanisms these become overlooked in the search for bigger solutions that meet certain criteria. There is also an increased regulatory burden in engaging with these centralised innovation funds, which is something Ofwat have listened to, and will be considered in reviewing how the innovation fund post PR19 is developing.

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

We note on page 51 the comment that "*Some stakeholders have suggested that financial incentives may sometimes cut across, and potentially override, ethical behaviour. They suggest that in these circumstances, it may be better to rely on ethical business regulation (or 'EBR') to ensure companies do the right thing by their customers.*" We do not make this assumption – if companies are operating for the long term, with a plan that they own, and do not see incentives as the only driver of success, then these risks can be mitigated. This is a principle in the Bristol Water Social Contract – it is designed to build trust beyond that regulatory frameworks and CSR reporting by companies can deliver because there are limits to the trust that can exist in customers and stakeholders from regulation or reporting. It becomes harder to maintain trust the greater that there are financial incentives that are not aligned with a companies' plan, but are regulatory interventions, in particular for targets that are hard to explain to customers.

Most of our views on this topic were set out in "Regulating for Consensus and Trust", as our concern is that as what the sector is expected to deliver goes beyond statutory outputs, the trade-offs that regulators make and the incentives they use need a stronger basis than a proxy for a contestable market. At its simplest, climate change is a symptom of a market failure, and the water sectors contribution is not just something Ofwat can incentivise through historical regulatory incentives, but equally cannot be seen as separate to other cost and incentives being placed on the industry. Long-term planning means we need a clear set of scenarios, as a whole, for what we are expecting the industry to deliver, who it is on behalf of, and how we explain the framework and its regulation to stakeholders in a way that maintains their trust.

We do not argue to move away from incentives, but to move away from this being the driving focus of price reviews and regulation.[2] The incentives should be designed based on the risk and return balance that society wants, which helps regulators better target incentives than a priori assumptions on what incentives will work best. We also note the

[2] Regulating for consensus and trust

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comment on page 52 that also is not a balanced interpretation of our views – incentives remain and may still be strong if that reflects the risk and reward trade-off that delivers in the long term for society:

"*We consider that strong incentives which align the interests of investors and customers are effective. This is supported by the emerging findings and conclusions of our forthcoming PR14 review. We would be concerned that the absence of such incentives may increase the risk of poor outcomes for customers and the environment.*" Of course Ofwat may achieve this concerning outcome at PR24 from a customer and environmental perspective by removing the focus of bespoke ODIs.

If we can improve and refine this balance, then the risk that there is over-focus on incentives rather than wider factors reduces. The answer for this balance is not likely to be other forms of regulation and incentives, unless we understand what are the factors in the trade-offs being made that upset the risk and return balance. At PR19 from our perspective (and as the CMA recognised this was company-specific), the issue was a lack of financeability from a range of sources, that once adjusted, happened to look very similar to our draft determination response. Our assessment is that that more strategic dialogue and a longer-term perspective could have avoided this risk. The incentives post-CMA are still strong, and we would argue are more effective because in the round they financeable if we deliver our plan, taking into account that there are factors outside of our immediate control where performance adjustments are still justified to maintain the power of incentives based regulation without ex-post judging all circumstances in deciding whether regulatory intervention and penalties should apply. If incentives are too strong, we increase the risk, as with PCC and Covid, that price reviews as a whole become less powerful as a tool, because they become less capable of being relied on by investors and stakeholders, and then customers in terms of bills and service levels.

On the one hand Ofwat recognises the importance of purposeful companies and public value (which we support) but does not see any link to how it regulates (which we do not support). The downside to this approach is that, in the extreme, it limits the potential of the water industry to what Ofwat thinks and drives the industry to focus on what Ofwat (not necessarily customers and society) wants.

We think Ofwat can build on social contracts, modernise economic regulation to reflect the trend towards purposeful companies, and adhere to the objectives of ethical based regulation with a few changes to the proposed approach to PR24 – we set these out in our covering letter and appendices. We do not think this is adoption of negotiated settlement *per se* – we think Ofwat can work with companies and stakeholders to address the same themes in a way that evolves the PR14 and PR19 regulatory framework. We continue to hope that "Refcat" and this response provides a clear, compelling and practical way of achieving this. We recognise that we do not have all the answers – but the principles behind

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our thought process (rather than the detailed individual solutions) should be able to work with other ideas and responses to the consultation. We would support any approach that can explore the themes and ideas from the consultation through engagement and workshops as a next stage of their development.

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Reflecting customers' preferences

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
To work with the sector to explore the design and implementation of a collaborative approach to customer research for the price review. This will allow us to consider if and how customers' preferences differ within and across company boundaries and within and across the nations	Loses local ownership. Loss of innovation and learning opportunities. Timing may not work for receiving outputs in time for plans.	There may be benefits from some elements of centralised or standardised research, but the risks seem to outweigh the benefits, as the benefits appear to us to be driven by a presumption on customer WTP research which may or may not be accurate.	Prefer that research remains under the ownership of companies, possibly with some standardised guidance but retaining freedom to innovate. We explore the evidence on WTP driving customer research in Appendices 3 and 4.
That the findings of the collaborative research informs common aspects of companies' business plans and our determinations, such as incentive rates for common performance commitments. We would expect the collaborative research to complement companies' own research	Duplication of cost. Conflicting outputs. Companies' own research overridden by collaborative research.	Common aspects of plan assumptions may be beneficial, but would need to be based on more than centralised research.	As above. We suggest a process to explore common performance commitments, based on our analysis of the potential impact on risk and return throughout our

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Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
			appendices to this response.
This research will aim to provide a significant amount of the information on customer views required to inform our determinations, so we propose not to require each company to have a customer challenge group at PR24. Instead, companies would put in place challenge and assurance solutions that meet their specific needs and ambitions	Loss of local stakeholder engagement. Local customer views not well represented. Loss of detailed, knowledgeable external challenge.	There may be benefits from a less rigid approach to assurance than at PR19. However, that underplays CCG roles.	Retain CCG. We think Ofwat should engage with local stakeholders irrespective of research assurance proposals. CCGs or equivalent bodies should be able to be involved in plan discussions with Ofwat and assist the process.
To work with the sector to develop and agree minimum standards for high quality research, ongoing independent customer challenge and independent assurance	Loses opportunities for innovation	There will be benefits from greater consistency.	On balance, we believe that acceptability of the plan proposed and the factors that lead to this are more important. Our bill options research at PR19 that we used inform triangulation of WTP was

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
			an innovative method that avoided this challenge being central to the use of research.

The proposed framework might be perceived as Ofwat becoming effectively in charge of the customer engagement process, setting the performance commitments and costs, establishing what good asset management practices look like, while companies become more passive recipients of the determinations. It is difficult to see how all companies could have a say in centralised research in order to overcome this perception, and still be practical as a delivery approach.

We continue to believe standardised customer research will constrain learning and innovation, and centralised research is unlikely to deliver in time, or for the process we propose. This is informed that the objective appears to be driven by reducing variability in WTP values, which we do not see as the central objective for research. The bill options research included in our business plan, based on plan scenarios and designed to assist triangulation "solved" this risk from our perspective, which is why we developed an approach that tested from plausible plan scenarios how customer views changed (segmented) as service and bill levels changed. This reduced reliance on a single WTP survey as it revisited triangulation and created a supply/demand curve for WTP values based on a plausible set of plans, with a clear long-term context. We do not believe trade offs can be informed based on standardised or national customer research in isolation of the plan the company is developing or testing with customers as a whole.

The centralisation of certain aspects of the customer engagement framework may reduce the risk of Ofwat over-writing companies' proposals in the course of the price review. However, the customer research (in particular with regards to outcome delivery incentive rates) may give different values to the companies' own research. Moreover, this could be seen to blur the company customer relationship.

We fundamentally disagree that there are specific aspects of price reviews that customer research can and cannot influence. This is the opposite of the evidence we presented at

PR19, which was considered high quality by Ofwat because of the full range of topics it covered.[3]

Section 6.1.2 on the reasons for variation seems speculative. We have repeatedly encouraged you to consider a comprehensive study to understand reasons for differences in valuation before concluding in this way. The non-discretionary spend arguments are a return to 2004, and in any case appear to be incorrect for Bristol Water. It is precisely when there is non-discretionary spend that local research is required to look at the long-term bill and societal context that affects WTP values. The lack of need drove lower WTP in Bristol Water – the evidence is compelling and quite clear. This should affect incentive rates, because it resulted in low WTP. We illustrate this below by showing the level of risk for the same service levels that would arise from using industry average incentive rates at PR19 for Bristol Water, rather than the ones that applied. You ended up with changing incentive designs iteratively (and in leakage ended up with a logic error from our proposals to the detriment of customers). The CMA corrected this. The same will happen again – we will consider any national research that you choose to carry out but have to carry out our own duplicate research and more testing to really understand these impacts. Therefore, we do not agree that national research can be funded by savings in the research we plan to carry out.

Your reference to the Asset Management Maturity Assessment in customer research is also concerning and a retrograde step. It is surprising given the PR19 developments of resilience action plans that we are returning to a PR09 style assessment, that constrained maintenance expenditure through regulator subjective judgements on relative asset management performance. It was one size fits all then, and would have the same effect at PR24. The AMMA is flawed in design and reflected poor asset management understanding and practice, so we do not feel this approach should be referenced in terms of customer research.

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 do not agree with centralised research, except where consensus between companies can be agreed, which has happened in the past and joint research undertaken. There are also some benefits from standardised research, but our experience is that standardisation has happened in the past through UKWIR studies, and there is very little divergence in overall methodologies taken. What differs is the focus of local company plans and local priorities. Our view is that this is likely to offset any benefits of standardised research, leaving the same issue as Ofwat perceive it (variation in WTP rates) still unexplained.

[3] Bristol Water - Test area assessment

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Ultimately the question of the process is whether this matters sufficiently to risk reducing innovation in research and company engagement on the local issues affect business plans. It is difficult to know how big a risk this will be, unless we understand how centralised research will inform trade-offs on overall bills and plans, if not done holistically for a company plan? At best it provides some comparative context of willingness to pay outside of the context of company specific plans. But there are better approaches to calibration, and centralised acceptability testing of plans once developed is a good development. This approach, rather than moving the sector forward, is going back to PR04.

The whole point of PR19 was not about customer research as such, but about channelling effective engagement, participation and co-creation – ensuring customer and stakeholder views would help shape the design of the business plan. Ofwat risks losing this, which is a retrograde step – a return to 2004. It risks regulation being 25 years out of date by 2029. Given our response to the previous consultation our views will not surprise you. We do not believe that the consumer interest can be defined just through centralised market research on a limited set of national topics.

We note on in section 6.2.1 the view that "*we wish to avoid companies repeating research delivered within the proposed collaborative research, or undertaking parallel and 'competing' research, not least to protect customers from the risk of duplicate costs. It may therefore be appropriate to give primacy to the findings of the collaborative research as we form our determinations.*" Would it not be more appropriate to allow companies to make the case for why their research should supersede any centralised research? This could even be considered as part of the early submission process.

Both a standardised or a national (which is in effect even more standardised) approach risk constraining exploration. Agreeing a set of standards and approaches reduces innovation and learning from other approaches. Governance of this will require every company to have a say, and lots of stakeholder input. Local engagement may also support bespoke PCs and ODIs.

Although we are suggesting these could be more limited at PR24, there may be scope for such outcomes in some instances. This attitude would have prevented much forward-looking work at PR19 – biodiversity, resilience, local community satisfaction, catchment management etc. If incentives are powerful, why limit them just to national issues – is that what customers really want? It is not what the water industry was established to deliver.

There is a specific issue about water vs wastewater that the discussion document does not address – centralised research risks not reflecting Water Only Company positions in a coherent way – or with many varieties of combined bills that then affect incentive design and risk as a consequence.

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We have set out an assessment of WTP variability and include our indicative results in the time available in Appendix 4. In any case, we take the view that bill option and acceptability research, that is used to triangulate a range of WTP sources, rather than a single national study, is more likely to have value.

This approach reflects something we considered at PR19 – using long-term scenarios to test how WTP varied with service levels and bill levels, both through a survey, with an informed customer panel, and through active engagement such as at festivals through the region with our Water Bar.

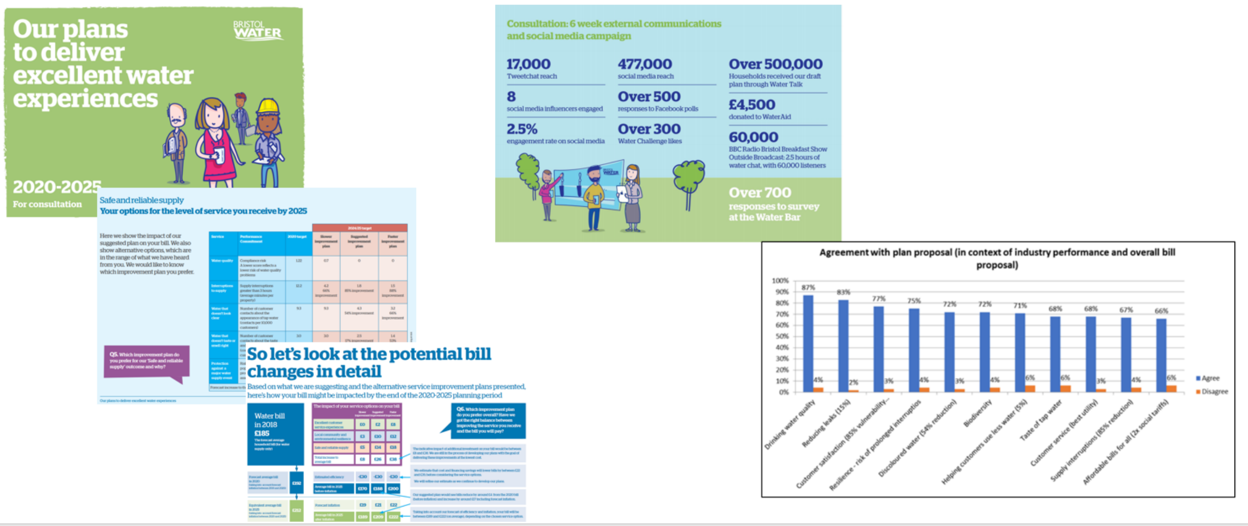
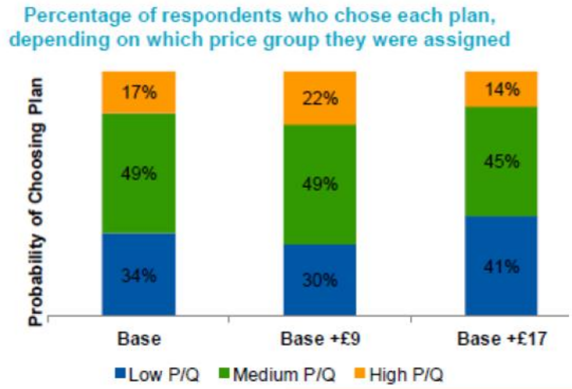
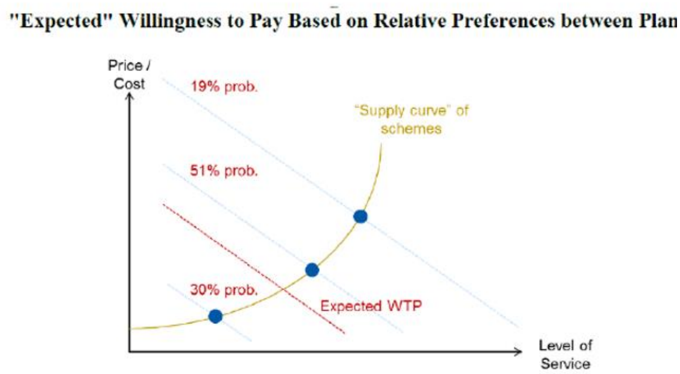


Figure 1 - Extracts from our PR19 Draft Business Plan

A range of WTP information was tested, by segment, through acceptability, which could then statistically draw a demand curve between service levels and total bill. This could then be applied at a individual metric level, by varying the choices presented – a sequential stated preference approach. Whilst our testing in Appendix 4 cannot go as far to evidence this, it reflects our experience that higher WTP numbers can be obtained with implausible or survey mechanisms that are not understood, up to a tipping point where protest responses or zero valuations kick in. Some examples are given in the UKWIR 2015 study on environmental valuation.





Plan:	Baseline price group:	Social Renter	Young Urban Renter	Comfort-able Family	Safely Affluent	Mature and Measured	Thirsty Empty Nester	All segments
Low P/Q	Base	88%	88%	94%	N/A	95%	100%	91%
	Base +£9	75%	93%	80%	100%	85%	100%	88%
	Base +£17	67%	68%	64%	100%	81%	60%	71%
	All groups	**78%**	**84%**	**81%**	**100%**	**88%**	**80%**	**84%**
Medium P/Q	Base	86%	54%	92%	100%	76%	67%	72%
	Base +£9	60%	76%	87%	100%	69%	80%	77%
	Base +£17	63%	57%	93%	100%	81%	50%	72%
	All groups	**70%**	**61%**	**90%**	**100%**	**75%**	**67%**	**74%**
High P/Q	Base	56%	67%	61%	67%	59%	100%	62%
	Base +£9	67%	52%	63%	100%	44%	80%	56%
	Base +£17	63%	55%	76%	67%	52%	100%	62%
	All groups	**60%**	**58%**	**67%**	**71%**	**52%**	**89%**	**60%**

Figure 2 - Results of our bill options research at PR19

This research helped to confirm something that goes beyond methodology – if water companies are trusted and performing well, there may be a high level of indifference between plausible cost and service scenarios. In our research there was a high degree of scepticism for the incentive consequences of high improvements in services for a relatively modest cost, which as this was part of the PR19 methodology, which provided an anchor to drag down WTP values. In other words, a more efficient and ambitious plan may have a lower WTP. We are not sure how centralised research separated from company plan development could resolve this conundrum without research being duplicated (as above) on the company specific plan. This implies that national research would need to include some inefficiently expensive plan options which customers would not be broadly indifferent too in the survey, even if they are not useful for individual company trade-offs (e.g. because of affordability considerations, financing constraints, or lack of necessity in making such expensive sunk commitments for future service level benefits that otherwise would not be considered).

We think that the trend in the UK will be towards devolution, because segmentation is needed on customer attributes and circumstances at a sub-regional level. Aggregation at a national level will often fail to understand the impact below this. We see from the CBI's recent report "Reviving regions: empowering places to revive and thrive"[4] how much economic indicators vary between regions, and within regions. The England North:South divide has more recently become much more localised. Part of the CBI's conclusions as a result of this suggest that regulatory reform should focus on investment and innovation, and that regional clusters for economic development, skills and finance will be vital. For the West Country, green growth and the environment are key contributors to improved productivity and growth. The water sector and its regulation for public value should be able to respond to this priority and it should inform our decision-making process, particularly from the customer and community viewpoint.

1 Regulatory reform for investment and innovation

Requiring all economic regulators to prioritise investment, innovation and agility as part of their core remits.

2 Globally leading clusters in our regions and nations

Commissioning the CBI to develop coalitions that can scale up economic clusters around the country and write the playbook for how to build distinctive regional and national comparative advantage.

3 Transformed skills provision for the economy of tomorrow

Making skills far more demand-led and accessible to all, and freeing up money trapped in the Apprenticeship Levy, so that business can invest in everyone's lifelong learning.

4 Unlocking finance for growth and investment

Creating a new Strategic Dialogue on Funding our Future, co-chaired by HM Treasury, the Bank of England and the CBI, to bring together the whole value chain – from hungry investees to private investors. This will add the customer viewpoint to the Bank's productive finance workstream and shape proposals to unlock more pension funds, patient capital and private sector finance, fostering a cultural change to power growth.

5 A long-term tax roadmap for the UK

Setting out how the tax system will restore the public finances in a way that is consistent with supporting business investment, the transition to net-zero and the UK's international competitiveness.

Figure 3 - Summary of CBI recommendations
Source: CBI "Reviving regions: empowering places to revive and thrive"

We think this trend towards more local understanding (sub regional rather than regional divides), means that Ofwat may need to adapt its strategy and PR24 approach, else it risks being too one-size-fits-all.

[4] https://www.cbi.org.uk/articles/reviving-regions-empowering-places-to-revive-and-thrive-1/

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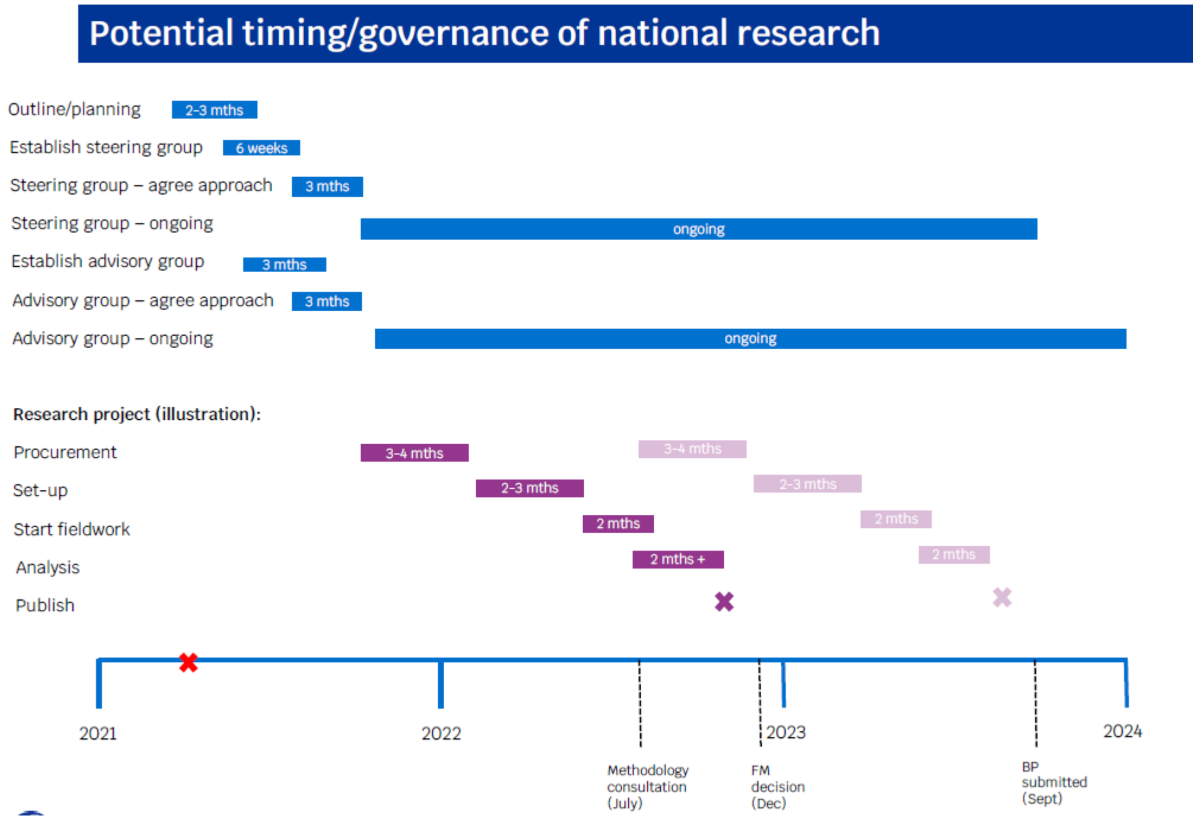
As we said in response to the earlier customer research consultation *"The proposals give the perception that only economic regulators or 'experts' have the right to decide on what customer research accurately reflects the opinions of customers. It may do nothing to improve the understanding of trade-offs, which must be the main purpose of research in a long-term infrastructure industry faced with uncertainty as to what the local impact of macro societal and environmental trends will be."*. And then in RefCat we explored this further, and came up with a process solution for the long term.

As with our response to "PR24 and beyond: Reflecting customers' preferences" we disagree with the centralisation of research. Whilst there has been a move away from the term 'centralisation' towards 'collaboration' and 'nationwide', the initial premise, and our concerns remain. As a local company, we believe that our research and engagement should be conducted at a local level, in order to best develop an understanding of what our customers need and how to best deliver this.

However, we understand that this approach to research, with particular regard to the areas of company proposals and determinations that are common to all companies, where it is important for findings to be comparable across companies is the favoured approach of Ofwat. Therefore, we believe that it is important at this stage to consider the following which we believe may impact on the practicality of the collaborative approach.

We believe that there are two main concerns with the implementation of a collaborative standardised/nationwide research: timescales and funding.

The timescales presented in the PR24 and beyond workshop suggest a considerable lead time to conduct, analyse and importantly report the results of research. We are currently in the process of planning our PR24 research programme, are aware that some companies will have already begun this process, and that the information required, and the findings of this research are required far in advance of the proposed timescales. We believe that this is a major flaw with the current proposal and an accelerated timescales should be worked on in order to make sure this research is delivering for the needs of the companies, so that we can deliver the needs of our customers.



The second major consideration with standardised research is funding. We understand the Ofwat position outlined in section 3.5 of the PR24 and Beyond: Creating tomorrow, together. Appendix - Reflecting customers' preferences that companies will be expected to provide resources for the research to be conducted, with 'top-up' options for enhanced sample sizes. However, this proposal does not take into account the companies' consideration and perceptions of the research approaches designed through the governance process (further discussion of this process is provided in 6.2). The research designed through this standardised approach is unlikely to be able to meet the needs/desires of each of the 17 companies nationally. This means that companies will be expected, and potentially enforced, to fund research which they inherently do not agree with. Given our preferred research approach as set out above, we are clear that the additional costs to us are unlikely to be affordable, unless we have a less locally focused plan on the issues we see for the long term, which we are unwilling to do.

Q6.2: Do you have any suggestions for how we best implement the collaborative approach to customer research for the price review?

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There are two key considerations here; that all companies will have their own opinion and values that underpin how they believe that research should be conducted, and that not all companies will agree on these factors.

These considerations are important because they severely limit the implementation of the proposed approach. One suggestion is to have a steering group which contains representation from the water industry, perhaps through Water UK. However, this 'representation' would dilute the company ownership, and would bring in concerns over the first consideration above. A middle party, which represents a group of 17 companies, cannot represent all the views of these companies, and therefore companies will be expected to compromise on a research design and methodology which has not been designed by them but by a third-party whose decisions are based on their perception of company preferences rather than the company preferences themselves.

However, it is not practical to have 17 companies trying to design one piece of research, and this is where the second consideration above is crucial. Attempting to design a research project with 17 water companies, Ofwat and perhaps other parties would take months, perhaps even years to decide upon, if ever. The competing needs and preferences of each company, their customers, their stakeholders and Ofwat will not be in line in a way where this method would be feasible.

If as we contend that local factors and plausibility of options, rather than just research methods, affect WTP research outcomes, the centralised or standardised research cannot be assumed to produce a "better" answer, without greater understanding of what causes the issue the research is trying to solve. Given that, the risks of centralisation or standardisation outweigh the benefits.

Q6.3: Are there aspects of negotiated settlements that could be reflected in our price review framework?

We note that aside from in Wales, where there appears to be a desire for a more collaborative approach, there are no particular proposed changes to the way price controls are conducted: negotiated settlements are explicitly rejected and a one size fits all approach seems to be favoured.

We agree with your analysis on the limitations of negotiated settlements, but not the conclusion. You have not considered our approach to scenario planning which would allow feedback at an open review and discussion stage, before final plans and draft and final determinations. This would allow the long-term and non-discretionary context to be explored, and challenged. It would not require decisions on cost baselines, but Ofwat could provide a specific scenario as part of the challenge so companies and stakeholders could explore the impact. This includes exploring risk and return.

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On your conclusion on page 60 that "*customer views are vitally important and we also want to ensure they are gathered in a targeted and proportionate way. We believe our proposals below may better help do this.*" We disagree – you do not address why your value judgements should be more trusted by customers than companies they have a direct service relationship with, even in the absence of choice. We repeated some of our PR19 evidence on what customers trust in Refcat.

Using negotiated settlement for small, specific areas is fine, but the question of legitimacy then arises of why it is being limited, outside of the context of the whole plan. We end up with the regulator determining most of the industries direction, which could be a retrograde step in terms of public value. Ofwat's words in the strategy appear not to influence the price review approach clearly enough to be understood by stakeholders. Clearly there will be circumstances where Ofwat must intervene in some or all aspects of company plans, and sometimes in the whole of a companies' plan. We think this should be considered as part of risk and return in the round, in the light of understanding the trade-offs companies and their customers / stakeholders have discussed in arriving at their plan – that is an England water sector framework approach which obtains the important principles of negotiated settlement, whilst recognising the benefits of Ofwat's incentive framework to attracting long-term investment.

Negotiated settlements, or aspects of them, could provide the foundations for a process that seeks to understand consensus and differences in views. Utilising negotiated settlement style discussions with a CCG may prove to provide similar outcomes with a group of customer representatives who are already informed of the water industry, its regulation and the company. The key point, is that dialogue that is seen to influence a company plan, which encourages stakeholders to care about the water sector, also has to influence Ofwat's judgements at some point.

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

Chapter 6.2.3 seems to push customer challenge groups to one side – whilst we note that "*Under our proposals, each company has freedom to maintain its CCG*" this misses a crucial point – that the importance of CCGs in the price review is as much about their dialogue with the regulator as it is about their challenge to the company. The approach proposed risks the customer voice being further shut out, as CCGs were a vital independent forum between customers and the regulator. We are concerned and somewhat surprised that Ofwat found so little benefit in the CCG contribution to the PR19 process, beyond the specific research assurance role.

Our belief is that our CCG, the Bristol Water Challenge Panel, delivers real benefit to our customers, actively challenging us to focus on customer priorities and preferences. Therefore, we will be continuing to utilise the customer challenge group model, and feel that this is the appropriate challenge solution for customer engagement that meets our specific needs and ambitions.
With regards to the assurance of customer engagement, there are no real proposals other than to suggest that there is a plan to work to develop a minimum standard for independent assurance. We welcome these standards to ensure that our CCG solution meets the needs of Ofwat.

Q6.5: What are your views on whether we should develop minimum standards or provide guidance in other areas?

We would welcome the further exploration on the extent to which conventional research and engagement techniques can be reliably used in the water sector. This exploration will affect the methodologies used throughout the PR24 process, and therefore it is crucial that the findings of this is exploration is published and available to water companies as soon as possible.

The draft minimum standards in Annex 1 of the consultation were reasonable, but will not be relevant to all circumstances. They were suitably high level, but there is a risk of conflating individual research topics (e.g. specifying use of independent assurance) with engagement and participation in developing a plan. As a set of principles that need to be considered in the round however, we agree with them. Sometimes however you can only judge research against such principles after it has been carried out.

Q6.6: How well does our proposed approach to customer engagement take appropriate account of the different regulatory frameworks in England and Wales?

On page 62 we note the view that "it may be appropriate to have different research in England and in Wales. Although many areas will be comparable, there may be some issues relating to the different priorities in the two nations which require a different focus." But what about different priorities within England – these exist, as was recognised by the NIC, but we are concerned that your approach does not achieve an appropriate level of decentralised involvement and input into your process.

The proposed approach does not highlight the difference between England and Wales too much, except in setting up different steering/advisory groups for the centralised research. This split means that the practicalities of this research will be much simpler in the Wales groups, as there would be a smaller number of involved parties. Therefore, this may skew the timelines by which research is agreed upon, designed, conducted and reported.

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Planning together for PR24

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
How to ensure water companies can most effectively engage with the strategic planning frameworks to enable them to bring their strategic plans together and reflect them in business plans	Overly focus PR24 on statutory obligations compared to customer led plans	Where statutory obligations are required, they provide better value for customers	We see a role for coordinated planning that retains company owned plans.
The role we expect water companies to take engaging with other regulators, and how we will seek input from other regulators before and after the submission of companies' plans	N/A	N/A	Engagement and two way dialogue is a fundamental expectation of any planning process
Whether there could be a role for a 'PR24 Challenge Panel' to inform the price review process	Could conflict with challenges received at a local level	May help to provide an external perspective to Ofwat's decisions	The role should be to challenge Ofwat's process – including how it engages with local customer and stakeholder views. With any panel, being clear on the remit and the accountability for the decisions is important.

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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?

Companies should consider the outputs of strategic planning frameworks in their long term and five year business plans. The main question companies need to understand is the basis of any assumptions in these frameworks, and the flexibility of companies to seek better value options where there is a valid debate about the degree of specificity in the statutory obligation, and the timeframe and risks in achieving them for any particular solution.

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 see more complexity than in the past with the strategic planning framework. We may risk moving away from clear and well-understood specific statutory obligations, to a situation where more generic obligations are expected from companies, which are not translated into local plan impacts sufficiently, leaving higher delivery and financing risk. We believe with RAPID Ofwat has sufficient co-ordination to avoid this risk, including staged gateways. With the DWI, the process is well-understood and evolution of the framework sits with the DWI. We are less clear on environmental obligations in terms of WRMPs and NEP at this stage. It may be the case that uncertainty of the degree to which obligations apply regionally or locally in terms of the environmental programme, which may mean that uncertainty mechanisms are required. We agree with Ofwat's thinking that companies should consider these frameworks in their long-term planning and consider their impact on the company plan. Independently of this consultation, as you will see from the scenarios in **Appendix 7**, we have been considering in our forward planning how we can do this.

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?

A centralised 'challenge panel' that considers the price review process on a national basis will not improve assessment of company plans. It may support independent review of Ofwat's trade-offs if it is suitably constituted and has sufficient resources to engage with stakeholders and sector participants independently from Ofwat. If this is not the intention, then we would suggest that this may be an advisory or policy panel, rather than a challenge panel. It is difficult to see how the wide range of local customer, community and environmental interests could be considered in a single central challenge panel, unless it engaged with local groups and company CCGs on an equal basis. Our limited understanding of the Ofgem RIIO2 process with a central challenge panel may indicate

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challenges in the voice of customers and stakeholders filtering through to regulator trade-offs, as well as conflicts with more local scrutiny, research and engagement. We are not convinced the answer to these conflicts – from a trust and confidence perspective – is to limit regulator engagement to one central challenge group, particularly if the remit is solely designed by the regulator. In our experience, independent access to the Board through a non-executive director, alongside similar measure for company engagement and non-national stakeholders, may benefit trust and confidence in the approach. At least Ofwat will be aware of areas of consensus and tension from a wide range of sources, with a wider approach to engagement.

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Design and implementation of price controls

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
Retain separate controls to enable targeted, pro-market regulation where appropriate - the broad structure of the price controls (for example, in terms of the number and duration of price controls) will stay the same as PR19	N/A	N/A	Broadly we agree that the structure of controls should remain similar, in the absence of compelling needs of further market introduction or changes in the industry cost structure.
Make a number of improvements to the implementation of these controls, for example in terms of reviewing the allocation of costs and undertaking other measures specific to each price control to promote markets	Changes to cost allocation may make no difference to either regulation or market introduction	Introduction of a specific market or development should ultimately change cost structures, and where the market design is clear, then cost allocation focus should follow	We do not see a compelling case for further cost allocation work from a market perspective. There is no clear evidence that further cost allocation work is needed based on planned markets, or that

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Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
			inappropriate cost allocation is limiting existing market development. We agree Ofwat should explore this further and keep under review, we just cannot see a case / need from the consultation.

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?

In general, we do not see evidence of a specific need to improve controls or change cost allocation. There is not a clear cost-benefit case, given the regulatory burden and potential unexpected consequences that cost or asset reallocation can bring.

On developer services, we do not think the assessment undertaken by CEPA to date or the discussion paper has properly defined the developer services market. We see three distinct markets which should be considered separately (noting that major sites may include more than one element, but they are separate activities):

- Off-site network reinforcement. This is non-contestable activity, which includes synergies with existing network management, maintenance and capacity planning. Evidence suggests it is unlikely to have cost assessment approaches separate from other regulated costs, so we see no obvious reason why the PR19 single till approach should not continue.

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- Direct connections of individual properties or small groups of properties to existing mains. These include a wide range of circumstances, but generally this is a monopoly network activity, and one where regulatory efficiency assessments are needed to protect customers. We think the PR19 approach works for these properties, but alternative designs (e.g. non-regulated, or separate tills etc), could work, but this is not a priority for these customers as protections equivalent to existing regulation would still be required.
- Sites with multiple properties and a designed connection to a main. There is competition between SLPs and NAVs to serve developers (and with incumbents as an alternative), with competition and delivery arrangements varying between regions. The market also appears to be dynamic. For this market, there is a clear case for considering the regulatory approach, including de-regulation, more active market development, or a separate till.

In our view, as recent changes made at PR19 have only recently been implemented, we see no particular data or evidence to support further changes at this stage. We think with a discussion on the market definition, there may be a case for change for some aspects of developer services, particularly where there are contestable activities largely delivered by contractors. However, the views of developer and SLPs will be key to this – such changes may not be a priority for them, and we sense a degree of change fatigue in this market. We would urge Ofwat to consider, from the developers' perspective, whether change for change's sake is their reaction, or what they would like to see. To a significant extent, as long as the market distinction we suggest above is maintained, our preference is to provide site developers with the market structure that supports their objectives of enabling development sites to be completed, and our objective of an efficient and cost reflective market price for the customer service these market participants want.

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?

Ofwat is reviewing the boundary definition of the water resources control. This could include extending the definition to include raw water distribution assets and water treatment. Our key concern with this proposal is the treatment of RCV. At PR19, Ofwat committed to treat pre-2020 water resources RCV the same as network plus, but new water resources RCV will have some exposure to market developments. It is not clear from the consultation if changing the price control would change the scope of the which assets going forward would be subject to the lower level of regulatory protections. This needs urgent clarification, as to do so would materially change the risk profile of the sector.

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We are concerned that Ofwat may be conflating cost efficiency modelling with the market boundary. Water industry modelling has never found acceptable water resource only models, reflecting the historical differences in water resource developments and therefore sunk costs with long asset lives. This was the principle behind the PR19 water resource RCV allocation (in contrast to bioresources). The nature of what cost models are generally better disaggregated model explanations of efficient industry costs (water resources plus water treatment vs water distribution), is different to what boundary definition is needed for the water resources control.

In our view, whilst there is a case for raw water distribution to be included within water resources, and this would be a relatively modest change, there appears to be no particular logic for also including water treatment from a market perspective, or because a more natural boundary for cost allocation would emerge. Water treatment has a mix of short and long asset lives, and water distribution has longer asset lives generally than water treatment. Water treatment new entrants are unlikely to be of any scale without an expansion of bilateral trading, something Ofwat postpone considering until PR24. Given the regulated nature of planning future water resource envisaged by RAPID, we think including water treatment within a control with water resources could become an unnecessary distraction without significant benefits. If there are benefits that are not obvious from the consultation and Ofwat wish to explore them with the sector – early engagement will be necessary as this change will require a significant amount of work to ensure it achieves the benefits, whatever they may be.

Ofwat is considering simplifying the residential retail controls so that it directly targets allowed revenue, rather than basing it on the number of customers served. We disagree with this proposal. The number of customers served is the primary driver of retail costs, so it would be more logical to continue the risk mitigation established from PR14 of adjusting for customer numbers. Setting the allowance in advance increases risk and so would require an increase in the allowed net margin, which we think is less in customers' interests than maintaining the current approach. Although there could be little variation in customer numbers and retail costs, it does not seem to us that there is a particular benefit from the simplification as there is very little burden of data, which we would need to report in any case. The simplification of removing the separate measured and unmeasured adjustment at PR19 was non-contentious, so it may be that this further step could be taken – we are just not sure what the benefits of the change are to make it worthwhile. It may be that the cost modelling and cost structure of the industry may reveal these benefits – we just could not see this from the consultation and in advance of post PR19 actual data.

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?

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We agree with the proposals as set out in the discussion paper.

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Outcomes

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
Should we reduce the number of performance commitments by focusing them on incentivising the delivery of outcomes of enduring interest to customers. These may mostly be common across companies, with far fewer bespoke performance commitments than in PR19	Outcomes and outcome delivery incentives do not reflect customer engagement or customers' views and priorities. Innovation removed from the outcomes framework and companies adopt a risk-averse approach	Simplifies the price review process but not the reporting process (as increased reporting is required for outputs)	Remove prescribed constraints from the outcomes framework – allow customers and stakeholders to input
Be clearer how our expectations of service levels are consistent with the costs that we allow. We could, for example, consider what performance commitment levels could be achieved given base costs in advance of the price review and then work with companies to consider any changes to tie in with their long-term ambitions or to match the immediate needs of local communities	Service levels set on inappropriate judgements	Simplifies the price review process	It is for companies to decide appropriate plan performance commitment levels. In some cases companies can explain the objective in relative terms (e.g. to match the industry

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
			upper quartile), rather than just the target.
Simplify our approach to setting incentive rates, and remove the formulaic use of marginal cost estimates. As with performance commitment levels, we could publish our initial views on appropriate incentive rates ahead of business plan submission	Incentives set on inappropriate judgements	Simplifies the price review process	Publishing views on incentive rates is acceptable if companies can use these as benchmarks (as opposed to then being required to be adopted), and subject to alternative research, engagement and testing.

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?

The focus on asset health should be on core water service metrics, rather than the contribution to wider benefits. It is not appropriate to just set the targets in terms of the mains bursts/ repairs, or even forward-looking resilience metrics (population protected, or DWSP RARI trends. Fundamentally we are concerned that Ofwat are conflating asset health with resilience, which implies an asset centric approach to the water sector, which sits uncomfortably with Ofwat's wider regulatory strategy (and PR19s focus on systems thinking Resilience Action Plans, potentially). Our assessment (Appendix 6 and Appendix 8) is that company specific measures of asset health are in many cases likely to be appropriate. We explore in Appendices 3 and 5 the impact on risk and return if a more standardised approach to asset health is taken than we believe evidence is likely to support.

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More generally, it should not (leaving aside an agreed list of common performance commitments) be up to Ofwat to decide (ex ante to receiving plans) which performance commitments should be included in company business plans. Outcomes are generally multi-dimensional so they can be difficult to measure through a single metric that meaningfully reflects the extent to which an outcome is being delivered. Likewise, outcomes are not achieved by means of a single, linear and finite process. If a company seeks to achieve an outcome, it may need to do different things at different times (and in our case as our Resilience Action Plan reminds us, not all capital or investment led – the social contract relationships were directly contributing to service improvements), adapting to changing circumstances. Outcomes are likely to be common across the sectors because they reflect things at a high level that customers and society value. But the emphasis that different companies place on different outcomes, and the way in which they resolve and trade off the tensions between them, may vary. The things that customers and society value highly in some parts of the country may be seen as less important in others. This is why the flexibility for companies to design and introduce their own bespoke measures is critical to the success of the outcomes framework. A framework that becomes focused on 'what is right' from the view of regulator will inevitably fail to reflect what customers want and value across the country. This will likely result in companies adopting a risk-averse approach and the scope for innovation and to consequently find better, more sustainable ways to deliver.

We therefore do not agree with the idea that there should be "far fewer bespoke performance commitments than in PR19". That will inevitably mean customers and communities get less of what they want because there is less choice and less flexibility to reflect preferences, which is the opposite of the outcomes framework. A key driver of the outcomes framework is that it should reflect customers' priorities for service improvements. Companies are able to address this through their own outcomes frameworks and through bespoke commitments.

Bespoke performance commitments ensure flexibility is included in the outcomes framework, with each bespoke PC reflecting each company's own circumstances and their customers' particular preferences. This was noted in Ofwat's PR19 lessons learned "*Bespoke performance commitments allowed companies to innovate and to cater for local circumstances*" and where it notes "*that bespoke performance commitments can play an important role in reflecting local priorities, and could have a role in developing future common performance commitments.*"[5] We are therefore puzzled with the proposal to reduce the number of bespoke performance commitments. A goal to reduce bespoke performance commitments, as an end in itself, could potentially stifle innovation because it limits companies' ability to seek new ways of measuring and managing performance.

[5] PR24 and beyond: Our reflections on lessons learnt from PR19

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In addition, setting a "limit" on the number of performance commitments is arbitrary. Would this limit be absolute or relative? Would there be a limit overall or just a limit on bespoke performance commitments? In addition to the reduced flexibility and ability to design a package to reflect customer priorities, such a proposal might lead to companies having less of a portfolio of measures where out and underperformance can be traded off. Companies' rewards/penalties would be more determined by a limited number of measures. This is a fundamental change to the balance of risk and reward.

A more welcome approach would be to give companies greater flexibility over the number of performance commitments they choose to include within their outcomes framework, rather than setting a prescribed list of criteria that companies must follow, which is what can cause a substantial increase in the number of performance commitments. It should be noted that contributory factors as to why there were 675 PCs across the industry is because the PR19 methodology, in addition to requiring the adoption of the common PCs, also prescribed a number of top-down rules, such as:[6]

- Companies needing to justify why they do not intend to continue with any of their PR14 performance commitments
- Bespoke performance commitments needing to cover specific areas, regardless of the suitability, including:
  - the different price controls;
  - vulnerability;
  - the environment;
  - resilience; and
  - abstraction, using the AIM (this area was particularly unhelpful to a company like Bristol Water – having not been required to report on the AIM in the period 2016-20, we then followed the guidance to identify the abstraction sites to which the AIM could be implemented by applying the three "filters" to potential abstraction sites, which resulted in being unable to identify any of our abstraction sites that met the direct criteria for the AIM)
- Requiring specific bespoke performance commitments, such as one on gap sites and voids
- Disallowing any aggregated performance commitments (particularly asset health metrics)

Removing such rules would ensure companies have greater flexibility over their outcomes framework, as well as ensuring that PCs are included because they reflect customer and stakeholder priorities, rather than the need to fulfil any selective criteria.

[6] Delivering Water 2020: Our methodology for the 2019 price review Appendix 2: Delivering outcomes for customers

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Finally, we note in section 6.2.1 on page 62 of the discussion paper that:

"We still expect companies to provide evidence of customer views on local issues, such as the proposed long term investments and their phasing, or the best way to meet a particular outcome to deliver public value. Local engagement may also support bespoke PCs and ODIs. Although we are suggesting these could be more limited at PR24, there may be scope for such outcomes in some instances."

At PR19 we introduced an innovative bespoke performance commitment "Local Community Satisfaction", which incentivises the company to improve our contributions to local communities through specified initiatives. If Ofwat's intention is to limit bespoke PCs we would urge that there remains space for the measurement of public value to be included within the outcomes framework.

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?

We recognise that outputs are more easily measured and monitored than outcomes and are more likely to be fully within a company's control. In general, they do not reflect things that customers and society value in themselves, but they may contribute to achieving those things. It may be possible to achieve an outcome by means of different sets of outputs. But it is unlikely that achieving any one output on its own would ensure the achievement of an outcome. The challenge is we end up with overlapping outputs and outcomes-based regulation, which as we know from PR09 created uncertainty in the eventual reconciliation. Price Control Deliverables (PCDs) should be used sparingly for specific uncertainties. If we are we looking to the long term, whilst pragmatic in the short term, moving from outcomes to PCDs will result in a shorter run focus, and more regulatory scrutiny, intervention and challenges in balancing incentives.

What then is the goal behind measuring outputs, or even worse with the asset management maturity approach and cost assessment proposals, potentially inputs? A more outputs-focused approach would require prescribing or holding the companies to account for the way in which they deliver outcomes, but then not necessarily allowing them scope to find alternative approaches. It would, likewise, involve specifying and monitoring output delivery, which is data intensive and a potential increase to the regulatory burden.

The outcomes framework recognised that companies should determine the outcomes they believe should be achieved (through engagement with customers and other stakeholders). Whilst it is important to define a means of measuring the achievement of an outcome, the monitoring of such outputs should not be subject to the same level of scrutiny (as seems to

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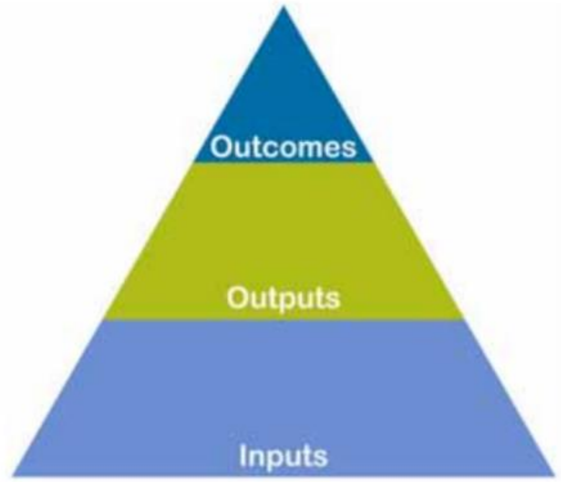
be implied). Is this not another retrograde step in terms of the burden of regulatory reporting?



Between privatisation in 1989 and the introduction of the outcomes framework at PR14, Ofwat's approach to ensuring water companies in England and Wales provided their customers with a good quality service at a fair price involved setting an extensive range of detailed outputs the companies must deliver and monitored their progress closely. The outcomes framework, if followed correctly, negates the need to continuously monitor outputs. Indeed, before introducing the outcomes framework, Ofwat proposed a hierarchy to underline the importance of outcomes over inputs and outputs. Ofwat also noted that "*economic regulation must focus on incentivising the companies to deliver efficiently the outcomes that customers and society value. The regulator should only concern itself with inputs or outputs to the extent that it is necessary to incentivise outcomes.*"[7] Ofwat was right about this at the time and its sentiment still holds today.

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 interests of customers?

We refer to figure 9.1 in the consultation document:

[7] Inputs, outputs and outcomes – what should price limits deliver? A discussion paper

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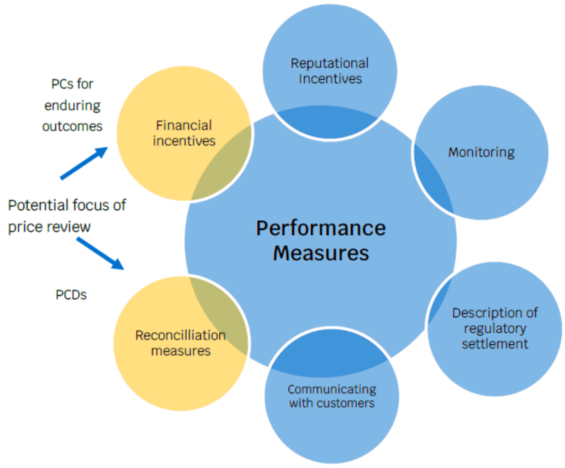
Figure 9.1 Potential functions of performance measures



Replacing ODIs with procedural or reputational incentives (or the confusing Price Control Deliverables which may just be a new name for end of period ODIs, or totex sharing mechanisms) is not new, but a return to the layers of input and output regulation from PR09. It did not work then for achieving a longer term focus, because it was not proportionate or risk-based regulation in its implementation. The layers of potential risk and return affecting incentives in the consultation sounded more complex than currently, for instance new mechanisms to claw back current outperformance in an attempt to install a long term focus on even shorter-term price review incentives than PR14 or PR19.

Whether we use reputational or process incentives, we should be clear about the regulatory framework that comes with the price control. It may avoid the increasing regulatory burden which we fear may rapidly become the main barrier to achieving the societal objectives for the water sector. This is not always possible, but these uncertainties should be understood. We are not convinced by the discussion document – we may be wrong, but our experience suggests that Ofwat will end up with a more short termist than long-term sector as a result. We set out alternative proposals at a high level, in particular for scenario planning and risk and return assessment, which if the logic is followed, will help to inform some of these decisions during the process.

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?

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Publishing your initial views on PCLs that correspond to the base costs is likely to be the equivalent of a regulator determining what companies should deliver for customers but more fundamentally, base costs should not drive PCLs. Besides, such views may be questionable (they may be based on inappropriate averages, and regulatory judgement, rather than insight) and could potentially become overbearing on the future of the industry.

The level of performance commitments should be set in line with the views of each company's customers, reflecting a balance of the cost of delivery of improvements and customers' willingness to pay for them. Attempting to intervene in this process by dictating levels of cost or service targets will lead to a sub-optimal business plan from customers' perspectives. We suggest a process in **Appendix 2** which will help to inform such decisions – what we do not see in the discussion document is sufficient evidence to have confidence that the proposed approach is the right one.

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?

On simplifying your approach to setting incentive rates, further to our response on the specific consultation on this issue, we still cannot see the logic of imposing "collaborative" customer research if a company chooses to undertake its own research. It is important for ownership of our own plans that companies are able to engage their own customers on important issues, to ensure that plans reflect those views. Companies are able to tailor their engagement to their own specific circumstances, and engage with their customers to obtain the most useful insights. The collaborative customer research (in particular with regards to outcome delivery incentive rates) may then give different values to the companies' own research, creating conflict and inefficient duplication. Such a framework should be flexible to allow companies to conduct their own research. Otherwise, there is a risk that such an approach could be seen to blur the company- customer relationship (which was a key success of PR14 and PR19).

On setting stronger incentives to deliver long-term benefits, we are concerned about the practicalities if the incentives are then set at the wrong levels? Such an inflexible framework may "lock in" incorrect incentives, which may not then be adaptable to future pressures and customer preferences. As with many of the other questions, we refer to our analysis and logic in the letter and appendices for how we would propose exploring these questions.

We note on page 38 the reference to deferring outperformance payments: "*rather than provide outperformance payments within a price review period, these could be paid over time, contingent on outcomes continuing to be delivered in future periods.*" We question this approach, especially after the PR19 methodology expectation that in-period ODIs become the norm rather than the exception. Our understanding was that the whole point of in-period

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ODIs was to improve legitimacy so changes in bills were closer to changes in performance, and financing – which aligned companies to customers and improved legitimacy. Indeed, Ofwat said at the time: "*In-period ODIs… bring service performance payments closer in time to when customers received the service performance. In-period ODIs should also result in companies compensating their customers for poor performance more quickly.*"[8] But this new approach of deferring outperformance and not underperformance makes investor returns less dynamic and would require a higher rate of return. The consequence of such an approach is to limit potential RoRE upside. This is, in our view, a backwards step, and would not result in more long-term focus, but in short-termism to avoid stronger penalties.

We do not believe that marginal costs are hard to calculate, and removing the neutrality for ODIs by incorporating WTP, marginal costs and cost sharing rates removes the totex/outcomes logic in its entirety. If we are to do this, a different regulatory model would be required, which effectively appears to be a return to PR04 or PR09, rather than a model for the future.

[8] Delivering Water 2020: Our methodology for the 2019 price review Appendix 2: Delivering outcomes for customers

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Cost assessment

Q10.1: What should be the priorities for improving our approach to cost modelling and assessment?

We agree that the cost assessment models were reasonable and proved to be statistically valid. We would not specifically recommend significant changes to the models or drivers, but would expect them to be subject to review to ensure they continue to pass relevant tests. If there are better models, the collaborative approach suggested (similar to that at PR19), will help to identify them. We welcome the intention to consult on potential models later this year. What will work less well is relying on the same modelling approach when some fundamental changes (such as in price control boundary or in PCL assumptions) are also being made. This may not work in practice.

A key issue at PR19 became the time period over which catch up efficiency was assessed. This mattered most where service level improvements were being made, and industry costs were responding to this and other external challenges. The most important thing Ofwat can do is analyse data with an open mind, understand cost changes, and then apply the cost models based on a prior theory and methodology. As the CMA found, changing cost benchmarks and efficiency frontier / forward looking efficiency assumptions from the perspective of a preconceived view of what efficiency challenge is necessary is not sufficient as a logic.

Q10.2: In what areas (both historical water sector and external) can we improve the range of benchmarks we use in cost assessment?

Our main concern is that in attempting to improve the range of benchmarks, we overlay different assessment approaches, and complicate modelling and its interpretation. For instance, separating opex and capex assessment, with base and enhancement bottom up models (e.g. using a cost base), in order to have greater benchmarks to make a greater cost challenge is not advisable. The greater the disaggregation and reaggregation, the greater the number of special factors, and potentially the weaker the benchmark has to be applied to avoid salami slicing.

Another consideration should be whether simpler (CPIH-x?) style approaches can be used. If efficiency benchmarking proves just to be noise, other approaches can be taken. However, as with any cost assessment, it should not be designed in isolation of other incentives – that is a key learning point from PR19. We expand on this in Appendix 5.

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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?

This question requires comparison of different scenarios, because we do not think there will be "one size fits all". We set out some of those facing us in **Appendix 7**. We suggest that Ofwat engages with companies as plans develop, to understand where costs can be compared, and where other approaches are needed. We are not sure whether public value makes a difference to cost assessment. If plans are not "least cost", then a) if enhancement then bespoke assessments can be carried out and b) if base costs, then changes in service levels or bespoke ODIs may provided a basis for cost assessment adjustments, or correction mechanisms, or a combination of two.

If Ofwat is concerned about the ability to compare such longer-term ambitions, then the answer is not to try and compare them, but to make more standardised efficiency challenges and adjust cost sharing rates. This is not exactly novel. We do not think there is a better solution, to avoid the risk that defining the assessment will define the solution (e.g. to net zero) that companies select.

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

For base costs we are not convinced there is an issue with a totex/outcomes assessment for nature based solutions. Not all nature based solutions are fully opex or fully capex. More specific analysis of any potential issue and solution would be required to comment on this further.

Q10.5: Where can we enhance our evidence base on the relationship between costs and service?

Ofwat should allow companies to develop plans and then consider the relationship between costs and service based on those plans. Where companies are proposing step changes in expenditure to deliver service levels, it is normal to expect a degree of continuation from current plans to show commitment – that was the basis of the totex/outcomes framework looking to the longer term. In our view, it was clearly the case from leakage and supply interruptions at PR19, and that the cost evidence up to 2020 then revealed the cost of these service improvements. Modelling can look at such trends based on the 2020-25 APR and service level information and then company plans where early starts for step changes are required. It reduces information asymmetry, and should reflect a balanced risk and return approach at the previous review.

If this is not apparent in the industry, then the question is whether the risk and return balance and the previous review was too harsh, or too soft. To understand this, changes in circumstances and strategy need to be understood. Ongoing strategic dialogue with companies as part of the process is our view of how Ofwat can modernise regulation to explore this further, as we suggestion Appendix 2 and Appendix 5.

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?

This is impossible to answer – because it presumes a definition of an efficient company that is not working in a long-term context, but a more static base allowance for the level of service. This needs further exploration, because that is not the position we had in terms of PR19 assumptions, but may be if we narrow performance measures to historic asset health measures and then project forward (e.g. through age based deterioration from there). We just disagree that this is logical as a direction of travel for the industry's regulation, if we have understood the discussion document correctly.

Ultimately we do not think that new mechanisms will necessarily be required. Commitment to long term outcomes should come with a risk and return framework that reflects this commitment. Ofwat can either signal the framework and then observe companies' response, which works for homogenous circumstances and outputs, or assess each company's plans on its own merits, supported by appropriate comparisons.

We suggest that we consider the risks and opportunities of these two approaches, against company long term scenarios, before designing the mechanisms. We are not convinced at the moment we have enough context to go into detailed mechanism design, until we have clarity on the framework we are trying to achieve.

Q10.7: Is there more that we need to do to reflect future pressure on operational resilience in our approach to cost assessment?

In our view, we proposed a longer term measure of operational resilience as an ODI at PR19, but Ofwat preferred a major scheme, end of period ODI reflecting a Price Control Deliverable type approach. That wasn't our choice, but because it was a long term plan, was a reasonable regulatory judgement which we adapted to. But not having the longer term metric was very difficult to explain, given its value to balancing operational resilience. We saw no particular reason why cost assessment for something of relatively low value, with standard totex sharing mechanisms and the ODI, should drive the decision.

Ultimately we think in most circumstances, operational resilience should not drive cost assessment, because companies should be planning to deliver operational resilience. Where there are changes to service or external factors, these can be assessed as enhancement, but our preference is to avoid salami slicing enhancement investments (in particular for lower

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value schemes), in return for assessing plans in the round from a long term risk and return perspective. We suggest in **Appendix 5** how scenarios could be used to help judge what degree of cost assessment is required, depending on the balance of a company plan.

Q10.8: Are the most significant challenges to the operational resilience of the sector adequately captured within current strategic planning frameworks?

For some companies, who have major statutory obligation gaps to close this may be true. This is not universal across the industry, as our PR19 plan, with the lowest amount of enhancement, and subsequent discussion of the lack of future statutory obligations to accelerate for green growth suggested. Our resilience focus (see **Appendix 6**) is rightly on longer term public value, trust and agility to maintain that position, which may be different in the future and in any case we do not take for granted. **Appendix 7** sets out how we are considering this.

However, if we look at resilience in the round (as we do not understand Ofwat's redefinition towards operational resilience from the focus Ofwat encouraged the sector to take at PR19, without engaging on this) the issues that matter continue to be trust and confidence, ethics and acceptability. The narrative and focus on this are not just for companies.

As we consider in our letter and appendices, outside of the statutory obligation gaps, operational resilience amounts to everything a water company does, particularly for the long term. It is therefore not remotely adequately captured by strategic planning frameworks, and we would be surprised if anyone felt that it was.

We are currently considering what we can learn from other sectors in terms of bespoke customer focus, with new technology, that if applied to the day to day asset and operational effectiveness / management in the water sector, would define operational resilience beyond statutory obligations (and the strategic planning framework).

As another example, RAPID has defined strategic schemes with a cut off in terms of size. Other smaller water resource schemes, that may need bilateral trading in order to commercialise, have been left to regional water resource plans. There may be untapped market potential to reveal improvements in operational resilience, which the strategic planning frameworks are not enabling, and Ofwat are also planning not to prioritise. We find this surprising, and we are not clear from the discussion paper why we are limiting price reviews and the regulatory framework to focus on strategic planning and statutory obligations which feels like a reversion to PR09 and before.

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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?

We believe a totex/outcomes approach, perhaps with long-term operational resilience measured through asset information, may ultimately either a) mean the assessment of enhancement expenditure becomes less important because of totex incentives, or b) company approaches show a range of outcomes and bespoke assessments are required. Having noted that the CMA took a bespoke approach to something that in theory was as comparable as leakage, it may take longer from where we are not to PR24 to understand what forward looking measures of resilience for planning, if they can be standardised, can be used. We suggest an appropriate potential measure for the water service in Appendix 8, but even this emerging measure will require significant work in order to be confident that it will work for long-term resilience planning – we won't know of course unless we have a process to explore it further. That is why we are not convinced the focus on asset management maturity assessment will lead us to the key issue of how to understand operational resilience and assess both asset, operational, cultural and service solutions, at a time that the pressures and expectations are changing rapidly, and with a range of local impacts. Our priority should be to avoid systemic failure (for individual companies or across the industry in a particular challenge), and ensure risk and return avoids this, to provide a long-term pathway for resilience.

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Risk and return

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
Seek to optimise our risk framework, reducing complexity where appropriate. We will also look at whether we can improve our understanding of risk	That in reducing complexity, we merely increase risk	Risk and return can be seen in a long term context.	See Appendix 5.
Consider updating our approach to estimating the allowed return on capital. We will, in particular, consider whether to index the allowed return on equity, to protect customers and shareholders from forecasting risk, as well as reviewing the role of balance sheet and index data in setting the allowed return on debt;	Indexing the return on equity increases complexity	If this is seen as a risk reduction, it may be worth the additional complexity and uncertainty it would generate.	If the cost of equity is long-term and investors are long term, why is indexation and forecasting risk a significant factor? The balance sheet data approach reflects the CMA outcome and therefore we support it.
Explore our approach to financeability, taking account of how we define the notional capital structure, and considering ways of incentivising financial resilience to protect customers from the adverse outcomes of risky financial structures	That we recreate an alternative to the Gearing Outperformance Sharing Mechanism, without a clear logic of the issue.	That financeability is considered in the round, and where there is an issue, the root cause in regulatory judgements can be amended as	We believe that if the risk and return is balanced, then financeability almost always will be as well. The notional structure appropriate to

Summary of Ofwat PR24 considerations	Risks	Opportunities	Bristol Water's Approach
		part of the determination	the circumstances of the appointee, is the right framing, as the CMA found.
Consider a further transition towards full CPIH indexation, to further reduce reliance on the discredited RPI measure	N/A	Given RPI may well look like CPIH in the near future, this may be a moot point.	Whilst some flexibility may be required, we assume further or full transition can be balanced with financeability and other risk and return approaches.

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?

In general we do not see this as a key decision. We note the list in the consultation excluded gearing outperformance sharing mechanisms / financial resilience mechanisms. We support its exclusion based on the lack of a clear logic or obvious effective mechanisms proportionate to the specific issue so far identified by Ofwat. We also note and support the CMA's conclusions on this.

We set out in **Appendix 5** our view of how we can explore what risk allocation mechanisms may be used in different scenarios. We would also observe our experience at PR19 – we suggested the 1% p.a. of RORE ODI bill cap as a financial mechanisms and bill smoothing measure, which was based on clear customer research to demonstrate the benefit to customers as well as the company for the long-term. This became a standard feature of the Final Determination. We also note the constructive and non-contentious discussions we had at PR19 on other risk mechanisms, in particular the uncertainty associated with the

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Gloucester & Sharpness Canal water purchase costs. We have a number of other examples at PR19 of how we could make a risk and return case, by considering risk allocation as part of our plan, and how Ofwat took into account the proposals. We see no reason why this cannot work for future reviews, and the scenarios approach we suggest to risk and return would boost this still further. There is obviously a risk that bespoke arrangements or a menu arrangement has a burden on Ofwat that should be reduced, although this is not obvious from PR19. A scenarios or pathway approach may help to reduce this risk, and illustrate what a good plan for different contexts may look like from Ofwat's perspective of its long term vision for the sector.

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?

We set out our suggestions in **Appendix 5**. We remind Ofwat that RoRE came with the totex/outcomes framework at PR14. If we move away from this (e.g. towards PCDs, or towards outperformance returns being postponed for the long term), then RoRE as an approach may become defunct, or more confusing that it is worth.

We agree that it may be useful to improve understanding of uncertainty, and how evaluation of risks can be incorporated into regulatory assessments. The approach at PR19 of assuming P10 and P90 ranges that scaled as performance commitment targets changed did not work. Whether such assessments can be standardised is something that our scenario proposals can explore, alongside Monte Carlo simulation tools such as Liquid Risk which was developed at PR04. We think standardisation may not be required, as company risks and impact of similar factors will vary, as has been found in the past.

Q11.3: Should we index the allowed return on equity, and if so, how ought this to be implemented?

We are not convinced that, given the allowed return on equity should reflect long-term returns, that it will necessarily require indexation for short term variations. It is more likely that a fixed long term cost of equity which does not vary with short term measured risk free rates is more appropriate. The CMA explored the factors behind this reference point, which would not necessarily result in a logic supporting equity indexation. This does not appear to be a demand from investors, and we are not convinced that based on our analysis it would make the risk and return allocation any "better". However, we are not opposed to a mechanism, we are just not sure whether indexation merely puts more accuracy on estimates of the cost of equity than can be assumed and is therefore not worth the additional complexity. It is more important to focus on whether expected returns are aligned with the assumed cost of equity, than to index it, given that indexation exists for all of the variations to the returns already.

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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?

We believe the CMA revealed much useful insight. The wider collection of balance sheet data should be given significant weight. This does not mean that an index data approach may not be a potential reference point, but balance sheet data should be considered against other historic and projected index and run-off weighting approaches.

Q11.5: Should we allow adjustments to the sector allowed return based on company size - and how should this be assessed?

On company-specific adjustments, we note in section 11.3.4 on page 118 of the discussion paper that Ofwat is *"interested in views around whether continuing to allow such uplifts is appropriate, under what conditions, and how to streamline the assessment process."* Such appropriateness should take into account regulatory precedent. The CMA's PR19 redetermination confirmed established precedent from PR14 and earlier price reviews, once again confirming that there is evidence that small companies have historically faced notably higher debt costs. As a reminder, the CMA assumed for Bristol Water the following uplifts on debt for size:

- 30bps CSA allowance on embedded debt for higher historic cost of issuance relative to larger companies
- 5bps CSA allowance on new debt for higher liquidity and transaction costs

On financing, we are pleased to see that Ofwat are considering with an open mind the evidence on the additional cost of small company finance. We believe that company specific research to test customer acceptance of the higher cost of finance of being served by a small company is a reasonable expectation. This should be the only additional test to allowing the notional cost of finance relevant to a company with the size characteristics of the appointee. As an additional cost, it is appropriate to test whether the actual company cost is below this notional allowance. The CMA findings at the PR19 redetermination (as at PR14 and PR09) are relevant reference points and were clear that continued use of a customer benefits test not related to the additional cost of finance was not an appropriate methodology.

We are concerned however that Ofwat are considering assuming a lower notional gearing level, to boost financial resilience e.g. from weather shocks. This would move away from the principle of a notional company. This could be justified if gearing levels were higher than the reference point for the industry used in setting the cost of debt, but as we support the approach (as the CMA followed) of considering the industry actual debt cost in the round, rather than just relying on the relationship to the IBOXX index, this is unlikely to be an appropriate assumption. The notional gearing should reflect an efficient level evidenced from actual industry information, including the regulatory gearing of companies that are used to

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set beta. If there are financial resilience issues from regulatory incentives, these should be taken into account in the cost of equity, or mitigated through those incentives, on a company specific basis for factors that are outside management control or not diversifiable for investors in notional companies equivalent to the appointee. Where notional gearing is assumed that is below the relevant notional company, then for smaller companies a higher cost of raising new equity would need to be assumed. This would be higher in the water sector than Ofgem assumed for smaller companies they regulate, given the scale of smaller in the water sector in terms of RCV is far lower than small company adjustments made by Ofgem at RIIO2.

Q11.6: Should we make different assumptions for the PR24 notional structure compared to PR19, and how should such a change be implemented?

We do not see a case for different notional assumptions than at PR24. The consultation does not provide a logic for this section. Any adjustments to the specification of the notional company that are not well justified could constrain scope for identifying financeability issues and as a clear check on the calibration of allowed returns.

Q11.7: Do you have any suggestions for mechanisms which could incentivise financial resilience within the price control process?

We disagree that such mechanisms are required, except as a company specific adjustment for existing financial resilience issues that have required regulatory intervention. As the CMA found, there was little logic in making adjustments within "normal" levels of gearing, and no evidence there was additional risk to customers from the gearing levels seen in the water sector. We would observe that in the case of financial resilience, Ofwat has more licence powers for ongoing regulation and moving away from the notional gearing and cost of capital through financial resilience mechanisms in the price control is likely, as with the Gearing Outperformance Sharing Mechanism, to make financial resilience worse, rather than better. If there is a financial resilience issue, then returning money to customers away from the regulatory company, lack logic. Clear dividend policies and financial resilience mechanisms already exist – and Ofwat can consider through the APR whether there is sufficient financial resilience assurance on-going.

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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?

The key consideration should be the proportion of company debt which remains linked to RPI, as where companies retain large amounts of long-term, RPI-linked debt then that should to some extent be reflected within the indexation of the RCV. However, given that the definition (and therefore level) of RPI may be very similar to CPIH in the near future, this may be a moot point, Ofwat should consider the views of the Bank of England and investors, and if there is not certainty as to the future of RPI, provide companies with similar flexibility to that provided at PR19.

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Next steps for PR24

Q12.1: What are your views on the draft timetable for PR24?

We provide a revised proposed process and timetable, with our reasons for making this alternative proposal, in **Appendix 2**.

Business plan submissions
We welcome the proposal to move the business plan submission date to 2 October 2023 (the equivalent of a month later than the same stage for PR19), which we feel fairly recognises the concern our investors raised (noting the impact on our staff) following PR19 of key submission deadlines being at the end of the summer holiday periods.

Possible early submissions
At PR19 the requirement for early submission of performance commitment definitions was a useful process for reducing ambiguity and improving consistency. We note on page 125 of the discussion paper that that you "*will consider what elements of business plans might usefully be included in an early submission from companies, for example with respect to enhancement schemes or outcomes with bespoke PCLs. We will also engage with other regulators at these early stages to get their initial views on the business plans' risks and opportunities.*"

The switch from definitions to bespoke PCLs may help reduce the risk of companies unknowingly submitting business plans that do not align to Ofwat's expectations, leading to a more focused business planning process. But early sight of bespoke performance commitment definitions should still be included in this submission (as this also helped to reduce ambiguity).

We are less clear on what value Ofwat derived from early submission of Cost Adjustment Claims, particularly those in relation to base cost models which were then subsequently revised or withdrawn once the models were revealed. Dependent upon Ofwat's decision on when to reveal base cost models it may be appropriate to align the submission of cost adjustment claims in relation to those so that they are received after companies have time to review the models. Early provision of CACs in relation to enhancement cases may allow Ofwat greater time for engagement and assessment, and we would support the continuation of that.

Draft timetable for PR24
We propose an amendment to the process and timetable in the consultation, so that the timetable starts with strategic dialogue and Ofwat is then able to observe the consensus as it emerges, whilst also having the opportunity to interact with areas of disagreement and trade-offs.

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We are proposing such an amendment because as it stands there is likely to be no understanding of risk and reward and without such understanding, we cannot describe the assumptions and trade-offs being made. And even if the right decisions are made, we cannot inspire trust and confidence in them. Our proposal is to rethink the price review timetable to avoid early submissions without strategic dialogue of long-term risk, with opportunities embedded via the discussions over business plan “scenarios”. This can then inform what early certainty and decisions can be made,

With the scenarios formalised, we can then consider more carefully the outcomes and incentives required.

Our analysis in **Appendix 3**, illustrates that we already know from PR19 that standardised incentive rates will have an asymmetric impact on different companies. At PR19 we went through, arguably with little value being added, rounds of redesigning incentives away from their intention. As Ofwat agreed at PR19, the balance of our plan was well considered and supported by high quality research. We are concerned to avoid a repeat of this process, but reducing the number of ODIs and replacing this with base cost / service level decisions is probably the wrong solution.

We need to understand what we are trying to achieve at a more detailed level than very high level concepts, before we dive into the design of regulatory tools.

Our proposed timetable would also provide a useful vehicle for engagement with customers in advance of the production of final Business Plans and final determinations. Customers and stakeholders will not trust economic regulation, including its traditional role of being a poor proxy for competition until contestable markets can be introduced, unless areas of consensus has been explored and routes to build trust in company plans and the regulatory framework they operate within is established. Currently, the lack of consensus limits both reducing the complexity of price reviews, and the introduction of more competition. Unless this changes economic regulation will fail to recognise the shift in expectations that see companies and markets focus more on purpose and public value.

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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?

We are not convinced that a case has been made for water resources costs and incentives to be targeted more effectively. In our view, the best way of testing this is to develop a framework for bilateral water resource and treated water trading, including from potential third party sources, taking into account the original intention of the Cave review for this to support the business retail market.

We water resource planning remaining as a regulated and a planned activity, covering the full supply value chain including treated water distribution, as well as the demand side of leakage and customer usage, water resources as a separate price control probably requires little changes from the PR19 approach.

In part the challenge is data, we have not had a full year of the PR19 framework yet to judge evidence on costs and incentives, which makes this question feel somewhat abstract to answer in the absence of evidence.

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?

We summarise this in our answer to question Q8,2, which we think duplicates this question. As we state above, in the absence of new data or evidence or market arrangements, we do not see any driver for further change at this stage.