



**Date: Wednesday 21 July 2021**

## **British Water's Response to Ofwat PR24 and Beyond: Creating Tomorrow Together**

### **Ambitions for PR24**

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

The themes are very broad and quite vague. However, British Water agrees with the overall themes but would like to see specific commitments in the form of the goals and targets that water companies will be required to meet.

### **How we regulate**

Q3.1: How can we best regulate the water sector to deliver value for customers, communities and the environment? Do you agree, or have comments on, our suggestion to maintain our 'building block' approach based on outcomes, costs and risk and return?

Q3.2 To what extent is greater co-ordination required across the sector? In what ways might we promote better co-ordination across companies and with other sectors, and how might this benefit customers?

'Outcomes' should remain a building block of PR24 but we would recommend that 'cost' be replaced with 'efficiency' in PR24. It is important that when addressing the well-known challenges of climate change and population growth and to meet net zero targets that cost not be the defining factor in future price control considerations. A focus on cost tends to lead to a greater emphasis on achieving savings rather than identifying efficient technologies that could potentially achieve greater whole life costs for the benefit of customers. A focus on costs also has the tendency to drive down margins in the supply chain, which can especially adversely affect smaller suppliers' capacity to innovate with innovative products and solutions. In water company interactions with customers it is widely accepted that customers want to see the necessary investment made to future proof ageing assets rather than keep costs the same or reduce them. A lack of sufficient investment in PR24 will have a negative impact on communities and the environment. Any regulatory building blocks will need to be clearly defined to facilitate excellent future services for customers and to safeguard the environment.

The very important role of the supply chain which enables the effective delivery of water company business plans ought to be recognised within the strategy. The supply community, which includes water companies and their inextricably linked supply chains, work together to serve customers and the wider environment.

The cost of delivering solutions to the UK Water Industry is structurally expensive due to some characteristics and behaviours such as heavy procurement processes, onerous terms and conditions and preferential engineering and bespoke specifications – currently each water company has their own variation of the supposedly cross industry WIMES. Like the cost of cyclicity, these costs are almost impossible to isolate but are levied on the supply chain and have to be borne by the Industry as a whole. At British Water we have identified and set up working groups to improve efficiency in some areas, such as a Procurement Project Team.

There are currently concerns on whether the supply chain has sufficient capacity to fulfil procurement requirements due to Brexit (contributing to labour shortages/increased wages) and Covid impacts which have led to project delays. Capacity is likely to be an ongoing issue in AMP8 and is expected to intensify due to the widely acknowledged skills shortage within the sector. In order for the water sector to be seen as an attractive place to work in PR24 and beyond, future regulation needs to foster an environment where the cyclical peaks and troughs are either eliminated or reduced. Every five years, water companies and their suppliers need to adapt to changes in regulatory requirements and performance commitments which can lead to project delays. An increase in greater coordination and collaboration should therefore ensure greater cohesion in project delivery, design and practices.

The regulator should seek to identify areas within company proposals and determinations that are common to all water companies, highlighting current and long-term priorities. Where appropriate, this could explore how efficiencies could be gained, implemented and duplication avoided. Stronger coordination between companies and the broader supply chain would also significantly improve the take up and roll out of innovation and prevent legacy players from being prioritised over newcomers. This will ensure customers get better value for money.

### Increasing focus on the long term

Q 4.1: What are your views on the need for greater focus in companies' regulatory business plans on how they will deliver for the long term?

A long-term focus is absolutely vital for PR24 to succeed in helping to address current and future challenges. The 5-year regulatory cycle is itself a barrier to long-term delivery. Companies at the bottom of the supply chain are most affected by the sometimes up to 18-month delays as the cycle winds up then ramps down at the start and end of each AMP. Despite the sectors' long-term plans for water resources management etc, the 5-year cycle still creates unavoidable peaks and troughs and short termism. The 2012 report [Smoothing Investment Cycles in the Water Sector](#) found that a smooth investment cycle could reduce the average customer water and sewage bills by 2 per cent, saving £6.50 on average annual bills; saving the water industry £600m every five years; and prevent up to 40,000 job losses. British Water's new Cyclical Project Team is currently assessing the continued impacts of cyclical on the supply chain and customers.

In the past we have worked with Ofwat, Water UK, HM Treasury and Water Company executives to try and ease this burden, which was highlighted in the Grey Report on Ofwat and the above cited HM Treasury paper – Smoothing Cycles in the Water Sector. During this process it was generally recognised that the 5-year cyclical spend pattern, cost jobs, skills, money and reduced efficiency. We learned that despite everyone agreeing that something should be done – the AMP cycle process created inhibiting behaviours/processes within water companies that could not be broken without Ofwat's intervention. The cycle is as pronounced as ever. This is why we believe that ODIs specifically linked to annual spend should be introduced as part of the performance measures. We also question the need for 5 yearly reviews for ongoing capital maintenance type work – this is the supply chain's bread and butter – large one-off projects that disguise the cycle need to be evaluated differently.

Anecdotally, our members report that despite the introduction of Totex, decisions are still predominantly based on capital cost. We are told that this is due to capital and operational expenditure being accounted for separately and that decisions are taken with a 5-year time horizon. Many AMP spanning innovations and initiatives are lost



for these reasons. Many of our supply chain companies do not understand the financial workings of Water Companies but they do live the consequences of them. A clear understanding of what Totex means and how decisions are made based on it would be helpful.

Water quality targets for both drinking water and wastewater need to improve and it is vital that confidence in the sector is not diminished as we work to ensure that water companies have the ability to deliver on long-term targets. Short-term and long-term goals should be interconnected to continuously deliver good performance.

The ability to deliver for the long-term will depend very much on the skills and people in the sector, which is not addressed in the document.

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?

Common requirements across water companies would help customers, stakeholders and supply chain companies better understand the sector's approach and each company's approach. Please refer to the points above and below about the need for a common understanding and standards.

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?

Business planning/the determination process should be an iterative and collaborative approach with water companies. This would enhance transparency and joined-up thinking and planning for the future.

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

Providing insight on comparable aspects would enable customers and stakeholders to understand differences and commonalities and enable the supply chain to plan for and build capacity where it can.

Q4.6: Should we adopt a collaborative approach to developing Welsh companies' plans at PR24? If so, how should we go about doing this?

A catchment-based approach should be adopted in developing Welsh companies' plans. The Environment Agency, which needs to be adequately resourced, could publish live data as a requirement. Detailed reports on drinking water and surface water quality should be made available to customers in an accessible format. There is currently a lack of visibility.

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

Clarity on the defined outcomes sought for a long-term regulatory framework and clearly defined building blocks are vital to ensure everyone is working towards the same aims and with a single-minded purpose.

Q 4.8: 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?

A holistic approach to environmental stewardship is required to bring better engagement across the farming,

industrial sector and other stakeholders. A whole water cycle approach is also required.

There is a weighting towards capital intensive projects over digital solutions in the way a water company's value is assessed. This is a barrier to delivering greater social and environmental value for customers and requires a change in how water companies are able to deliver their core functions. Including asset maintenance within civils contracts may not be the best use of a company's reserves. Currently the supply chain has to work with 17 different companies with solutions that could be applicable to all. This is complicated and resource intensive as supply chain companies need to facilitate multiple negotiations for a single solution. It is hoped that the Centre of Excellence will help facilitate better sharing of information across water companies and learning from other industries. Efficiencies can be won with much greater collaboration and streamlining of processes across the industry.

Research could be carried out to better understand barriers, similarities and differences in how water companies operate, including across geographical boundaries.

As with the customer challenge process, where appropriate, provide comparable outputs across all companies that can help better understand and identify actions that would break down barriers from inefficiency and duplication impacting the sector.

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

The sector needs to take a long-term view on delivering an effective operational model which includes the supply chain, looking at end-to-end procurement policy, the sector's pool of resources, and available technologies and capabilities.

Water companies should continue to collaborate and explore supply chain capabilities and expertise to develop solutions at the earliest stage of procurement. The sector needs to move away from the attraction of adopting the 'lowest cost' and 'least cost' approach to fully embrace Totex, using procurement strategically to provide real opportunities for cost reduction and energy saving solutions.

Embedded carbon needs greater consideration in plans, driving a move towards more nature-based solutions with digital management. The need to understand the cost implications, on the supply chain, of working with water companies on decarbonisation is absolutely vital.

A circular economy approach is also needed with a greater focus on opportunities to replace parts, reuse current assets and technologies that can be easily repaired and maintained, for example.

Asset management – the industry needs clear visibility of defined and agreed life expectancy figures for different types of asset.

### **Strengthening Incentives**

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

Ofwat should undertake an initial assessment of plans focussed on a water companies' statements of needs, outcomes and how they plan to adopt and roll out innovation. New incentives/targets which encourage water companies to limit variance in supply chain spend through and between AMP periods should also be considered



to promote sustainability and continuity.

Greater clarity on statement of needs and outcomes will lead to better procurement processes and terms and conditions. This should also increase the exploration of innovations and better supply chain relationships for the long-term benefit of the environment. This should also enable effective and acceptable levels of risk-sharing.

Procurement teams should be incentivized to continually improve their own policies. To achieve best value, all relevant parts of the company should be involved in procurement, not just the procurement department.

Where water companies are outsourcing their services, they need to include partners and framework contractors early in the decision-making process, to ensure best value for customers.

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 are pleased with the introduction of the Innovation Fund to date and consider it to be an effective way for water companies to collaborate with suppliers. We recognise that the companies have also improved the information available on their websites to help suppliers engage directly.

Innovation specific incentive mechanisms at PR24 will help ensure continued collaboration and the take up of innovation through clearly defined statement of needs/outcomes. By specifying their needs and the outcomes expected, innovative companies will be better positioned to engage.

### **Reflecting customers' preferences**

Q6.1: What are your views on the merits of our proposals for a collaborative approach to standardised and/or nationwide customer research to inform company business plans and our determinations?

The collaborative approach outlined for customer research to inform company business plans should be extended to the supply chain. As customer expectations change, so do the demands on the supply chain. Supply chain companies should also be engaged at an early stage so that customers fully understand the sector's challenges and the range of possible solutions on offer. Currently the customer's voice is heard but not the supply chain.

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

The collaborative approach should involve supply chain representation so that customers understand the range of solutions available - some of the solutions will be from their own business communities.

### **Design and implementation of price controls**

Q8.1: Do you agree with, or have any comments on, our general approach to the design and implementation of controls, i.e. to retain separate controls with the same broad structure as at PR19, but with improvements to our implementation?

We urge the regulator to move to a longer-term approach to planning with a move away from the 5-year cycle to a 10-year minimum. Lots of time and effort is expended in managing the cycle which is difficult for suppliers and

water companies as work slows down and ramps up within the cycle. By extending it, the focus can be put back on delivering commitments for the long term.

Another option available is to separate out price controls for water and wastewater, with timing staggered, which would streamline the total workload over a longer, more continuous period.

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?

We welcome the intention to understand where it is possible to harmonise procurement frameworks between companies, such as payment terms and approaches to risk management and apportionment, to help reduce costs for the supply chain which will lead to better outcomes for customers.

### **Outcomes**

Q9.1: What kinds of performance commitments should we include in the price review? What outcomes require financial incentives for all companies for the foreseeable future?

Please refer to the points above on innovation and yearly spend commitments etc.

### **Cost assessment**

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

The achievement towards operational resilience should be driven by current challenges and not costs.

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?

To maintain and improve operational resilience in the long-term, the resilience and wellbeing of the supply chain is critical. The document does not take account of the people working in the industry or the skills required, which underpins resilience.