

## Response to OFWAT consultation

### PR24 and beyond: Creating tomorrow, together

#### Summary

Ofwat have set out in this consultation their aspirations and direction for the next, and future price reviews. This document sets out a shift in approach for the sector which has a significant influence over the protection and management of our environment. These changes to ways of working should provide the significant progress we wish to see in benefits for the environment and society.

There are areas where we think Ofwat could strengthen the PR24 guidance and provide a greater opportunity for water companies to play a part in doing more for the environment, their customers and society. These are:

- Ensuring that there is an equal focus on resilience of natural systems. Enhancing the environment and recognising the importance of a healthy, functioning ecosystem helps to ensure resilience to pressures from climate change, provides economic benefit and underpins water companies' services to customers.
- Building flexibility into the price review process to allow companies to respond to new legal obligations and new opportunities (such as the government green recovery initiative) as they arrive.
- Recognising the wider role that water companies play, beyond their core functions as suppliers of water and wastewater services. We believe water companies should be more actively engaged in working with partners to secure a wider set of environmental and societal benefits which company schemes could deliver. Companies will need to understand how these wider benefits may be important to customers and how these can be delivered.
- Setting out clearly the engagement framework which needs to be in place to replace the Customer Challenge Groups, and,
- Ensuring that the costs for delivery of catchment and nature based solutions are consistent with other existing delivery routes and cost frameworks for catchment and nature based solutions.

#### 1. Introduction

As the environmental regulator for the water industry in England our role also is to advise government, water companies and Ofwat on the likely environmental opportunities and risks associated with the price review. We have set out a summary of our consultation response below, and, in Annex 1 answered 42 of the 60 questions asked in the document. We have also taken the opportunity to provide some information regarding the role Ofwat and water companies play in Green Finance and suggestions how this could be covered within the guidance for PR24.

This consultation will strongly influence the type and level of investment that water companies make in protecting and enhancing the environment, reducing flood risk and improving resilience.

Our priority for PR24 is to ensure good performance from all water companies across all services and assets that deliver both for the environment and communities. We need to ensure that this new approach corroborates ours, won't hamper the obligations and expectations set out in WISER<sup>1</sup> and will genuinely help companies tackle some of the long-standing challenges they face.

Many of Ofwat's proposals will have a positive effect on the environment and are borne out of close collaboration between the Environment Agency and Ofwat over the last 2 price reviews. We think further action to strengthen penalties around poor performers is required. Equally we will need to ensure that incentives encourage innovation and trials.

Our response to the consultation will help Ofwat to further shape the price review framework in advance of the publication of their draft methodology for PR24, due in summer 2022.

## **2. Summary of response**

We welcome the move to an approach which looks beyond the 5 year price review period and recognises the need to look at long term outcomes to reflect profound environmental challenges such as climate change, population growth and pollutants such as microplastics and chemicals of concern.

It is equally important that shorter term outcomes are delivered. Our Environmental Performance Assessment (EPA) shows that companies are still falling short, with some significantly behind in the actions they need to take to deliver for people and the environment. Water Companies need to make significant progress during PR24 in tackling immediate challenges including delivering major improvements in storm overflows and undertaking action needed for protected sites and chalk streams.

Collaboration between companies is important, particularly to ensure all companies use the best approaches for delivery and that local differences in company performance are addressed. We are seeing through the EPA that certain companies are falling behind the industry in terms of performance and struggling to catch-up. While we support the traditional frontier approach, we also believe that the process should be designed to enable '2 star' companies to better understand and address the root cause of their poor performance.

We think there are opportunities through Ofwat's outcome framework to use performance commitments and delivery incentives to better link with regulatory metrics and with our EPA. The simplification of the outcome framework should ensure that targets set for companies are challenging and explicit, for example, zero pollution incidents should mean zero. These should be combined with more significant penalties for failure.

The move to different ways of working necessary to deliver long term outcomes and provide a resilient future in the face of climate change and population growth will be a challenge for us, Ofwat and Companies to get right. It presents tremendous opportunity through using nature based solutions, working closer with partners and developing adaptive approaches which can deliver for the long term. The funding of

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<sup>1</sup> The Water Industry Strategic Environmental Requirements (WISER) supports the government's strategic policy statement for OFWAT (SPS) and provides strategic steer to water companies on the environment, resilience, and flood risk for business planning purposes. The WISER is designed to help water companies understand the statutory obligations and regulator's expectations that apply. WISER is issued jointly by the Environment Agency and Natural England.

Nature Based Solutions needs to be carefully approached in order to compliment existing mechanisms and also ensure that it includes provision for monitoring and sharing learning. Ofwat's performance framework should not penalise failure when linked to innovation or trials of new approaches, giving companies an opportunity to revisit and adapt approaches to meet the eventual challenge.

We have concerns that the timescale for the price review will compromise some of the ambition laid out and reduce the opportunities for the next price review. We'd like to work with Ofwat to revisit timescales to allow the time for these new approaches to be embedded within companies planning timescales and achieve the benefits we know are possible.

### **3. Green Finance**

We are a member of the Green Technical Advisory Group (GTAG), tasked with advising HMT on how to define what green finance is and developing metrics for climate mitigation and adaptation to complete by the end of 2021.

We're working with Ofwat to examine how adopting innovative and commercial approaches to diversify sources of income and investment into green growth, climate resilience and sustainability can ensure companies deliver for people and the environment in the long term.

Ofwat and the water companies have a key role to help grow the UK green finance sector. We think there is an opportunity for Ofwat to promote green finance approaches through the price review process and to develop its regulatory approach to enable new investment models and mechanisms—stimulating collaboration with private investors to deliver more.

Through PR24, we'd like Ofwat and water companies to:

- adopt, promote, and encourage use of UK Green Taxonomy to help grow the UK market, green their supply chains and set a green framework for their network of stakeholders;
- use Climate and Nature related Financial Disclosures reporting and analysis to drive their business plans and provide the foundation for their corporate social responsibility;
- collaborate across sectors to develop and deliver an ambitious programme of demonstrator projects: a programme to test and ultimately embed green finance models and mechanisms to deliver more for customers and the environment.

### **3.0 Conclusions**

The support which we give many of the proposals within the document represent the close working between us and Ofwat over this and previous price reviews. We look forward to our continuing collaboration in the future to develop the methodology for this and future price reviews.

### **Further Information**

Further information or background to this response can be obtained from:

Kathryn Tanner, Senior Advisor – Price Review.



July 2021.

## **Annex 1 - Response to Questions**

### **PR24 and beyond: Creating tomorrow, together**

#### **Section 2 Ambitions for PR24**

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

Yes, we think the suggested Themes are appropriate for England, but would like to see 'resilience' feature up front in the themes as this is such a key focus for companies over the next and future Asset Management Plan (AMP) periods.

Resilience is captured as thread throughout the document. We'd like to ensure that Ofwat include recognition of the company's role in contributing to environmental resilience in its definition alongside that set out as Ofwat's 'resilience in the round' covering corporate, financial and operational resilience.

Improving the environment to make it more resilient to the effects of future pressures like climate change lie at the forefront of water companies' provision of services to customers and the economy. The environment is a valuable asset, the services of which companies use for their customers benefit. The resilience of the environment is an essential component in water companies business. This needs to be reflected in Ofwat's funding of companies work ensuring that resilience can also form part of enhancement funding.

It is also important to ensure that 'environment' and social are not always represented together as a single entity with the same issues and solutions.

We strongly support the following statement: "We want to encourage companies to routinely consider the wider, long-term benefits to communities and the environment when putting forward solutions, using a systems-oriented approach. For example, nature-based solutions can not only deliver direct benefits like better water quality, but can also improve biodiversity, reduce flooding, reduce emissions, and help to eliminate harm from storm overflows." Ofwat's assessment processes should enable companies to deliver the ambition in this statement.

We support the challenges identified, particularly the priority given to climate change and its threat to the resilience of companies' networks. The increased likelihood of extreme rainfall events leading to fluvial, surface water and sewer flooding should be referred to here. Reference should be made to the [National Flood and Coastal Erosion Risk Management Strategy for England](#) and the role water companies (as risk management authorities - RMAs) have to play in its delivery.

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

We agree with the principles of streamlining the process, sharpening incentives and targeting regulation to where it most matters. The process also needs to be able to help address local differences, for example, in water company performance. We are seeing through the EPA that certain companies are falling behind the industry in terms of performance and struggling to catch-up. While we support the traditional

frontier approach, we also believe that the process should be designed to enable '2 star' companies to better understand and address the root cause of their poor performance. Our detailed response on each consideration is captured in the appropriate section below.

Fig 2.1 should also refer to the industry's net zero target for 2030.

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

We agree that it can be difficult to evaluate the difference that regulatory interventions and mechanisms are having. We would advocate looking at what difference is being made in the round rather than focussing on one part of the process. However, one area that does need to be assessed is the effectiveness of the outcome approach and the use of performance commitments and incentives. We fully support the outcomes approach, but this is the third price review to incorporate the approach and it would be good to do a thorough review ahead of PR24.

Given the emphasis on nature-based solutions it would also be helpful to understand how successful the proposed set of cost assessment interventions are in enabling the shift to green infrastructure solutions and other innovative approaches where the outcome may be uncertain. Ofwat should ensure that appropriate monitoring and learning are funded as part of these proposals.

Evaluation and metrics used by Ofwat should also reflect those by companies and those who have a role in regulating and managing the environment to enable coherent and consistent tracking. This wider consideration of appropriate metrics should include ways in which metrics can be combined to reflect a larger scale, for example catchment or landscape resilience. They also should incorporate outcomes of research to understand how the activities of risk management authorities affect resilience to flooding and coastal change, and how changes in resilience can be monitored over time through the use of indicators.

## **Section 3 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 proposal to maintain our 'building block' approach based on outcomes, costs and risk and return?**

We agree with maintaining the building block approach. There may be an opportunity to strengthen these by developing a more consistent set of performance metrics that are common to all the water regulators. We support that there should be fewer performance commitments which are common across companies, but would like to see the retention of an approach which enables a few bespoke performance commitments to be developed. These could reflect innovation / trial working. Some of the existing performance commitments could be amended to reflect changes in ways of working and build on learning from PR19. We would, for example, advocate including a common natural capital / net gain performance commitment and would welcome being involved in the design.

We would like to see Ofwat consider using a broader set of outcomes that drives better value approaches while maintaining high standards of protection of the environment, for example, outcomes that include both climate and nature / biodiversity resilience. This could also include a wider set of standardised metrics for environmental and social outcomes to assess against which includes climate,

biodiversity, health as well as water management (water supply, quality and flood risk).

**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?**

Greater coordination is required across the sector and with all stakeholders that have a role to play in managing the environment. Ofwat should look to strengthen the guidance and incentives on coordination and build on best practice examples such as the Water Resource East initiative. Companies should be strongly encouraged to share innovation and technologies that benefit the environment and address environmental challenges – and competition should drive improved environmental benefits rather than restrict or reduce them.

The recent Green Recovery process established a regulators group to assess and agree funding. This worked well in recognising a joint regulatory view and also ensured that companies got feedback on proposals from all the regulators jointly. Learning from this process should be included in the final guidance.

Better coordination and cooperation will be necessary to ensure that outcomes across numerous strategic plans and delivery mechanisms are recognised and form a coherent programme and direction for companies. Coordination across companies will be vital in ensuring that outcomes can be delivered which cross company boundaries.

Another example is the Drainage and Wastewater Water Management Plan (DWMP) process. Consistent definitions (for example on resilience), and clear and simple metrics need to be used that ensure consistency between companies and alignment between all stakeholders and strategic plans. Metrics that can be commonly applied by different organisations would be beneficial. Improved sharing of data between risk management authorities (RMA) should enable planned schemes to deliver multiple objectives more easily. To support this, Ofwat should work with the Environment Agency and others to set clear guidance for how water companies can invest in resilience schemes. We note that Ofwat acknowledges resilience expenditure as an area to improve for PR24.

Water companies need to be part of, and in some circumstances lead regional facilitation mechanisms – distinct from the Dieter Helm System Operator model - that can coordinate action and co-fund the transition to delivering a broader set of outcomes, by adopting activities such as nature-based solutions and regenerative approaches across whole catchments and landscapes. Establishing these governance structures is key to solving the current blockers around free-riding, accountabilities and risk and ongoing maintenance and monitoring of outcomes.

We would like to see water companies learning from the emerging best practice examples of cross-sector collaborative approaches to water management, for example being adopted by United Utilities (examples of Petteril, Wyre and IGNITION) and Water Resources East (Norfolk Water Fund) and north east (The Water Hub).

**Section 4 Increasing focus on the long term**

**Q4.1: What are your views on the need for greater focus in companies' regulatory business plans on how they will deliver for the long term?**

We strongly support the need for companies to have a long term focus in their business plans and for delivery. They should not, though, lose sight of shorter term priorities to meet statutory requirements – the 2021 EPA report shows that there is significant work to do to bring companies up to the required standard. Water Companies need to make significant progress during PR24 in tackling immediate challenges including delivering major improvements in storm overflows and undertaking action needed for protected sites and chalk streams

Long term plans will allow the alignment with other plans and strategies and the sequencing of investments so that long term outcomes can be achieved. This longer term focus will need to incorporate a framework for review and adaptation.

We agree that looking at the long term requires co-design and we would strongly support water companies collaborating more formally with stakeholders and customers to identify high-level outcomes and long-term objectives.

**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?**

The strategies should cover the full range of water company activities and other areas that are fundamental to the provision of services, such as the resilience of natural assets. There will be a strong link to existing planning frameworks and we see water company business plans as the main mechanism for implementing the long-term plans. Actions associated with WRMPs, DWMPs, RBMPs and FRMP's should be clearly set out and documented within business plans. This transparency is important not just for regulators but for other parties involved in developing those plans.

Companies long term strategies (such as WRMPs and DWMPs) should be adaptive and set in the context of other long term plans related to the water environment (25 Year Environment Plan, National Flood and Coastal Erosion Risk Management Strategy for England). They should also clearly account for key strategic plans such as WISER and explain how WISER expectations will be met. Clear and consistent use of definitions and language across these documents (for example on resilience) is important.

It is important that companies set out clear plans to hit net zero targets. These will need to include:

- Approaches to reduce emissions including looking at emissions from the rest of the supply and value chain (including contractors, IT services, staff travel, pensions) alongside direct reductions.
- Development of carbon offsetting strategies - recognising not all carbon emissions are avoidable. These strategies need to work alongside reductions and not be instead of them and recognise the time needed for benefits from schemes, for example, around habitat restoration/creation to be realised.
- Collaborative approaches and sharing learning of implementation for nature-based solutions for carbon sequestration, but also where these are successful for treatment and for water resources management.

Adaptation plans should be developed by companies to enable planning for a response to different climate change scenarios. An example can be seen in the approach taken for flood risk as part of TE2100 against a range of different climate change scenarios.

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

The proposed approach should complement and align with the existing strategic planning frameworks. This would allow for adaptation and flexibility across the strategic planning frameworks and help manage the mismatch in planning timescales. It allows for opportunities to be taken at the 'right' time – but with the caveat that this shouldn't allow for endless delay whilst the 'right time' is waited for. Partial or temporary solutions should be considered alongside planning for final solutions.

**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?**

It is inevitable that new information and new obligations will come to light over time. Key to managing these is to have an effective approach to monitoring progress, reviewing and evaluating options and a willingness to change direction where required. Adoption of adaptive planning across the water industry will enable flexibility within a framework to adapt to uncertainty whilst maintaining progress towards long term delivery. There is a need to ensure that short term measures are not lost and all measures are delivered in a timely way and not just pushed towards the latter dates in a programme.

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

We think it's a positive move to share where companies are working well together – and where they are not, and where this may result in missed outcomes or lower benefits in advance of business plan submission. We think there is value in setting up a constructive learning approach and that incentives for companies working together ahead of a price review could be introduced.

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

In principle collaborative approaches should apply to all companies.

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

We suggest that establishing an adaptive approach should ensure that changes in the future regulatory framework should be able to be accommodated. Regulatory change is also not only about the long term, and it is sometime necessary to accommodate regulatory change that happens mid-price review period.

**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?**

Yes, there are potential barriers. The role and function of water companies is changing. Customers' and society expect companies to be actively involved in tackling emerging challenges, such as the climate and biodiversity crisis. Doing this will mean greater collaboration and a different set of solutions and may require a different approach to funding; one that prioritises wider social and environmental benefits alongside direct customer benefits.

Ultimately these wider benefits will benefit customers but the direct links may be less obvious. There will need to be customer support, but also recognition that in some cases doing a small amount of additional work could have an exponential benefit for the wider communities.

Some wider benefit solutions may need to attract partnership funding for benefits that go beyond those for companies' customers. Not receiving co-funding should not be a reason for a company not delivering an outcome / obligation and companies must have a mechanism for fully funding these approaches. Consideration should also be given to the funding where the outcome is uncertain. If monitoring demonstrates an approach has not achieved the desired outcome companies will need a fall-back position that doesn't always rely on the customer funding further additional delivery.

## **Section 5 Getting more for customers, communities and the environment**

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

Yes. The initial assessment of plans (IAP) was a successful addition to last price review. Ofwat must be able to make independent decisions but for PR24 we suggest that other water regulators should be more heavily involved using an approach similar to the green recovery 'regulators group'.

Assessment of plans should include a review of previous performance and how companies are planning to meet the expectations set out in WISER.

### **Q5.2: Should we consider adopting a more light touch approach at PR24 for companies with a strong track record of delivery during the PR19 price review period? If so, what factors should we consider in our assessment and why?**

Yes – but this decision should be made through a regulators group (see Q5.1) to ensure there is agreement of the criteria to be applied. We would expect regulatory compliance to feature prominently in any assessment.

### **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?**

In principle yes consideration should be given to streamlining the process. It is important to give water companies (and regulators) time to react to the IAP so we would not necessarily favour combining the IAP and draft determination. Strengthening the IAP process could help with the issue around 'limited movement'. There are benefits in having an incentive of an early draft determination and agree with the benefits providing feedback after an initial assessment could provide. On balance we would prefer a 3-step process but with more weight placed on the IAP.

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

As mentioned in Q5.3, we think more weight should be placed on the IAP with greater cross regulator involvement.

### **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 think use should be made of early draft determinations as an incentive.

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

We support the targeted challenges Ofwat have set out around water efficiency and reducing harm caused by discharges from the wastewater network. We believe there is also an opportunity to use targeted challenges to promote more sustainable water management and to promote collaboration between water companies and other stakeholders with responsibility for managing the water environment to deliver joint schemes which provide multiple benefits (for example through the DWMP process).

**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?**

Yes we believe that Ofwat should use innovation specific incentive mechanisms at PR24. These will be important in supporting new ways of working and delivery such as landscape scale nature based solutions.

Another area where Ofwat should encourage companies to innovate is in collaboration with other stakeholders. This should cover both Ofwat's innovation programmes, and in those of other organisations such as the Environment Agency's Flood and Coastal Resilience innovation Programme - Flood and coastal resilience innovation programme - GOV.UK ([www.gov.uk](http://www.gov.uk)).

**Section 6. Reflecting customers' preferences**

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

We would fully support a collaborative approach to standardise / nationwide customer research. The approach should be consistent but recognise that there are local differences affecting customers which needs to form part of any approach.

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

The approach will need to ensure we understand customer expectations around net zero, long-term resilience and the delivery by water companies of wider environmental and societal benefits. This includes who is best placed to fund these outcomes. Customers must be able to grasp future challenges and recognise the cost implications. Plain English should be used to provide clear, concise and understandable messages for customers without dumbing down the significance of the decisions they are involved in.

The approach should involve stakeholders and engagement with Catchment Partnerships, especially at options appraisal stage, would help to ensure that environmental outcomes are maximised and understand which ones which are most valued by the local community.

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

No, we don't think there is benefit in negotiated settlements for PR24.

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

Customer Challenge Groups provided a valuable forum for us to share information on environmental and flood risk obligations and to comment on business plan proposals. We welcome the recognition that these need a review and that there may be company-specific alternatives, but the benefits these groups provide should not be lost in new approaches.

Any approach would need to ensure that groups represented on CCG's still had a voice in the planning process and that customers are able to give a view on local priorities and areas which are going to be more prevalent in future price reviews, such as where customers may be prepared to pay more to achieve wider benefits.

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

We think it is essential that there is a minimum level or framework set out which companies must adhere to for customer input.

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

We think there is further work to be done to ensure that the customer engagement approach takes account of other regulatory frameworks in England. We think that the approach should include a framework to which brings in customer input from other statutory planning frameworks such as Water Resources Management Plans, and the Challenges and Choices document from River Basin Management Plans. These, and others, should form part of the framework companies should use and build on as part of customer engagement.

**Section 7. Planning together for PR24**

**Q7.1: How can we ensure that companies bring together the outputs of the strategic planning frameworks in the most coherent and effective way for business plans?**

Companies need to ensure they have appropriate engagement plans in place with all those that have responsibilities for managing the water environment. This is critical for the success of long term plans such as DWMPs and increases the likelihood that schemes will be delivered in partnership. This expectation will be captured within WISER and the WINEP process and potentially could form one of the tests in the initial business plans.

The strategic planning frameworks set out what companies need to do to meet their environmental and flood risk obligations. Our view is that the outputs from these plans should be included into the business planning process for implementation as part of the company's AMP Asset Management Plan. As far as possible enhancements should be included within the WINEP, but there may be advantages to including additional actions within the WINEP where this enables wider benefits to be secured. Companies will need to take full responsibility for identifying and bringing together outputs from strategic planning frameworks and identifying the actions they need to deliver.

There is currently no established link between DWMPs and WINEP although it makes sense for certain DWMPs options to be included in the WINEP. This would be most appropriate where options contribute to addressing environmental and

resilience impacts or again where they are part of a scheme that delivers a wider set of environment outcomes.

**Q7.2: What are your views on our and companies' roles in engaging with other regulators between business plan submission and our issuing of the final determinations?**

Water companies will need to be proactively engaging other water regulators throughout the price review. We agree that it is the role of the water companies to seek challenge to their plans from other regulators and stakeholders in advance of submission. However, this must be done in an efficient and consistent manner so that alignment across companies can be achieved in such a way that doesn't place an excessive burden on regulators. Clearly outlining expectations for the timeframes for this process is essential.

We support the proposal for Ofwat to engage with other regulators. The recent green recovery regulators group provided a useful approach to bring together the views of regulators and CCW in the assessment of companies' proposals

**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?**

In principle, the proposed challenge panel could be an effective mechanism to ensure consistency and sharing of good practice between companies and plans, so long as it is initiated in good time. We would like to work with Ofwat the role of the panels and establish who should be represented.

**Section 9. Outcomes**

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

We agree with the suggestion of a smaller set of performance commitments which are consistent between companies. These should include focus on long-term objectives and will require careful design to capture long term outcomes and incentivise the delivery of those outcomes in the right way and allow for adaptation and change where necessary. For example, resilience should not be delivered solely through a focus on response and recovery measures. An appropriate blend of different ways of delivering resilience is essential.

Ofwat should also require companies to demonstrate how during the AMP they are progressing on delivering long-term ambitions for the sector. For example, they should provide regular updates on how they are delivering the expectations in WISER and how they are supporting the delivery of the National Flood and Erosion Risk Management Strategy for England and the 25 Year Environment Plan.

We would like to explore with Ofwat better alignment of performance commitments with our Environment Performance Assessment (EPA) – both in terms of timescales and in the measures that are being assessed. We think further action to strengthen penalties around poor performers is required. Equally we will need to ensure that incentives encourage innovation and trials. Ofwat should also continue to ensure that incentives are not provided to companies for compliance.

**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 support the proposal to introduce Price Control Deliverables (PCD) to monitor outputs, and think it is helpful to distinguish between performance commitments (PC) and price control deliverables (PCD). We'd welcome the opportunity to work with Ofwat on their development to ensure they complement other existing regulatory metrics.

**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 think that there may be an opportunity to set stretching performance commitments for companies for trials and innovation which are not linked to price control but are incentivised in other ways. This would ensure that companies are willing to look at developing approaches in areas, such as landscape scale delivery and collaboration, where measurable success may be uncertain, but where investment by companies will be needed over the longer term.

**Q9.4: What should be our aim in setting the levels of performance commitments? Do you agree with the suggestion 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?**

We do agree that performance commitments should be set at a level which should be achieved by an efficient company. These should be stretching targets which align with long-term objectives which support wider environmental goals. This line of sight is important for prompting alignment across sectors and supporting effective engagement with customers and stakeholders.

We think there are opportunities through Ofwat's outcome framework to use performance commitments and delivery incentives to better link with regulatory metrics and with our EPA. The simplification of the outcome framework should ensure that targets set for companies are challenging and explicit, for example, zero pollution incidents should mean zero. These should be combined with more significant penalties for failure.

**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?**

We think that outcome delivery incentives (ODI) are a valuable tool. We would like to ensure that ODI are aligned with our objectives where applicable and that there is a clear relationship set out between ODI, PC and PCD.

ODI should be considered to incentivise on track delivery towards a longer term outcome. This could be helpful in reinforcing progress that needs to be made. We would also like to see incentives introduced to encourage the collaboration and sharing of best practice across the industry, for example for innovation, nature based solutions for catchment treatment and pollution management.

## **Cost assessment approach**

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

There's a need to look at embedding a natural capital approach to maximise the delivery of environmental outcomes and highlights the full range of benefits and dis-benefits of different approaches.

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

We think there is an opportunity to expand the benchmarking of costs to drive innovation and development over the longer term. Historical costs provide a good assessment of costs using the same techniques and technologies that have always been used but there needs to be consideration of how cost allowance can drive the development of different technologies and efficient delivery. Taking a longer term approach to cost setting may mean that companies are willing to invest in innovative approaches in order to meet a future 'benchmark' for costs.

## **Long Term Ambitions**

### **Q10.3: How can we take account of longer term ambitions such as delivering net zero and increasing public value in our approach to setting costs?**

We think it is important to consider the value of the delivery mechanism when considering costs. The cheapest option isn't necessarily the one with the greatest value – and any approach to cost setting must not drive perverse outcomes by purely looking at the cost.

## **Nature Based Solutions**

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

Yes. The delivery of nature based approaches is an evolving and relatively new area in many aspects. Cost assessment needs to take account of the wider framework of delivery through partnership and land management schemes which have cost frameworks associated with them. The cost assessment for companies should look to these frameworks for the most up to date and constant information on costs so that companies' delivery is on a fair and equitable footing with other delivery bodies.

The commitment to deliver nature based solutions (NBS) should recognise the uncertainty in the outcome. Further work is needed to develop and test tools to identify, validate and monetise benefits derived from NBS. This will enable water companies to move beyond grey infrastructure solutions to design, deliver and finance grey / green solutions.

Delivery of Nature Based Solutions needs to be carefully approached in order to complement existing mechanisms and also ensure that it includes provision for monitoring and sharing learning. Ofwat's performance framework should not penalise failure when linked to innovation or trials of new approaches, giving companies an opportunity to revisit and adapt approaches to meet the eventual challenge.

The IGNITION NBS pilot project has shown the need for water companies to better understand, value and monetise the wider socio-economic and customer case and benefits from NBS vs grey investment. This is also linked to land owners willingness

to host the solutions and/or generate a saving or return on investment. IGNITION may be viewed as an “off balance sheet solution” in terms of its capex, which would be repaid by others over time. Therefore, even before NBS are costed against grey infrastructure, this would require income to be able to flow across AMP periods and other performance measures to be developed and tested. PR24 provides an opportunity to test and facilitate these processes.

## **Operational Resilience**

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

Resilience is a broad topic area and it is important to understand how companies are performing and investment across component aspects (flooding for example). Ofwat should promote this transparency by assessing costs by component type. Knowing that £13 Bn was provided on resilience at PR19 is good, but understanding the breakdown enables comparison between companies against the long-term challenges. Companies must provide a clear line of sight between their organisational objectives, resilience planning framework, planned level of service, and required cost.

Ofwat should make it clear how different aspects of resilience should be funded by companies (base costs, different forms of enhancement expenditure), including co-funding with other parties. It should work with the Environment Agency and others to set out this framework.

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

We agree that Ofwat should strengthen incentives for long-term resilience and promote wider use of resilience metrics. This should include flood resilience. This will hold companies to account and enable cross-company comparisons.

### **Q10.9: How can we strengthen incentives for long term operational resilience and improve the assessment of resilience enhancement expenditure whilst continuing to protect customers' interests?**

Ofwat should consider what role the Resilience Action Plans it requested companies prepare at PR19 Initial Assessment of Plans (IAP) should play going forward. Companies invested significant resources in to developing these plans however, their approaches were inconsistent. Positive aspects of these Resilience Action Plans should be identified and taken forward in the long term.

We are undertaking research to understand how the activities of risk management authorities affect resilience to flooding and coastal change, and how changes in resilience can be monitored over time using indicators. We look forward to working with Ofwat to ensure this work is informed by the activities and role of water and sewerage companies in flood risk management.

Incentives for resilience should also consider companies contribution to environmental resilience. As set out in the response to Q2.1 an environment which is resilient to the effects of future pressures like climate change lie at the forefront of water companies' provision of services to customers and the economy. The environment is a valuable asset, the services of which companies use for their customers benefit. The resilience of the environment is therefore an essential component in water companies business which should be reflected in Ofwat's

funding of companies work ensuring that resilience can also form part of enhancement funding.

## **Section 12 – Next Steps for PR24**

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

There is limited time between the final methodology and potential early submission of business plans. Ofwat should be clear about key aspects of its methodology as early as possible to give appropriate time for companies to thoroughly engage and collaborate with their customers and stakeholders in the development of their business plans.

The pressures and delays over the last 18 months has compounded what would be a very ambitious timetable and we would like to explore with Ofwat what adjustments can be made to allow companies, customers, regulators and other stakeholders the best opportunity to get the guidance right and ensure its incorporated into company plans for the future.

There is a risk with the timescales set out that environmental outcomes could be severely compromised, and the shift in ways of working that we would like to see is not accommodated.