South West Water
Peninsula House, Rydon Lane, Exeter, EX2 7HR
www.southwestwater.co.uk

22 July 2021

Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

By email: PR24@ofwat.gov.uk

Dear colleagues

PR24 AND BEYOND: CREATING TOMORROW, TOGETHER

Thank you for the opportunity to respond to the consultation on Ofwat's initial views on the framework for PR24 and future price reviews.

South West Water has long advocated for companies to have great ambition, enabling the industry to excel, with targets and incentives aligned to imperative societal impacts and longer-term outcomes. There is scope for water companies, as responsible businesses, to build on a proud heritage and history of public service. As such there is much to welcome in the high-level framework set out by Ofwat.

The challenges the sector faces are significant, and we want to address these challenges effectively, delivering the right outcomes for current and future customers, the environment and society. We see the shift to the long term rather than a five-year planning cycle as of particular importance. This could be a key enabler when combined with the clear objective of streamlining the regulatory framework and greater collaboration between regulators and companies. A five-year review, under an overarching long-term regulatory strategy developed by Ofwat in association with other regulators, will maintain the incentives for high-quality business plans, allow companies to develop their own strategies and deliver at pace, and avoid 'starting from scratch' at each price review. Viewed in this way, the price reviews can provide risk and review stages in the delivery of the long-term context and vision.

Whilst there have undoubtedly been a number of positive outcomes resulting from the recent price review, there are areas which are of upmost importance to society, such as Net Zero and inland bathing waters (and the links to storm overflows), which regrettably were not higher profile in PR19. As an industry we need to ensure that there are no such regrets following PR24. We believe that a shift toward a longer term and more joined up strategy between regulators, and incentivising delivery of wider values rather than prescriptive outputs, will deliver a successful price control.

Early clarity on expectations and on-going engagement are key to a successful PR24 price control. For South West Water, it will be helpful and important to have early sight of regulatory priorities, methodologies and key metrics. Given the importance of regulatory assessments and price reviews, increased certainty around these key factors will enable us to put forward the best plans possible for the future. In particular, we would welcome early engagement with Ofwat on expectations surrounding the evaluation of wider benefits to support investment proposals, and their delivery pace, at PR24. Given that companies have taken different approaches in recent years and its importance as part of PR24 plans, it will be essential for us to understand regulatory expectations early so that there is enough time to incorporate these requirements at the earliest stages of our planning investigations and engagement processes.

We want to see incentives that drive the protection of customers interest and fair benefits to all stakeholders. A number of bespoke performance commitments (PCs) have driven environmental and social value across the industry and remain essential to the future; these give us the flexibility to recognise regional variances and ultimately delivering what our customers want, and in a way that reflects public value. They also provide scope for innovative solutions to support delivery. Ofwat's review of public value in the water industry has been timely, and we feel that there is an opportunity to recognise activities linked to social purpose frameworks (such as our ESG framework and capitals approach) via targeted PCs bespoke to our circumstances.

While we recognise the benefits of a collaborative approach to standardised or nationwide customer research to support PR24 planning, local priorities must not be lost, such as the importance of bathing waters and tourism in our region. Comparability is a key pillar of the water sector's regulatory framework, but we greatly value the close relationships with our customers developed over previous prices reviews. Given also that each company manages very different resources, assets and networks, it is important to get the balance right between focusing on comparability and the ability to respond effectively to local priorities and needs. Furthermore, it is important not to limit the capability of companies to exercise creativity and ingenuity in the development of proposals to improve outcomes for customers and the environment.

Finally, as an industry is it crucial to support the UK achieve net zero. The Government's 2050 - and associated interim targets to 2050 - reflect some sectors being able to respond quickly and some needing a longer time frame to achieve this requirement. Our customers support our sector's ambition to deliver ahead of 2050. The ambitious target for 2030 shows how water companies are taking ownership of the issue, and we urge Ofwat to work with them to achieve this.

Our responses to the specific consultation questions are in Appendix 1.

We hope you find our comments helpful. Please contact me if you would like further detail; I would welcome open dialogue between our respective teams to explore our responses in more detail.

Yours faithfully

[redacted]

Dr Lisa Gahan
Regulatory Director
D: 01392 443878
E: lgahan@southwestwater.co.uk

APPENDIX 1 – SWW RESPONSE TO CONSULTATION QUESTIONS

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

We agree that the themes Ofwat has suggested for PR24 of increased focus on the long term; delivering greater environmental and social value; clearer understanding of customers and communities; driving improvements through efficiency and innovation are appropriate.
These themes fully align with our own priorities and long-term vision of delivering the right balance and value, meeting the diverse needs of the customers we serve and the responsibilities we have to the environment while keeping our costs as low as possible. The themes align with our company sustainability strategy which outlines our aims and objectives for Environmental, Social and Governance (ESG) aspects.

As a sector we need to be confident that decisions are right for customers and the environment, now and in the future. A strong focus on the long term has never been more important. Even though service demand may be subject to change over time, decisions taken today must reflect the needs of the future and avoid burdening future generations. In the face of climate change and population growth, we will need a step change in investment and innovation to deliver long term resilience and sustainability. Without the right investment now, we risk passing on significant challenges to future generations of customers.

We recognise the reputational and financial benefits of having strong ESG performance. This is an area where scope for water companies, as responsible businesses, to have great ambition and build on a proud heritage and history of public service. To that end, we welcome the theme proposed by Ofwat encouraging companies to deliver greater environmental and social value, as part of the next price review process, enabling a step change in the industry, with targets and incentives aligned to imperative societal impacts and longer-term outcomes. At South West Water, we want to develop this further by taking into consideration how we can value our social purpose and expand our view of the impact on the environment outside of our existing core frameworks. We see the theme proposed by Ofwat as encouragement and support to our direction to develop a proactive framework which recognises that natural and social capital should be considered in ambitious plans for the long-term. We believe that PR24 will be the opportunity, under this theme, to explore and ensure that all stakeholders receive the benefits of this broader approach.

Over the last ten years, the regulatory framework has provided the opportunity for companies to put customers at the heart of their business plan and to develop strong links with communities and other stakeholders. We believe that it is appropriate to maintain a strong and clear focus on understanding and delivering what matters most to customers, striking the right balance between the sector's ambition and bills for our customers. The regulatory regime has been successful in driving efficiency, so the scope for further efficiency and productivity increases across the industry is diminishing. This amplifies the importance of Ofwat's suggested themes, whereby focus on dealing with long term challenges now is considered equally alongside delivering value for both current and future customers.

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

We believe that the scope for PR24 is right and Ofwat's ambition to simplify the process design is commendable. Simplification of the price review process and methodology – whilst ensuring robust and accurate assessments - has the potential to reduce regulatory burdens. Ultimately, this provides the opportunity to focus further on delivering excellent outcomes to customers and the environment in the long run. We would also welcome any opportunity to use information and digital capability to improve the price review process and allow us to continue focusing on high quality business plan proposals.

In addition, we welcome Ofwat's intention to provide more clarity about how price reviews will be conducted in the long term. For South West Water, it is important to have early sight of regulatory priorities, methodologies and key metrics. Given the importance of regulatory assessments and price reviews for everything we do, increased certainty around these key factors will enable us to put forward the best plans possible for the future. In particular, we would welcome early engagement with Ofwat on expectations surrounding the evaluation of wider benefits to support investment proposals, and their delivery pace, at PR24. Given that companies have taken different approaches in recent years and its importance as part of PR24 plans, it will be essential for us to understand regulatory expectations early so that there is enough time to incorporate these requirements at the earliest stages of our planning investigations and engagement processes. Therefore, we would welcome the opportunity to contribute to the development of the approach for PR24, sharing insight and knowledge we have from our own company experiences to date.

We are supportive of Ofwat's intended aims around customer engagement but have some reservations about the application in practice. Our customer research and engagement has helped us to develop and deliver successive high-quality fast track business plans, and we see a role for national, regional and company specific engagement to continue this in the future. Whilst we recognise that comparability is a key pillar of the water sector's regulatory framework, we greatly value the close relationships with our customers we have developed over previous prices reviews through extensive engagement and challenge. Given also that each company manages very different resources, assets and networks, there is a balance between focusing on comparability and the ability to respond effectively to local priorities and needs.

Furthermore, it is important not to limit the capability of companies to exercise creativity and ingenuity in the development of proposals to improve outcomes for customers and the environment. Ultimately, we want to ensure that our plans respond closely to our customers' needs, and that we are able to think independently and innovatively to continue delivering high-quality resilient outcomes, now and in the future.

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

Regular, systematic evaluation of progress is critical for the successful implementation of a long-term approach to price reviews and the future of regulatory frameworks. We believe that to provide rich and meaningful insight, without being overly complex or intensive in resources, an evaluation could focus on two main areas:

- The regulatory process efficiency and effectiveness.
- Price review outputs and outcomes.

To assess the efficiency and effectiveness of the regulatory process we would welcome a stakeholder questionnaire to collect feedback, understand views and perceptions of companies, regulators and other stakeholders. This should focus on the experience of regulatory processes, and assessments of how it enables the delivery of plans meeting objectives; for example, does it foster trust and confidence between parties? Does it remove blockers and effectively recognise lessons learnt? Are there any further opportunities for improvement of process efficiency? Repeated over time, this questionnaire could form an invaluable channel for the sector, supporting on-going engagement between Ofwat and companies now and post-PR24, and be a useful reference to inform cases for changes and the design of future regulatory frameworks and reviews.

We would also welcome initiatives to assess the outputs and outcomes generated as a result of regulatory assessments and price reviews. These initiatives should focus on whether the outcomes and outputs respond effectively to the original priorities, objectives and ambition for the price review. To achieve this, we believe that the PR24 Challenge Panel could be mandated to identify successes and shortcomings in outcomes resulting from the price review process and provide an independent analysis of root causes where appropriate. This will provide the sector with a valuable independent view whilst accelerating the lessons learned process and helping set direction for future price reviews.

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

We support a building block approach. Over time, it has ensured service improvement has been incentivised based on least cost, and regulatory tools such the OPA, Serviceability, SIM and most recently outcomes and ODIs have been successful in driving sustained service improvements over time.

However, the balance and attention given to each building block is essential to get right. Going forward, the approach needs to fully account for long-term issues such as resilience and health of our assets, and the increased erosion of natural capital stocks. In order to deliver value, there will need to be a common understanding and recognition of what value means to the environment as well as customers and communities, how to express that value through common metrics and how to quantify that worth on a consistent basis. We also believe that bespoke performance commitments (PCs) play an important part in the process, giving companies flexibility to recognise regional variances and ultimately delivering what their customers want, and in doing so reflecting public value. Bespoke PCs also provide scope for innovative solutions to support their delivery.

The UKWIR 2021 report '*Assessing the effectiveness of the regulatory framework'* shows an example of how balancing priorities between parties and balancing short-term and long-term incentives may impact on the building blocks of the price control.

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?*

At face value, greater co-ordination could deliver benefits for the sectors. There have been examples of good collaboration and co-ordination across the sector over time and further opportunities to continue these approaches should be explored.

However, the nature of the regulatory regime – which is competitive and comparative in nature – provides incentives to excel relative to other water companies and is a barrier to some aspects of co-ordination. Therefore, to determine the extent to which greater co-ordination is required, it is essential to understand the incentives to collaborate versus the incentives to show sector leadership (i.e. 'stand out' / excel relative to peers).

Collaboration should be encouraged around the implementation of better policy approaches and improving understanding around technical issues. The sector is already effective at co-ordination, but this is typically once the benefits of excelling relative to peers have occurred. For example, the industry is effective at sharing best practice through UKWIR after the end of each price review. The collaborative UKWIR project *Common Framework for Expenditure Planning* is a good example of this point, as this has been important in sharing and progressing the sector's planning and cost-benefit capability to the benefit of all customers. More recently innovation opportunities, such as the Ofwat Innovation Fund as well as our own innovation collaborations with universities and partners have great potential to share and promote the uptake of innovation in a collaborative manner where appropriate.

However, where it is important to demonstrate sector leadership relative to other water companies – for example in the area of C-Mex where companies seek to be at the top of the league table for financial and reputational reasons, collaboration is somewhat discouraged.

It is important that co-ordination and collaboration are not allowed to distort competition and create unintended cost pass through mechanisms. This should not preclude co-ordination from occurring, but the right incentives need to be in place. For example, when preparing interventions associated with raw water resource provision, flood risk management and sludge treatment and disposal the framework should be encouraging companies to develop and assess co-ordinated and collaborative interventions where they offer cost-efficient alternatives to conventional water company only proposals leading to lower long term revenue requirements. Inevitably there will be a trade off in achieving the cost efficiency, with this likely to be in the form of outcome delivery risk. It is important that this is not lost in the analysis and that companies proposing higher risk co-ordinated interventions are appropriately rewarded for taking the risk.

Collaboration is not just between water companies. The industry has also seen good examples in areas such as companies working alongside farmers to voluntarily reduce the use of metaldehyde-based mollusc control in agriculture, replacing it with viable alternatives that preserve drinking water quality standards. Similarly, on the wastewater service companies have actively co-ordinated and collaborated with third parties to develop and deliver integrated flood protection interventions to the direct benefit of customers.

There are other important considerations when developing co-ordinated and collaborative interventions.

The first is the lead times for development, agreement and implementation may be extended when compared with solutions under the control of a single party. This should be factored into the wider thinking about delivering long-term outcomes.

Secondly, the adoption of such approaches introduces risk of outcome delivery due to the potentially longer timescales and the need to maintain long-standing relationships through periods of uncertainty and change.

As a result, robust scenario and adaptive planning approaches would be needed to ensure that any uncertainties can be managed and the ultimate interventions adjusted to ensure customers receive the overall long-term outcome.

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 believe in the importance of having a clear long-term focus, and our business plans are already underpinned by this philosophy. At PR19 we set out our Vision to 2050, based on customers' and stakeholders' long-term priorities and we see the five-year price reviews as milestones within the context of that long term vision, rather than as discreet planning periods.

At this forthcoming price review we will review and refresh our vision to ensure it remains reflective of what matters most to our current and future customers and stakeholders. We will use this as an opportunity to understand in more detail how customers expect us to get to 2050 – i.e. what is the priority for PR24 and subsequent price controls. This in turn will allow us to build a long term plan that meets the needs of our region and is aligned with our purpose: *Bringing water to life – supporting the lives of people and the places they love for generations to come.*

We therefore agree that price reviews should support long-term solutions, especially around environmental investment where we welcome a longer-term view aligned across regulators. This is of increasing importance given the scale of the challenges to be addressed by the sector that will undoubtedly require a multi-AMP approach to resolve, and the use of solutions for which benefits may take longer to fully manifest, e.g. nature based solutions for net zero.

> **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 would help us and other stakeholders to understand each company's approach?*

Our view is that price reviews should be milestones in our long-term strategy and vision, which is driven not only by regulatory, stakeholder and governmental expectations, but by what matters most to our customers and stakeholders to meet the needs of our region.

While we accept that Ofwat may want to set out some common themes or expectations around which elements should be included, there is a risk that if common requirements are overly prescriptive they may constrain companies from developing long-term approaches that are aligned with customers' expectations and regional needs.

We will be seeking to refresh and rebuild our Vision to 2050 in collaboration with customers, stakeholders and regulators, potentially through a negotiated settlement-type approach. We would expect that through involvement in this process regulators and stakeholders would have a deeper understanding of our long-term strategy and approach to delivery than could be achieved through the setting of common requirements which may stifle flexibility to adapt to regional circumstances.

We would welcome the transition to a five-year review under an overarching and rolling long-term regulatory strategy developed by Ofwat in association with the EA and DWI etc. Under the current approach, although we set out long-term plans, each price review sees different baselining and regulatory priorities. A long-term regulatory strategy would support companies in developing their own strategies and would ensure that companies, and regulators, are not "starting from scratch" at each price review.

Common themes that could be included within a long-term strategic framework could cover areas where there are industry-wide environmental challenges, such as resilience, environment and asset health. Storm overflows touch on all of these aspects and would be covered by a long term approach.

However we note that we need to ensure that longer term commitments are not squeezed out by cost pressures on shorter-term requirements.

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

Focus on resilience and environment in the price review process would align very strongly with the work already done as part of WRMP, DWMP and WINEP frameworks. These existing frameworks currently already address issues of resilience in supply and the environment, although this is in a limited way as their scope is restricted to a part of a company's operations or service provision. Introducing these themes as part of long-term price review ambition will provide a visible line of sight, and connection points, for companies to extend the scope of the environmental and resilience ambition to their whole operations.

We see that providing this additional, long-term clarity, will enable companies to build on their existing strategic planning approaches by aligning their wider investment (e.g. network and operations) around these common objectives.

We believe that a clear focus on asset health will also build on existing frameworks by addressing a key gap in long term planning mechanisms. Currently, WRMPs, DWMPs and WINEP focus less on the management of existing assets, and assessment of the long term sustainability of asset bases in an effective way. By refocusing on asset management as part of the price review process this would build on the good progress made by the outcomes approach to regulation, incentivising companies to understand the interrelationships between their assets and services.

Q4.4 *How can we allow such strategies and plans to adapt to new information at future reviews while continuing to hold companies to account to deliver expected benefits into the future?*

We agree that customers must get the benefits for which they pay. We consult regularly with our customers about their priorities and preferences relating to different benefits they will receive in return for their water bill, as well as the pace at which they see those benefits being delivered. In previous price reviews, our strong focus on delivery excellence has provided useful evidence that these benefits are delivered, and customers are protected.

In recent years, the implementation of adaptive and dynamic investment strategies in the fields of water resources and drainage planning have shown potential in providing a useful overarching framework to deal with future uncertainty and climate related threats. We see that similar approaches can be implemented for water supply management plans and resilience frameworks to adapt to new information and adjust investment as needs change. Adopting robust scenario planning and tested adaptive techniques would allow companies to flex plans quickly as uncertainty and change materialise, whilst making sure that outcomes are met. We welcome Ofwat's support for such approach to strategy and planning for price reviews.

Within the context of a long-term strategy for the water sector, price reviews provide a clear 'risk and review' stage. As we have stated above, we regard them as milestones in a longer-term planning process. In this setting, rigorous scenario planning and an incremental approach to investment and measuring benefits over multiple price reviews may be considered. We believe that this approach would provide significant opportunity to adapt to changing situations and customer preferences, as well offering opportunities to introduce innovative approaches in the future and ensuring that the balance of risk and reward remains appropriate for all. Ultimately, we believe companies can use the benefits of adaptive and dynamic strategies and remain accountable, through Board assurance, for the delivery of plans that can meet customers' expectations, now and in the long term.

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

Providing these views and agreeing financial assumptions and common performance commitment definitions early, in advance of business plan submission, would streamline the process and support the delivery of high-quality plans that are likely to meet regulator expectations.

However, as with much of the business planning process timing will be critical as companies will need to engage with customers (whether through national or local research) on the acceptability of their plans and bill impacts in totality. This engagement must be meaningful and provide an opportunity for companies to adjust plans to account for customers' preferences and for customers to challenge plans.

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

We consider it important that the Welsh companies follow a comparable process and are treated consistently if Ofwat are to continue to use them as comparators in the cost and performance assessment processes.

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

We believe that clarity over the long-term can be achieved through the combination of several approaches.

The introduction of outcomes has proven very successful over time and it is a regime to which Ofwat and companies are committed. It has brought flexibility and innovation in delivering benefits to customers and the environment and has delivered sustainable efficiency. We are supportive of the work being done to reform the WINEP and to move it towards a more outcome-focused environmental programme.

The development of agreed long-term outcomes for the environment, looking beyond five years, would provide a useful framework within which the water sector can develop long-term strategies. This is fully aligned with our aim to deliver greater long-term environmental and social value, and with our direction to develop a proactive framework which recognises that natural and social capital in plans for the long-term.

We believe that the delivery of long-term outcomes can be underpinned by an adaptive framework of regulatory incentives with review points on performance, costs and risks at the time of price reviews. Building on the current work for WINEP, an adaptive framework itself may be developed collaboratively by regulators through joined-up scenario planning.

We also believe that it is important to have early clarity on regulators' intended approaches and decision-making processes including the roles of customers and stakeholders, as well as Ofwat's expectations of costs, PCLs and ODIs and expectations surrounding the evaluation of wider benefits to support investment proposals, and their delivery pace.

Please also see our previous answer 4.2 where we provide thoughts on the long-term regulatory framework.

Q4.8 *Are there barriers to water companies changing how they deliver their core functions to deliver greater environmental and social value? How can we address any barriers?*

One of the key barriers to a delivery of greater value for society and the environment is the disconnect within the price review methodology of costs and performance when setting Ofwat's view of efficient costs.

Currently companies are incentivised to optimise service performance and statutory compliance but not necessarily social value. Within the five-year period the incentive remains to deliver against those targets rather than against a framework of wider value. We consider changes driving greater value delivery could include the incentivisation of value, which would firstly encourage delivery through nature-based and behavioural interventions, and secondly ensure cost and performance targets are considered together.

We view these changes as being aligned with our own current direction. We have already commenced setting our baseline for the measurement of our natural and social assets, as well as identifying how specific activities (‘flows’) can increase or indeed decrease our natural and social capital. We are also identifying and measuring impacts which South West Water might have on other parties (i.e. land not owned by us). We believe that ‘valuing’ such assets and flows and embedding them into our decision making and investment proposals will enhance our long-term benefits to the environment and communities.

We also consider that this approach is consistent with Ofwat’s and our ambitions to enhance public value and our societal benefit, as well as embedding environmental investment and solutions for a truly sustainable future.

Considering specific barriers, further thought would need to be given to issues such as uncertainty surrounding nature based solutions, where there can be conflicts with items such as permits. A further example is how a water company dealing with multi-agent activities would be addressed, for the fact that sewerage networks are open systems means that there is less accountability on other parties (e.g. the impact of highways and microplastics).

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

Maintaining long-term trust and legitimacy with customers, who should be at the heart of companies’ plans and the industry’s long-term strategy, is vital. At each stage of the planning process our plans need to be aligned with customers’ expectations and gain their and our stakeholders’ support. To enable this, early clarity on roles, decision-making processes and where the boundaries of our customer relationship will lie will be important.

We also believe that focus on asset health and continuous improvement in decision-making including companies’ scope and ability to account for uncertainty in planning approaches would help focus on the long-term.

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

Simplicity of the price review process and consensus on price review outcomes require excellent engagement and clarity on what we, as a sector, are looking to achieve. Consequently, while we are supportive of simplifying processes where possible we believe that defined stages for review and communication provide essential vehicles to increase understanding of expectations and targets. They can also bring necessary clarity on opportunities for improvement and for removing obstacles to meet these expectations.

We consider the IAP is a key stage, having proved very useful in assisting companies to understand Ofwat’s position and correct course if needed, bringing consistency in regulatory assessments and driving improvement in proposals.

There is a risk that removing an early review stage such as the IAP may introduce late changes to plans that would be detrimental to the plan quality and would be costly, in time and resources, to redress at a later stage of the price review process. This in turn could ultimately affect the robustness of plans and the confidence that Ofwat, customers and stakeholders have that companies’ submissions are of the highest quality.

That said, it is also important that as a review step the IAP (or equivalent) adds value to the overall process. We see most of its value as the opportunity to have a two-way exchange with Ofwat rather than as a ‘marking’ exercise. Removal of this stage would surely make companies produce cautious safe plans that are easier to justify in a single stage and with less dialogue. We question if this can be optimal.

With this in mind and considering the proposed timetable, areas for focus could include early assessment of areas of strength in companies’ submissions and areas for improvement in a long-term context, as well as a deep dive in customer research findings to ensure that Ofwat have sufficient information and knowledge of companies’ customers preferences and priorities when delivering draft determinations.

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?*

We believe that companies with a sustained record of high-quality plans and effective delivery should be incentivised to continue to perform via a lighter touch approach.

Periodic review ‘fast-track’ assessments are reflective of companies’ quality and efficiency of operation and delivery in the round. We believe that a lighter touch for high-performing companies would allow both them and Ofwat to focus on delivering more value out of the price review by freeing up resources firstly to keep focus on continuity of delivery for customers and the environment, and secondly on the smooth transition between reviews.

Companies with a track record of high-quality plans and strong track record of delivery during PR19 price review period should be trusted to be able to operationalise their strategies and deliver their business plans. We believe the price review approach can be more valuably delivered through a lighter touch using simple tests on key points such as alignment between business plans proposals and long-term strategies, assessment of value (rather than costs) of the services provided and test of the robustness of the planning process demonstrating adaptability to uncertainty.

This more strategic review would enable performing companies ‘to get on with it’, driving the sector to maintain a high pace of improvement, whilst setting a framework of performance, value and benefits that can be used as a benchmark for others within the sector and across sectors going forward.

Q5.3 *Should we streamline the price review by combining different steps in the process? If so, which of the three options outlined in this paper should we consider? And are there other options we can usefully consider?*

We do not support Option 1 whereby the IAP and draft determination (DD) stages are merged for the reasons given above. The current approach of Option 2, with distinct phases for IAP and DD stages are separate remains acceptable to use.

Option 3, whereby Ofwat publishes IAP and early DDs for some companies is worth exploring. This could provide the best combination of clarity on expectations and incentive for high-quality plans. In principle, this is our preferred option.

As we have stated in our response to question Q5.1 the IAP stage provides useful feedback to companies on their draft proposals. This is particularly important when making the step-changes proposed in the PR24 themes such as driving the delivery of longer-term strategies and the creation of wider value. We see it essential to maintain proactive communication between companies and Ofwat at the time of implementing a new area of assessment i.e. against a long-term context.

We also believe that by offering the opportunity for setting draft determinations early Option 3 does not remove the incentive for companies to put forward high-quality plans (in favour of safer plans). This would be well supported by an early incentive mechanism allowing companies 'to get on with it' with confidence, as discussed in our response to question Q5.2.

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

As companies in England and in Wales share common long-term objectives and sustainability goals we believe that the initial assessment for companies in England and in Wales should be consistent.

Moreover, if Welsh companies are comparators in the regulatory process, it is important that they are treated consistently in the overall process.

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?*

As discussed in our response to question Q5.3 we would support retaining early draft determinations as part of a fast track approach. Whilst this fast track approach enables companies to maintain focus on delivery of service and improvements at pace, we also believe that there should be no detriment to those companies under the early principles. Fast track status should mean that companies receive financial benefits, early decisions and early certainty.

High-quality plans inherently deliver more value to customers, we believe that this should be recognised in a balanced and fair reward of benefits to all stakeholders recognising risks and securing long-term resilience in the round.

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 support continued simplicity in this area and believe that there is significant merit supporting a base position with an equal share between customers and shareholders for the majority of costs in the wholesale controls. However, we would also welcome and recommend enhanced cost sharing rates similar to the PR14 approach to better incentivise companies to put forward efficient plans.

If ODI payments and funding adjustments are correctly set these provide the right incentives around asset health.

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

The themes proposed for PR24 provide a useful and ambitious strategic direction for companies and Ofwat. By themselves they define the targeted challenges that, together, we will have to embrace in plans that are fully reflective of customers preferences, deliver value for money and are affordable.

More specific challenges will have to be considered in full light of the control companies can exercise on the interventions required in meeting them. For example, more challenging PCC targets will require actions that need to be supported by changes in legislation, for example changes building regulations for new homes, introducing mandatory water efficiency labelling for appliances, changes to tariffs, etc.

We also believe that the cost-service relationship must be considered in more detail to ensure that the challenges of improvements to current service levels or of enhancements to achieve frontier or beyond-frontier performance are adequately funded to ensure that benefits are long-lasting and enable the delivery of sustainable solutions.

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?*

The introduction of outcomes has promoted the implementation of more innovative solutions and more collaborative approaches in the delivery of plans. In addition, innovation is also built into the current regulatory framework through the use of service performance and efficiency incentives.

The recently created innovation fund is a further positive incentive for companies to collaborate and innovate.

We believe that the mechanisms in place are sufficient and should be subject to review to ensure they work as effectively as possible. But we do not consider that additional specific incentives are needed – and favour ensuring existing mechanisms work as well as they can. We believe that additional mechanisms may work against Ofwat's stated objectives of more simplicity in its price review process.

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

We believe that there is much that can be learned from looking at what companies already do in this area. Thanks to our customer engagement, we know that our customers expect us to act ethically as a responsible company delivering public value; as a result we have adopted a number of approaches consistent with Ethical Business Regulation (EBR) which should be recognised via the regulatory framework.

For example, we see that paying our fair share of tax is one of the many ways we contribute to our communities and we believe we were the first water companies to achieve the Fair Tax Mark accreditation. This ensures that we have a robust and transparent tax strategy.

Similarly, we already adopt sustainable and ethical financing. Investors (both equity and debt) are increasingly integrating ESG into their investment criteria and research shows that companies that focus on material sustainability concerns outperform their peers by almost 5% (based on total shareholder returns).

This philosophy further links to debt financing and was the driver for South West Water (and Pennon) when launching the first Sustainable Financing Framework in the UK in 2018. Since then we have raised over £385m (70%) of South West Water's debt under this framework. This financing is either linked directly to the company's green projects, such as the innovative new Mayflower Water Treatment Works, or specifically links the amount of interest we pay to specific environmental outcomes, such as bathing water quality, and our overall performance against ODIs.

Our approach demonstrates our commitment to environmentally and socially sustainable outcomes as well as delivering efficient financing increasing the availability of funds. We believe we have a unique role to play societally, and environmentally and our purpose *Bringing water to life - supporting the lives of people and the places they love for generations to come* goes further again, being supported and underpinned by our core values, and our public interest commitments.

We believe that elements such as those mentioned above should be part of a high-quality business plan, given that they are already address the themes of EBR.

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 agree with the principle that methodological differences should not obscure customers' views. We also want to ensure that local priorities are not lost if national research is used, for example the importance of bathing waters and tourism to our own region. We therefore believe that companies would need to triangulate to their own evidence.

There needs to continue to be a good balance between local and national programmes so that our customers' views are heard, and we can maintain our relationships with them. Consideration of where a company's research should have primacy is needed. For example, our quarterly priority tracking research captures customers views over time, and allows us to see the significant impact of events such as Covid-19, general and local elections, weather patterns and the seasons on customers priorities (as well as other metrics such as satisfaction, trust, and value for money). We would hope that this incredibly rich time series would take primacy over a national study which may occur at one point in time.

Furthermore, we believe there may be instances where companies should be able to opt out of the national/standardised research programme, if they be able to demonstrate that their business as usual programme exceeds the minimum guidance (e.g., around the research methodology and sampling strategy).

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

While we welcome a more centralised approach to engaging on topics that impact on all companies in the same way, such as national policies and the application of regulatory mechanisms.

Direct company-specific customer research and engagement has been vital in supporting South West Water to deliver successive high-quality fast track business plans, and we want this to continue. We see a role for national, regional and company specific engagement to further these aims. Additional research will be needed to support future price limits and Ofwat's evaluation of future plans, and we welcome engagement at these differing levels to meet those needs.

It is important that any collaborative approach to customer research is adopted early, and that companies are comfortable with the processes to be followed, including the role of companies and stakeholders in contributing and working together to design, deliver and interpret the research.

Ofwat should take the opportunity to base this collaborative research on practices used by companies previously highlighted for a strong methodology in previous price previews. As we have previously raised in our response to Ofwat's consultation on reflecting customer preferences in future price reviews, a guidance document akin to our own sampling strategy would be very helpful to develop in advance of any national research being conducted.

Strong independent oversight would also be required when adopting any collaborative approach and industry experts must be represented on the review panel. We also feel strongly that national research should not entirely replace any other research and playback sessions should be incorporated to test findings, and results triangulated with other research.

Similarly, we believe there is still a role for CCGs in this new framework, but their involvement should lie more in strategic challenge around the purpose of the research and how it will shape and refine business plans. Collaboration and/or prescriptive guidance would allow CCGs to focus more at this strategic level.

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

Introducing aspects of negotiated settlements would introduce a transformational step change to the price review process and could be appropriate for the development of long-term visions and outcomes. Having seen examples of this working well elsewhere, such as in the Scottish water market, we would welcome this. Adopting their use would mean that future price reviews would not start from scratch every five years but would instead have relevant agreed longer-term investment already embedded in plans.

We believe this approach could be used to manage company and regional differences. For example, resilience and priorities of communities and for the environment can differ vastly between regions and we know already that the Covid-19 pandemic has affected affordability and livelihood of our customers in different ways than in other regions. These regional priorities and circumstances should inform bespoke performance commitments as currently there are few that really capture the regional value for customers.

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

As part of our internal governance we would want to maintain an element of challenge and independent assurance of our plans and we believe it is appropriate for the current assurance framework to mature. We believe the evolution of the CCG process is an important component of this.

Our independent WaterShare+ Advisory Panel (the Panel) has evolved since its predecessor was established to oversee delivery of our PR14 plan. The Panel now advises on the interests of our customers by providing independent review and challenge of our performance to our PR19 business plan (including our commitments and Board Pledges).

The Panel uses customer research and engagement, alongside performance data to inform its dialogue with us. As detailed in our response to question Q6.2, we believe a CCG's involvement should now lie more in this strategic challenge around the purpose of research and how it will shape and refine business plans.

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

As previously stated in our response to question Q6.2, where national research is appropriate a guidance document developed in advance of any research being conducted would be very helpful. This would set out the processes to be followed including the role of companies and stakeholders in contributing and working together to design, deliver and interpret the research, and could be based on best practices identified from companies with a track record of delivering high quality business plans.

We would recommend that any standards or guidance applies equally to all parties (regional companies and national/regulator-driven research).

We strongly believe that quality research requires undertaking agencies to have a sound understanding of the industry, its challenges and the regulatory framework. Without this context, it can be difficult for agencies to have meaningful conversations with customers.

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

If Welsh companies are to be a comparator for comparing customer priorities and preferences, the research needs to be consistent.

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

We welcome Ofwat's ambition to integrate and align the outputs of existing strategic planning frameworks as part of business plans. Doing this effectively will also be essential to ensure that the sector adequately responds to long term challenges a whole. We believe that there are two critical factors which will enable effective integration of strategic planning frameworks in future price reviews.

Setting clear direction and line of sight with sector wide long-term vision and objectives in the design of the next price review is essential. The next price review must provide a framework which enables, incentivises and mandates companies to build on the foundations set by long-term planning frameworks, aligning wider business plan investments with their long-term ambition and objectives of customer service, resilience and with their own purpose. We see early communication from Ofwat on expectations and methodology as key to securing alignment. We also see that increased collaboration between regulators to agree both timeline and framework of benefits assessment as an enabler to integration of plans and to gaining support from our customers and stakeholders.

In addition, the introduction of peer review as part of the price review process will help to ensure that determinations achieve and enable the right level of long-term ambition for customers and the environment. This review should focus on providing constructive challenge during design and delivery of regulatory assessments, as well as contributing to a broader lessons learned process.

This would help to ensure that not only does the current price review effectively respond to long-term needs, but that also continuous improvement can be achieved over future reviews.

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?*

In developing our plans we engage proactively with our customers, stakeholders and regulators to gain deep understanding of preferences, needs and obligations. We agree that companies need to make sure their plans are responsive, coherent and integrated. We also agree that Ofwat has a role to play to ensure the voices of customers and stakeholders are heard and adequately represented, and to ensure that plans responding to those are adequately funded. The evolution of the CCGs process may mean that prior to the submission of business plans there will be a need for a robust way of replacing and replicating the challenge via the CCG process of other regulators with appropriate knowledge of company specific views, environment and local issues. This could be by peer review, which we view as important as the collection of evidence.

Once the IAP and draft determination stages are completed, it is appropriate that other regulators can formally review plans (but noting that they should have already been involved in the process of developing plans and should be aware of plans prior to this stage). This will be particularly important if the business plan includes PCDs, as involving other regulators as part of the assurance process would help deem whether funding adjustments are still applicable should a measure not have been met where it is outside of the company's control.

Through Ofwat, quality regulators and policy makers working together to drive a long-term approach and collaborative working and partnerships, the regulatory framework will evolve. For example, we see RAPID as evidence of the successes we can have when we work together and we strongly support steps to enhance regulators engagement, partnering and reporting, as well as working together to achieve industry goals (such as Net Zero). We are very supportive of the collaborative approach regulators are taking in the development of the WINEP methodology and we believe that the adoption of a common framework of benefits would drive a more coherent process of assessment of plans.

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?*

We agree that Ofwat's proposition to include a 'PR24 Challenge Panel' could help to ensure that the interests of customers, communities and environment are best protected through the price review process. We believe that, if well-established from the outset, this could become an important factor in determining the success of future price reviews. We believe that the two main elements to doing this successfully are: 1) Ensuring that this panel is able to meaningfully check and challenge the price review process; and 2) Ensuring the panel can effectively represent the interests of customers, communities and the environment. In other words, good challenge will come from parties that understand the price review process and regulatory framework.

We believe that the panel should be given ability to influence the price review process from end-to-end. This should include ability to challenge and review price review objectives, design and delivery of assessments, as well as overall outcomes of the review in an independent manner. Having this end-to-end approach will provide opportunity to ensure outcomes for PR24 respond effectively to long term objectives but also allow for critical review of whether the plans and process have achieved intended ambition, ultimately supporting development of future price reviews.

The panel should be comprised of a range of members with expertise and knowledge in different fields. This should include expertise and knowledge of challenges relating to customers, communities and the environment. Ultimately the objective of these panel members should be to ensure that interests are represented wholly and effectively, not just to ensure that voices are heard. To complement this, we would welcome panel members with experience of price reviews (for both regulators and companies) to provide rounded challenge of price review processes and assessments. Finally, we would also strongly welcome the inclusion of members who are able to manage and mediate disputes, conflicts, and trade-offs. In any price review trade-offs are inevitable, therefore it is essential that the panel contains members who can ensure that trade-offs achieve intended outcomes.

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 support maintaining the existing approach to the design and implementation of controls.

Maintaining consistency enables the sector to make direct comparisons in trends over time and between companies on a consistent basis. The approach is also more efficient for companies to model and report against.

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?*

As noted in our response to question Q8.1, to support the comparability and stability of key metrics for the sector we would support maintaining the existing approach.

More specifically, we make the following comments on elements of the value chain:

Water resources – we do not support Ofwat's view that putting water resources and water treatment together under a 'control for sourcing treated water' will result in improved visibility of water resources cost drivers and econometrics.

Developer services – bringing together water and wastewater costs under a single developer services control may lead to distortion of the controls. It is not clear how other mechanisms, including the DRSA, would work in conjunction with a new control.

Residential retail – the current average control is easy for both the industry and customers to understand. By introducing a fixed control there is a risk that transparency may be reduced.

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?*

The proposal looks to expand the detail disclosed for major projects beyond the scope of DPC schemes. We would therefore welcome further discussion and clarity on the proposition, because as currently presented we believe it may be difficult to define major schemes as disparity could be seen between different sized companies.

That said, we welcome the intention to take a longer-term view of for example, 10/15 year plans with three supporting steps, which would also increase the likelihood of DPC opportunities being presented to the market. In our view this longer outlook should consider not just projects, but also strategic asset health initiatives and WINEP, for example.

Our recommendation is for reconciliation models to be simplified to ensure consistent classification of in and end of period reconciliations. We do not support incorporating reconciliation models into the main model.

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 believe that the inclusion of both common and bespoke performance commitments is vital in building an outcomes framework which is reflective of challenges facing the industry and prioritised by customers, as well as regional issues.

Common measures should ensure that the industry is incentivised to provide better outcomes with wider societal benefits. We believe that the framework should move away from lagging metrics, such as leakage and pollutions, and focus instead on ESG measures. Areas such as environmental leadership, river water quality and partnership working are of utmost importance to our customers, stakeholders and regulators. This is because in recent years there has been a shift in what is important to customers, and the challenges that the industry faces today are not necessarily aligned to the more output-focussed traditional common measures introduced in PR19.

Whilst it is important that the industry has common goals to enable comparison as well as partnership working, it is of the upmost importance that we continue to have bespoke measures within the outcomes framework. This will enable us to report against measures which reflect conditions that are important to our region. For example, tourism is higher in the South West, especially with the rise of ‘staycations’, therefore our customer priorities will differ from companies that mainly cover inner cities. Similarly, we have high levels of depravation in some areas of our region, therefore our focus on affordability will always be at the forefront of our strategic planning. It is very important to us that bespoke measures remain in place to reflect what our customers tell us should be at the heart of our plans, and that we reflect the needs of our region.

Net zero should also be funded within the regulatory framework and be driven by common commitments. Our customers have told us that climate change is a top priority and are fully supportive of actions we can take to reduce our carbon footprint as well as mitigate and reverse carbon emissions. We are determined to achieve net zero by 2030 and are already working towards this in a sustainable way. However, working with Ofwat through PR24 gives an opportunity to do this in a way that minimises costs, maximises public value, builds the reputation of the water industry, and therefore enhances and fosters trust between the water industry and customers, communities, policy makers and other industries.

The PR24 process should deliver a regulatory framework focused on supporting the water industry meeting its long-term goals. Financial incentives will need to apply to multi-AMP commitments and recognise the wider environmental benefits and efficiencies by which large-scale environmental programmes can be delivered. This will encourage and support investment that can address the environmental and sustainability challenges facing the sector.

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?*

As noted in elsewhere in our responses we support the intent to move more towards outcomes-based incentives, rather than outputs, particularly where these are linked to ESG and public value.

It would be beneficial to differentiate between PCs that monitor outcomes and PCDs that monitor outputs. However appropriate processes and assurance would need to be agreed to deem whether a PCD has been delivered, or if a metric has not been met, whether this was outside of the company's control and as such whether penalties or funding adjustments should be applied.

In terms of alternative options, PCDs could be adopted as alternatives to scheme-based ODIs.

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 do consider that there will be elements which would sit better outside of the price control. In particular, where companies are not wholly responsible for the performance of a system, for example microplastics in wastewater discharges stem from an open network and can only be remedied at source; or the performance of nature-based solutions which may be less certain and dependent on partnership working.

We agree that companies need to be responsive, as evidenced most recently in the industry's response to affordability concerns resulting from Covid-19, and that reputational pressures can provide a strong incentive to improve performance. An unintended consequence of prescriptive expectation setting can be stifling of innovation or responsiveness, so care should be taken in this regard.

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?*

Whilst we agree that performance commitments need to be stretching, we strongly believe that companies need to be properly funded but also operating efficiently in order to deliver their commitments.

When setting funding, factors to be considered would need to be varied according to individual company circumstances, such as the level of performance given costs associated with catch up and frontier shift will be different.

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 would welcome early sight of Ofwat's views of appropriate incentive rates ahead of business plan submission.

As noted in our response to question Q9.4 above, companies may require additional funding in order to push frontier-level performance or the proposed PCL. We also note that there is a risk in baselining PCLs and deadbands where there may be a range of historic performance levels across the industry.

Further company-specific risk may occur when setting common ODIs and rates, as a result of their particular circumstances, such as the geography/topography of the region that they serve. This can be evident by the choice of denominators used to normalise performance across the industry; for example, where length of sewer network is used but companies due to their topography may have a relatively short sewer network but a relatively high number of assets (pumping stations). We would urge that where this is evident, that it is recognised when ODIs and/or costs are set.

Marginal costs and marginal benefits are essential for the computation of economic incentive rates. Our valuation approach is strong and we are able to provide robust marginal benefits in line with HM Treasury Green Book advice. Marginal costs are more difficult to establish given the joint costs of provision: most project deliver multiple benefits across asset health and performance, and the allocation of costs across the full range of metrics requires a clear and robust process. Our approach of allocating costs in proportion to benefits in PR14 and PR19 was effective, but we recognise this is an area that would benefit from collaboration so there is consistency of approach around the estimation of marginal costs across the industry.

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

Over time cost assessment has proven a powerful tool for driving focus and productivity improvements. But as the industry costs and performance converge, it is important that cost assessment continues to fully finance the costs of asset health and service provision.

It is important that there is clarity on modelling assumptions, for example elements which are included in base versus enhancement modelling. We would also welcome earlier certainty on elements included in growth assumptions to allow companies time to review and to challenge.

Cost adjustment claims should continue to be recognised in the process or should be incorporated after standard modelling, as it is essential to recognise genuine cost differences across the sector.

We would welcome strong engagement with companies throughout, to ensure that key assumptions can be reviewed and agreed early in the process.

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

The approach to cost assessment has encouraged companies to move away from separate assessments of operating and capital expenditure in plans and adopt totex assessments, which we continue to support. It further ensures companies take a whole life cost approach to appraising all investment and has driven greater consistency and comparability across companies.

The current approach to totex cost modelling is positive, balancing econometric and unit cost models with engagement with Companies. We support Ofwat taking into consideration company specific cost pressures where there is robust evidence for this and believe this should continue for future price reviews.

We also support Ofwat’s approach of separately assessing enhancement costs and not relying on econometric modelling for these specific and more complex areas. For example, we would welcome growth expenditure with its unique and differing cost drivers being treated this way.

Ofwat’s models have correctly identified our costs to be efficient. In our experience, confidence of efficient costs comes from taking evidence from a range of sources. Our process of triangulating and benchmarking costs using all methods – tendered costs, bottom up cost estimation based on bills of quantity, and top down statistical methods – builds our confidence in the required total expenditure. We would welcome Ofwat using methods to triangulate its econometric cost assessment in much the same way.

External benchmarks can be useful for certain aspects of costs and performance. But these need to be genuine comparisons and similar contexts. For example, comparisons to international water companies, for example, requires there to be similar legislative requirements, network and treatment characteristics, customer demographics, and performance levels to be useful; and comparisons to other industries needs to be similar in terms of the services provided. Where external benchmarks are used we recommend early engagement in the process to discussion and challenge the consistency and robustness of the benchmark used.

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?*

As noted above, we support an approach of assessing enhancement costs outside of the econometric modelling framework. Public value is one consideration that would be considered in this way.

Whilst there may be challenges in creating consistent cost data sets across companies, benefit/value assessments are potentially even more difficult to harmonise without a clear industry wide approach. Therefore, we believe it will be necessary to establish a consistent industry approach to deriving the methodologies that can assess the delivery of environmental and public value over time.

It should also be recognised that while 2050 is the stated date upon which the UK will achieve net zero (recognising that some sectors will take longer than others), when developing targets it was the government aim that sectors that can deliver net zero sooner than 2050, such as the water sector, do so.

Assessing the long-term cost efficiency of interventions such as achieving net zero, inevitably means that looking at plans and costs over relatively short timescales will not be sufficient to protect customers and companies from unwanted impacts that may result from analysis of the near-term only. Analysis of near-term cost efficiency will therefore need to be judged against a backdrop of robust whole life cost-benefit analysis.

The challenge will also require a return to formal long-term planning where customers and their representatives can challenge a company’s approach to delivering environmental and public value over time. Companies should be expected to set their business plans in the context of a best value long-term strategy. This would enable Ofwat to assess which plans were set in the context of a best value strategy. There may be a need to allow companies to utilise pay-as-you-go and run-off rates to smooth any short-term impacts for customers but, within the constraints of maintaining a financeable notional company.

The critical consideration will be, having established efficient cost assessments in the near-term, how to ensure customers are protected by locking-in the long-term value offerings from companies. At the same time companies will need to be protected from any policy changes that could materially impact costs. Companies will need to develop robust proposals and systems for tracking costs and being able to revaluate the benefits being delivered to customers and the environment.

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

The challenges raised in question Q10.3 apply to the adoption of nature-based solutions, where it is likely that the long-term cost/benefit will need to drive the decision. Ofwat will need to determine efficient revenues in the short term.

Work is required to develop the value recognition framework so that the wider benefits associated with, for example, integrated catchment solutions and nature-based solutions are considered as part of the comparative cost efficiency of solutions. The ongoing costs, benefits and wider benefits of catchment solutions need appropriate recognition.

Furthermore, the treatment of opex-heavy solutions and enhancement solutions should be reviewed, and consideration given to recognising ongoing costs rather than one-off AMP costs (as part of putting investment in future AMPs).

The use of solutions with less certain outcomes would also benefit from a more flexible change protocol to manage change such that customers and companies are not penalised should new information come to light. A concept of shared regulatory risk between EA, WASCs and Ofwat could unlock more widespread use of nature-based and catchment solutions that can deliver more sustainable solutions, wider benefits, and better overall outcomes.

We consider that the ideas proposed in response to question Q10.3 are equally applicable to question Q10.4.

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

As a company we strive to ensure customer priorities and affordability aspects are at the heart of our delivery plans. We undertook significant engagement with customers at PR19 and continue to believe that this should be given significant weighting in any price review.

Further to the CMA's recent findings on cost assessment, we believe that an element of forward-looking cost assessment would be beneficial.

We also note that where a step change in service levels is required, the costs of achieving this should be adequately reviewed.

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?*

In general, customers are aware of value for money with an expectation that when they are asked to pay for goods and services, they should receive them to an acceptable standard. Where benefits can take several years to deliver, it may be appropriate to set longer term performance incentives.

With those two principles in mind the idea of establishing an efficient service level at an efficient cost and then planning for an adjustment for expected over/underperformance over the control period would seem sensible. This would address the second principle. The first principle could be reflected in the form of an annual outcome delivery adjustment to ensure customers are asked to pay for what they receive, but with a manageable year-on-year impact on price.

Performance levels need to remain linked to customers' priorities and willingness to pay; we believe that these elements should remain regionally focussed with the ability to be scaled and compared across companies.

The long-term service performance levels would need to be established utilising the whichever approach is adopted to address the challenges set out in question Q10.3.

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

It is important to customers that essential water and sewerage service remain resilient against the impacts of shocks and stresses such as a changing climate and population growth. Companies need to be able to demonstrate that their plans are resilient in delivering the flow of services to existing and new customers and achieve it at the lowest whole life cost-benefit by optimising the application of resistance, reliability, redundancy, and response/recovery.

While much work has been done to determine headline measures to assess resilience and to ascertain the efficient costs of delivering the determined performance levels it has not necessarily made an explicit assessment of risk. Additionally, the approach at PR19 did not provide a clear vision of delivery and framework required for resilience assessment as part of the cost assessment.

Past periodic review assessments, and importantly econometric models, cannot fully capture an underlying change in risk within the asset base. This contributes to explaining why past costs may not be a good reflection of future costs. In the past companies may have been funded to maintain stable levels of performance, but may take different risk positions, which may or may not be clear in the presentation of performance levels.

For PR24 a more focused forward-looking resilience framework is needed, which addresses the above issues. This may need to consider the role of leading indicators of asset health. For example, the Ofwat 2001 study 'Development of Enhanced Serviceability Indicators for Sewerage Assets' incorporated risk into indicators (measures). Revisiting some of this early work may help provide measures that reflect risk to service resilience.
Please also see our response to question Q10.8.

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

Regional groups, WRMP and DWMP strategic planning frameworks are important mechanisms for companies to understand many key risks and operational resilience threats robustly and consistently in the long term. This includes accounting for uncertainty, scenario planning and understanding potential operational / service resilience implications of climate change and population growth.

As nature-based solutions to asset health and operational resilience continue to be increasingly important to customers, the right framework and methods in place to measure, predict and monitor asset health risk and performance is essential. The sector is increasingly keen to work together on these frameworks to ensure they evolve to meet current challenges and opportunities, and we intend to be at the forefront of the discussions.

We believe that current frameworks do not provide enough focus on long-term asset health and its role in supporting overall company operational resilience. Current resilience approaches, as part of the periodic review process, could have a greater focus on monitoring of asset bases and understanding long-term asset investment need. For example, local asset needs, threats and risks should be understood in conjunction with the long-term resource planning of WRMP / DWMPs as well as existing company emergency and service continuity plans. This will provide an effective framework to develop a true systems-based understanding of operational resilience. Ultimately, without a renewed focus on assets and their operating context, it will be difficult for companies to respond effectively to current and future shocks and stresses.

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?*

When considering whether to make incentive payment contingent on sustained delivery beyond the end of the period, it is important to maintain the balance of risk sharing between the customer and company that is afforded by the five-year review cycle.

We believe that the introduction of a mechanism that would defer a potential incentive payment to a point when sustained performance can be demonstrated, focussing on a potential longer-term downside risk with incentives structured towards underperformance, could create the risks of caution and a disincentive for companies looking to move the frontier. The introduction of an unintended hurdle to driving better performance for customers should be avoided.

As stated in our response to question Q10.6 it remains important that customers pay for the services at the time of receipt where possible and companies are remunerated at the time of investment delivery. Balancing this with the need to incentivise long-term as well as near-term performance could be achieved by incentivising both within period and at the end of period. A proportion of the incentive could be used to adjust revenues year on year to incentivise near-term performance, with the residual proportion retained for an end of period adjustment to incentivise sustained delivery.

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?*

We continually look for further simplification with regard to mechanisms. While the balance between mechanisms continues to evolve over time, adding more creates additional complexity and creates a more rigid and rules-led form of regulation.

We would support further thought into the current disparity between revenue and costs; atypical events that create material changes in demand which are trued up via the RFI mechanism, whereas costs are not.

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 would welcome greater consistency applied to all companies with clearer rules on the application of incentive caps and collars between companies. National research is likely to be preferential in ensuring a consistent approach to this across the industry.

A clear approach and understanding on how financing and totex outperformance will be treated in conjunction would be useful. The approach should continue to incentivise outperformance in all areas of totex, financing and ODIs, rather than favouring one area disproportionately.

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

We do not believe this is necessary or desirable as this reduces certainty for companies and investors.

In addition, the benchmarking available to derive indexation assumptions for this would likely include the three listed companies themselves, which creates a circular risk.

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?*

In our view the current focus on net debt is measured and sensible.

Further detail on balance sheet could be influenced by different accounting treatments and other unique factors and structures within and between companies, which would serve to restrict comparability.

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

We believe that sector returns should be set sector-wide and not include small company premiums. Companies that are too small to be as efficient as other companies in the industry should merge or consolidate in order that customer bills are efficient. If used, we would recommend any adjustment is based on RCV to assess the different scale of companies.

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

We believe that 60% continues to reflect a desirable notional structure in line with PR19.

We would welcome clarity on the rationale for setting the notional structure.

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

The gearing mechanism is a simple and effective means of incentivising financial resilience, and sharing benefits with customers reflecting the risk profile.

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?*

Given that each company may be in different positions at 2025, further consideration needs to be given to the potential impact of any proposal to accelerate the change to RCV being fully indexed using CPIH.

In principle this change will make modelling simpler and therefore, subject to assessing impacts, we support Ofwat's proposal, noting the government's desire to remove reporting of RPI from official statistics by 2030.

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

We see the PR24 timetable as key to a successful price review outcome and determination. In our previous responses we have welcomed and agreed with the themes proposed by Ofwat for PR24. While these themes build on work that is already ongoing, they also introduce significant planning changes such as, for example, the introduction of a new step of challenge and review (through the creation of a PR24 Challenge Panel), a new approach to customer research and proposals for new price controls.

However, as it stands the current proposed draft PR24 timetable does not reflect material changes from PR19 in the timing of the publication of final methodology (December 2022) and of business plans assessment and determinations.

At South West Water we consider that given the importance of regulatory assessments and price reviews for our customers and everything we do, increased certainty around critical factors will enable us to put forward the best plans possible for the future. We particularly support early engagement with Ofwat on expectations surrounding the evaluation of wider benefits to support investment proposals, and their delivery pace. We also believe that early sight of key parameters such as Ofwat's approach to long-term, PCL/ODI framework and financial parameters such as WACC is critical to success.

To achieve the best price review outcome as a sector we also think that the timetable should allow for the PR24 Challenge Panel to carry an independent review of Ofwat's proposals for draft determination to ensure that obligations and needs are not just included in companies' plans but also adequately recognised in the determinations.

The periodic review planning timeline is complex and we would welcome an ongoing exchange with Ofwat and other regulators on the development of detailed milestones that ensure the best alignment between all planning components, which can be met in a timeframe that also allows the highest quality of plans and appropriate scrutiny.

Appendix Q14.1 *How can costs and incentives for the existing water resources control be targeted more effectively?*

We understand and support the principles implemented at PR19 for the target controls for water resources. We also recognise the opportunities to build upon the approach and improve efficiency and service performance for customers and the environment.

To answer the question more usefully we feel that there is a need for more clarity on what outcome Ofwat seeks to achieve through these incentives, for example is there to be a focus on costs or the reliability of trades, as these will drive different focus for companies. Some water resource assets already fulfil multiple tasks across different parts of the value chain and looking at how water resources are likely to develop over the coming periods, we believe that the boundaries between water resources and network plus are strongly connected when delivering wider value.

The PR24 approach needs to be able to adequately differentiate local operating conditions for water resources in order to not mask inefficiencies and potentially introduce risks.

Appendix 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?*

On balance we would support amending the boundary to include the raw water system. In our view this has a higher potential to improve operational control and ensure the balance between efficiency, service performance and risk. A boundary shift to include abstraction, raw water and treatment together is more closely aligned to the system of operation within a company.

As outlined in our response to question Q14.1 we also anticipate that water resources activities will become increasingly aggerated across water resource and network plus activities. We agree that removing potentially artificial divides has greater potential to capture the inherent choices and trade-offs across the value chain for the benefit of customers and the environment.

We also think that it is useful to consider how such a change is likely to better align with the need to strengthen resilience. Enhancing resilience requires a more systems-based approach – being able to understand the interactions and interdependences across all parts of the value change, building on the work done by regional groups.