



Aileen Armstrong
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Name: Peter Trafford

E-Mail: [REDACTED]

22 September 2021

PR14 Review: Discussion paper on findings

Aileen,

We welcome the opportunity to comment on this discussion paper. We believe that Ofwat's 'Future Price Limits' principles still provide a good basis for regulation. These set out a regime focussed on outcomes, based on customer engagement, with allowed revenues based on total expenditure (thereby distorting incentives), and with companies incentivised to do well on things like efficiency and outcome delivery that benefit their customers. We consider that Ofwat's 2014 price review used these principles well and provides a good foundation on which to build PR24.

Overall, PR14 delivered value for customers, in that there were significant improvements in company performance. In the round, PR14 struck an appropriate balance between risk and return for customers, companies and their investors, when assessing outcomes, totex and financial returns as a package¹. The risk and return was also more symmetrical in PR14 than PR19. In our view it more closely reflected the views of customers and investors in assessing the balance of risk and return.

The paper shows important areas of service improved during PR14. This included water quality contacts, which fell by 25%; supply interruptions, which fell by 27%; mains bursts, which fell by 10%; and customer satisfaction, which improved by 4%. 73% of bathing waters achieved the 'excellent' standard in 2019, up from 67% in 2015. Ofwat concluded that all companies delivered reductions in pollution incidents over the 2015-20 period, with a sector average reduction of 36%. This evidence shows how the control made a positive difference for consumers.

The finding that companies spent £45 billion (2012-13 prices) over the 2015-20 period and achieved improved service levels, whilst average bills still fell by 5% in real terms is also highly relevant. We agree that a further evolution of the regulatory regime is needed for future price

¹ Over AMP6, half of the industry (8 out of 17 companies) outperformed their base RORE after consolidating outturn performances from ODI, SIM, totex and financing. The sector had an overall ODI reward of £50m and a combined wholesale Totex overspend of 1% as per Ofwat Service Delivery Report 2019-20. We note that Ofwat choose to make adjustments (Figure 3.8) to exclude what it regards as outliers on penalty performances to suggest overall industry performance was better than the headline figures suggest. We are not convinced that the adjustments are necessary – the industry performance is as reported but if outliers are to be removed, they should also be removed from the reward side.

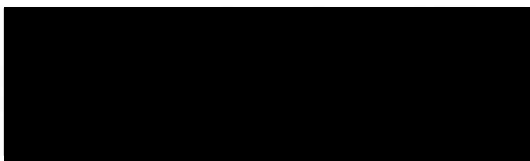
reviews given the challenges ahead. It is important to ensure a balanced risk and return package in the round when calibrating certain elements of the regulatory framework.

In retrospect we can identify some key themes from our own assessment of PR14 that we think will be critical for the success of PR24 and the ability of the sector to deliver against expectations over the long term. We highlighted these in our response to PR24 and beyond: Creating tomorrow, together. These lessons include:

- The need for adaptive, shared long-term (2050) targets with stable financial incentives over multiple price control periods for performance commitments that contribute to long term outcomes will encourage companies to invest and deliver best value over the long term. This will allow both regulator and companies to move towards thinking more strategically.
- An explicit steer on the envelope of the levels of expenditure that customers can afford and how this is expected to evolve over the long term (supported by arrangements for those less able to pay). Both the regulator and companies would be better able to understand and make more efficient trade-offs between different investment strategies
- A clear long-term approach to asset health and resilience over a single price control period will give Ofwat full assurance of the health of the networks
- In preparation for 2030 and beyond we need a predictable cost assessment approach that recognises and incentivises the need for nature-based solutions, vulnerability, and achievement of Net Zero.
- Clear, explicit linkages between existing strategic processes in the sector, notably the Water Resource Management Plan process, the Drainage Water Management Plan process and the process for the Water Industry National Environment Programme
- Clarity on the long-term information, through to 2050, that Ofwat would like to see included in business plan submissions.

Overall, we welcome this exercise and hope the lessons can usefully be drawn from previous price control experiences to improve regulation in the future. This could be for example in thinking about the scope for change in the areas we have highlighted and how they might have an impact the price control design.

Yours sincerely



Peter Trafford

Head of Regulatory & Market Economics