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21st July 2021

Dear Sir/Madam

PR24@ofwat.gov.uk - Deadline 22nd July

Consultation on PR24 and beyond; creating tomorrow together

Many thanks for the opportunity to respond to the above consultation.

Ambitions for PR24

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

- We agree with including a greater focus on the long term and with increased delivery of greater environmental and social value. We need a focus on “what needs to be done” working back from that as well as the more typical approach of “how far we can we get from where we are now”.
- As we highlighted in our submission to the Ideas Lab we believe that it is critical that the regulatory regime supports not just the water sector but wider society in meeting the climate and ecological emergency. How we manage and use water as a society is central to both mitigating adverse climate and ecological impacts and adapting to the changes that we can't avoid. Water is the medium through which many of the impacts of climate change will be felt (drought, flooding, pollution, environmental health).
- We want to see a shift in the balance of economic regulation so that it gives greater weight to investments and actions, such as water demand management, that address the climate and ecological emergencies - this means an economic framework that is flexible enough to value multiple benefits.
- We want to see governments and regulators providing an early, clear indication of their scale of ambition, backing this up with the policy changes and the funding settlements required to ensure they can be delivered in full.

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

- We agree with the need for some simplification and streamlining. For smaller stakeholders such as Waterwise the process has become increasingly complex and more difficult to see how the various elements relate together.
- We also support a greater element of centralised comparative customer research (see response to Q6.1).

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

- Having moved in AMP5 and AMP6 to an outcomes based framework it is important that delivery against those outcomes is clearly visible to stakeholders and customers. We believe there needs to be far greater visibility and transparency around how the companies are performing within the AMP period. This issue was highlighted in PR19 by Blueprint for Water eNGOs however little appears to have changed.
- We would like to see a further development of the DiscoverWater website that enables stakeholders and customers to more readily see how companies are performing against their PR24 and longer term outcomes and performance commitments. Alternatively a new Ofwat performance dashboard could be built for PR24.
- It is also important that the regulatory regime is adaptable. The Covid pandemic has shown how quickly external events can change the baseline or impact performance in an area (e.g. per capita consumption).
- One key test of the PR24 will be whether the cost models used value multiple benefits to customers and the environment, including for example the contribution to net zero, economic growth and tackling poverty. It is critical that in seeking cost efficiency the delivery of key outcomes for customers and the environment is not prevented.

How we regulate

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

- We support the outcomes framework element of the current approach. We believe that, overall, the use of outcomes and performance commitments has been useful in focussing efforts on areas where government, regulators and customers want to see investment and progress.
- However, we feel that use of reputational commitments has not been a success in part because of limited visibility or reporting against them (see Q 2.3).
- We would support further in period work to ensure/confirm that cost efficiency isn't at the expense of service levels. We need to make sure that in pushing for greater cost savings that these are not made at the expense of cutting crucial programmes such as water efficiency which may have lower penalty or reward levels than other areas.
- We support ongoing efforts to ensure the system does not unduly favour capex solutions and allows companies to develop nature based solutions that have less certainty but greater benefits
- When considering operational resilience we would like to see this include measures to build resilience to peak water demand during hot weather - and to cutting carbon, rather than defaulting to carbon-intensive options during resilience events.

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?

- One straightforward and effective way would be for Ofwat to formally recognise and support existing initiatives to foster co-ordination such as the UK Water Efficiency Strategy and the associated Water Efficiency Collaborative Fund. Waterwise wrote to David Black recently suggesting that as part of proposals to push the PCC ODI back to the end of the AMP7 he write to companies suggesting that they establish a new water efficiency collaborative fund for AMP7 (as was the case in AMP5 and AMP6).
- In other sectors such as Education, schools performing poorly in one area can be buddied up with organisations that perform strongly in those areas - this approach could be explored in the water industry where poorly performing companies are matched up to better performers for the AMP with both parties getting shared benefits from accelerated progress. Delivery of smart metering could be one area where this is looked at.
- Although we are pleased to see retailers and wholesalers making progress with delivering the RWG Action Plan we do feel that Ofwat will also need to introduce regulatory incentives and mechanisms for PR24 to encourage collaboration and investment in improving non-household water efficiency in PR24. For example, through a reframed distribution input based ODI rather than one solely based on domestic water consumption and through greater clarity on roles and responsibilities with regards competition law. We also would like to see Ofwat taking a more positive position in encouraging the rapid roll out of smart meters/technology to the 200,000 highest NHH water users who use over 80% of NHH water.

Increasing focus on the long term

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

- We support a greater focus in the investment plans on delivering what society needs in the longer term as well as short term.
- We would question what is the future role for water company 25 Year Strategic Direction Statements? We suggest that companies integrate them into their business plan so that looks at both the short term and at longer term connecting the two things more explicitly within the plan.
- We do want to see the sector look beyond its 2030 net zero commitment for its own operations and to consider how it can help wider society reduce emissions and reach our statutory net zero targets, for example by efficient use of water supplied.

Q4.2: What should long-term strategies seek to cover and what details should we expect companies to set out in business plans? Would common requirements help us and other stakeholders to understand each company's approach?

- Yes, some common requirements would help stakeholders understand each company's approach. For example, their PCC or DI target in 2050..

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

- Help translate long term policy into a long term investment plan

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?

- Accept that they will change, we cant precisely predict the future. But include an audit trail process that captures what changed that has a substantive impact and what has been done to adapt to it. The use of graphed trajectories may be a good way to present this to stakeholders and customers.

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

- Yes we think so. It would also be very useful to stakeholders as highlighted above

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

- Yes, it would be very interesting to assess how an alternative approach translates through to the investment plans and ultimately to outcome delivery.

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

- Agree with suggestion to indicate which areas will be retained over several cycles as long term priorities
- We agree that there may be value in ensuring that outperformance and underperformance incentives and penalties could be more strongly linked to sustained performance levels. As it currently stands payments for some ODIs such as sewer flooding, PCC and supply interruptions can be very heavily influenced by externalities such as weather or Covid.

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?

- Smart metering technology is a game changer for the water sector. Emerging evidence from smart meters already installed has shown the richer data set they provide can help reduce household demand by around 17-18% through both leakage reduction and usage savings. These savings benefit customers and the environment and are needed to meet longer term water supply resilience needs. Similar opportunities exist for the non-household market and are emerging from MOSLs Strategic Metering Review. Timely and accurate consumption data could significantly improve the functioning of the market and help deliver greater water and leakage savings. We believe Ofwat has an important role to play in actively encouraging the

sector to increase the pace of roll-out to both household and non household customers.

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

Strengthening incentives

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

- We think the Initial Assessment step should be retained. It provides an early insight into whether the draft plans put forward are likely to meet expectations but allowing enough time for challenge and improvements to be made.
- We want to see the Initial Assessment take far greater account in PR24 of how the plan delivers wider environmental and social value in both the short and long term; including the net zero contribution. In PR19 there was a lack of prominence of environmental value in the assessment criteria. This was highlighted by eNGOs along with the limited involvement of the environmental regulators in the Initial Assessment. PR24 is an opportunity to put that right.

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 track record should be an important element in assessing the plans and deciding whether to take a light touch approach or not.
- We believe additional scrutiny should be applied to companies that have failed to meet specific ODIs and PCs in the past to ensure that they have adequately funded plans to deliver more going forward in those relevant areas.

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 as it does not leave sufficient scope for companies to adapt and improve their plans. Our preference is option 2.

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

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 highlighted above we would rather see early draft submissions retained.
- We do believe it would be useful for Ofwat to set its expectations in more detail in PR24 rather than rely as heavily as in PR19 on company submissions and then relative comparison.

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?

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

- We think that, if signalled early enough in the process, a targeted challenge can really help deliver a step change in performance. As we highlighted in our submission to the Ideas Lab we believe the leakage 15% challenge has led to a marked improvement in ambition and performance.
- Waterwise would welcome a targeted challenge around water efficiency and reducing water demand given the benefits it can deliver for the environment; for water supply resilience; on emissions and net zero and for customers. Progress in reducing personal consumption has flattened and has been challenging in AMP7 with the Covid pandemic. Reducing water demand has also been impacted by repeated delays in bringing forth supportive policy from the government (water labelling, metering, building regulations) although the recent ministerial statement on water labelling is welcome.
- Care will need to be taken with regards to the choice of any challenge metric given recent experience with PCC during Covid. A % reduction in distribution input may be an alternative option (see Q9.1) and would map across to the long term water demand target reduction approach being considered in the Environment Bill.
- For example the challenge outcome could be to reduce the amount of water taken from the environment by the water companies. It could be measured as water put into PWS (i.e. DI) with a challenge target to reduce DI by say 10% by the end of AMP8. This would allow companies some flexibility as to how it is achieved. For example; Company A could achieve it through a 15% reduction in leakage + 5% reduction in NHH demand + 10% reduction in household demand. Company B might go further on leakage and not as far on HH reductions. However, the outcome would be to reduce the amount of water taken from the environment by 10%.
- An alternative approach might be to propose that all companies plan to at least double their Final Determination AMP7 spend on water efficiency. This step change in funding could be linked to more thorough requirements for companies to report savings; to collaborate and to share evidence of best practice and to report into Defra's new Senior Water Demand Reduction Group.
- Another area which may be suited to a targeted challenge is around the pace of smart meter rollout to both domestic and business customers. The technology is a game changer for the sector helping significantly reduce leakage, water consumption, carbon emissions and enriching how customers engage with their customers and with water use.

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?

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

Reflecting customers' preferences

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

- We support a greater element of centralised, standardised customer research.
- The lack of any central, comparative data on customer priorities and willingness to pay was raised by eNGOs in the run up to PR19 as a weakness in the process and we are glad to see it being addressed. It is evident from the findings presented by Ofwat that there were very wide variations in willingness to pay figures submitted by the companies.
- However, we do also want to see any more centralised approach complemented with ongoing regional and local engagement with customers and communities to tease out where there may be regional or local differences for example on willingness to pay to protect chalk streams for example.

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

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

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

- As highlighted above (Q 5.9) we do have a concern that in effectively taking CCGs out of the PR24 process Ofwat are losing a key element of plan scrutiny from local stakeholders covering social and environmental perspectives/EBR.

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

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

Planning together for PR24

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

- A number of companies started to use GIS to share their investment plan spatially with stakeholders and customers. This approach could be developed further in PR24 and may provide opportunities to overlay programmes including with other organisations. However, we believe that this should not be left to the water

companies to lead, there is a role for regulators such as the Environment Agency who lead the development of the WFD RBMPs.

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

- We are pleased to see Ofwat committing to ensure it is "joined up" in its regulatory approach to PR24 with other relevant regulators Natural England, NRW and the Environment Agency. This was a criticism from environmental NGOs in PR19 especially in relation to the IAP process and criteria

Q7.3: How could we best involve a 'PR24 Challenge Panel' in the price review process to help ensure that our decisions best reflect the interests of customers, communities and the environment?

- A PR24 challenge panel sounds like a positive step that we would support. It enables Ofwat to tap into a broader, more diverse range of expertise and perspectives than those held in-house. However, the time commitment could be significant and participants will need to have their costs covered where appropriate.

Design and implementation of price controls

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

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?

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?

Outcomes

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

- We support Ofwat continuing to use a number of common performance commitments. We agree that they should be focussed on issues and outcomes of enduring interest and importance for society, customers and the environment.
- We believe one of the outcome areas should definitely be water efficiency/demand management. We need to see an ambitious target on reducing water demand but the companies must have adequate funding available and committed to deliver it. The desired outcome being to reduce the amount of water that the water companies need to put into supply / take from the environment.

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- The benefits of this outcome span across the three proposed categories. It will deliver benefits to the environment by leaving more water in it; to customers through reduced utility bills, to society through reducing water related carbon emissions and to operational resilience through helping secure future water supplies including protecting them against drought and peak demand events.
- By framing the outcome as reducing distribution input (Mld or %) it will achieve the outcomes above but it will enable the companies to achieve the outcome through a cost effective mix of household demand reduction, non-household and by reducing leakage. It would also help address shorter term fluctuations in the three elements such as due to Covid 19 where water use shifted from businesses to homes.
- Indicators of each of these three elements could be used to track progress but with financial incentives and penalties linked to the overall combined outcome. This approach would also align with the likely demand reduction target in the Environment Bill and address some of the issues holding back delivery of water efficiency in the business sector.
- There is a risk that companies put all their efforts into one element such as leakage reduction and pull back on engaging with customers on water efficiency. We also need to be careful of the scenario which we heard anecdotally in PR19 that companies were calculating the cost of PC failure, balancing that off against the cost of delivery. So in terms of DI or demand reduction outcome it may be necessary to set some minimum expectations across all three indicator areas.
- As highlighted earlier in our response to Q5.7 we would also like to see an outcome incentive linked to the roll-out of smart meter technology to both household and non-household customers. The technology is a game changer for the sector helping significantly reduce leakage, water consumption, carbon emissions and enriching how customers engage with their customers and with water use.
- The large number of company specific reputational commitments coupled with very limited publicity or visibility of them and hence limited consequences relating to how companies are doing against them makes their value questionable. Potentially companies should be asked to have three maximum.

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?

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?

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?

- The proposed approach is sensible in principle although the devil is in the detail. It would require companies to present a clear auditable rationale behind why they would propose to deviate from it with associated linked penalties or incentives.

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?

Cost assessment

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

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

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?

- A natural capital accounting approach could facilitate this, as could considering the long-term costs (to companies, customers and society) of NOT acting.

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

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

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?

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

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

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?

Risk and return

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?

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?

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

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?

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

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

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

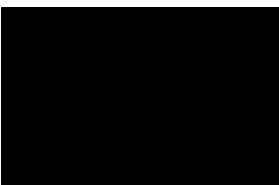
Q11.8: To what extent should we further increase the share of the notional company RCV which is indexed to CPIH in our assumptions for the period 2025-30, and how should this be implemented?

Next steps for PR24

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

- The draft timetable looks reasonable.

Regards



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Head of Policy and Strategy



Who is Waterwise

[Waterwise](#) was founded in 2005 and is the leading authority on water efficiency in the UK. We are an independent, not-for-profit organisation, receiving funding from supporters across

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and beyond the water sector and wider sponsorship and research projects. We like to be at the front, leading and supporting innovative efforts to realise our mission; that water will be used wisely, every day, everywhere.