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**Aileen Armstrong Westminster  
Energy, Environment and Transport  
Forum (WEET) speech: Creating  
tomorrow, together: creating the  
framework for PR24 and future price  
reviews**

# Creating tomorrow, together: creating the framework for PR24 and future price reviews

## Introduction

Hello, and thank you for inviting me to speak this morning.

We are, I'm sure, all aware of the main challenges to the water sector:

- Firstly, the threat of climate change to our water supply and our infrastructure. The last decade has seen the wettest winter on record and the warmest year on record.
- Secondly, the growing customer expectations around the service companies deliver and how they look after our environment. Every day brings a new story about the state of our rivers, and it's clear that concerns about how water companies conduct themselves are rising across society.
- And thirdly, as the need for investment grows, how we address the affordability challenge as the country slowly emerges from the pandemic. Over a third of water customers say their finances got worse over the first year of the pandemic. A quarter expect them to get worse in the following year.

All this means the water sector faces an immediate challenge – one that must be met now for us to safeguard our services and the environment for the future. And taking the right action now depends on us all looking ahead. Taking a genuinely long-term perspective is key.

While there is inherent uncertainty about what the future will bring, I think recent events have given us just a taste of the challenges we face, both as a sector and in wider society.

Climate change is already precipitating disaster, across the world and closer to home. Just last month, we saw flash floods rushing into Tube stations in London and cars sinking underwater in the Black Country; earlier this year, Storm Christoph brought some of the highest rainfall North Wales has ever seen.

At the same time, Covid-19 has really laid bare the importance of supporting customers who are vulnerable or struggling to pay. According to the Trussell Trust, distribution of emergency food accelerated by a third over the last financial year. Being able to afford life's essentials is becoming more of a problem for millions of people.

The water sector must take the lead on these issues.

Now is the time for fresh thinking and real change. Companies will need to change how they work; we need to change how we regulate. We can only achieve our ambitions together.

So I want to talk about how we can set up the price review to facilitate better, more sustainable outcomes.

We're just two years away from companies submitting their plans for PR24. We set out our early thinking on what PR24 could look like back in May. And I want to thank everyone who's given their feedback and offered genuinely constructive suggestions for how we can build on those ideas.

We outlined four ambitions for PR24. I'm glad to see that so many companies and stakeholders thought they reflected what needs to be done through the price review.

So it's worth just reiterating those themes briefly:

- First, we set out that we want **an increased focus on the long term**. The price review should support the best value long-term solutions – and companies need to set out clearly their roadmap to meeting ambitious long-term outcomes.
- Second, as key stakeholders in their communities, companies can deliver **greater environmental and social value**. That means incentivising nature-based over capital solutions where they're the best option. It means helping companies realise the potential of working with third parties, and optimising how schemes are delivered to meet wider environmental outcomes like net zero.
- Third, we'll place **customers and communities** at the heart of the price review. We want to make customer input more meaningful, so it can be better reflected in our determinations. We think this can be achieved through a more targeted, collaborative approach to capturing customer views, to complement companies' own engagement.
- And fourth, companies must **step up their productivity, increase innovation and improve efficiency**: whether embracing data, using markets, or taking in learnings from across the industry. And when we talk about improving efficiency, we're thinking of creating the space to do more for customers and the environment, rather than simply cost-cutting.

This morning, I'm going to set out three significant changes we're suggesting for PR24, so that we can meet these ambitions. First, the proposed changes to create a greater long-term focus. Second, how we plan to encourage new and innovative ways of working across the sector. And third, how we can approach the future in the most intelligent way, by anticipating and preparing for change.

## Long term

Let's start with creating a greater long-term focus.

I think we all agree that the challenges we are facing require a long-term focus. We often hear that companies are too focused on the five-year period, when what really matters is achieving the best possible outcomes into the future. Sometimes the best solutions will take

decades. And some assets in the sector will outlive us all. It could hardly be a more long-term industry.

But what does a long-term focus mean in practice – in terms of how price reviews are carried out?

Let me say first of all that I don't think it means changing the length of the price review period. That's been tried in the energy sector, for example, and Ofgem found that having to make assumptions for an eight-year period risks underestimating investor returns and overshooting on customer bills.

And, in any case, even a slightly longer review period wouldn't come close to the investment period for many of the water sector's assets. I don't think the review period needs to mimic that – it just needs to be a sensible period of time for the regulatory reset.

So what having a long-term focus means in practice is, I think, that five-year price reviews must be staging posts in a long-term trajectory – long term meaning 25, 30, 40 years. We shouldn't be starting from a blank slate at each review.

We think a big part of the solution is for companies to design their five-year plans in the context of long-term strategies. Companies should set out what long-term outcomes they aim to deliver, and how they're going to work towards them. And, as with their business plans, they should work closely with their customers and communities, to reflect their long-term preferences and priorities.

There are three key benefits to this:

- it would give us greater confidence that the five-year plan will deliver against the companies' long-term ambitions. We'd be able to stand back and see whether companies are sequencing their investments to deliver the best-value outcomes;
- at future price reviews, there'll be greater clarity about the outcomes that companies have already committed to and been funded for. This will create a better platform to hold companies to account, and enable companies to develop better business cases for further improvements;
- and it would give customers and stakeholders greater confidence that the challenges of the next few decades will be met.

But while a clear long-term strategy is a positive step forward, it won't necessarily deliver everything that's needed in practice.

There's a difference between creating just another document, and driving real change. So other changes are needed to support the long-term focus we need to see.

The conversation at each price review should be centred around how we can reach long-term goals together, rather than focusing narrowly on the short term. So we're looking at providing

companies with more short-term information before they submit their business plan. By setting out our expectations early on, we may be able to reach common ground on short-term parameters more quickly.

At PR19, we did this with the cost of capital; several companies said it helped them to plan ahead. We could do the same for other areas: we're considering whether we could provide an early view on base costs, performance commitment levels and outcome delivery incentives.

And if you're leading a water company and planning your long-term investments, I recognise that confidence in how the regulatory regime will operate into the future is important. So we're also looking at how the incentives framework could reinforce the focus on the long term, such as setting out indicative performance commitment levels for the next price review.

## Working in new ways

Let's also acknowledge that we need to work in different ways going forward. When you look at the scale of change required, it's abundantly clear that the sector needs to work differently.

To summarise: by 2050, we should see leakage at least halved, per capita consumption reduced to 110 litres per day, and significantly increased drought resilience. And, with net zero on the horizon too, every single investment to achieve these targets must consider the carbon impacts – not only from the operation of assets but their construction too. Embedded emissions currently account for a fifth of industry emissions and they represent one of the toughest parts of the journey to net zero.

We're talking about a real transformation, where how the sector solves problems now could seem almost alien to us in 30 years' time.

And some of that will come at a cost. It's exactly why a long-term strategy is needed – to help identify the best solutions over the right time period, to help sequence key investments at the right times, and to spread the cost fairly between current and future generations.

So real change is required in how companies do things and what investments they choose.

We all know that, over the long run, nature-based solutions can offer multiple benefits for customers and the environment. Working with partners to co-design, co-deliver and co-fund schemes opens up a whole range of opportunities. So can engaging with customers on issues like water consumption and wet wipes. As I've already said, being more efficient isn't simply about cutting costs – it's embracing those innovative, win-win solutions.

Which begs the question: if these solutions are more efficient, why aren't they everywhere? I think Ofwat can do more to facilitate them, including increasing the long-term focus in our framework and taking better account of the social and environmental impact of schemes.

And, while I think some companies are pushing forward and adopting new ways of working, we need to see the whole sector shift how it works. Maybe there are still pockets of culture that believe that all problems can be solved by pouring concrete. But even where there is an understanding that this isn't the case, there may still be systems in place that incentivise heavy infrastructure. There needs to be a concerted effort to review internal processes to ensure they support the best solutions.

The sector is on a journey here, but one that needs to accelerate.

It's great to see some companies taking the initiative to finance these schemes through partnerships. Whether it's embracing market solutions, like Wessex Water's EnTrade project, or pooling resources for mutual benefit, like United Utilities' collaboration with Nestle in the River Eden valley: we want to see more.

And this year, the green recovery initiative saw more exciting schemes go forward.

Like Severn Trent working with local authorities in Mansfield to deliver flood resilience, using attractive blue-green solutions like street planters and permeable paving. It's a great example of – not only the benefits working with third parties can bring – but also the opportunities to deliver wider value for local communities.

As we build up to PR24, I want to be clear that we need to see companies turning to these innovative solutions by default. Where these schemes are well-evidenced, we will support them.

## **Adapting for the future**

Finally, I want to touch on how we approach the next 30 years in the most intelligent way.

The industry's capacity to model future trends has improved leaps and bounds in recent years. But that doesn't mean any of us can predict the future. The shock of a global pandemic has brought that home to all of us.

I acknowledge that it's too simplistic to just call on companies to meet the challenges ahead as though there's a simple path to follow. The reality is that we don't completely know what the right solutions look like. And we should reflect that humility in how we plan together for the future.

Companies should be testing their long-term strategies against different versions of the future. Scenario planning can give us confidence that the strategies are likely to be the right

ones in different circumstances. But it isn't the full story: scenarios still rely on an idea, or a few ideas, of what the future looks like. And recent history shows that change can seem to come out of nowhere.

Looking at the last ten years, social media has transformed the advertising sector; the advent of streaming has upended the music industry; the gig economy has changed the landscape of so many industries, for better or worse. And who can honestly say they thought a Covid-19 vaccine would be developed so quickly?

In the water sector, technological developments have opened up so many new opportunities to deliver better outcomes. In ten, fifteen years' time, what impact might green innovation have on the costs of decarbonisation? For now, we can only speculate.

The unpredictability of change means that strategies need to be adaptive. We want to see companies embrace the world of adaptive pathways: laying out potential courses of action over the long term, identifying no-regrets solutions in some areas, and keeping options open in others until the best time to make a decision.

Some companies started to develop adaptive plans for their last round of WRMPs, but this was the exception, and more work is needed to ensure that these can be delivered. The next round of regional and company plans promises a much bigger step into an adaptive future. I expect PR24 to represent another huge step forward in this area.

## Next steps

To sum up, achieving the water sector's goals requires a change in focus from all involved.

We need to imagine what the long-term future can look like, and work backwards from there. Then we can strive to deliver that future, by embracing the innovations and opportunities ahead. But we should also expect to be surprised – the future probably won't look quite like that picture we've conjured up for ourselves – and prepare intelligently.

I'm really pleased with the engagement we've had around PR24 so far. We're still at an early stage in the process, and we'll keep on working with the industry and wider stakeholders to shape the next price review and beyond.

We're planning to publish a series of discussion papers over the next few months, expanding on our initial suggestions. I want to continue the conversation on this – this is the opportunity to nail down how ambitious objectives can translate into practical action, ahead of our draft methodology next summer.

At the same time, this isn't just about technicalities and regulatory frameworks. As we approach PR24, I want companies to focus on what 2050 and beyond looks like. We might

come up with different answers, and of course customers and communities have different needs and wants.

But strip everything back to key themes and we're all striving for the same goals: a healthy, thriving environment, an industry leading on climate change, customers and communities who feel engaged and are satisfied with their company, and resilient networks fit for generations to come.

It's an enticing future – but it doesn't come easily; it won't arrive unless we shift some of the mindsets of the past; but if we take ownership and do everything with those goals in mind, I'm confident we can achieve them together. Thank you.



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