

By email: [REDACTED]

13 January 2021

Re Long-Term Delivery Strategies and Common Reference Scenarios

We welcome this opportunity to comment on the proposals set out in Ofwat's discussion paper Long-term delivery strategies and common reference scenarios. This represents the most significant development in the regulatory framework put forward so far for PR24, with potential far-reaching implications. We agree that it strengthens the focus on the long-term and are supportive of the framework as a whole, though much will depend on the details of how it is interpreted and applied by Ofwat in future price reviews.

The benefits of the proposal include increasing transparency of companies' long-term investment plans and bill forecasts, tying more closely together successive price reviews, and helping to demonstrate that investment proposals are optimal in each AMP period. The guidance provides welcome clarity on how companies should make the link between long-term ambitions and proposals for the next price review. We also welcome the emphasis on ensuring our long-term planning frameworks are brought together in a coherent way.

While the guidance is common to all companies, within the framework there is considerable scope for companies to interpret and apply it in different ways. We would welcome further engagement sessions on the application of the framework, perhaps with worked examples. This would aid companies in ensuring that Ofwat can draw meaningful conclusions from comparisons across companies. While the strategies will make a helpful contribution to Ofwat's assessment of company investment plans, there will be a great deal of relevant information that will be outside the scope of the LTDSs, and the adaptive plans will not be applicable to all areas of investment. For PR24 in particular it will be important for Ofwat to proceed with a degree of caution in how it uses and applies the framework, while sharing information on best practice in relation to how the sector has adopted the LTDS framework, and taking forward the learnings to future price reviews.

At Welsh Water we set out our long-term ambitions in Welsh Water 2050 in 2018, and are reviewing that strategy ahead of PR24. Achieving our objectives will require significant investment

in a wide range of areas, and the key constraints are affordability and the pace of innovation rather than exogenous 'triggers'. For this reason we welcome Ofwat's acknowledgement that companies may need to use the framework in a constructive and proportionate way, taking into account the nature of their long-term plans.

We welcome the recognition that in Wales the long-term ambition will be agreed through discussions as part of the 'collaborative approach in Wales'. We are committed to supporting this process and bringing forward proposals, building on Welsh Water 2050 and other relevant work on which we have already engaged with customers and stakeholders. We are also ready to work closely with Hafren Dyfrdwy to take an 'All Wales' approach where appropriate. As recognised by Ofwat in its proposals in relation to Wales, a major factor underpinning our plans will be the level of bill increases that stakeholders and customers are willing to consider. This will influence the level of ambition, and the speed at which we can move towards meeting our joint long-term ambitions. We will also need to consider how to reflect the uncertainty over future environmental standards, and the extent of regulatory innovation (in particularly the ability to address problems 'at source') in our analysis of scenarios and adaptive pathways.

With regard to outcomes, we recognise the importance of agreeing what level of performance each company can deliver from base expenditure (noting that some will deteriorate due to climate change) so that expenditure to achieve enhanced levels can be classified as 'enhancement expenditure. However, we have concerns about the process of determining this – something we will address also in our consultation response on base costs. Companies' views on 'what base buys' will be subject to a range of uncertainties, not least the actual level of base expenditure allowances, and future operating conditions. Ofwat should carefully consider to what extent it can legitimately compare companies' positions on this. It is also unclear, given the importance of companies owning their own long-term strategies, how we should deal with a situation in which company views differ from Ofwat's view.

We note that not all elements of our long-term ambitions are able to be captured within the outcomes framework, particularly resilience which is a key feature of our vision for 2050. Ofwat has recognised this in the performance commitments framework, noting the Price Control Deliverables may be required where the actual outcome, as opposed to the output, cannot be measured (at least not in the short term). It would be helpful if Ofwat could clarify how we should reflect Price Control Deliverables in this framework, and also provide guidance as to the materiality of investments to include in the scenarios and sensitivity testing.

With regard to the scenarios, we understand these to be alternative eventualities with respect to four individual areas of uncertainty. The term "scenarios" usually refers to a fully described plausible future, used to illuminate possible risks and opportunities. This appears to have been a source of some confusion, as the "scenarios" here are focused on individual uncertainty factors.

We welcome the recognition that not all of the scenarios will lead to alternative pathways, though again some guidance on 'materiality' in this respect would be helpful.

We note the guidance that companies should include in their core pathway investments needed to meet future 'low' scenarios. We agree, but this is surely a minimum, as guidance for Water Resources Management Planning, for example, specifies that companies should plan for a baseline 'most likely' outcome. The document also states, and we agree, that companies should be responsible for determining their baseline assumptions. We can then use the scenarios to set out higher or lower investment adaptive pathways describing the impact of the relevant scenarios on investment plans.

Some of the scenarios are likely to have a more material impact on our investment plan than others. In particular, it appears strange that the 'environmental ambition' scenario is framed only around abstraction, and not, for example, river water quality standards. However, we welcome Ofwat's recognition that it is for companies to determine whether the scenarios are impactful, and to set out other relevant scenarios and uncertainties.

On customer engagement, we agree that it is important in principle to ensure that long-term ambitions and bill levels are consistent with customer views. However, research by the Consumer Council for Water has shown clearly that customers do not want to be asked about complex and long-term issues. Our interpretation of that research is that customers would also not find it meaningful to be asked about the fair balance between current and future customers. We welcome the recognition of this point in the document and will work with stakeholders in Wales to take a sensible and proportionate approach.

In conclusion, we agree with the underlying principle that companies should develop flexible and adaptable long-term plans in the face of uncertainty. We are keen to explore the benefits offered by the Long Term Delivery Strategies framework, and share our learnings with Ofwat and the industry. There are some problems and limitations of the proposals require further consideration. We would encourage Ofwat therefore to take a proportionate and cautious approach in terms of how it applies its conclusions, in particular from cross-company comparisons, at the next Price Review.

We look forward to continued engagement on this important topic for PR24 and beyond.

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