

By email

[REDACTED]

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Email:

[REDACTED]

Date: 13 January 2022

Dear [REDACTED],

Response to PR24 and beyond: Long term delivery strategies and common reference scenarios

Thank you for the opportunity to comment on this document.

We strongly support the need for companies' PR24 business plans to be part of a long term delivery strategy; this is evidenced by our work to date promoting outcome based regulation. The principles of long term adaptive planning are not new to the industry; strategic activities such as the water resources management plan (WRMP) our strategic direction statements, as well as more catchment specific activities such as catchment management to extend the life of treatment assets, have been part of our operations for many years.

Please see our response to the questions below.

[REDACTED]

Director of Economic Regulation

Thank you for the opportunity to respond to the PR24 and beyond - Long term delivery strategies and common reference scenarios consultation.

We strongly support the need for companies' PR24 business plans to be part of a long term delivery strategy; this is evidenced by our work to date promoting outcome based regulation, with companies targeted to meet long term outcomes rather than a wide variety of output based targets (which are often contradictory). The principles of long term adaptive planning are not new to the industry; strategic activities such as the water resources management plan (WRMP) our strategic direction statements, as well as more catchment specific activities such as catchment management to extend the life of treatment assets, have been part of our operations for many years.

We would like to note that this is a relatively short consultation period on what is an important and positive addition to the price review (PR) process. As one of the smaller companies, but a concern by no means limited by company size, we have some concerns over our ability to meet the requirements fully for PR24, but equally see this as the first step in a multi-PR journey.

The five-year targets set at PR24 should be the first staging post in our longer term delivery strategies, with the ability to reflect and adapt both between and during each five-year period depending on the circumstances at the time. This is an excellent intervention that, if appropriately targeted and sufficiently common across companies, will drive consistency and improve long-term planning.

However, it is imperative that these targets are set at an outcome based level to allow companies' plans to be truly adaptive to both their individual and national circumstances at the time and make full use of their adaptive plans. What may be the right 'lever' to pull at a given time in adaptive plans will vary between companies (for example, in a sustainable abstraction outcome, whether to reduce leakage, focus on working with customers or widen the use of grey water will vary depending on their current position and cost-benefit analysis). Each company is at a different level of performance depending on decisions made over 30+ years, as seen for example in the wide range of output on numbers of mains repairs and sewer collapses against the common PCs in PR19. The degree of resilience / risk appetite is a Board consideration, and all companies will have adapted their plans from being based on long-term asset age and condition, to serviceability and then to risk to reflect the constraints of infrastructure maintenance funding and acceptable levels of bills in particular. Expanding slightly further on the ability to adapt within a PR period; a consideration for adaptive plans and the PR24 business plan will be the uncertainty of changing regulations / expectations within the five-year period. For example, the EA's stance on Farming Rules for Water has widespread and significant implications on many companies to the extent that it is now under judicial review. The lack of alignment of regulatory actions and the business plan is a prime example of the need for adaptive plans to be flexible within periods.

We do have concerns over the focus of this being solely on enhancement. There also needs to be recognition that long-term asset health is a feature of both enhancement and maintenance expenditure. Improvements in performance, such as leakage, will have been impacted by both base maintenance and enhancement spend. We request that both are covered by these plans, or that there is a reconfirmation of what constitutes enhancement.

Common reference scenario areas

We understand the aim of comparability between companies' long-term plans through predetermining high and low scenarios, but would caution that there are still going to be large elements open to individual companies' interpretation within these that will reduce the comparability. For example, 100% roll out of smart meters; each company could interpret the demand consequences differently (e.g. does smart metering have a short-term impact on demand that reverts to historical levels, or a sustained lower level?; does it revert after 1 year, 5 years, or 10 years?; is the demand reduction 1%, 5%, 10%?). And the climate change scenarios have a large degree of modelling required within them that will also lead to differences. We are not proposing that Ofwat should provide further detail here, or the guidance would be too prescriptive, but flag that caution should be used in the comparisons.

We support the five principles of the scenarios being simple, plausible, material, exogenous and national; it is important that these are maintained when any changes are made as a response to consultation feedback to ensure that companies are able to reflect these in their plans given the tight timeframes. However, we would like to flag that for both large and small companies, the requirements placed on us by this approach are not insignificant and will require additional skills and resource that are not readily available within companies given the resource requirements already utilised in delivering the WRMP and DWMP. Being able to fully deliver against these requirements for PR24 will be challenging; our long term plans will evolve and adapt over time as we gain maturity in this area.

The difference between the DWMP guidance and common reference scenarios is also important to note. Whilst many of the aspects align with the requirements for the WRMP, the DWMP requirements differ to those here.

UKCP18 data was not the climate change model specified (instead it was UKCP09) and given the timescales we will not be able to do any re-runs to the models. However, we compared the models when the WRMP guidance was released and we are satisfied that they are suitably similar not to cause any material issues.

There is also a difference in the growth models specified; the DWMP guidance framework advocates use of a central estimate for standard catchments and +/- 30% sensitivity analysis for extended catchments; this is different to that in the common reference scenarios. Again, there is no time to re-run any models.

We intend to continue using the scenarios that we have been using to date for the DWMPs and seek earlier alignment for PR29.

Data tables

We do not believe it will be possible to meaningfully fill in the tables to the required granularity (£m 3dp).

For example, when current engineering schemes move from outline to detailed design there can be movement of +/- 30% in the costs, and these are in schemes that are understood with existing technology (albeit sometimes with innovative approaches).

A further example is the recent issue of the replacement of PSTN lines by 2024. We became aware of this issue, which would fall into the technology area in these scenarios, just before business plan submission. Our initial estimates suggested this would cost c.£7m but this had to be calculated quickly considering a range of possible solutions (some known, some hypothesised that the technology innovation would arise). After significant effort in this area,

including an external marketplace challenge to attempt to secure the best value solution, this programme is set to cost in the region of £20m this AMP.

If data tables filled out this far in advance with monetary figures are required, we suggest that the accuracy is to within £5m or similar post-PR24, and within £1m within PR24 (acknowledging that even this will have significant uncertainty in many cases).

It is unclear how Ofwat intends to use these data tables and long term plans in future price reviews, but we request that the evidence required to make changes to these long term plans and data tables at subsequent price reviews is proportionate given the high degree of uncertainty in forecasting the future.

Climate change

We are pleased to see that these scenarios align with those for the WRMP.

We would propose that a carbon target is added that aligns with the WaterUK work that itself is seeking to align with government targets.

Technology

We caution that this area is far more subjective and cannot be mathematically modelled in the same way as climate change and demand. Despite this, to make it a more rounded area we feel that communications changes need to be included as these are outside of our control (note the PSTN example commented on previously) but are a key driver of activities and investment (this is separate to the resilience point you have in this section which mentions communications).

We would also highlight the area of communications; several of the technologies highlighted will require the assumption that the communications technology is there to support the use of this. This is by no means certain – with no regulatory driver to rollout networks such as NB-IoT to replace 2G, a lack of competition or coverage in this area will limit our options. We also note the requirement for a non-digital back up in the high technology scenario; the implications of this are vast having investigated these options, albeit briefly due to the cost and complexity, when planning for the replacement of our PSTN lines.

Demand

We disagree that per capita consumption (PCC) is largely within our control and we believe it should be included within this area as a separate item, not just within the building regulations and product standards element (which, based on the modelling by Artesia, shows a huge variation in the impact this could have on PCC supporting our view that it is largely outside of our control).

This viewpoint is also reflected in our response to the performance commitment consultation; we do not believe it is sufficiently within our control to have as a common performance commitment. Weather, behavioural, and societal attitudes (which we note is reflected in your technology scenario as something outside of our control) and pandemics all have an impact that we cannot influence. Whilst we have water efficiency and metering programmes, the impact of these on PCC is unclear, and we believe without guidance from Ofwat of high and low PCC scenarios any form of comparison of the companies' strategies will be nigh on impossible.

Environmental ambition

We are pleased to see the alignment here with the WRMP requirements. However, we would like to flag (and this will be highlighted at our end of the month WRMP discussion sessions) that understanding these scenarios and getting the associated figures has not been as simple as we might have hoped. Whilst the figures have been provided at a national level, translating them into local figures has taken time.

The current drafting of this area also only comments on the supply side environmental ambition. We would also expect there to be an equivalent on waste for storm overflows. We understand that the guidance from Defra has not yet been confirmed and so it couldn't be stated, but would have expected some form of reference here. We will restate, without labouring the point, our position that any improvements made to storm overflows should be on an impact basis and not simply a frequency of event standard.