



The voice for water consumers  
Llais defnyddwyr dŵr

# **CCW's response to Ofwat's draft methodology for the 2024 Price Review (PR24)**

**7 September 2022**

## **1. Introduction**

- 1.1 The Consumer Council for Water (CCW) is the statutory consumer organisation representing household and non-household water and sewerage consumers in England and Wales. We welcome the opportunity to provide input to Ofwat's methodology for the next price review in 2024.

## **2. Executive Summary**

- 2.1 The 2024 Price Review (PR24) urgently needs to address a number of challenges facing the water sector, which will have implications for the long term affordability of bills, as well as the resilience and reliability of water and wastewater services and how they impact our environment.
- 2.2 All of these challenges come with potentially high costs. Alongside this, the current cost of living pressures on households means there is a greater need than ever to protect people less able to pay their water bills at a time when the need to invest implies potential bill increases for many.
- 2.3 The price review methodology needs to clearly set the process for how companies should be expected to address these challenges and the trade-offs they imply. In its price determinations, Ofwat must ensure that companies are challenged to deliver for people and the environment in an affordable way, whilst meeting the UK and Welsh Government's strategic and legislative priorities.
- 2.4 It also needs to show how evidence of people's needs, expectations and priorities will shape decision-making by companies and Ofwat. Recent high-profile pollution incidents, drought risks and affordability pressures have put the sector's reputation under greater scrutiny. So in order to make sure people trust the sector and perceive it to operate fairly, the price review needs to have outcomes that people accept, with a pace of delivering improvements at a cost they find affordable.
- 2.5 CCW welcomes many of the initiatives Ofwat proposes in its draft methodology to address these challenges, and as well as the engagement CCW has had with Ofwat since the conclusion of PR19. There are areas of the methodology where Ofwat should strengthen its approach to assessing business plans and setting price determinations.

2.6 While we explain this in detail as part of our formal responses to the consultation questions, there are three key areas where the methodology should be improved to reinforce the customer influence on decision-making, provide adequate protection for people who may struggle to pay, and focus companies on providing their customers with a high quality service.

### **People's role in the price-setting process and in agreeing solutions**

2.7 Water companies need to be better at engaging with people so they will help address the challenges that the water sector and wider society are facing over the short and long term. The best plans will reflect household and business customers' priorities and, crucially, involve them in both the design and delivery of solutions, taking care to explain why decisions are made and how.

2.8 We want to see Ofwat provide clear and specific information and guidance in the final methodology on the following issues:

- The weight of customer evidence in Ofwat and companies' decision-making right through the process of assessing company business plans and setting price determinations.
- How people's behaviour can be part of the solution to the challenges the sector faces.
- Re-emphasising what good customer engagement looks like.

2.9 Household customers in England and Wales have no choice in their water and sewerage provider. A monopoly situation like this can easily lead to a disengaged, transactional relationship from both customer and company without efforts to change. Recent joint research conducted by Ofwat and CCW<sup>1</sup> found that just 27% of customers agreed that companies acted in the interests of people and the environment – with 10% actively disagreeing. While we believe that, in general, companies have improved in this area in recent years, they will need to go further as the challenges facing the water sector can only be overcome if all parties are fully committed and pulling in the same direction.

2.10 We think the PR24 methodology should include more detail about the metrics Ofwat will be using to assess how well companies have engaged with people, communities and businesses. This must include the weight given to customers' views in Ofwat's decision-making. In CCW's *Engaging water customers for better consumer and business outcomes*<sup>2</sup> research, two key elements that indicated meaningful engagement were:

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<sup>1</sup> [Ofwat/CCW: Customer spotlight: People's views and experiences of water](#)

<sup>2</sup> [CCW/Blue Marble: Engaging water customers for better consumer and business outcomes. May 2020](#)

- That customers thought they were being listened to, and
- That their views made a difference.

- 2.11 Transparency from both Ofwat and companies (and the Competition and Markets Authority in any future re-determinations) about how they have used people's views and the impact they have made on decisions must be a key part of PR24 in order to demonstrate that people are central to the process.
- 2.12 People looking at company plans and Ofwat's decisions should be able to clearly understand how customer and community engagement has shaped decision-making, including where evidence of business and residential people's views have been used and why. This is particularly important when considering the enhancement cases to improve levels of service for the environment. If people are being expected to pay more, then companies need to demonstrate that the evidence shows that these schemes will deliver the outcomes their customers want.
- 2.13 For people's roles in price setting to be meaningful, their influence needs to go beyond understanding their preferences to actively involving them in delivering the solutions. The formation of RAPID and the regional water resource planning groups was an excellent example of how bringing different parties together to work towards a common goal can accelerate the delivery of water resource solutions. In CCW's view, there would be real benefit in establishing a similar body to look at demand reduction and behaviour change and therefore a proposal is being developed.
- 2.14 One of the biggest challenges the sector faces is finding the extra four billion litres of water per day it will need by 2050 to ensure it has sufficient supplies to meet the pressures of climate change and an increasing population. To achieve this target, around a third of the reduction will need to be delivered through reducing consumption, which can only be done if people change their water use habits and understand why it is necessary to do so. Yet CCW's recent research<sup>3</sup> found that 41% of people living in water stressed areas actually thought that their water supplies were plentiful. Failure to tackle this misconception and effectively engage people in understanding the part they can play in securing the future of our water supplies will create a disaster for future generations.
- 2.15 The solutions are not easy, but they must begin by ensuring that people have a meaningful say on their water companies' future plans. Companies need to understand more about the

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<sup>3</sup> [CCW: Watervoice: Views of current customers on water resources. October 2021](#)

diverse communities they serve and use this knowledge to engage with people on the solutions to the environmental challenges. Our *Water Matters*<sup>4</sup> survey found that around three in 10 people felt their company did not care about the services they provide. Companies need to work hard to improve this perception – to demonstrate to their customers that they are doing the right things to protect supplies and deliver great customer service. Once people can see that companies are doing the right things they are more likely to be influenced to change their own behaviours.

- 2.16 We are encouraged by the positive, collaborative approach that Ofwat has taken to customer engagement at PR24. There is a clear reflection of the recommendations from CCW's *Engaging water customers...* research, specifically a focus on the need for engagement with people, communities and businesses to be meaningful.
- 2.17 Ofwat should reiterate what it expects from companies' research and engagement programmes in its final methodology, and go beyond simply asking companies to reflect consumer priorities. CCW will be updating our *Framework for water company research*<sup>5</sup>, reviewing all the work we have done since it was published and creating a clear and simple guide for companies. In the final methodology, we ask Ofwat to mandate companies to demonstrate that they have adhered to the principles of our framework in the evidence they include in their plans.

### **Single Water Affordability Scheme**

- 2.18 Water affordability is the defining issue of this price review. Current arrangements are not adequately meeting the needs of low income households, and so it is vital that the PR24 methodology sets out the path to securing change. Current arrangements cannot continue.
- 2.19 The methodology needs to set out:
- The mechanism for a single social tariff scheme including details of how the joint company funding pot will operate.
  - The steps which companies should take to transition towards the introduction of the single social tariff in the event that the legislation for the scheme is not in place by the start of the next price review period.

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<sup>4</sup> [CCC: Water Matters. July 2022](#)

<sup>5</sup> [CCW: Framework for water company research: November 2020](#)

- 2.20 Our 2021 water affordability review<sup>6</sup> identified that although companies are supporting water customers who struggle to pay through a range of measures, including through reduced bills to more than 1 million households<sup>7</sup>, around 1.5m households remain in water poverty<sup>8</sup>.
- 2.21 Since completing our review, the financial pressures facing lower income households have escalated further due to the current cost of living challenges. Indeed, our Water Matters research found that just over a third of bill payers said their finances had got worse during the past year. 1 in 10 households currently consider their water bill to be unaffordable. That rises to around 1 in 5 among the unemployed, students and households with a disabled occupant.
- 2.21 Water is an essential service and it is vital that people have the peace of mind that their charges will be affordable whatever their circumstances. Having adequate protections in place to shield financially vulnerable households from unaffordable bills would also unlock the industry's ability to make the investment necessary to deliver environmental objectives and improved asset resilience.
- 2.22 A key recommendation of the affordability review was the introduction of a single social tariff scheme across England and Wales to more effectively and consistently target help to those who need it most, wherever they live. The UK and Welsh Governments have established a working group to explore options for the implementation of such a scheme and are planning a consultation on the proposal. In our view, it is essential that this enhanced support is in place for the start of the next AMP period in 2025.
- 2.23 We welcome Ofwat's signal to companies that their business plans should outline how they would deliver on a legislative requirement to implement a single social tariff and its forecast impact. The methodology document should also set out clearly how the new mechanism will work from a price review perspective. This should include details of how a single funding pot will operate and how the flow of revenue between companies will be managed. There is an opportunity to set out this detail now rather than in the late stages of the review, as happened with the establishment of the innovation fund mechanism during PR19.
- 2.24 Ofwat has also asked companies to set out their proposed approach in the event that the legislation for a single social tariff is not in place for 1 April 2025. We are concerned that without clear guidance this could result in a continuation of current arrangements. This is not

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<sup>6</sup> [CCW: Independent review of water affordability](#)

<sup>7</sup> Around 750,000 to 1,000,000 unique households are supported

<sup>8</sup> Spending more than 5% of income on water charges after housing costs (equalised for household size)

sustainable. Many companies will have exhausted all capacity within their social tariff schemes by that point.

2.25 Given the scale of the affordability challenges facing households, and the fact that we cannot afford to constrain essential investment, continuing with the status quo is not a viable option.

2.26 Ofwat should instead direct companies that, under a scenario that the legislation for a new scheme is not in place by 2025, they should take steps to transition towards implementation in terms of:

- Consistency in eligibility criteria and the support provided;
- Enhanced funding; and
- Consistent scheme branding to make it easier for customers to access support.

The exact nature of these arrangements will, of course, need to reflect thinking and decisions which emerge from the current work to explore the single social tariff scheme.

2.27 We welcome the clear signal from Ofwat that companies should do more to share financial outperformance with customers, particularly where this arises from high inflation levels. We believe such gains could be utilised to help accelerate the transition to the new single social tariff, with this being recognised favourably by Ofwat when assessing company business plan proposals. We also believe companies who are currently benefiting from high inflation and who use that outperformance to help customers struggling to pay right now should be favourably recognised.

**Ensuring water companies' culture is measured, fit for purpose and delivers for customers and communities.**

2.28 The price review process places much emphasis on companies' business plans without equally considering how company culture needs to consistently show a 'customer-first' attitude and work to deliver a great customer experience.

2.29 Company culture drives many aspects of business performance, from the boardroom to the operational teams out in the field. Strong company values that are embraced by all employees can help improve both customer and employee satisfaction.

2.30 At PR24, we're asking companies to show a commitment to putting their customers first, at all organisational levels, and demonstrate how they are developing a positive company culture. We'd like Ofwat to make this a requirement of all companies as part of its methodology for PR24.

- 2.31 A strong customer focused culture can deliver business plans and price determinations that can lead to outcomes customers accept and value. This is needed urgently as CCW's annual Water Matters survey for 2021<sup>9</sup> shows some downward trends in customers' overall satisfaction with sewerage services and people's confidence that their water supply will be available in the longer term without restriction. There has also been a significant decrease in customers perceiving their charges to be fair (62% compared to 69% in 2020) while customer trust in the sector is at its lowest point for a decade.
- 2.32 This downward trend could worsen if people do not see water companies as delivering services with their best interests in mind, particularly as the cost of living increases. There is also a risk that people will not respond to messages to increase water efficiency if there is a lack of trust and a sense of unfairness. Company plans will also be compromised in their delivery if company culture is not fit for purpose.
- 2.33 The PR24 methodology should encourage companies to deliver business plans (and for Ofwat to set price determinations) that demonstrate that companies have a customer-focused culture and can deliver public value. The draft methodology proposes the following initiatives to help drive a customer-focused culture, which we support:
- The role of customer engagement in building evidence of people' and businesses' priorities and expectations to drive business plans and Ofwat's assessments and determinations (discussed in more detail above).
  - Common Performance Commitments that reflect evidence of customers' priorities (as shown in the Ofwat/CCW collaborative research in 2021 -22<sup>10</sup>).
  - The new incentive to measure the satisfaction of business customers and non-household retailers, which could help deliver much needed improvements in the non-household retail market in England.

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<sup>9</sup> [Water Matters](#) tracks the views of household customers on the services they receive from water companies in England and Wales.

<sup>10</sup> [Understanding customers' preferences for Performance Commitments at PR24](#)



- The requirement for companies to show how dividends and performance-related executive pay for 2025-30 aligns to benefits delivered for customers and the environment.

2.34 There is an opportunity to go further and incentivise companies to embed a customer-focused working culture, outlining their strategies for addressing the issues the sector faces as well as day-to-day service delivery:

- A stronger household customer experience incentive (C-MeX) could effectively motivate companies from Board level to increase and maintain a high level of customer satisfaction. A higher financial value should be applied to this incentive so it has relative value compared to other Outcome Delivery Incentives. The C-MeX component related to customer complaint volumes should no longer be relegated to a gateway to higher rewards and be part of the main C-MeX score. This would incentivise companies to reduce complaints and resolve them at first point of contact.
- As part of the incentive for companies to submit high quality, well evidenced and ambitious business plans, Ofwat should include an assessment of companies' past delivery for customers and evidence of good practice sharing with the rest of the sector. A company should not be rewarded for a high quality plan if it has failed to deliver its commitments to customers in the past.
- While we welcome the draft methodology's signal that companies' financial outperformance success should be shared with customers (for example, where this has been driven by high inflation), the final methodology should require companies to consult with customers about where that outperformance success should be invested. This could include increasing support for people struggling to pay or increasing funds into nature based alternatives for delivering environmental improvements and reduce pollution.
- Further measures could be used to indicate how strongly companies' working culture is orientated around understanding and delivering for customers. We would like to see consistently-applied annual surveys to track employee satisfaction, with a focus on raising the bar for employee engagement across the sector. Without motivated employees, the needs of people and the environment may not be met and customer satisfaction and public value may not increase. There are also various accreditations available to measure the community impact of water and wastewater services. These measures, alongside the need for companies to justify executive pay and dividends with increased customer benefits, would all help

increase the emphasis on the culture and the leadership needed to deliver for customers and the environment.

## **Responses to the consultation questions**

### **Regulating through the price review**

**Q2.1: Do you agree with the challenges facing the sector and the ambitions for PR24 we have identified?**

Yes. We agree combatting climate change, protecting the environment, and sustainable use of natural resources are some of the key challenges. What the draft methodology does not adequately deal with is on creating the framework for delivering on the affordability challenge and on customer expectations of the services they receive. Without a clear affordability framework for companies to base their plans on, achieving the ambition needed on climate change, the environment and natural resources is at risk.

**Q2.2: Do you agree that continuing to use our three building blocks helps push companies to meet our ambitions for PR24?**

Yes. Outcomes, costs, and risk and return are the building blocks of price determinations. But more clarity is needed to show how customer engagement evidence/priorities and customer affordability informs decisions in each one.

**Q2.3: Do you agree that we have struck the right balance between what's in and what's outside of the price control?**

Yes. We agree that a price review is not the only opportunity available to address customer affordability and company performance, but should complement non-PR24 activities such as changes to company licences to encourage greater support for vulnerable customers. But there is a need to see how these initiatives work as a 'package' of measures delivered by costs allowed at PR24 and that the affordability assistance initiatives associated with the price review are progressed and not viewed as secondary or lower priority

**Q2.4: Do you have any comments on our approach to evaluating progress? What specific evaluation questions (based within the four key ambitions) do you think an evaluation should look to answer?**

We support the approach. Specific questions should include:

- Do PR24 outcomes (long term strategies, PCs/ODIs, investment etc.) reflect evidence of household and business customer priorities?
- Has company culture been measured and improved as a result of PR24?
- Are companies delivering their commitments to customers?
- Does post-PR24 outperformance justify an intervention if companies are not sharing their success with customers?
- Has past performance been taken into account?
- Is the company tracking customer affordability in a way that can help assess the impact of the PR24 price determinations on customers' finances, and the extent to which new affordability initiatives are a success?

**Design and implementation of price controls**

**Q3.1. Do you agree that in our final methodology we should commit to introducing either an adapted water trading incentive or a new water trading incentive at PR29? If you have a preferred approach, please provide reasons, including any thoughts on how the options we set out in Appendix 2 could be improved.**

Given the urgency with which solutions for more water scarce areas are needed, it is questionable whether the current incentive is fit for purpose. As collaborative working across companies and stakeholders can help achieve longer term water supply sustainability, we support Ofwat consulting and collaboratively designing a replacement incentive for introduction before PR29. A company that is able to build new water resources should be strongly encouraged to use any headroom to supply areas of the country that need it.

Water trading should also be part of a wider strategy to manage demand as well as supply, so water trading is part of the solution delivered alongside demand management initiatives such as promoting greater water efficiency. Given our changing climate it is clear that there will be a limit to the amount of water that is available for trading. It would be helpful for Ofwat to work with the sector

to fully understand the potential scope for water trading as part of a sustainable mix of solutions to balance supply and demand into the future.

**Q3.2. Do you agree with our proposals to: a) Continue to include network reinforcement in the network plus price controls? b) Remove wastewater site-specific developer services from the wholesale wastewater network plus price control?**

Yes. Site-specific developer services are open to competition and should be exempt from the network plus control. But developers need protection from the risk of over-paying (see our answer to Q3.3).

**Q3.3 Do you agree that the inclusion of network reinforcement in cost sharing would be enough to manage uncertainty around the volume and mix of network reinforcement work to be delivered?**

Yes, this should protect customers from the risk of over-paying if the assumption of what the incumbent company needs to deliver is incorrect.

**Q3.4. For water site-specific developer services: a) Do you agree with our proposal to exclude new developments of more than 25 properties from the wholesale water network plus price control at PR24, but with transitional arrangements for companies with low levels of competition? b) Do you think that new developments of 25 properties and fewer should remain in the wholesale water network plus control or be removed? If they were removed from the price control, what alternative protections could we introduce to protect new connection customers from monopoly power?**

We agree with (a) as these developments are subject to a competitive 'self-lay' market and companies with low competitive activity in their area should be transitioned gradually.

In response to (b), small developments should remain in the wholesale water network plus control to protect customers. However, if there is evidence that smaller developments have been delivered by non-incumbents at a more efficient cost, this could be reviewed again (it is unclear at present). If included, Ofwat would still need to set an efficient baseline cost assumption to protect customers from over-paying.

It is not clear to us whether these changes will result in any short-term effects on the charges that companies will make to developers. Developers are unlikely to welcome significant increases so Ofwat's approach needs to be flexible enough to enable companies to manage any increases as they see fit. **Q3.5. Do you agree with our proposals: a) to raise the size threshold above which companies should deliver schemes through DPC to around £200m lifetime totex? b) For companies to deliver schemes through DPC by default above this threshold?**

Yes, as the draft methodology shows that there may be lower net benefits for customers when smaller schemes are subject to direct procurement. Third party delivery of large schemes should deliver greater efficiency for customers with protection in place so customers are protected from over-payment if costs increase unexpectedly. Incumbents should also set service standards with third parties so that there is clear responsibilities when something goes wrong and effective communication with customers.

**Q3.6. Do you have any views on any other aspect of our proposals in relation to:**

**a) The design of price controls;**

No, as the price control design is well established.

**b) Water resources;**

We support the aim to include RAPID solutions in PR24. Ofwat and companies need to demonstrate that schemes allowed under the water resource price control represent best value and are sustainable, and can deliver the solutions needed alongside companies' work to encourage greater water efficiency by business and behavioural change in residential consumers.

**c) Developer services;**

See Q3.4

**d) Retail activities;**

We support continued use of the business retail price control in Wales based on the number of non-household customers served by companies in Wales.

**e) Bioresources;**

While this only has a minor impact on customers' prices, a price control for this area of the wholesale chain should encourage efficient bioresources processing and trading to benefit customers.

**f) Other controls;**

We support continued separate price controls for Thames Tideway Tunnel and Havant Thicket.

**g) The revenue forecasting incentive mechanism;**

We support the principle of the revenue forecasting incentive as it can help protect customers from bill 'spikes' in the early part of a price control period if actual revenue was significantly different than that assumed in price determinations. However, the draft methodology shows that the penalty across all companies amounted to £6m in 2020-21 but the true-up for revenue adjustments was £250m, so we question the effectiveness of this incentive to encourage companies to forecast more accurately.

**or h) Direct procurement for customers?**

See Q3.5

**Reflecting an understanding of customers and communities**

**Q4.1. Do you agree with our approach to making sure that companies' price review submissions and our determinations reflect an understanding of customers', communities' and environmental concerns?**

CCW has been working closely with Ofwat on customer engagement for PR24 and we are supportive of the approach to engagement that Ofwat outlines in the draft methodology.

We welcome the clear message that companies must ensure that engagement with customers is meaningful. This was the key message from our *Engaging water customers for better consumer and*

*business outcomes*<sup>11</sup> research. The collaborative research programme being run by Ofwat and CCW will deliver consistent, comparable information to inform Ofwat's decision-making in a number of key areas but, crucially, also leaves room for companies to involve their customers and communities in decision making about how individual plans are constructed.

CCWs framework for engagement<sup>12</sup> emphasises the need to bring together business planning research with ongoing research and community engagement. This should also include the results from any customer engagement to inform regional and sector-wide plans.

Companies must ensure there is a more visible link between people's views and the investment decisions in their business plans than was sometimes seen at PR19. This involves not only being transparent about how the results of research and engagement activity has influenced decision making but also how household and business customers, stakeholders and the wider local communities are part of the delivery of solutions and if relevant, why changes need to be made.

To overcome the environmental challenges we face will require a collaborative effort from water companies and the communities they serve. Engagement must play a key role in the success of this collaboration and we would like to see Ofwat requiring companies to set out not only how they will understand people's concerns but also company plans for involving people in delivering the solutions. There are already some examples of this in catchment management, working with landowners on agricultural practices to limit the sources of pollution before they affect water sources. Lessons from these examples – and the success of RAPID in bringing together wider stakeholders to expedite delivery of water resource solutions – should be applied more widely in business planning.

Companies face significant challenges in tackling storm overflows and ensuring future water supplies are able to meet the pressures of climate change and population growth. Customers, communities and stakeholders must be integral to the delivery of the solutions to these problems to make sure the right interventions are made at the right time to deliver for people and the environment. Customers cannot simply be seen as the funding pot.

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<sup>11</sup> [CCW/Blue Marble: Engaging Water Customers for better consumer and business outcomes. May 2020](#)

<sup>12</sup> [CCW Framework for water company research. November 2020](#)

#### **Q4.2. Do you agree with our proposal to conduct open challenge sessions?**

Yes. Open challenge sessions can play an important role in opening up the business planning process to wider scrutiny and challenge if these sessions are effective. CCW will work with Ofwat to determine how to make these challenge sessions successful.

The content and format of the sessions needs careful consideration to make the best use of the time available. CCW and Ofwat have emphasised the need for engagement to be meaningful for PR24 and this should be the guiding principal when determining how the Open challenge sessions will run. Which parts of the companies' plans will be subject to scrutiny, how the information is presented, and securing the right participants to provide this meaningful challenge will be the key to the success of the sessions.

We would also like Ofwat to make it clear in the final methodology how the outcomes from the sessions will be used by companies and the regulator. For example, how will companies be expected to demonstrate that they have considered the challenges at their session in the further development of their plans? It will also be important for Ofwat to set out the role that feedback from the open challenge session will have on its determinations.

#### **Q4.3. Do you have views on open challenge sessions can align with the collaborative approach in Wales?**

We believe that the role of the open challenge sessions in opening up the business planning process to wider scrutiny and challenge from customers and stakeholders will be equally applicable in Wales.

Although there is a collaborative approach in Wales we believe it is still appropriate for there to be individual open challenge sessions for both Dŵr Cymru and Hafren Dyfrdwy. The decision of Hafren Dyfrdwy to deliver its challenge through the work of a single independent expert means that the open challenge session will play an important role in allowing the views of a wider group of company stakeholders to influence the company's plans.

As mentioned above in response to Q4.2, we will continue to work closely with Ofwat to determine the best approach for running the open challenge sessions.



**Q4.4. Do you have views on how the outcome of collaborative customer research can contribute in the context of the collaborative approach in Wales?**

The outputs from the collaborative customer research will provide information on a few specific areas of business planning – customer priorities, valuations (which Ofwat will use for ODI rate setting) and a view on the acceptability and affordability of business plans.

This allows companies and the Wales PR24 Forum plenty of scope to carry out additional research and engagement to ensure plans are focussed on delivering for the people of Wales. This could include further collaborative Wales-only research across the two company areas to inform the development of bespoke PCs – or PCDs – aligned to the policy priorities of the Welsh Government.

**Delivering outcomes for customers**

**Q5.1. Do you agree with our proposed package of common performance commitments? Is water demand best incentivised through separate performance commitments on household and domestic consumption and leakage or through a performance commitment measuring total demand?**

Yes, the set of 24 common PCs reflect customer priorities in the 2021-22 Ofwat/CCW joint research<sup>13</sup>. As a result, we think customers would expect companies to be ambitious and challenging in the targets set for the areas of service customers prioritise or value. The methodology should require companies to set out their proposed targets, taking into account past performance, their comparative performance with other companies, and evidence of the expectations of customers. Alongside this should be a commentary to describe the activities the company is proposing to undertake to meet targets.

**Water demand**

We consider water demand reduction is better incentivised through separate PCs for leakage reduction, Per Capita Consumption and business demand rather than total demand and/or distributional input. This would also give greater transparency at a time when customers are

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<sup>13</sup> [Understanding customers' preferences for Performance Commitments at PR24](#)

increasingly concerned about drought risk and usage restrictions occurring more frequently in the future (as our Water Matters research shows).

In its final methodology, Ofwat should advise companies that when they propose their targets for water demand PCs in their plans, they need to show how influencing/promoting customer behaviour forms part of the strategy for achieving their proposed targets. The draft methodology does not encourage this at present. This is an important part of utilising customers as part of the solution, which is one of the key themes of our response to the draft methodology.

**Q5.2. Do you agree with our proposed guidance for bespoke performance commitments?**

Yes, as there are more common PCs than PR19 there should be fewer bespoke ones. Bespoke PCs should be justified by customer evidence/support and reflect regional/company specific priorities that are not covered by the common PCs. We agree that there should be a small number per company.

**Q5.3. Do you agree with our proposed approach to setting standard rates?**

We agree that standard rates should be informed by the results of the Ofwat/CCW customer research on customer values of service delivery/failures. It is unclear at this stage how Ofwat will do this but we welcome Ofwat's commitment to engage with stakeholders and be transparent in this process. We expect the indicative rates to be included in the final methodology in December 2022 with a clear explanation of how the research results underpin this.

With regard to whether ODI rewards/penalties should be symmetrical, we do not think that Ofwat should pre-judge the outcome of the joint research. If the impact of a failure is greater than the value (to customers) of a service being delivered well, then customers may think that the value of the penalty should be greater in this scenario.

**Q5.4. Do you agree with our proposed approach to the measures of experience performance commitments, including to increase the size of C-MeX?**

To motivate companies to more effectively improve the customer experience and to demonstrate to customers that they are truly valued the C-MeX design needs:

- A greater financial value (rewards and penalties) than present as this will strongly motivate companies at board level down to improve performance.

- A stronger weighting for the complaints volume as there is a risk of companies with high customer satisfaction but with a high complaint volume getting rewards<sup>14</sup>.
- Companies required to address reasons for dissatisfaction expressed by customers in the two surveys for customer satisfaction and company contacts.
- An additional sub-metric in the complaints measure to show the number of repeat customer contacts on water supply interruptions, sewer flooding and low pressure. This could reveal the extent to which companies' are responding to the needs of customers who are worst served and are more vulnerable as a result.

To strengthen the complaints/repeat contacts measure, we think that this should carry a 20% weighting in the overall incentive value, with the two customer surveys carrying 40% each.

We also think a company should also be above mean average total complaints and show no significant decline in complaint handling performance to access the standard rate. To access the higher rate of reward, companies should be in the top three of complaint handling performance.

As it stands the C-MeX rewards/penalties are dwarfed by those for financing, ODIs and totex. We are looking for recalibration of the overall risk/reward package between the constituent parts rather than increasing overall upside/downside risk.

We support the introduction of BR-MeX and the retention of D-MeX at PR24. We offer further comments on BR-MeX in our response to question A6.3.

**Q5.5 Do you agree with our proposed approach to estimating marginal benefits for common and bespoke performance commitments?**

Yes. Customer evidence should inform this as well as standard rates (see Q.5.3). Companies should do similar research to inform the marginal benefits of any bespoke PCs they propose.

**Q5.6. Do you agree with our proposed approach to incentivising asset health performance?**

Yes. We support using the same asset health performance commitments as at PR19 (mains repairs, unplanned outage and sewer collapses) but this needs to be complemented with further monitoring and auditing outside the price review to get a more frequent and accurate picture of

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<sup>14</sup> For example, Northumbrian Water were third in the 2020-21 C-MeX results, despite receiving a comparatively high volume of complaints. This was due to their stronger results in the two surveys. This shows that companies may not be sufficiently motivated to reduce complaint volumes.

asset health and operational resilience. This may help avoid the high profile service failures (e. g. pollution) seen recently.

**Q5.7. Do you agree with our proposal to retain, expand and streamline enhanced incentives?**

Yes, but only if there is clear evidence of customer support for paying more in return stretching and ambitious PC targets that must be achieved to earn an enhanced reward. While this could set the bar higher for all companies, customers must find the potential enhanced rewards affordable and acceptable.

We strongly support the claw back of any reward, which has arisen from innovation, if the innovative company has not shared that knowledge with the rest of the industry.

We do not support the removal of underperformance rates which were triggered if a company's performance was below the industry lower quartile level at PR19. To only have outperformance incentives seems to skew the risk and return balance in favour of the companies albeit recognising that customers would benefit at certain levels of outperformance through the proposed aggregate sharing mechanism.

**Q5.8. Do you agree with our proposed approach to selecting performance commitments for enhanced incentives?**

**Q5.9. Do you agree with our proposed approach to setting enhanced thresholds, rates and caps?**

In answer to both questions, yes – but PC targets should be ambitious/stretching, be applied to established PCs where there is past performance to inform the 2025-30 targets, and a commitment by companies to share their good practice if they achieve the targets.

**Q5.10. Do you agree with our proposed approach to knowledge sharing?**

Yes. See Q .5.9.

**Q5.11. Do you agree with our proposal to set caps and collars on a targeted basis, and apply a two-sided aggregate sharing mechanism to all companies?**

We support targeted caps and collars to help protect customers from excessive rewards. We agree that this is more important for new or bespoke PCs where the potential level of outperformance is uncertain. Caps and collars should also be applied where the evidence from the Ofwat/CCW research on customers' values shows that a cap is justified for some areas of service where customers may have placed a lower value on it compared to other areas of service.

**Q5.12. Do you agree with our proposal to not set deadbands on any performance commitment?**

Yes. Deadbands can weaken incentives as a company could potentially avoid penalties by aiming for the deadband range in their performance levels. As the consultation paper outlines, removal of the deadband on statutory compliance PCs would mean companies are financially incentivised to achieve full compliance with underperformance payments to customers in the event of non-compliance.

**Q5.13. Do you agree with our proposed approach to estimating ODI risk?**

Yes. We agree that ODI risk should be managed at an aggregate level across all ODIs, with a mechanism to share net outperformance above a +3% RoRE threshold. The net outperformance sharing should see customers protected from paying excessive rewards by gaining a share if companies are very successful.

We agree that C-MeX, D-MeX and BR-MeX are excluded from this, but on condition that targets for these measures are appropriately high so that greater rewards reflect very strong evidence that customers/retailers are highly satisfied and complaints are low.

**Q5.14. Are there instances where providing greater clarity over our intended approach to incentive rates in PR29 would clearly be in the interests of customers? Please explain why and provide supporting evidence.**

It will be beneficial to look at incentive rates for PR29, especially for PCs that relate more directly to long term strategic aims (e.g. biodiversity, asset resilience). Given the way customer priorities may change over time, and evidence that may emerge from actual performance and ODI results in 2025-30, this should be with the caveat that Ofwat can change approach if new evidence drives this.

**Q5.15. Do you have any comments on our proposed approach to implementing and streamlining payments at PR24?**

**Q5.16. Do you have any wider comments about the ODI framework at PR24?**

In answer to both questions, we support Ofwat's intention to make no exceptions to penalties or rewards due to weather conditions as companies should carry this risk, but question whether in period payments are appropriate for sewer flooding ODIs. As sewer flooding performance can fluctuate each year depending on weather, it may be better to assess net rewards/penalties at the end of period. If a company experiences fewer sewer flooding incidents due to drier weather, it may earn rewards without a significant improvements in its delivery of asset improvements.

We have already seen unexpected changes in circumstances affecting PC measures with the move to an 'end of period' ODI for the common PC that measures Per Capita Consumption, following the effects of the Covid lockdowns in 2020 and 2021. This shows how a PC can be re-calibrated to an end of period assessment where factors outside a company's control can influence the ability to achieve targets.

### **Providing companies with an efficient cost allowance**

#### **Q6.1. Do you agree with our proposed approach to setting efficient expenditure allowances at PR24?**

There are two elements of the proposed approach that we think need attention - the bad debt costs within the retail cost model<sup>15</sup> and the top-down retail cost model.

The single water affordability scheme (single social tariff), is likely to reduce companies' bad debt costs because of the higher numbers of customers potentially benefitting from social tariff support. Ofwat will need to be clear whether companies need to submit retail costs both with and without the water affordability impact on bad debt costs factored in. Ofwat should also seek to understand how companies have calculated that bad debt benefit. Ofwat may want to make its own assessment of the impact of the water affordability scheme on bad debt costs to ensure consistency of approach.

We have some reservations about reliance on a top-down retail cost model and inclusion of atypical costs in modelled costs. Whilst we understand that the top-down retail cost model gave broadly similar results to the bottom-up model, we would be concerned if this resulted in a less granular understanding of drivers behind retail costs. On atypical costs, judgement will need to be made about the likelihood of an atypical event being repeated. Customers should be protected from paying for events that are unlikely to occur again over the course of the price control period.

We agree that Ofwat should not rule out introducing some kind of cap where a company's business plan forecast is lower than Ofwat's modelled cost allowance. While we understand that exposure of these costs could influence the catch-up efficiency for the industry it would be perverse if, at an individual company level, customers paid significantly over the odds.

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<sup>15</sup> Recognising that Ofwat is giving consideration on how to model the impact of deprivation on bad debt costs.

We fully support a two-sided adjustment for cost adjustment claims and agree that where companies fail to provide stretching efficiency targets or poorly evidenced cost adjustment claims then this should prevent them accessing more favourable cost sharing rates.

**Q6.2. What are your views on how we can best align the treatment of third-party costs and revenues?**

We fully support Ofwat's expectation that companies work with third parties and maximise co-funding opportunities where this is efficient to do so. Maximising these third-party revenues means that customers ultimately pay less.

**Q6.3. Do you agree that companies that submit the most stretching and well evidenced business plans should receive the most favourable cost sharing rates at PR24?**

We are concerned that Ofwat's proposals around both the strength of cost sharing rates and determining which sharing rates apply to each company mean that, relative to PR19, companies' with poorly evidenced plans - coupled with poor relative efficiency compared to Ofwat's view of efficient costs - will have more beneficial sharing rates.

While we agree that the most stretching and well-evidenced plans should get more favourable cost sharing rates, this is contingent on Ofwat being able to identify, for a particular company, what is genuinely stretching as opposed to a target well within a company's grasp. Ofwat's intention to rely solely on its assessment of the quality of business plans to determine cost-sharing rates, discontinuing the PR19 'sliding-scale' approach of relative efficiency versus Ofwat's view of efficient costs, seems to make this harder.

While having less cost sharing rates is probably to be welcomed from the perspective of simplicity we would be concerned if the narrowing of the range of outperformance and underperformance rates reduced companies' incentives to deliver well-evidenced and stretching business plans. We expect Ofwat's assurance that its approach will not undermine the existing incentive properties.

The proposal to reduce the strength and asymmetry of incentives for lower quality business plans appears predicated on theoretical reasons that:

- Low sharing rates (of outperformance) may limit incentives for companies to spend efficiently;
- High sharing rates (of underperformance) may mean higher risk impacting efficient financing costs; and
- That high asymmetric cost sharing rates may lead to higher whole life costs (owing to disincentives to invest in the current period).

These arguments seem to be viewed from the downside risk to the company that in a low cost sharing environment they would only retain a small proportion of outperformance, which in a high underperformance environment the risk could increase risk and financing costs ultimately borne by customers.

Theoretical arguments could equally be made that high cost sharing rates could be inefficient as it incentivises companies to spend now regardless of the benefit arising from that spend. With regard to risk and financing costs a low underperformance rate may lower risk and consequently financing costs. We expect Ofwat to take account of these issues in the overall risk and return package.

### **Funding for water companies to maintain good asset health and resilience**

**Q6.4. Do you agree that resilience enhancement should be used to fund companies to manage increasing risks to specific hazards that are beyond their control and not covered by base expenditure and other enhancement areas?**

This is a sensible approach but to safeguard customers from paying twice for the same thing it is paramount that the risk assessment and solution are well evidenced and that there is absolute certainty that expenditure is not covered in base or other enhancement costs. There also ought to be some customer protection mechanism whereby they should not pay to manage perceived risks that then do not emerge to the scale or frequency that were originally envisaged.

### **Delivering service improvements to customers and the environment from expenditure allowances**

**Q6.5. Do you agree with our proposed approach to setting performance commitment levels at PR24?**



**Q6.6. Do you agree with our view on what performance commitments should be set using common or company specific performance commitment levels**

In answer to both questions, we understand the rationale for assuming a common level of performance from base expenditure as the cost drivers inherent in that base cost assessment accounts for the differences impacting the company. Whilst Ofwat recognises that its base cost models will not reflect all drivers of differential performance we think that there ought to be a high evidential bar for any company seeking to change either the level of base expenditure to deliver an expected common level of performance or an adjustment to that level of performance within its base cost allowance.

We agree with Ofwat's basis for setting performance levels in terms of which PCLs are to be delivered from base costs and totex.

We agree that baseline performance for 2024-25 should be on the basis that the PCLs set at PR19 have been achieved. The price limits companies are operating under were set to enable an efficient company to deliver in line with its obligations. If Ofwat does move away from PR19 PCLs as the baseline, by putting more onus on outturn for example where companies have underperformance, there ought to be a very high evidential bar for doing so. Customers will have paid for a certain service delivery. It would clearly not be in their interests to pay twice for the same thing.

**Facilitating efficient investment over 2025-30 and the long term**

**Q6.7. Do you agree with our proposed approach to incentivising and funding efficient investment in reducing greenhouse gas emissions and reducing the use of storm overflows?**

We support Ofwat's expectations that:

- Further improvements are funded through base expenditure during 2025-30.
- Companies deliver enhancement activities in a way that reduces the impact on emissions.
- Companies' enhancement activities are addressing issues that are causing the most harm or risk first.

We are unclear what constitutes a common reduction level for operational emissions and therefore how Ofwat proposes to allow the efficient expenditure to meet this target. We think that Ofwat should be more explicit about how it will take account of companies' different starting points in this regard.

We question Ofwat's assumption that all companies will have no more than 20 spills per storm overflow by 2025, as we think more work needs to be carried out to develop more specific measures of the harm caused by spills, and what constitutes 'exceptional circumstances' for when a spill is acceptable. We expand on this further in our comments on Performance Commitments on page 40.

Ofwat notes that companies have already been funded in current price limits to meet their storm overflow commitments. They have also been funded to investigate whether further reductions are needed in storm overflow spills through enhancement expenditure in 2025-30. From the customer perspective it is essential that they do not pay twice for storm overflows. If companies have received funding but have not delivered their commitments, then companies alone should bear the cost of putting things right.

**Q6.8. Do you agree with our proposed approach to implementing nutrient neutrality in the PR24 regulatory framework?**

No comment.

**Delivering best value**

**Q6.9. Do you agree with our proposed approach to encouraging companies to deliver best value through our cost assessment?**

While we agree with the concept of best value, it will be necessary for companies to assess all potential costs and benefits of a scheme in a consistent way. We completely agree that where companies claim that the additional benefits they have identified most influence the choice of solution, those benefits need to be measurable and robustly demonstrated.

**Q6.10. Do you agree with our proposed approach to removing the potential disadvantage that nature-based operating expenditure solutions may face in relation to the treatment of enhancement operating expenditure?**

We are supportive of Ofwat's desire to facilitate a greater use of nature-based solutions, but the proposals to do this are complex. This desire seems to be borne of a theoretical unintended consequence that long-term, primarily opex based solutions don't provide funding surety beyond a single price control period. What the consultation paper is silent about is the extent to which companies have chosen schemes without an ongoing high proportion of opex because of this lack of surety.

Of the options presented it seems that a ten-year operating expenditure allowance is simpler. Capitalisation of the whole-life operating costs of nature based solutions would need to prevent the distortive impact on cost sharing, the risk of double counting of expenditure in base after ten years and implications for financial metrics.

From the customer perspective it will be important to ensure that there is no double counting. In addition it would be useful to understand any divergence in bills of the alternative approaches.

**Aligning risk and return**

**Q7.1. Do you have any comments on our approach to the overall balance of the PR24 incentive package, our proposed guidance on producing risk ranges, and our view of the balance of risk facing the notional company?**

We are concerned that some of the proposals skew the risk return package in favour of the companies. For example the proposal to expand enhanced outperformance rates and remove enhanced underperformance rates and the proposed changes to the totex sharing regime seem beneficial to companies at the cost of customers.

We welcome the consideration that Ofwat is giving to increasing the financial incentive attached to C-MeX to help focus companies more strongly on the customer experience (see our response to question 5.4).

We think it is premature to rule out asymmetrical ODI rewards as this pre-supposes the outcome of the joint ODI research (see question 5.3).

If the incentive package is deemed to skew returns we agree that any steps to address this ought to be a recalibration of the incentive package rather than to adjust the allowed return on equity.

With reference to companies' 2021-22 APRs, seven companies' financing outperformance exceeds the reasonable upside of 1.05% that is being provisionally considered for PR24. There is a case for companies to share some of this outperformance with their customers in view of the benefit many companies are experiencing as a result of the high inflationary environment.

**Q7.2. Do you agree with our proposals on the regulatory regime for managing companies' exposure to uncertainty over 2025-30?**

We support the changes planned for the reconciliation mechanisms. In particular we are very supportive of a high evidential bar for company-proposed notified items and/or bespoke uncertainty mechanisms.

Ofwat may need to retain the RPI-CPIH wedge reconciliation model should there be a transition to full indexation by CPIH over the course of the 2025-30 period rather than at the outset. It may be that the bill impacts of full transition at the outset, coupled with other competing price pressures, prove to be a significant cost for customers. The use of CPIH transition as a means to alleviate affordability pressures should not be overlooked.

**Q7.3. Is there value in introducing more prescriptive requirements and guidance for company-produced RoRE risk ranges? How might this be implemented for: a. Interactions between performance on cost and service? b. Interactions between performance on different ODIs?**

We can see merit in more prescriptive requirements and guidance as this will strip out methodological issues for divergence of companies' risk ranges.

#### **Q7.4. Do you agree with our proposed approach to setting the allowed return on equity?**

We broadly support the proposed approach to setting the cost of equity. In particular:

- We strongly believe that any company-specific adjustment to return (i.e. small company premium) should only be granted if there is clear evidence of customer support in the absence of any benefits test. We would expect any small company premium would be returned to customers in the event of acquisition akin to the remedy in the case of South West Water's acquisition of Bristol Water<sup>16</sup>.
- We agree with primarily looking at index-linked gilts to inform the risk free rate with no weight given to AAA corporate bonds.
- In the context of beta and de-levering and re-levering, while we recognise Ofwat's preference we think that there is merit in considering setting the notional level of equal to listed comparator gearing.

We will consider commissioning an independent assessment of Ofwat's provisional view of the WaCC from the customer interest angle. There are obviously numerous parameters in the WaCC with multiple calculation methods for some, primary approaches and cross checks, central estimates or asymmetry to consider. Ultimately, the point estimate used at PR24 requires some regulatory judgement. We would encourage clarity and transparency about all these issues in the early view of the WaCC in the final methodology and also at the draft and final determination stages.

#### **Q7.5. Do you agree with our proposed approach to setting the allowed return on debt?**

We support the approach to setting the allowed return on debt.

We agree with the balance sheet approach being the primary source of evidence with a benchmark index cross check. However, Ofwat highlights a number of reasons why an index-based approach may overstate efficient financing costs. In performing the cross-check to the balance sheet

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<sup>16</sup> [Completed acquisition by Pennon Group plc of Bristol Water Holdings UK Limited](#)

approach it will be important to take these impacts into account to ensure that customers do not pay over the odds.

With regard to new debt we agree that customers should not, through any unadjusted indexation approach, pay a premium for financing costs in view of any divergence between the underlying characteristics of companies within the index, relative to the water companies themselves. If Ofwat can evidence that the notional company would issue at a discount to the index, then a discount ought to be applied so the financial benefit does not sit entirely with companies and ultimately their investors.

Were an adjustment to be made we would favour the ex-post method outlined in the consultation as the reconciliations of this approach using outturn data would avoid the risk of the ex-ante approach that the discount applied proves to be too low or high relative to outturn data.

We strongly support the requirement for companies to clearly evidence customer support for any premium on the cost of debt by virtue of company size.

**Q7.6. What are your views on the options we have set out for estimating the RPI-CPIH wedge for converting RPI-linked yields to a CPIH basis?**

We agree with Ofwat's preferred option – the 'official forecasts' approach. Whilst preserving a 1% wedge between RPI and CPIH is arguably simpler, as the consultation document points out this is likely to overstate the size of the wedge particularly in the post-2030 period.

**Q7.7. Do you agree with our proposed approach to the notional structure and setting allowances for corporation tax?**

We support the proposed framework to determine the appropriate capital structure and setting allowances for corporation tax.

## **Financeability**

### **Q8.1. Do you agree with our approach to assessing financeability?**

We support the approach as outlined in the consultation document.

### **Q8.2. Do you agree with the focus on the metrics outlined in section 8.4 for the assessment of financeability?**

We agree that the assessment of financeability should focus on the metrics outlined in section 8.4

### **Q8.3. Do you agree with our proposed approach to cost recovery, in particular that we set a narrow range for RCV run-off rates within which companies will be required to evidence their choice of rate which best achieves a fair balance between current and future customers?**

We welcome Ofwat's proposed approach on RCV run-off. As the consultation document makes clear, planned non-enhancement capex spend was less than the total cost recovery in the PR19 price review period. Ofwat's figure 5.1 shows that cost recovery at PR19 exceeded cost allowance for 15 of the 17 companies. It does not seem appropriate that customers foot the bill for companies then not to use that money to maintain the long-term capability of their assets.

The range in run-rates at the last price review (3.7% to 7.1%) was very wide. We think that an Ofwat-specified narrow range for run-off rates is reasonable. This should seek to equalise planned spend versus cost recovery.

We agree that where companies are seeking to change PAYG and RCV run off from their natural rates their reasons for doing so should be made explicit. In this regard, we wonder whether there is any merit in taking customer views into account.

Whilst it is obvious from Appendix 10 that assuming full transition to CPIH at the outset of the 2025-30 price control benefits financeability indicators (in particular ACICR) there are also implications for bills. With the suggestion that this transition could add up £12 on bills the impact is significant for some companies and their customers.

Against other price pressures at PR24 we emphasise the need to keep the speed of transition under review and welcome Ofwat's commitment to take stock of any implications for the impact on customer bills and consider whether any mitigations would be appropriate. What the consultation does not make clear is the extent to which any financeability interventions at PR19 would have been avoided with an assumed full transition to CPIH and what that net bill impact might be i.e. impact of full transition less any avoided financeability support.

### **Promoting financial resilience**

#### **Q9.1. Do you agree with the proposed standard set of scenarios for testing financial resilience?**

We agree with the standard set of stress tests as outlined. We wonder if there is any merit in specifying the combinations of scenarios that companies should stress test rather than leaving it to the companies.

#### **Q9.2. Do you agree with our approach to how the board of the company should approach its board assurance statement?**

We agree with the approach.

#### **Q9.3. Do you agree with our proposed approach to dividend policies, performance related executive pay and voluntary sharing of financial outperformance?**

With regard to the call for companies to promise a fair share of outperformance we welcome Ofwat's intention to assess the voluntary sharing arrangements as part of the ambition assessment of business plan incentives. We have been a strong advocate of companies sharing outperformance with customers especially in those areas where there are currently no sharing mechanisms. This is particularly the case where outperformance arises because of a regulatory assumption.

In terms of the business plan incentives we would see voluntary sharing arrangements as a pre-requisite to getting outstanding status. We would like the final methodology to state that it will view companies that have already shared outperformance with customers, especially via extra help to



those struggling to pay, more positively than companies that haven't. Companies' past performance on issues should be strongly accounted for when business plans are assessed.

On dividends we strongly support the non-operational outperformance gained in a high inflationary environment (particularly for those with a large fixed-debt component) ought to be retained or reinvested.

While it is important that companies explain their dividend policies covering 2025-30 including delivery of obligations and commitments to customers, communities and the environment it is also important that companies are transparent about these considerations in relation to actual dividends paid. As our work and Ofwat's monitoring financial resilience report noted, there is scope for companies to significantly improve in this regard. We think a consideration at future reviews around business plan incentives ought to be how transparent companies have ultimately been with regard to dividends paid.

These considerations are equally relevant to executive pay. Companies need be transparent about how executive pay links to performance including delivery of obligations and commitments to customers, communities and the environment.

### **Companies' PR24 submissions**

#### **Q10.1. Are the PR24 submission requirements clear and sufficiently specified?**

Yes. While business plans are often written by companies with Ofwat as the primary 'audience', companies should be accountable to the public too, so we welcome guidance to help stakeholders and customers more easily navigate and understand the plans.

We particularly support the requirement for summary narratives, guides to reading the plan and clear, succinct commentaries to explain the evidence behind the proposals.

#### **Q10.2. Is any data missing, or included but not required or areas we need to look at again?**

#### **Q10.3. Are the limits on the number and size of documents workable? Should we be more prescriptive in terms of file and folder structures etc.?**

No comment on the 2 questions above. This is relevant to companies only.

**Q10.4 Do our expectations for company board’s assurance and governance arrangements provide enough guidance to ensure that boards have sufficient level of ‘ownership’ and so ensure a high quality submission?**

Yes. This is clearer guidance to the area of the plan where the Boards should give assurance than used at PR19. As we explain in the executive summary, we're asking companies to show a commitment to putting their customers' first, at all organisational levels, and demonstrate how they are developing a positive company culture. The evidence of assurance and governance included with the plan should demonstrate that at Board level, companies are showing how they are focused on understanding and delivering current and future customers' needs.

We particularly want to see Board responsibility for assuring that the plan is affordable for customers, and will deliver outcomes reflecting customer engagement evidence. This will help Boards focus on customer priorities and help companies' maintain and evolve a customer-focussed working culture.

**Q10.5. Do you agree with our proposal to continue to apply revenue adjustments for past performance across all years of 2025-30, after the financeability assessment?**

We agree that revenue adjustments for past performance ought to be applied after the financeability assessment. This guards against any potential revenue reduction resulting from past performance being compensated through the financeability assessment.

**Q10.6 Do you agree with our proposal for 2024-25 blind year adjustments? Should we treat in period ODI adjustments in the same way as other blind year adjustments or retain the approach set out in the Rulebook?**

We see merit in using the in-period adjustments model for in-period 2024-25 ODIs. This would mean an adjustment to revenues in 2026-27. If Ofwat used forecast performance for 2024-25 it may lead to a need to change this on account of forecasting inaccuracy.

We support companies having some discretion over the proportion of blind year adjustments to be recovered in each year of the 2025-30 period. It will be imperative, as the consultation recognises, that the resultant bills and profile of bills are aligned to customers' preferences. Our research has shown that customers prefer stable bills.

**Q10.7. Do you have any comments on how to best deal with the impact of shadow and non-shadow reporting in table BIO3 on other tables?**

No comment.

**Q10.8. Do you have any comments on the data we should collect in table BIO5?**

No comment.

**Encouraging quality and ambitious business plans**

**Q11.1. Do you agree with the framework we propose to encourage the best business plans? Specifically, do you agree:**

- **That we should first assess 'quality' followed by 'ambition'?**
- **With our proposed allocation of rewards and penalties for performance on each?**

No, we think the scope of what is taken into account in the assessment should go further (our recommendations are set out in the answer to Q11.2 below).

We think 'quality' and 'ambition' should be assessed alongside 'understanding and delivering for customers' and 'sharing good practice'.

We have no issues with the calculation of rewards and penalties for each assessment, but there should be additional weighting given to the additional criteria we suggest below in response to Q11.2.

**Q11.2. Do you agree with the proposed scope of our 'quality' assessment? Specifically, do you agree:**

- **We should have minimum expectations in the six areas described above?**
- **With the minimum expectations we specify in each of the six areas?**

No, this should go further. We agree that Ofwat should assess the following business plan quality and ambition criteria:

- Data, information and assurance.
- Long term delivery strategy
- Customer affordability and acceptability
- Costs
- Outcomes
- Risk and return

But it needs to go further to give customers a stronger justification for any plans assessed as standard or above, specifically:

- Past performance for customers: How well companies have delivered their commitments in the previous price control period for customer priorities should be taken into account. Otherwise a company with a poor performance in delivery could gain a reward for a high quality plan. There should be confidence that company can deliver their commitments, and taking into account past performance can achieve this if a company has delivered well for customers.
- Innovation and good practice: Companies should demonstrate that they are proposing innovations for service delivery that offer improvements for customers and the environment. They should also demonstrate good practice in terms of how effectively they have engaged customers, reflected this evidence in their plans and long term strategies, and shared their good practice with their peers. This should include good practice in promoting customer behaviour change in helping reducing demand, as well as operational good practice.

The additional criteria above (along with the existing criteria proposed by Ofwat) will be a greater assessment of how far the company's working culture is focussed on understanding and delivering for customers – as well as how ambitious and efficient it will be in the price control ahead. If the additional criteria we suggest are added, this could lead to a stronger justification for standard or outstanding plans.

**Q11.3. Do you agree with the proposed scope of our ambition assessment?**

We agree that companies should have stretching levels of service at an efficient cost to customers. This should reflect evidence of household and business customers' expectations of service from meaningful customer engagement. While Ofwat make reference to customer evidence underpinning proposed service delivery targets, this should be emphasised in the final methodology.

**Q11.4. Do agree with our proposed reputational, financial and procedural rewards and penalties, including the overall package of reward and penalty?**

**Q11.5. Do you have any other comments regarding our proposed approach to business plan incentives at PR24?**

In answer to both questions, we agree that offering a financial incentive for high quality business plans should encourage companies as a reputational incentive only may fail to achieve this. However, it is unclear what customer bill impacts are implied by the range of +10/+30 bps return on regulated equity for standard/outstanding plans proposed at PR24 and would welcome Ofwat confirming this. It is essential that customers receive good value from incentives offered to companies.

## **Appendix 6: Performance Commitments: Customers receiving excellent service every day**

### **QA6.1. Do you have further views on whether the proposals laid out for C-MeX are appropriate?**

No. We are disappointed that Ofwat propose only minor adjustments to C-MeX when there is an opportunity to strengthen this incentive to drive improvements in the customer experience and reduce complaints, which contributes to a more customer focused company culture.

As per our response to question 5.4, we would like to see:

- A greater value of C-MeX out/under performance payments as this will strongly motivate companies to improve the customer experience.
- A stronger weighting for the complaint volume as there is a risk of companies with high customer satisfaction but with high complaint volume getting rewards. This should be done by including complaints as a component of the main C-MeX score, as opposed to a gateway to higher rewards.
- Companies demonstrating in their C-MeX reporting that they understand and are addressing reasons for dissatisfaction express by customers in the two surveys.

### **QA6.2. Do you agree that C-MeX needs to adapt to provide better service to vulnerable and worse served customers?**

Yes. As we suggest in our response to question 5.4, this can be achieved through adding a metric to C-MeX to cover repeat customer contacts on water supply interruptions, sewer flooding and low pressure. This could reveal the extent to which companies' are responding to the needs of customers who are worst served and more vulnerable as a result.

### **QA6.3. What are your views on our proposal to introduce a single, combined common performance commitment ('BR-MeX') capturing the experience of both end business customers and retailers as intermediate customers?**

BR-MeX should motivate wholesalers to serve business customers and retailers well, and could help address the causes of the high level of customer billing complaints in the non-household retail market. A high level of retailer satisfaction should reflect effective data exchange and other relationships between wholesalers and retailers which should benefit customers.

While the measures and definitions for BR-MeX are yet to be developed, we think that surveys with a sample of business customers and all retailers would provide the measures of satisfaction needed.

The retailer survey should focus on retailers' satisfaction with their interactions with wholesalers, particularly on process and data exchanges that most affect customer billing activities. CCW has had input to the design of the current retailer survey, which can be used for this new incentive.

Consideration of the weighting of each measure should be given in terms of the potential financial value of the associated ODI. It may be possible for a wholesaler to achieve a higher score on the retailer satisfaction measure, with a lower score on the business customer satisfaction measure, and still qualify for an outperformance payment (and vice versa). This could happen if a wholesaler's relationship with their retailers is good, but they are comparatively poor at handling direct customer contacts. To avoid this scenario, a high threshold for outperformance targets should be set for each measure with both needing to be reached in order to trigger the payment.

We will be happy to work with Ofwat in developing these measures.

#### Business Customer experience in Wales

Even if Wales does not have the same water retail market for business customers as England, we think it is important to retain the business customer experience PC for Wales at PR24. The company-delivered business customer satisfaction survey could use some of the same questions as the business experience survey in England, to allow a degree of comparability. This measure should also be compulsory in Wales from PR24.

To gain a more in-depth picture of how well business customers are served and their level of satisfaction with the service provided, for the customer research in England and Wales, there could be a move toward a more qualitative approach (used alongside the quantitative surveys). We would welcome further engagement with Ofwat and stakeholders on the potential benefits and practicality of moving to this approach.

**QA6.4. Do you consider evidence suggests that the current water supply interruptions performance commitment is inhibiting innovation? If so please provide it.**

We understand the arguments from Yorkshire and UU that the majority of companies continue to use open trenching techniques for mains repairs rather than trialling new techniques which they are concerned could take longer to resolve interruptions.

PCs should work together as a package and complement each other. The new proposed PCs for reducing greenhouse gas emissions and the measures for reducing leakage should encourage companies to try new techniques for addressing supply interruptions (planned and unplanned), with companies challenged to find approaches that could also reduce duration of supply interruption. The requirements of all three measures could see customers benefit if targets are achieved, so we think the three PCs give sufficient incentive for companies to improve.

**Appendix 6: Performance Commitments: Environmental**

**QA6.5. Do you agree with our proposed definition for the biodiversity performance commitment?**

While we welcome the intention to measure biodiversity performance in a consistent way in England and Wales, this PC needs to be practical and further development is needed before it can be finalised.

There are several issues to consider:

- With a financial ODI in place to drive the biodiversity PC, outperformance payments will need to be timed appropriately enough to be an incentive but not too early so that companies are not inadvertently dis-incentivised to deliver what in many cases will be long term programmes.
- The proposals in the methodology paper are based around rewarding water companies for increasing habitat only. While this is a limited activity, Ofwat's proposal to introduce long-term Price Control Deliverables for companies' environment programmes means other regulatory tools will be in place to track delivery of the full range of schemes that should protect and enhance biodiversity. This means the ODI will, essentially, be a reward for

discrete net biodiversity gain while the Price Control Deliverable will assess decades of value.

- Companies should not benefit if they are rewarded for taking action on land that they subsequently sell (especially if that means they relinquish control over the quality and use of the land), so there needs to be a mechanism to ensure that benefits that they are rewarded for are benefits that actually last.
- There also needs to be absolute clarity about the requirements. At the moment, it is not clear at all what level of evidence might be required to assess whether a site has improved. While some companies have hundreds, if not thousands, of sites, it should be a company's core activity to understand the environmental impact of its activities, so companies should have a range of data to both strengthen this PC and report on asset performance under Ofwat's new monitoring regime.

We support using the already established Ofwat Outcomes Working Group as a platform for further engagement with stakeholders to address these issues ahead of the final methodology in December 2022.

**QA6.6. Do you agree with our proposal to have separate operational greenhouse gas emissions performance commitments for water and wastewater, which are based on a normalised measure?**

Yes, as this will give transparency of the emissions for each separate chain of the business for water and sewerage companies, as well as water only companies.

**QA6.7. Do you agree with our proposal that the performance commitment on serious pollution incidents should only apply to water and wastewater companies?**

Yes, as pollution can come from both water and wastewater assets, so it's important that the impact of both sets of assets are measured.

As per our response to question 5.3, when considering the ODI to be applied to this PC, Ofwat should take account of the current customer value research which will be used to inform rates. This could reveal that customers place a greater negative value on pollutions caused by company



failures, compared to the value of the benefits of improved performance to reduce or avoid failures . If this is the case, this would justify higher value penalties compared to rewards – or possibly having a penalty only ODI. In customers' perception, it may be unacceptable to reward companies for improved performance if there are still pollution incidents.

There is also a risk of customers paying two rewards for the same benefit if a company outperforms both targets. This is a particular concern as Ofwat proposes an enhanced ODI for total pollution incidents, with the intention that by achieving leading performance, a company can raise the benchmark for all companies.

To avoid the risk of customers paying two rewards, the serious pollution incident PC could carry a penalty only to discourage failure, while companies will still be able to gain standard (and possibly enhanced) rewards for the total pollution incidents PC – but only if the research shows customers place a value on improve performance. The risk of higher penalties for serious pollution incidents should help ensure companies target the highest risks first, without discouraging work to reduce all pollution.

**QA6.8. Do you agree we should focus the bathing water performance commitment on the outcome that customers have received and should continue to develop an alternative definition to do this?**

Yes, and the Ofwat Outcomes Working Group can be used to develop the definition in collaboration with stakeholders. Ofwat's new asset monitoring framework could be used to gather supplementary data on bathing water quality at asset level, while the PC measures progress toward the outcome.

**QA6.9. Do you agree with our proposal for the river water quality performance commitment to measure the reduction of phosphorus entering rivers?**

Yes in principle. However, it is difficult to see how any measure can differentiate between phosphorus originating from wastewater treatment works and from other sources. As phosphorus removal at water treatment works can be carbon and cost intensive, we support companies working with landowners to address pollution at source through nature based solutions where this can be shown to be a more sustainable and cost beneficial option.

## **Appendix 13 – Data and modelling**

### **QA13.1. Do you agree with our proposed approach to mechanisms at PR24?**

We think that Ofwat should be developing an additional model to accommodate the financial flows into and out of a fund to support the single water affordability scheme (single social tariff). In this regard we see the funding model for the existing innovation fund as a useful starting point. We see benefit in working out now how the financial flows could work so it benefits from earlier consideration than the model/method underpinning the innovation fund at PR19.

We note that consideration is being given to removing GOSM at PR24 in view that proposals to strengthen the regulatory ring-fence could better protect customer interests but Ofwat retains the right to apply an incentive-based mechanism if companies' progress is not as envisaged. We support this.

It is apparent from some companies APRs that the high inflationary environment in 2021-22 lead to financial rewards for some companies where their nominal interest is higher than Ofwat's 6.27% nominal cost of equity. This means that the gearing outperformance sharing mechanism (which implied an asymmetric risk/reward) is also, in a high inflationary environment, an underperformance sharing mechanism. Whilst we understand that Ofwat has issued guidance to companies that GOSM should not result in a return to shareholders, we are not convinced that companies have applied this consistently in their APRs.

We would obviously be concerned if GOSM created perverse incentives to increase gearing and, if GOSM is to continue beyond PR24, it ought to be addressed in any GOSM model. Where companies are reporting a return to shareholders through the operation of GOSM in the 2020-25 price control period, Ofwat should ensure that customers do not foot the bill.

### **Price Control Deliverables and Common Performance Commitments**

In addition to the responses to the questions above, we have further suggestions and comments on the new Price Control Deliverable proposals, and some of the revised common Performance Commitments.

## **Price Control Deliverables (PCDs)**

We welcome the proposal as a way of tracking, and making companies accountable for the delivery of schemes (or programmes of schemes). This will help CCW and other stakeholders see how well companies are delivering their commitments.

As part of the set of PCDs, there should be a commonly applied measure to track the delivery of asset maintenance allowed through base costs. This is because it was unclear in previous price determinations what specific cost allowances were made for water and wastewater asset maintenance.

While the common PCs on leakage, mains repairs, unplanned outages and sewer flooding show how companies are progressing towards their performance targets, a PCD tracking asset maintenance will give further transparency as to how well companies are maintaining assets effectively and efficiently in the cost allowance they have been set, helping CCW challenge companies where asset maintenance is not on track.

## **Specific Performance Commitments**

We have comments on the following specific PCs in addition to our responses to questions 5.1 to 5.6 and the questions raised in Appendix 6. This covers PCs that were not raised in Ofwat's questions.

### **Sewer flooding (internal and external)**

As the draft methodology acknowledges, CCW supports the development of a measure of consequence to complement the measures for the number of internal and external flooding incidents.

While we accept that the joint working with Water UK has led to proposed categories of consequence that may not accurately reflect the actual consequence in all cases, we would like to see further engagement from Ofwat with stakeholders to look at how to make this work.

The weighting given to individual flooding incidents based on consequence could be set by:

- a. Evidence of the property occupier's view of the severity of the event.

Whether it is a repeat incident. Sewer flooding incidents that have occurred at a property more than once should be measured as having had a greater consequence on the property occupiers. We agree that companies should continue collecting data on consequence and would like Ofwat to

continue its engagement with the Outcomes Working Group to develop a consequence measure for PR24, as at present the PC metrics have no differentiation between incidents with a minor impact on property occupiers and ones that have a major impact.

### **Storm overflows**

While we support a common measure to track storm overflows, we question whether the proposed metric is appropriate to measure the harm caused by spills and incentivise the delivery of improvements in the right areas.

While measuring the average number of spills per overflow meets the Defra requirement for tracking spills<sup>17</sup>, this needs to be a starting point for a journey towards reaching a siltation where only spills in exceptional circumstances are permitted.

The following issues should be taken into account in developing the new common storm overflows PC further:

- Further consultation on what now constitutes ‘exceptional circumstances’ given changing weather patterns. Spills that are currently regarded as ‘exceptional’ but actually occur frequently calls into question whether this should be classified as exceptional. We would welcome further work between Ofwat, the Met Office, companies and stakeholders to review and revise the definition of ‘exceptional’ to be used for this measure as the companies aim for the long term outcome the UK and Welsh Governments require.
- Measuring the average number of spills only may not give an accurate picture of the harm caused to rivers and bathing waters. We would like to see the storm overflow measures expanded to consider how to consistently track where overflows are spilling into more sensitive waters. Separate reporting where spills are occurring in more environmentally sensitive locations<sup>18</sup> will help show to what extent the most harmful spills are being addressed as a priority.
- The measure also looks at the average number of spills per overflow. There is a risk that the average could mask where companies could be choosing to remove less harmful overflows that are easier to address with possible lower costs in order to bring the average down, while the more harmful (and potentially more costly) overflows are not addressed. An additional measure to report overflows in sensitive areas may help reduce this risk.

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<sup>17</sup> In the context of the long term target to reach 20 spills per overflow p.a. by 2050

<sup>18</sup> For example, designated areas that require protection and higher environmental standards under Government/regulator frameworks

- Measuring the average number of spills could disincentivise companies from removing some storm overflows altogether, as a more infrequently spilling overflow may help keep the average number of spills at a low level.
- The level of harm caused by the level of pollution detected from spills into river/bathing water can be defined from water testing after spill events. Some spills are diluted and cause less harm than others, though we recognise that a consistent measure that is easy to apply is currently a challenge. There may be benefits in developing greater correlation between the bathing water and river water quality PCs and the storm overflows PC.
- Companies should also be encouraged to develop lower carbon nature based or partnership based solutions with landowners to reduce the level of surface water entering the sewerage system, which contributes to storm overflows. In Wales, the design of the new sustainable farming scheme presents opportunities to incentivise such collaborations. While these options (when successful) can deliver a lower cost and more sustainable solution, they can be riskier in terms of delivery timescales but should be encouraged as an innovation.

We are supportive of exploring proposals for alternative storm overflow PCs such as those presented by Dŵr Cymru Welsh Water and the Wales taskforce with an emphasis of impact on water quality impact rather than the number of spills. These additional measures to complement the 'number of spills per overflow' should be considered as to address the points raised above as the design for an England and Wales storm overflows PC is developed further.

Reducing spills should lead to environmental benefits that show customers that they are getting improvements they can value in return for the cost. We would like to see further consideration of these additional measures and support Ofwat's commitment to continue working with stakeholders to develop the storm overflows PC further.

### **Business demand**

We support a new separate PC across England and Wales to track business demand based on the percentage reduction of three year average business demand in MI/d from the 2019-20 baseline (consistent with the business demand reporting for Water Resource Management Plans).

This added transparency should act as evidence to help encourage wholesale companies to work with retailers in reducing business demand and increase water efficiency where possible.

As with all other PCs, we want to see companies propose ambitious targets in their plans with a description of the activities they will undertake to achieve this, including how the wholesale companies intend to collaborate with retailers to reduce demand.

This should be based the assumption that wholesalers will continue to be responsible for meter assets. Companies should also include an explanation of their strategies for increasing the roll out of smart meters to non-household premises, in a way that addresses customer demand for smart meters, and increasing smart meter penetration in areas at risk of water scarcity where the enhanced data collection will be highly beneficial.

We also recommend that business demand from customers consuming more than 50 mega litres a year should be measured separately, not excluded from the business demand measure altogether.

While we recognise that the behaviour of the largest water users, for example due to expanding or reducing production, could dwarf the impact of greater water efficiency of smaller businesses in overall business demand, we see value in measuring 50 megalitre+ users' level of demand to gain a full picture of business demand trends over time and the effectiveness of companies' work to increase water efficiency.

## **Enquiries**

Enquiries about this consultation should be addressed to:

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