

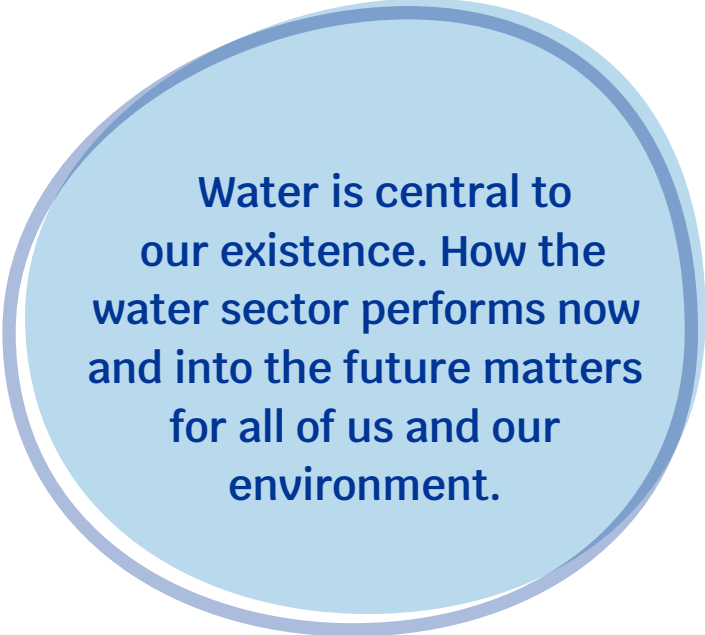
July 2022

Creating tomorrow, together

# **An overview of our consultation on the methodology for PR24**

**Ofwat**

## Creating tomorrow, together



**Water is central to our existence. How the water sector performs now and into the future matters for all of us and our environment.**

We've listened to people's concerns and ambitions for the water sector. We understand the urgency of the environment and climate change challenges, and that customers need reliable and resilient services. We're also conscious of the pressure on people's finances, and the need to find new and innovative ways of delivering now and into the future.

We have set out our proposals to drive companies to deliver value for customers and the environment, and to meet four key ambitions for PR24:

**Focusing on the long term** with stronger adaptive planning to deliver the right investment to meet immediate and long-term challenges when the future is uncertain, as well as holding companies to account for the improvements that they need to deliver

**Reflecting a clearer understanding of customers and communities** with open meetings on companies' plans, more robust research to ensure customers' voices are heard and better understood, and wider engagement with partners.

**Delivering greater environmental and social value**, including by acting immediately on river water quality, moving faster towards net zero, and working differently to deliver more catchment- and nature-based solutions.

**Driving improvements through efficiency and innovation** innovation and rewarding companies that produce the most ambitious business plans to meet the challenges facing the sector.

We welcome feedback from all stakeholders by 7 September 2022. We will take account of these views, and we will finalise the methodology for PR24 in December 2022.

## What happens in a price review

### Companies

work with their **customers and communities** to develop a five-year business plan, set in the context of a long-term delivery strategy which looks at the next 25 years. Companies' plans must deliver their legal obligations, including for drinking water quality, and the environmental improvements set by the **Environment Agency** and **Natural Resources Wales**.

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sets the framework for the review, in line with priorities set by the **UK and Welsh Governments**. We scrutinise and challenge companies' plans and we set the price, service and incentive package for the next five years. We encourage companies to set new standards of what can be achieved, and push the whole sector forward to deliver great outcomes at prices customers can afford. We then monitor performance and hold the companies to account for the outcomes they deliver.

### Customers

fund each company to be prepared for the future and to deliver key outcomes. These include core services for customers and their obligations to improve the environment and tackle climate change.

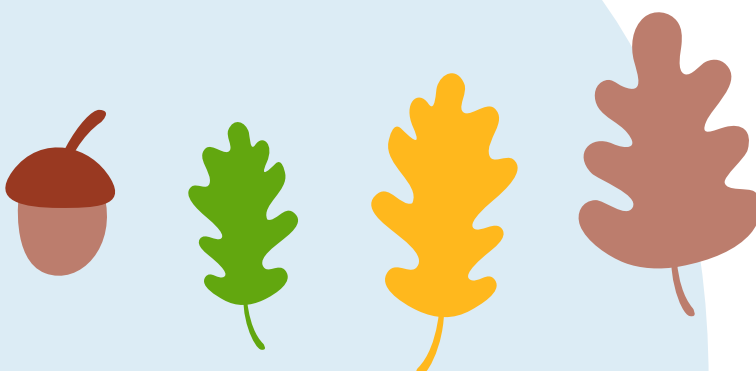
## Focusing on the long term

Tackling climate change, cleaning up our rivers, securing our future water supplies and enhancing biodiversity are all challenges that require action now to deliver the environment we all want for future generations. Companies will set their business plans for 2025–30 in the context of clear delivery strategies for the next 25 years. These strategies will focus on the long-term improvements needed, in line with the priorities set for Ofwat by the UK and Welsh Governments.

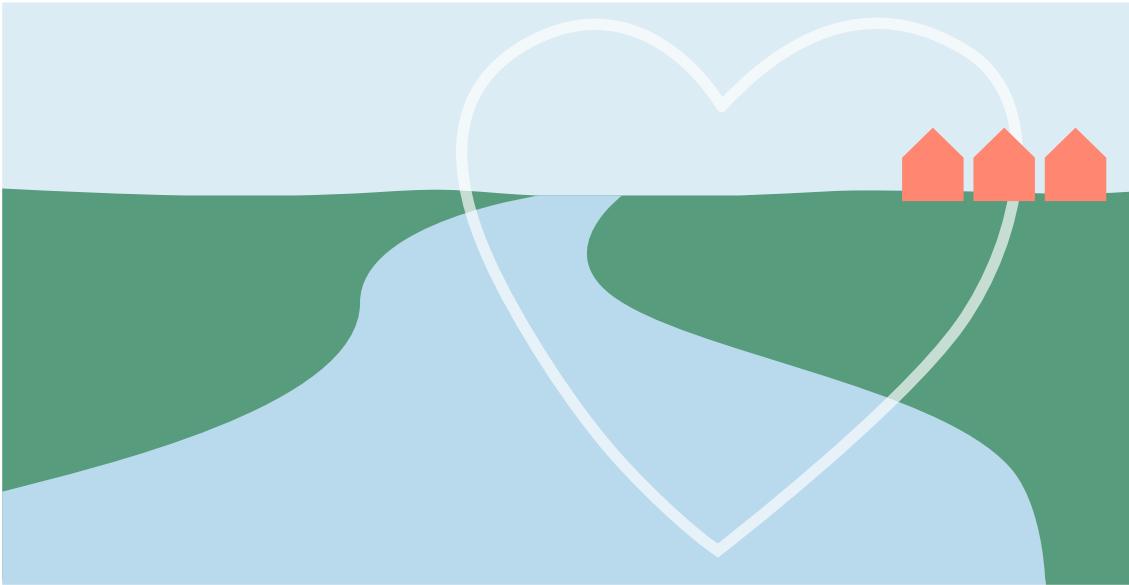
Our approach in the price review will mean that customers' money can be spent well to deliver what is needed over the long term. Funding will support adaptive planning by companies – supporting work for investment that is needed now, as well as keeping options open for the future when better information might reveal the best value solution. Avoiding costly approaches that turn out not to be needed means that more money can be spent on solutions that will deliver tangible benefits.

Price controls already provide a great deal of long-term certainty for water companies, particularly when compared to unregulated sectors. We are building on this in PR24. We are focusing on the outcomes that matter most to customers, and we're going to keep focusing on these into the future. We'll use financial incentives to align the interests of companies and investors with what's best for customers, communities and the environment. And we will continue to hold companies to account, and reward great performance into the future, by ensuring that future price reviews reflect what companies have promised at PR24.

Our approach will allow companies to invest now in improvements that will benefit future generations. And we'll ensure that the costs of these improvements are shared fairly between current and future customers. We propose to steer companies more strongly to ensure that the costs recovered in 2025–30 reflect a reasonable balance between current and future customers. And we will use incentives on business plans to reiterate our expectations that companies' dividends and approach to executives' performance-related pay should reflect how well they deliver for customers, communities and the environment.



## Delivering greater environmental and social value



Water companies are key long-term members of their local communities. They provide essential services to people and organisations in their areas, and they can have a profound impact on the environment.

This price review will push companies to do better across a range of key issues, particularly on the environment. We will incentivise company performance on biodiversity, carbon emissions, water use, storm overflows and impacts on rivers and bathing water. Our approach in PR24 will provide greater certainty about the funding for nature-based solutions and other alternatives to traditional, capital investment heavy, choices. Companies need to step up, be ambitious, and deliver affordable, best value solutions.

We want to see companies making rapid progress on the operation of storm overflows. In advance of PR24, several companies have responded to our calls for improvements in river quality and storm overflows. We expect all companies to at least match the most ambitious commitments offered and to improve performance by 2025. PR24 will then drive further improvements from this higher standard.

We are also challenging companies to identify the most impactful, best value solutions towards net zero. We propose to make additional funding available to the most efficient companies, to allow them to go further, faster, to reduce emissions. And overall, the environment and all customers will feel the benefits more quickly as these innovative solutions will then set the standard for the whole sector to adopt.

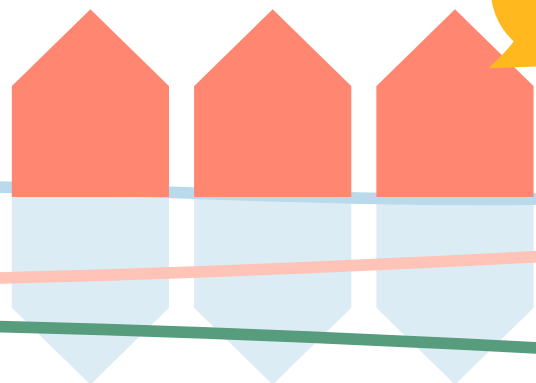
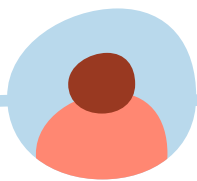
## Reflecting a clearer understanding of customers and communities

Business plans need to reflect the expectations of customers and communities for the services and benefits the company will deliver, and the cost of those services. Our ambition is that residential and business customers' voices are heard more directly and more effectively in PR24 than ever before. Closer, more transparent engagement will also be vital to address urgent challenges such as driving down water demand, which require much more effective partnerships with customers and communities.

Working with the companies and CCW (the voice of the water consumer), we've developed targeted cross-sector research to reveal customers' relative priorities and views on the outcomes that companies need to deliver. Having robust and comparable company-by-company information about customers' views will help us to make decisions that better reflect the needs of customers and communities.

We will also ensure that customers and other stakeholders can comment directly on companies' plans. We plan to introduce open challenge sessions which will give customers and stakeholders a chance to share concerns and ask companies questions. Companies will need to demonstrate that their plans are affordable, including for those struggling to pay. And reflecting the specific circumstances and ways of working in Wales we are taking forward a new collaborative approach. We are engaged in the new Wales PR24 Forum that will enable Welsh stakeholders to identify key high-level outcomes and priorities for the sector in Wales.

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## Driving improvements through efficiency and innovation

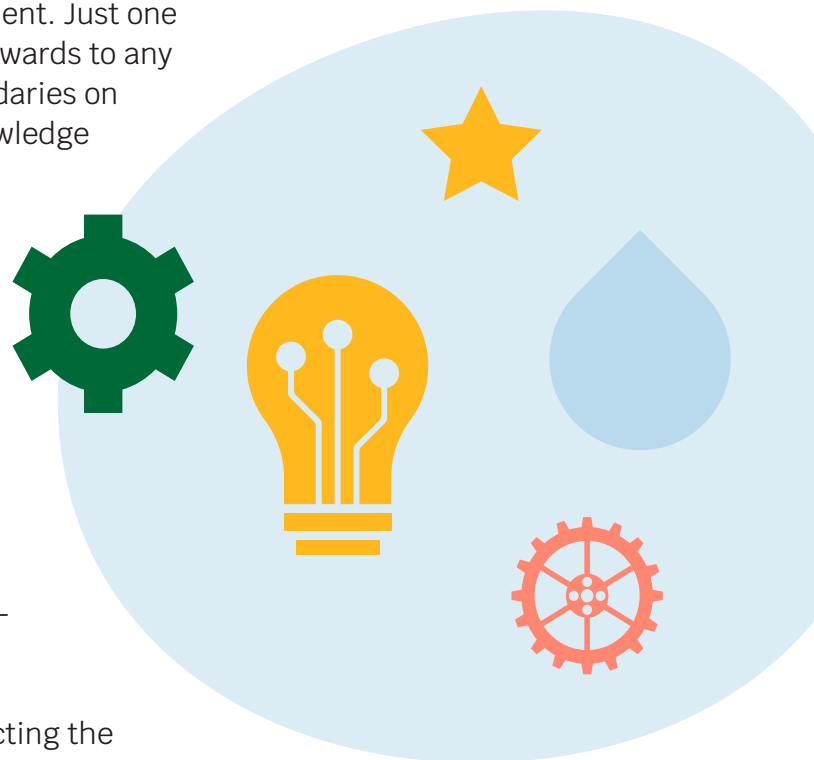
Companies need to innovate constantly to achieve the best outcomes for customers, communities and the environment at a cost that people can afford. PR24 will ensure that customers do not pay more than they need to, and reward only those companies that are ambitious and deliver great outcomes.

We will do this by setting stretching but achievable performance standards for the whole sector. And we will encourage companies to go further through simple and powerful incentives to deliver better performance where it is in the interests of customers, communities and the environment. Just one example is a new approach to offer greater rewards to any company that exceptionally pushes the boundaries on performance, provided that it shares the knowledge gained with the rest of the sector.

At PR24 we will continue to expect companies to work in different ways to achieve more. We will incentivise companies to work in partnership with others where appropriate to identify better, more holistic and sustainable solutions. We propose to continue using development funding to drive more progress on the delivery of strategic water resource solutions. And we intend to extend our Innovation Fund to support sector-changing ideas and ways of working.

We will use markets where appropriate, reflecting the UK and Welsh Governments' strategic priorities. We intend to make more use of direct procurement for customers for large infrastructure projects to deliver more efficient financing costs, and we will incentivise companies to manage the process well. PR24 will also introduce more scope for innovation in developer services and bioresources to deliver more for customers.

And we are proposing to conduct the price review process differently. In addition to streamlining our approach to outcomes and business plan incentives, we are cutting the determination stage from three phases to two. We expect companies to provide quality and ambitious information up front in their business plans. We will penalise those that fall short, as well as rewarding those that show the most ambition. Overall, we expect these changes to allow everyone to focus more on what really matters to deliver better outcomes for customers, communities and the environment.



**Ofwat (The Water Services Regulation Authority)  
is a non-ministerial government department.  
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