**Registered Office**:
Portsmouth Water Ltd
PO Box 8
Havant
Hampshire PO9 1LG

Tel: 023 9249 9888
Fax: 023 9245 3632
Web:
www.portsmouthwater.co.uk

David Black
Chief Executive Officer
Ofwat
11 Westferry Circus,
Canary Wharf,
London E14 4HD

06 September 2022

Dear David,

**Creating Tomorrow, Together: Consulting on our Methodology for PR24**

Thank you for the opportunity to contribute to the consultation on the methodology for PR24.

We are supportive of the objectives Ofwat are looking to achieve through the methodology and can see real progress in terms of industry consultation and engagement. While we accept the need for firm and robust regulation, the scale of the challenges we face means that collaboration across the sector is increasingly important.

The greater focus on the long term is a welcome build on the progress made at PR14 and PR19 reviews. Given the scale of the challenges we face, we recognise the need for reform to meet the investment needs whilst at the same time ensuring bills remain affordable for all; most of all we need to maintain strong confidence in the sector.

We have provided a full response to the consultation but I thought it helpful to highlight five key points where we would welcome further consideration and detail ahead of the final methodology:

1. We caution on delaying investment decisions and passing risk onto future generations; we think reform is required to tariff structures to enable higher levels of investment whilst at the same time protecting vulnerable customers such that water is affordable for all.

2. We support the simplification and focus on common performance commitments and see benefits from centralisation of customer research. We advocate that regional results should be considered as part of the research and believe it is vital that our customers feel the plan reflects their local priorities.

3. We support the greater focus on financial resilience but emphasise that this needs to be supported by adequate returns so efficient companies can deliver their plans and support the additional investment required to address future challenges. In our case

having confidence in stable returns is key as we deliver a critical piece of national infrastructure in the Havant Thicket Winter Storage Reservoir.

4. We are concerned about the impact wastewater environmental issues are having on the sector and the risk this poses to Water Only Companies. We think that it is important that consideration on investment and rewards for water and wastewater services are balanced and equitable.

5. We would advocate that consideration is given to whether a water only company notional structure is required to reflect difference in cost of embedded and new debt for smaller water only companies alongside the provision for specific company premium.

We welcome the opportunity to further contribute to the development of the framework for PR24. We hope our continued central role in regional water resources through the development of Havant Thicket illustrates the scale of Portsmouth Water's ambitions for the future and also refer you to our recent publication outlining our vision and ambition for the next 25 years sent to you under separate cover.

Your sincerely,

**C R Taylor**
**Chief Executive Officer**

### ***Response to key discussion areas***

*Regulating through the price review*

We are supportive of retaining the building blocks from PR19 and building on the successes of recent price reviews but welcome the greater focus on long term. The impact of the cost of living crisis on our customers is a real concern but we caution against this leading to short termism and delays to investment decisions and in doing so pass risk onto future generations. We believe reform of tariff frameworks including development of a national approach to social tariffs is essential to ensure investment can be supported while keeping bills affordable. We are fully supportive of the retention of the innovation fund and see this as a major success from PR19.

*Design & implementation of controls*

We are supportive of the development of DPC for major infrastructure schemes. However, we emphasise that integration considerations remain a key eligibility criteria. We believe more consideration needs to be given to whether we know the efficient threshold for DPC schemes given the additional procurement and legal costs; we believe there is still a role for appointed business to deliver large projects.

We believe the form of the current retail control creates barriers for investment for small high performing businesses as it focuses on price in a market where there is limited opportunity to generating synergies of scale to support investment. We welcome the potential strengthening of customer service incentives but also advocate ensuring technology to support demand reduction can be funded through wholesale controls e.g. smart metering roll out and associated digital infrastructure. Looking across to the leading energy sector participants such as Octopus Energy we can see that digitisation and real time data is key to truly influence customer behaviour and reducing demand remains the key water resource challenge. We support the industry position that inflation should be included in retail costs, particularly in the current high inflation environment.

*Reflecting understanding of customer & communities*

We welcome the better integration of the WRMP, regional water resources plans and the PR24 timetables but we do have concerns on risk of alignment of WINEP & PR24 investment plans. Namely we are concerned the timing differences could result in unfunded commitments restricting investment elsewhere.

We welcome the greater collaboration on customer engagement but we think more developed thinking is needed on the customer challenge sessions and how they interact with companies' local plans to assess plan acceptability.

We have concern over the single survey approach used for centralised research and potential mis-alignment between national research and local priorities. We would like further detail on how regional priorities will be considered and how companies own research can be used to support this. At a stage where the sector is under extreme scrutiny we are concerned that customers could be further disenfranchised it they do not feel company plans address local concerns.

*Delivering outcomes for customers*

We support the move to common performance commitments, further simplification and strengthening of C-Mex incentives outlined in the draft methodology. We have concerns on the removal of caps / collars and the removal of the dead band on CRI indices (we note the

DWI does not support this for CRI either). We believe removal of protections of caps / collars exposes companies to uncontrollable risks which could skew investment decisions. We would advocate retention of caps / collars or inclusion of force majeure / third party clauses to limit exposure but support tightening performance expectations to drive improvements for customers.

*Setting expenditure allowances*

We support continued use of econometric modelling to set efficient costs but think more consideration is needed on how future maintenance needs are impacted by climate change. We are concerned about the understanding of 'what base buys' and barriers to make case for investment to improve asset health standards but we welcome the provision to put forward investment case through resilience expenditure. We think there is an opportunity for the industry and Ofwat to work closely together to further develop the thinking in this area before the final methodology is issued. The early publication of the models is a positive development but we stress the need for developments of the models to be supported by robust data.

Additional funding for efficient companies for decarbonisation for is very positive but we welcome more detail in the final methodology.

*Aligning risk and return*

We support the provision for a specific company premium on cost of debt but think wider consideration is needed around the challenges small companies face on the cost of embedded debt.

The current approach to determining specific company adjustments assumes that an efficient cost benchmark is provided by a scaled down version of the notional company structure. However, real world conditions mean that smaller companies such as PW do not have access to the same funding structures and as a result the scaled-down notional company is not achievable. As a result of this PW currently unable to recover the costs of its efficiently incurred debt, the stated objective of Ofwat's approach to determining capital costs.

We believe this results in inequality across the sector limiting investment as smaller companies have to work harder to maintain financial resilience. We are recommending the final methodology considers either a small company notional company or potentially a Water Only Company notional company approach that more closely reflects the true cost of embedded debt and new debt. This should include the provision for a specific company premium relating to the higher transactional costs and fees faced when raising new funding.

We advocate that the final methodology gives companies the opportunity to evidence the debt premia as part of the PR24 business plan submission to Ofwat.

*Promoting financial resilience*

We support the enhanced Board role in ensuring oversight of financial resilience. We believe this is part of the remit of a responsible governance body and reflects good practise.

*Encouraging quality and ambitious plans*

We support incentivising companies to deliver high quality and ambitious plans but we caution on the unintended consequences a penalty regime could have in what appears to be another very challenging price control. We do not believe the current draft methodology provides clear enough guidance on what constitutes a quality and an ambitious plan and as such removal of stage of review leaves companies facing a cliff edge with no chance of recover other than appealing to the CMA.

We would advocate that the final methodology includes more clarity for the assessment criteria for company plans and incorporates an Ofwat check point where there is potential for feedback before plans are submitted. We think there is merit in considering how rewards and penalties are applied. We would advocate that penalties reduce RORE incentives available rather than reduce base returns as this could have a significant destabilising effect for even high performing companies at a time where further investment is needed to address sector challenges.