

## Creating tomorrow, together: consulting on our methodology for PR24 Blueprint for Water Response – September 2022

*Wildlife and Countryside Link is a coalition of 65 organisations working for the protection of nature. Together we have the support of over eight million people in the UK and directly protect over 750,000 hectares of land and 800 miles of coastline.*

*Blueprint for Water, part of Wildlife and Countryside Link, is a unique coalition of environmental, water efficiency, fisheries and recreational organisations that come together to form a powerful joint voice across a range of water-based issues.*

This response is supported by the following Link members:

- Angling Trust
- British Canoeing
- Friends of the Earth
- Institute of Fisheries Management
- Marine Conservation Society
- RSPB
- The Rivers Trust
- The Wildlife Trusts
- Waterwise
- Wildfowl and Wetlands Trust

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### Summary

Blueprint for Water welcomes this opportunity to comment on the draft PR24 methodology.

PR24 has huge potential to drive action to protect and enhance our water environment. It could deliver a step-change, allowing water companies to lead the way in driving environmental improvements, and building the resilience of both our natural environment and our water sector. To achieve this, we need a challenging and transformational Price Review, which places the environment at the core of decision-making and delivery. Indeed, as the recent Strategic Policy

Statement to Ofwat has stated, to ‘protect and enhance the environment’ should be the top strategic priority for the water industry.<sup>1</sup>

However, whilst there are some welcome elements, the current draft of the PR24 methodology will not deliver on this potential. We therefore set out recommendations in our response for how the methodology should be improved and strengthened. These recommendations include:

- Recognise the scale of the challenge resulting from long-term underinvestment and failure to build resilience.
- Incorporate greater consideration of natural capital, rather than financial costs alone, to ensure that PR24 takes full account of environmental benefits and risk. The methodology document does not currently mention natural capital accounting.
- Go further to facilitate the use of nature-based solutions. For example, through setting a 15-year operating expenditure allowance.
- Set out in greater detail how the Price Review will support the achievement of Government and societal ambitions for the environment. For example, companies should ensure they contribute to meeting targets under the Environment Act as a minimum.
- Place greater responsibility on water companies, not customers, to pay for poor performance and past failures to invest in both industry and environmental resilience.
- Refocus the three building blocks of the Price Review, to ensure that these work cohesively and comprehensively for environmental benefit. We will provide further details in our follow-up response to the methodology appendices.

Further detail can be found in our [‘Environmental Manifesto for PR24’](#). This sets out our ambition for PR24, and the action required from Government, regulators, and water companies, to ensure the Price Review meaningfully delivers for people and for nature.

## Chapter 2 - Regulating through the price review

We welcome the four ambitions set out by Ofwat – increasing focus on the long term; delivering greater environmental and social value; reflecting a clearer understanding of customers and communities; and driving improvements through efficiency and innovation. Although clearly inherent within the second ambition, the natural environment is in fact central to all.

In terms of a long term focus we need to understand the environmental destination that companies must aim for, and the pressures and tipping points that must be avoided. In understanding customers, companies must take account of the importance that customers place upon the natural environment and reflect this in their investment priorities. In driving efficiency and innovation, companies and regulators must embrace the benefits that nature-based solutions can bring.

Central to achieving all four ambitions is therefore the need to increase resilience, in its broadest sense. This means not only business resilience in the form of financial resources and practices, but the resilience of the natural environment upon which these businesses depend. Just this summer we

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<sup>1</sup> Defra. (2022). ‘The government’s strategic priorities for Ofwat’.  
<https://www.gov.uk/government/publications/strategic-policy-statement-to-ofwat-incorporating-social-and-environmental-guidance/february-2022-the-governments-strategic-priorities-for-ofwat>

have seen the impacts of a lack of resilience – neither the environment nor the sector’s infrastructure can cope when demand is high and supplies are low, or when excess rains then follow. Whilst much of this highlights that we have failed to prepare for a changing climate, the summer has also continued to expose other issues, such as the frequent operation of CSOs despite near-drought conditions. These issues are more symptomatic of long-term under-investment. Customers are rightly concerned. Building resilience would help to tackle each of the three challenges that impact these ambitions (climate change & natural environment, customer expectations, and rising bills) by ensuring that water supplies, wastewater services, and the natural environment upon which they rely, are much better prepared for the challenges of the future.

This failure to prepare and historic lack of investment in infrastructure **should be an additional challenge recognised by Ofwat**. Due to decades of inaction and failure to invest, and now the cost-of-living crisis and inflation, we are facing a ‘perfect storm’ with a suffering water environment at the centre. To rectify this requires greater recognition of resilience (as above), framed in the following context:

- **Cuts to capital investment by the water industry, required by Ofwat through previous price reviews have hampered maintenance and improvement of this infrastructure.**

For example, PR14 saw Ofwat cut £1bn of capital investment from business plans, £100m of which was for Water Industry National Environment Programme (WINEP) schemes. For PR19, Ofwat proposed to cut £6.7bn, though this was reduced following water company appeal.<sup>2</sup> Analysis by conservation eNGOs Angling Trust and WildFish suggests there has been a £10bn investment funding gap over the past 10 years, and that the consequences of failing to invest in water infrastructure will cost significantly more in the long term – £40bn versus £21bn, plus thousands of jobs.<sup>3</sup> Whilst it is important to protect customers from inefficient spending and unnecessary investment, it is clear that the lack of investment in both asset health and in new infrastructure has been a false economy.

- **Ofwat should promote greater investment in water and sewerage infrastructure through the Price Review, and enable water companies to take holistic action to tackle the synergy of stressors on the water and sewerage network.**

For example, Ofwat must further incentivise and approve the use of catchment and nature-based solutions (C&NBS) and the multiple benefits these can offer for both environmental and industry resilience, through transition to a natural capital accounting approach.

- **As a recent CIWEM report explains, whilst provision has been made by Ofwat for companies to maintain and upgrade their sewerage infrastructure as part of the 5-yearly price review, insufficient use of this provision has been made.**<sup>4</sup>

The House of Commons Environment Audit Committee's Water Quality in Rivers report too concluded that Ofwat ‘has hitherto focused on security of water supply and on keeping bills down

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<sup>2</sup> Angling Trust and Salmon & Trout Conservation. (2021). ‘Time to Fix the Broken Water Sector’.  
<https://anglingtrust.net/wp-content/uploads/2021/09/STC-AT-%E2%80%93-OFWAT-Report-final-draft.pdf>

<sup>3</sup> Angling Trust and Salmon & Trout Conservation. (2021). ‘Time to Fix the Broken Water Sector’.  
<https://anglingtrust.net/wp-content/uploads/2021/09/STC-AT-%E2%80%93-OFWAT-Report-final-draft.pdf>

<sup>4</sup> CIWEM. (2022). ‘River water quality and storm overflows’.  
<https://www.ciwem.org/assets/pdf/Policy/Reports/Storm%20Overflows%20Systems%20Full.pdf>

with insufficient emphasis on facilitating the investment necessary to ensure that the sewerage system in England is fit for the 21st century'.<sup>5</sup>

With the acceptability of raising bills hampered by the cost-of-living crisis, Ofwat will need to carefully balance the financial impacts of the price review upon customers. In this regard it is crucial that companies bear the costs of rectifying past failures; where costs have *already* been awarded customers must not foot the bill again. The regulator must also push companies to tie executive pay more closely to environmental performance, ensuring that bonuses are not paid to the leaders of companies that don't meet customers' expectations whilst those customers themselves may be struggling to pay their bills. We expect to see Ofwat using all the tools at its disposal to ensure that companies perform better, and that their customers are protected from company failings.

Yet despite the pressures on customers, increased investment will be necessary, and some of this will need to come in the form of bill increases. This may be unpalatable, but is nevertheless necessary because: the scale of risk to our natural environment demands immediate action; the failure to invest in the environment will mean greater costs in the long run, and the careful choice of solutions will make it possible to offset many of these costs. Water companies have a key role in delivering the Government's environmental objectives, so consumer money spent in delivering these objectives displaces public spending that would otherwise be needed. Optimising spending proposals through the robust assessment framework of the PR, and doing so at scale, offers an opportunity to meet our environmental objectives efficiently and holistically, whilst ensuring that efforts to clean up the environment are not thwarted by continued poor performance by water companies. This is the context in which Ofwat must approach PR24.

To meet the ambitions and tackle the challenges identified by Ofwat, the environment should be at the heart of PR24. Indeed, Defra's Strategic Policy Statement (SPS) to the sector states that to 'protect and enhance the environment' is the top strategic priority for the water industry. To achieve this:

- **Cost Benefit Assessment (CBA) needs to consider natural capital rather than financial costs alone.**

For too long, traditional accounting has seen the sector externalise negative impacts with little financial penalty. Despite many companies looking to move in this direction, and an ambition to facilitate a greater use of nature-based solutions, there is **no mention of natural capital accounting in the consultation document** and only fleeting mentions in Appendix 9 (Setting expenditure allowances), despite acknowledgement that various stakeholders proposed 'the adoption of an industry wide approach to assessing environmental and social impacts'. It is therefore unclear how such solutions will ever 'measure up' against traditional capital expenditure.

Blueprint for Water called for a natural capital approach to CBA to be incorporated for PR24. Ofwat should set out more clearly how it expects companies to demonstrate the value of nature-based solutions and other resilience investments for PR24, and should adopt a standardised, sector-wide NCA approach for PR29. Ofwat also notes that a separate consultation will look at proposals to 'strengthen the regulatory protections from risky financial structures' - we would query how any financial structure which fails to take full account of environmental risk and benefits, and of the reputational impacts that such risks can have, could be considered resilient.

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<sup>5</sup> Environmental Audit Committee. (2021). 'Water Quality in Rivers'.  
<https://committees.parliament.uk/publications/8460/documents/88412/default/>

- **The Price Review must facilitate the greater use of nature-based solutions.**

Evidence from past Price Reviews demonstrates that companies find it easier to secure funding for large capital schemes. It is therefore welcome that Ofwat recognise that the current regulatory approach provides less funding surety for schemes which are more reliant on operating expenditure, and so may disadvantage nature-based solutions compared to more traditional capital-intensive solutions since they require longer-term or ongoing operational expenditure. We agree that whilst capitalising the net present value of the whole-life operating expenditure of nature-based solutions would give the greatest certainty to companies, it could also present complexities such as double funding.

However, we do not feel that setting a ten-year operating expenditure allowance (to be recovered over two price control periods) is a sufficiently facilitative alternative. This is because, particularly where nature-based solutions have not been heavily utilised in the past, they will take time to develop and implement, meaning that in PR24, many will likely be implemented towards the latter part of the AMP. Given that maintenance needs could be lowest in the early years after installation, and may grow over time, a 10-year allowance may in reality only allow 3-4 years of 'typical' operational costs to be included. We suggest that a 15-year (three Price Control period) allowance should be considered.

- **Long term strategies must ensure contributions to long-term ambitions.**

We welcome the long-term focus promoted by Ofwat, and the requirement for companies to produce long-term delivery strategies. We acknowledge that tackling the environmental impacts that the sector causes / contributes to cannot be achieved in a single Price Review, and believe that better outcomes for the environment will be achieved when planning for the long term. The adoption of agreed principles, metrics and targets for areas requiring investment over the long-term – such as sustainable abstraction and environmental resilience – will be key to help facilitate this long-term focus, for example, through giving companies the confidence to invest in delivery that will help achieve long-term aspirations.

Also crucial will be ensuring that company plans support the achievement of Government and societal ambitions for the environment, such as the targets that will be set under the Environment Act to reduce water pollution, water use, and halt the decline of species by 2030. Our response to Defra's consultation on these targets made it clear that we think many of the proposals did not go far enough. As such, if the targets published in October have not been strengthened following the consultation, we believe that – given the importance of the water environment to the water sector – companies should ensure that they contribute to meeting these targets as a minimum.

Focus on the long-term should recognise the urgency of the crises we face and therefore recognise the value of early action with long term benefits. Long term targets should therefore not act as cover for delaying early interventions. Greater clarity is needed on how long-term delivery aspirations can be meaningfully committed to ahead of future PRs to provide confidence that commitments made can be relied upon.

- **The three building blocks of the Price Review need to be refocussed.**

The outcomes regime, cost assessment process, and risk and return framework must work cohesively and comprehensively to ensure environmental benefit. We discuss our thoughts on Performance Commitments and Outcome Delivery Incentives further in our response to the

questions posed regarding Appendix 6 (submission to follow separately), however initial concerns include:

- **The principle that financial incentives should apply symmetrically for out- and under-performance.**

This would be problematic if PC levels are set at the level of legal compliance, since we do not agree that complying with the law warrants a financial reward. It also implies that 'do nothing' is environmentally neutral, which is difficult to maintain given the current state of infrastructure and water company performance.

- **Revenues at risk from ODIs could be as low as 1% of Return on Regulatory Equity (RoRE).**

Given the importance placed upon the outcomes regime as a means by which environmental improvement can be incentivised, this figure does not seem sufficiently large. It takes no account of the water company's share of meeting 2030 targets and progress towards future goals and targets. The overall ODI figure should be informed by assessment of the likely costs of meeting this share to ensure sufficient revenues will be available, otherwise the PR will effectively ensure that such targets cannot be met.

### **Chapter 3 - Design and implementation of price controls**

**(Q3.1)** Strong incentives for trading water could be a useful tool in increasing the resilience of the water system, so long as bulk trades support wider environmental goals and do not exacerbate local water resource issues during times of water stress. Long term bulk supply contracts can help ensure strategic resilience over the longer term. Ofwat should explore the role for shorter term (e.g., seasonal), lower volume trades in providing local resilience during drought conditions and incentivising investment in on-farm and nature-based storage solutions.

Physical trades of water through the existing open channel network represents a water quality risk that must be strictly controlled for e.g., invasive species. At times of stress, however, such trades could help maintain healthy river levels. Any future incentive should therefore seek to encourage environmentally beneficial trading relationships between water companies and diverse suppliers across water resource zones. Enhanced incentives should encourage the use of nature-based and nature-positive suppliers.

The current drought illustrates that many preventative actions to avoid the critical conditions currently faced in England are under-valued or not valued at all. Shorter-term trading mechanisms should be assessed for their potential in helping avoid the slide into drought. Ofwat should therefore also explore opportunities for further market-creation in relation to shorter-term demand reduction during dry weather years (or, conversely, increased uptake/storage during times of excess) to better manage seasonal supply and demand mismatches.

**(Q.3.6) (b)** The proposals must include reducing water demand, in addition to the current focus on water resources infrastructure, to reflect that reducing demand and improving water efficiency will be critical to tackling the huge water deficit that England currently faces. Ofwat must direct the regional groups and water companies to invest sufficiently in water efficiency; the regulators themselves must also be adequately resourced to tackle water efficiency issues effectively. The remit of RAPID should also be expanded, to include demand management.

**(Q3.6) (h)** DPC projects constitute significant national infrastructure and it is therefore crucial that they are delivered to impeccable environmental standards. Ofwat should strengthen the DPC guidance to enhance environmental outcomes from the DPC regime as whole and use the regime as means of achieving a wide range of public environmental goods. DPC bidders should be assessed against environmental metrics as well as financial ones. DPC should therefore be assessed as providing more sustainable solutions than self-delivery and there should be a presumption in favour of nature-based solutions. Competitively Appointed Providers (CAP) should be required to submit robust sustainability plans alongside other procurement documents. Appropriate weighting should be given to the environmental performance of potential CAPs, and some weighting/preference should be given towards ethical investors, BREEAM (or equivalent) certified sub-contractors etc. and the environmental record of tier 1 contractors and their supply chain.

Ofwat should fund and incentivise water companies to introduce a parallel DPC process to procure nature-based ecosystem services from third parties, as well as large scale infrastructure. Such services would be procured in pursuance of relevant environmental performance commitments (see below) and ODIs, as well as WINEP tier 2 goals and/or tier 3 outputs. Co-developing WINEP solutions for PR24 business plans has proven difficult within the timescales of the price review, so an early signal that third parties may be able to bid for delivery of those services will buy time for options to be developed in parallel with the regulatory framework and business plans. The procurement principles and institutional arrangements (including any necessary funding) for enabling DPC could thereby be extended to ecosystem services.

Given the required lead-in times, we would still expect initial uptake and competition for such services to be somewhat weak in PR24, but such a mechanism under PR24 would act as useful discovery exercise for developing more robust markets for ecosystem services in future price reviews. Longer-term, Ofwat should work towards increasing the competitive pressures on water companies to deliver for the environment by making more of the WINEP tier 1 outcomes (and any other relevant business plan incentives or outcomes) contestable by nature-based service providers, and working to introduce appropriate market arrangements to encourage bidders.

## **Chapter 4 - Reflecting an understanding of customers and communities**

**(Q4.1)** We agree that the proposed approach reflects an understanding of customers', communities' and environmental concerns and we welcome Ofwat's expectations around greater customer and community engagement to help shape water companies' business plans throughout the Price Review. We welcome in particular:

- The focus on supporting customers who are financially vulnerable, in debt or struggling to pay their bills and we ask for greater and continuous support outside of PR24, particularly towards addressing the rise in cost of living;
- A consistent and collaborative approach to customer research and evidence, which is an improvement on PR19's customer research – although we still expect regional/local key differences and priorities to be accounted for;
- The wider community and stakeholder engagement; and
- The expectations around higher standards for customer research, challenge and assurance.

We expect this approach to drive greater accountability and transparency to customers and

stakeholders in helping to shape PR24. However, it is important that Ofwat continues to scrutinise how the engagement is carried out, and that customer evidence is clearly reflected in the water companies' next business plans. Besides the proposed open challenge sessions, the methodology is still somewhat vague on how this scrutiny will be implemented, although we expect this to be made clearer through subsequent customer research documents.

We welcome the expectation for effective partnerships between water companies and their customers and communities to address urgent challenges, such as driving water demand down and reducing sewer blockages. However, more can be done by the Government as well to influence consumer behaviour – in our [Blueprint PR24 Manifesto](#) we have proposed that [ENGAGING COMMUNITIES, ASK 1]: “Government should fund a national campaign, developed and delivered in partnership with others, to change consumer behaviour with regard to water use and the way people dispose of items and chemicals down drains and toilets”.

We welcome the recommendation for greater company-specific customer engagement where water companies seek to deliver wider environmental and social benefits beyond statutory requirements and at a greater cost to customers. However, we ask that water companies and OFWAT adopt a value-added assessment when considering these wider benefits, which tend to be provided through catchment and nature-based solutions (C&NBS) for example. Traditional cost-benefit assessments tend to be biased towards engineered capital solutions, often resulting in the more resilient C&NBS being assessed as costly, uncertain and risky. A value-added assessment can account for the wider benefits of these solutions and make them comparable to engineered solutions, as well as attracting wider investment that can drive cost savings for customers. This level playing field will enable customers to compare like for like and to have a more informed view on the development of plans.

Furthermore, in our [Blueprint PR24 Manifesto](#), we specifically ask that [ENGAGING COMMUNITIES, ASK 2]: “companies should invest in quality engagement with local communities wherever nature-based solutions are being considered. Schemes with community support are more resilient and the community often play a key role in ensuring their operational effectiveness”. This kind of co-design is as important as ‘generic’ customer engagement over the environment in terms of demonstrating support for environmental investment. The timescales for developing the various components of the PR creates a significant barrier to meaningful public engagement. Public engagement should therefore be an ongoing commitment throughout the PR to build local networks and help customers understand the opportunities that the PR presents for place-making in their local areas i.e., beyond the traditional customer service aspects of the water company-public relationship. This should include co-design of locally informed Bespoke Performance Commitments with eNGOs and local community groups, and co-design of future solutions to meet WINEP outcomes and long-term plan commitments. Public confidence in the sector has suffered in relation to CSOs and the drought and a step change in public engagement on, and delivery of, environmental enhancement will be needed to earn this confidence back.

We would welcome further steps by Ofwat to increase the visibility and transparency of in-AMP progress against expectations, and greater clarity on expectations for future Price Reviews to further facilitate focus on long-term outcomes. Significant customer engagement and public discussion of water company plans is often limited to the Price Review period; Ofwat should consider how this could be extended, for example through the production of a new performance dashboard.

**(Q4.2)** We agree with the proposed open challenge sessions, although we ask for greater scrutiny from CCW, customer representation groups and Ofwat on whether the views expressed in these challenge sessions are indeed being reflected in water companies' plans. We also expect that open



challenge sessions will take into account customer and community diversity in their representations.

## Chapter 5 - Delivering outcomes for customers

**(Q5.1)** We welcome that the package of performance commitments has a strong environmental focus, reflecting the need for the sector to decrease its impact upon the environment on which it depends, and the desire of customers and stakeholders to see significantly-increased environmental performance.

We welcome the consideration of operational GHG emissions and understand that this will include Scope 3 emissions, which is welcome.<sup>6</sup> We suggest that wider reporting to customers could include aspects such as the carbon emissions saved via the adoption of nature-based solutions, and the carbon costs of the sector as understandable by customers e.g., the ‘carbon cost of every litre of water used’, which would link through to water saving messages.

We welcome consideration of both Serious (Categories 1 & 2) and Total (plus Category 3) pollution incidents; as per our [PR24 Environmental Manifesto](#) and consistent with Government strategic priorities for the environment, we believe that these should be set at Zero by all companies. Given that Serious Pollution Incidents include those from water and not just wastewater assets, we suggest that this PC should apply to WOCs as well as WASCs.

We welcome that the PCs on water demand will include Business use; this accounts for around a fifth of water abstracted yet has been neglected in past AMPS. We support the design principles set out by Waterwise for a performance commitment on reducing water demand.<sup>7</sup> The performance commitments for reducing water demand should remain as three separate commitments – business use, household use, and leakage – rather than being combined into a single demand performance commitment. This would help drive improvements across all three areas, and mitigate the risk of unequal progress and prioritisation on these areas within a single, combined commitment. We are disappointed that smart meters do not feature within the methodology document, despite their importance for water efficiency and consumer behaviour change.

In considering whether further performance commitments are required to support a more outcomes-based approach to the Water Industry National Environment Programme, we suggest a target that incentivises the increased use of Catchment and Nature-based Solutions. As these solutions are not yet ‘mainstreamed’, such a target would encourage companies to upscale their use, paving the way for their much greater adoption in PR29 and beyond.

**(Q5.2)** As communicated previously, we welcome that bespoke PCs will be less extensively used in PR24 and will be utilised for certain specific circumstances, such as where issues are locally specific or where performance has fallen well below that of the industry as a whole and does not warrant a sector-wide PC. We also suggest that bespoke PCs could be employed for industry-leading activity,

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<sup>6</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2021/10/Consultation\\_Regulatory\\_Reporting\\_For\\_2021\\_22\\_Responses\\_Document.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2021/10/Consultation_Regulatory_Reporting_For_2021_22_Responses_Document.pdf)  
See A3 operational Emissions Reporting Table.

<sup>7</sup> Waterwise. (2022). ‘Ofwat Consultation on PR24 Performance Commitments – Waterwise Response (2022)’  
<https://www.waterwise.org.uk/knowledge-base/ofwat-consultation-on-pr24-performance-commitments-waterwise-response-2022/>

and could be therefore be important in driving ambition and innovation on topics where there has been limited sector-wide progress. An example could be: A PC on tackling emerging pollutants, or embedding circular economy approaches. Any such innovative PCs should be accompanied by a requirement for sector-wide knowledge sharing.

**(Q5.6)** The use of the same asset health performance commitments as at PR19 is welcomed, but more can and should be done to expand on the common asset health outcome metrics to include other measures that reflect on the life of the asset, criticality and how fit for purpose they really are. We want to see greater commitment and transparency around resilience of asset health, for example, how this resilience is being tracked over time and compared across the sector. A clearer understanding of current and future asset health risks and the plans that water companies will put in place to mitigate these would also be welcomed. Furthermore, an industry-wide transition to a more systems-based approach would add to resilience of asset health in the long term.

**(Q5.10)** We agree with the requirement for knowledge sharing such that the customers of all companies ultimately benefit from enhanced ODIs, and the proposal to claw back payments if a company's knowledge sharing activities are inadequate. Since companies are not in direct competition there is no justification for refusing to share knowledge and experience which will enable the sector as a whole to improve performance, particularly when it comes to environmental performance, as current poor practice is known to reflect badly upon the sector as a whole.

**(Q5.11)** We disagree with the application of a symmetrical two-sided aggregate sharing mechanism. ODIs are intended to act as an incentive for companies to deliver their committed levels of performance, returning funding to customers for foregone benefits if they deliver less than is expected – as such it is unclear to us why the proportion of the potential payment that customers receive varies with the severity of the underperformance. We suggest that companies (and indirectly, their shareholders), should always bear the cost of funding returns to customers, in full. We do however welcome the concept of a sharing mechanism to protect customers from the financial impacts of very high performance (since is it customer bills that would finance the reward), but recognise that such limits can also disincentivise companies from stretching performance. As such we feel that the ability for companies to earn up to 3% RoRE without any sharing of payments strikes this balance.

**(Q5.12)** We agree with the proposal not to use deadbands, as we do not see the benefit of removing financial incentives for performance within a specific range; deadbands can have the effect of discouraging investment in improved performance because additional investment provides no resultant financial reward. We agree that removing deadbands would lead to stronger incentives on companies, and consider that this would be in keeping with customer expectations upon the sector.

**(Q5.16)** Our thoughts on specific Performance Commitments will be discussed in more detail in our subsequent submission in response to the questions covering Appendix 6.

## **Chapter 6 - Setting expenditure allowances**

**(Q6.1)** Efficiencies in baseline expenditure that deliver carbon saving or nature protection benefits should be rewarded more than those which are neutral or harmful. Water companies should

therefore be able to keep a greater proportion of baseline efficiencies that have been delivered by low carbon or nature positive actions.

The case for any enhanced expenditure should be considered against a presumption in favour of nature-based or nature-positive solutions. Water companies should be expected to demonstrate engagement with eNGOs and local environmental groups in developing their proposals for enhanced expenditure PCDs.

**(Q6.7)** Awards for enhanced spending on net zero actions should embed a preference for cost effective nature-based solutions, so assessments should reflect metrics other than lowest cost.

The principles of competitively awarded enhancement spending should also be considered for actions that contribute towards urgent priorities in nature protection. As noted above, these are often better defined with reference to local conditions and priorities. GHG mitigation or adaptation benefits may also be considered in assessing the value of such schemes. Particular emphasis should be placed on the desirability of enhancing water company SSSIs/SACs and SPAs and recreational/wellbeing benefits of accessing nature. Such schemes should encourage partnership working at scale and co-financing with e.g., BNG habitat banks or other funding streams.

Notwithstanding [our views on the Storm Overflows Discharge Reduction Plan](#), Ofwat must accept the ambitions of companies to go above and beyond the targets set by the Government. Indeed, several companies have already expressed such ambitions. Government targets should be considered a baseline, and not a ceiling to ambition.

**(Q6.8)** The price incentives to deliver environmental goals such as nutrient neutrality could be effective, and it is important that the customer does not pay the consequences for undelivered outcomes. We welcome the tracking of intermediate milestones. Financial rewarding to encourage water companies to produce business plans that incentivise treatment wetland creation to tackle nutrient neutrality would also be an effective way to mitigate issues around nutrients in water quality.

Wetlands perform a critical role in protecting and improving water quality. They filter out pollutants such as industrial and road runoff in urban areas and remove nutrients (e.g., nitrogen and phosphorus), pesticides and sediment from agricultural runoff with the benefits far outweighing the costs.<sup>8</sup> Specifically designed and managed treatment wetlands can remove nitrogen by up to 70%.<sup>9 10</sup> For over 30 years Wildfowl and Wetlands Trust (WWT) have created wetlands that are designed to improve water quality. These treatment wetlands perform a wide range of purposes, from treating sewage and agricultural waste to landfill leachate, mine drainage and road runoff. Well designed and managed treatment wetlands can reduce nitrogen loading in a catchment, preferably on site but potentially through nitrogen trading/offsetting.

**(Q6.9)** We agree with delivering a best value approach, however more clarity is needed in terms of how water companies will go about identifying the best solution for customers and the

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<sup>8</sup> For example, horizontal-flow constructed wetlands can remove between 50 and 99% of nitrogen, depending on its form and effluent loading. Dunne, E. J., Culleton, N., O'Donovan, G., Harrington, R., & Olsen, A. E. (2005). 'An integrated constructed wetland to treat contaminants and nutrients from dairy farmyard dirty water.' *Ecological Engineering*, 24(3), 219-232.

<sup>9</sup> Uusheimo, U. et al. (2018) [High Nitrogen Removal in a Constructed Wetland Receiving Treated Wastewater in a Cold Climate](#), *Environ. Sci. Technol.* 52, 22, 13343–13350.

<sup>10</sup> Lee, C., Fletcher, T. & Sun G. (2009) [Nitrogen removal in constructed wetland system](#), *Engineering in Life Sciences*, 9(1):11-12.

environment. To expect companies to approach options appraisal “with an open mind” when considering best value, is open to interpretation. Therefore, specific guidance is needed. Otherwise, we will continue to see the same bias towards traditional end-of-pipe solutions, which rarely provide multiple benefits and do not necessarily respond to multiple drivers, but nevertheless offer a business-as-usual tried and tested approach to how least cost is assessed (i.e., no “open mind” is needed). Optioneering and options appraisals should be carried out with extensive engagement from customers and wider stakeholders, particularly when considering options that sit outside of the traditional asset base, such as catchment & nature-based solutions (C&NBS).

In our [Blueprint PR24 Manifesto](#) we recommended that the WINEP optioneering should include “specific ambitious targets for the increased use of C&NBS, supporting their ‘mainstreaming’ and securing their contributions to nature and climate goals. Water companies should adopt these as a matter of course, and be able to provide good evidence where such solutions cannot be incorporated. Clear appraisal guidance is needed to ensure that where C&NBS are the preferred options by water companies and stakeholders, proposals will be accepted by the regulators”. We further recommended the incorporation of a natural capital approach to cost benefit assessments.

**(Q6.10)** We welcome the positive steps towards a greater consideration for nature-based solutions and the flexibility around the longer 10-year operating expenditure, as well as the maximising of co-funding opportunities through working with others. However, we note that the proposed approach is still not ambitious enough. It falls short of levelling the playing field between nature-based and capital solutions and does not resolve the CAPEX bias, particularly as water companies will now be required to produce long-term strategies and adaptive plans that go far beyond 10 years. There needs to be greater incentivisation of nature-based solutions, particularly where multiple drivers, multiple benefits and wider outcomes can be achieved.

## Chapter 9 - Promoting financial resilience

We agree that dividends policies must be transparent and adhere to Ofwat guidance, including the need to take account of company performance in delivering obligations and commitments to customers, communities and the environment. We also agree that policies for performance-rated pay should ‘demonstrate clearly a substantial link to stretching performance delivery for customers, communities and the environment’. However, given the current state of the water environment, and the significant rise in customer interest and expectations for the environment, we believe this approach needs to be stronger.

Since privatisation, water companies have paid out nearly £2 billion per year in dividends, and company bosses have received £58 million in pay and benefits in the last five years alone. This is in spite of ongoing poor environmental performance. For example, in 2021 alone, untreated sewage was released from Storm Overflows in England 327,533 times, for over 2.6 million hours, despite the fact that Storm Overflows are only permitted to discharge during extreme rainfall events.<sup>11</sup> As the current investigation into over 2200 sewage treatment works demonstrates, these sewage pollution

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<sup>11</sup> Wildlife and Countryside Link. (2022). <https://www.wcl.org.uk/stem-tide-of-sewage-pollution.asp>

incidents are the result of widespread, ongoing failures by water companies to comply with permit conditions, to the detriment of both the environment and customers.<sup>12</sup> The 2022 drought has also highlighted a lack of investment in water resources infrastructure, which has not kept pace with demand and undermines long-term resilience. There have been no new reservoirs in the southeast of England since 1976 despite a 3 million population increase.<sup>13</sup> Nearly 20% of water supply is lost to leaks, equivalent to 2.4 billion litres per day across England's nine major water companies.<sup>14</sup>

We appreciate, as stated in the document, that Ofwat believes 'executive pay is a matter for each company' and therefore that the draft methodology focuses more on the transparency of process than regulating pay itself. However, under the current approach, it remains profitable for companies to pollute, to fail to meet environmental legislation, and for water and sewerage infrastructure to not be fit for purpose. Furthermore, it should not be permissible for the water industry to pass the cost of legal compliance onto customers. In the midst of a cost-of-living crisis, it is particularly important that consumers do not have to foot the bill for historic failures to invest to mitigate known challenges whilst these significant pay-outs are being made.

That dividends payments should 'take account of company performance in delivering obligations and commitments', and performance related pay should 'demonstrate clearly a substantial link to stretching performance delivery for customers, communities and the environment' must be *requirements* of water companies, not merely Ofwat guidance. These requirements should also be strengthened, from 'taking account' and having a 'substantial link', so that payments are dependent on the delivery of statutory obligations. Ofwat has powers under the Water Industry Act 1991 to limit the payment of bonuses to water company executives who consistently breach their permits; this was an action recommended by the EAC in their 2022 report on water quality in rivers.<sup>15</sup> These powers should therefore be part of Ofwat's PR24 toolkit.

## Chapter 11 - Encouraging quality and ambitious business plans

**(Q11.1) a)** We agree that quality should take precedence over ambition because sufficient plans to deliver are more important than laying out higher ambition with insufficient plans to deliver. However, it should not mean that we do not receive ambitious business plans.

**b)** Whilst we acknowledge that penalties are a useful mechanism for incentivising business plans that meet the quality and ambition expectations, we do not believe that these are sufficient for curbing pollution by water companies. The stark increase in sewage dumping by water companies in the past year demonstrates this; for example, the Environment Agency reported 258 pollution incidents committed by Anglian Water in 2021. In cases such as these, it is evident that penalties should outweigh incentives.

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<sup>12</sup> Ofwat. (2021). <https://www.ofwat.gov.uk/joint-ofwat-environment-agency-and-defra-announcement-november-2021/>

<sup>13</sup> Angling Trust and Salmon & Trout Conservation. (2021). 'Time to Fix the Broken Water Sector'. <https://anglingtrust.net/wp-content/uploads/2021/09/STC-AT-%E2%80%93-OFWAT-Report-final-draft.pdf>

<sup>14</sup> Telegraph. (2022). <https://www.telegraph.co.uk/news/2022/08/04/water-executive-promises-halve-leaks-2050/>

<sup>15</sup> Environmental Audit Committee. (2022). 'Water Quality in Rivers' <https://committees.parliament.uk/publications/8460/documents/88412/default/>

**(Q11.3)** We welcome the inclusion of 'wider environmental and social benefits, costs, risks, opportunities for third party funding and the affordability of customers' bills' into the ambition assessment. However, more detail of how much this should affect investment should be outlined. A standardised framework for assessment of environmental risks, opportunities and costs should be provided to water companies so they are able to meet the requirements and understand the priority of environmental considerations.

**(Q11.4)** Penalties must be increased in order to reduce the number of pollution incidents. However, penalties that are too large could detract from funds for investment if enforced too often, and could dampen progress to deliver the infrastructure needed to prevent greater pollution and sewage discharge. Ofwat should consider recirculating penalty funds into pollution preventative infrastructure under a watchful regulatory eye in a streamlined version of the current environmental undertaking processes. For example, treatment wetlands have been shown to improve water quality by filtering out pollutants, save money through lower maintenance and decreased chemical input, and have a positive effect on the environment and surrounding biodiversity by providing a habitat.