



# Speech

Given by David Black, Chief Executive Officer, Ofwat  
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## Environmental ambition and delivery – from challenge to opportunity

Good morning all,

Thank you for having me here today. I am going to discuss environmental ambition and delivery – from challenge to opportunity. It's clear that the sector is facing real challenge on its environmental performance and questions over resilience to drought. Successfully addressing these challenges will require companies to transform performance, to embrace new ways of working and a step-up investment. All in time a where customers are facing squeeze on the cost of living and trust has diminished in the sector.

The natural environment and public health have always been central to the sector. The water sector has sometimes been called the silent utility, often barely noticed, its work, benefits and its flaws receiving little attention. That has now dramatically changed – and I don't think we are going back to the comforts of the quiet life.

### In the news



This summer has shown us that the sector no longer has the luxury of operating in a under the radar. We have rarely seen such a laser-like focus on the performance of water and wastewater companies and their regulators, and just as much attention on how we're all going to improve the situation. The headlines tell the story. Outrage about leakage levels when hosepipe bans are introduced. Fury over river water quality. Questions about how our future water needs will be met. Ongoing anger over sewage discharges. Debates over the extent to which future investment should be felt on bills. Anger about dividends and executive bonuses.

A common thread running through the challenges has been that companies are falling short of public expectations and that customer trust has been shaken. It could be argued that expectations on environment have risen post pandemic and some issues such as leakage are not new and can be explained. But this misses the point, companies are clearly falling well short of expectations of customers and communities.

This is not to say that progress hasn't been made in some areas - it has. And there have been some notable individual improvements on some performance measures. But when all the areas that require improvement are laid out, it's clear to see that the sector needs to change.

## **So what needs to change?**

Companies need to deliver to the expectations of customers and the public. That will require improved performance, more investment and creating greater value from what they do. It also requires recognising the impact on affordability and reflecting customer views in business plans and ensuring that assistance is available to those in need.

Improving performance will require strong leadership from companies, recognising the concerns of customers and transforming performance to do better. This means getting the basics of customer service right.

The sector still lags behind other sectors in terms of service and the business retail market has revealed a host of problems with poor data on customers, which are likely to be present in residential market too. There are far too many customer complaints over basic service errors. Our sewage in homes study with CCW revealed poor support and follow up after the awful experience of sewer flooding. Looking to other sectors, I see UKPN is now ranked as number 1 on UKCSI across all sectors, while no water company makes the top 100, suggesting a considerable scope for improvement. That said, I should acknowledge the improvements by several companies in recent years, who both succeeded in improving customer satisfaction and reducing their cost of service.

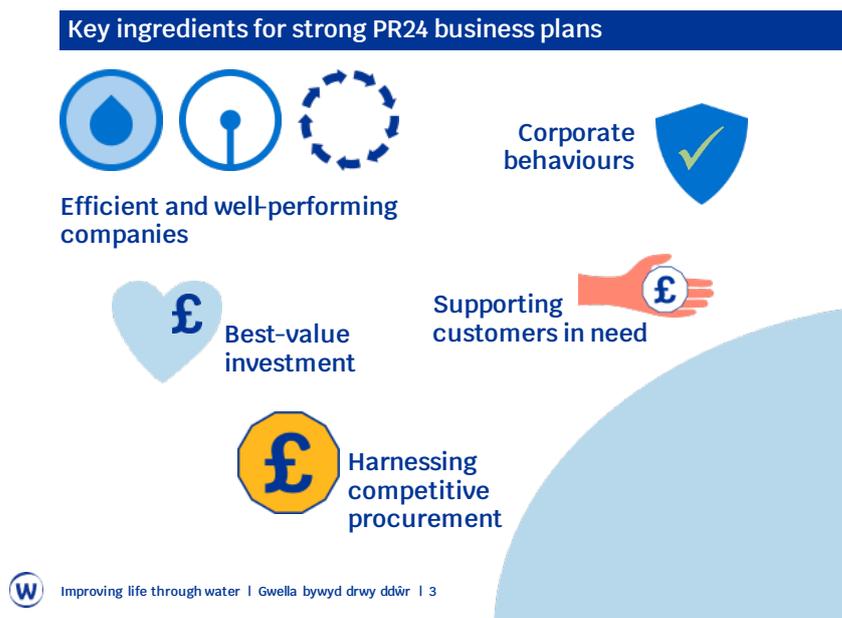
A contentious area of performance has been on leakage. While the sector can point to significant improvements since Ofwat's 15% reduction challenge in 2017, the failure to reduce leakage for the previous 17 years and an aggregate level of leakage of 21% is damning. While

the sector has committed to reduce leakage by 50% by 2050, many will probably consider a long term ambition to leak 11% of water from the system as not good enough. And I would agree.

The flashpoint for public anger has been the excessive use of CSOs. They were intended as an emergency release valve on the sewage system, but the 15,000 overflows in England resulted in over 370,000 sewage spills last year.

I am pleased to see 5 companies have now committed to early action to reduce use of storm overflows to no more than 20 per year by 2025, a reduction of 40% or more for some companies.

I see grounds for optimism that the sector can rise to the challenge with evidence of sustained reduction in leakage and a start on reducing use of storm overflows. I am also pleased to see that companies seeking to transform their performance have secured backing from shareholders to finance their turnaround.



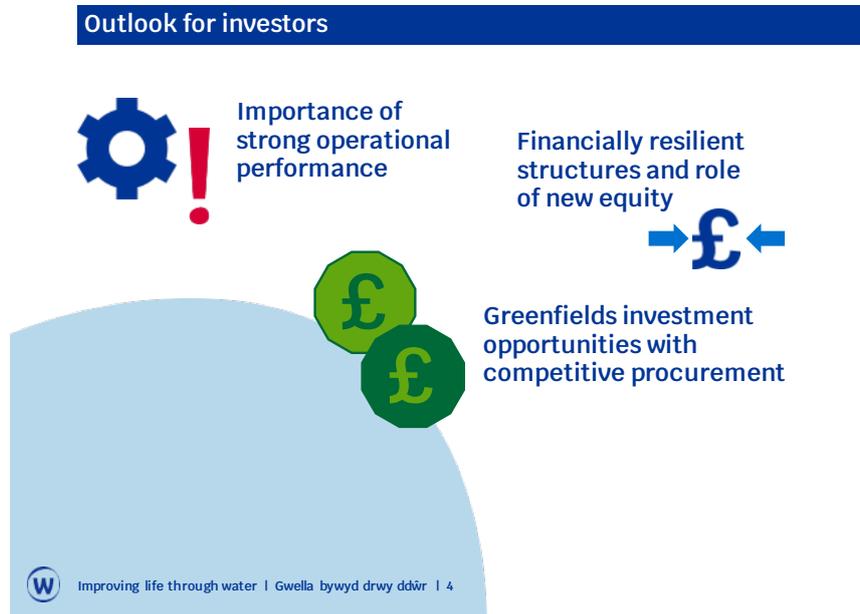
I recognise that the scale of challenge facing the sector in improving river quality, addressing storm overflows, and improving drought resilience will require major investment at PR24 and this will put upward pressure on customer bills along with impact of rising inflation.

## Five key elements of PR24 business plans

I see five key ingredients for justifying a step up investment at PR24 in time of unprecedented strain on customers from rising inflation and falling real incomes:

- An efficient and well performing sector. A monopoly sector will always be vulnerable to criticism that it could do more with existing resources. We set stretching efficiency and performance challenges at PR19. It will be vital for companies to demonstrate that they are leaving no stone unturned in running their core business as efficiently as possible. We have established the innovation fund along with extra returns for outperformance to support management teams drive for better performance.
- Companies must demonstrate that new investment is best value. Customers understandably are concerned about making sure their own incomes are well spent. They expect nothing less of companies and that investment plans will be able to demonstrate the value to customers and the environment from proposed enhancements. The diminishing marginal returns of conventional investment in wastewater treatment works are clear. We are putting much greater focus on adaptive planning and social and environmental value at PR24 to support the delivery of best value.
- Companies need to harness the benefits of competitive procurement processes. We see the benefits of competitive procurement for Thames Tideway in lowering bills for customers from around £70 to £20. we expect to see more competitive procurement at PR24.
- Efficient and best value plans will need to show support for hard pressed customers. We welcome companies that have stepped in to put shareholder money into providing additional support for customers. We have also opened the way for more innovative tariffs which could help share the burden more equitable across customers.
- The 5th element is aligning corporate behaviours with public expectations of companies which have privilege of monopoly licence for this essential service. It is important that customers can trust that additional investment is being used to improve environment and service and not disappearing in dividends or exec pay. Companies committed to linking performance related exec pay to their performance in PR19, but currently a significant number are failing to do so. We are introducing licence changes to require dividends to be linked to performance and to tighten the regulatory ring fence to support financial resilience. I find it extraordinary that some companies have been slow to recognise the merits of these proposals given the evidence widespread public concerns. We have extensively engaged with companies and investors to address potential concerns. I question whether any further delay will serve company or investor interests.

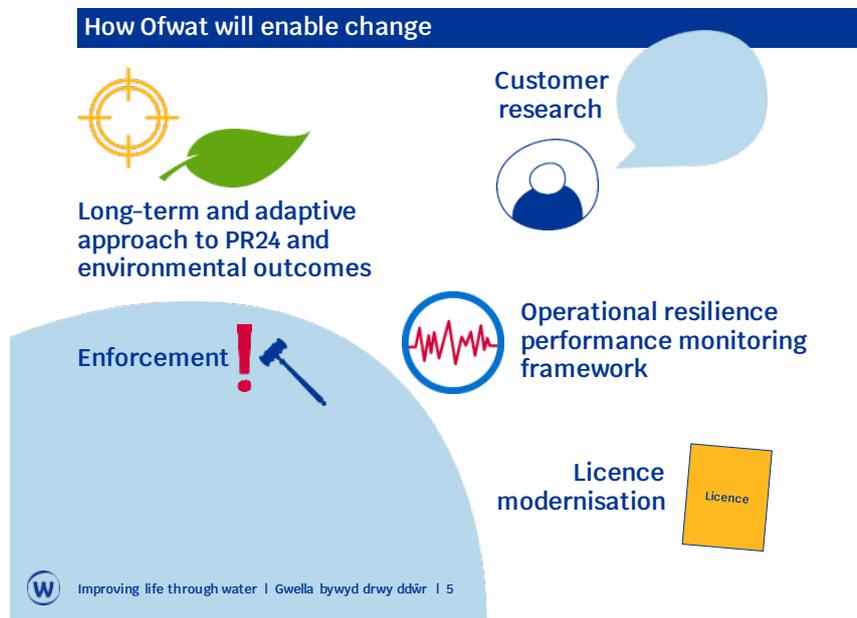
## Investors play a key role...



And what about investors. The sectors offers attractive opportunities for investors, with prospects of strong RCV growth and attractive regulatory model offering inflation protected returns and protection against macroeconomic cycle. Three points for investors:

- Operational performance will be key to determining investor returns – this continues the evolution from previous reviews. As investors in Southern have found to their cost, poor performance will impact returns and even much of the value of their investment. Operational performance will only grow in importance for investors at PR24.
- We are looking for financially resilient structures – investors need to be committed to the long term. Its possible given investment requirements in the sector, that companies may need to raise more equity as well debt to finance investment. We saw successful rights issue by Severn Trent earlier this AMP. Other companies may need to consider this as they are face the investment requirements for the next AMP. Financial structures that make equity raising difficult are likely to face challenging times.
- Competitive procurement will offer new opportunities for greenfield investment in the sector – but also help manage challenges with major construction projects.

## ...And Ofwat too



So if companies and investors need to change, what about Ofwat? What do we need to change?

- Our approach to PR24 puts increased focus on the long term and adaptive planning. We have worked with EA to reform WINEP to shift to a more outcomes based approach and to enable advanced WINEP to push this approach further. I am also pleased that we see change in company approach under outcomes regime of PR19, where companies are willing to overspend against allowance to improve returns from ODIs from better performance. We will introduce greater range of environmental performance commitments in PR24 to support much greater focus on environmental performance. We will continue to work closely with the EA on our approach to PR24 and the longer term, seeking to ensure we get the best out of both of regulators respective roles.
- We are developing a operational resilience performance monitoring framework to support greater focus on asset stewardship for the long term.
- We have developed our own in-house customer research and environmental expertise, recognising the increasing importance of these areas.
- We are using our new licence changes powers from Environment Act 2021 to modernise company licences and ensure they support high performing sector.
- We will not hesitate to take enforcement action against companies that fail to comply with statutory and licence obligation.

So, we are changing too, but what is not changing is our purpose to drive the sector to perform better for customers and the environment.

The sector had lost public trust and faces the extraordinary challenge of justifying a significant increase in investment at PR24 in times of crisis for customer's standards of living. This is going to require a collective step up from the sector. It also offers significant new opportunities for growth for investors – and in turn requires investors committed to the long term and who are focused on company performance and improving environmental and social value.