

December 2022

Creating tomorrow, together:
Our final methodology for PR24

Appendix 12

Quality and ambition incentive

About this document

This appendix relates to the PR24 final methodology on encouraging quality and ambitious business plans using a quality and ambition assessment (QAA) with associated rewards and penalties.

In this document we:

- summarise our final methodology policies;
- present stakeholder responses in detail;
- highlight any changes from draft methodology; and
- provide our reasoning for our final decisions.

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1. Introduction

We want companies' 2024 price review business plans to play an important role in demonstrating how they will rise to the major challenges that confront the sector, as well as the level of performance they will deliver and associated costs. The quality and ambition assessment (QAA) will use a range of reputational, financial and procedural rewards and penalties to encourage companies to prepare business plans which:

- significantly push forward the performance of the sector for the benefit of customers, communities and the environment; and
- contain the information we need to conduct the price review efficiently and effectively.

In the following sections we set out our final methodology policies and stakeholder responses to the consultation on our draft methodology proposals. We also provide our considered views and reasoning for our final decisions. We do this for each of the following topics:

- our quality and ambition assessment;
- rewards and penalties; and
- the assessment and our PR24 timeline.

Our final methodology policies on our QAA can be found in [Chapter 11 of our final methodology](#).

2. A quality and ambition assessment (QAA)

The following sections relate to our use of a quality and ambition assessment (QAA) to support the sector to transform its performance.

2.1 Our final methodology policies

The QAA and associated rewards and penalties are designed to encourage companies to submit quality and ambitious business plans using rewards and penalties. We will use the QAA to assign companies to one of four categories with associated rewards or penalties.

2.2 Changes from our draft methodology

For final methodology we add a minimum expectation to the 'Data, information and assurance' area of the quality component of the QAA. We expect each company to:

- provide sufficient and convincing evidence to demonstrate how its track record of performance, or lessons learnt from poor performance, support the credible deliverability of the proposals in its plan.

2.3 Stakeholder views

In this section we set out stakeholder views to our draft methodology proposals on the QAA.

2.3.1 Using the QAA to encourage the sector to transform performance

Most stakeholders agreed with, or did not comment on, the:

- use of a business plan assessment and associated rewards and penalties to encourage quality and ambitious business plans; and
- principle of assessing the quality of business plans first, followed by ambition.

2.3.2 Quality assessment

Many stakeholders agreed with the broad scope of our quality assessment. Respondents were strongly supportive of the inclusion of customer affordability and acceptability. They said this is always important but is a particularly acute issue for PR24 given inflationary pressures and

the ongoing cost of living crisis. However, some respondents considered that our quality assessment will place insufficient emphasis on the deliverability of proposals.¹ As a result, they considered that a company could be encouraged to include in its plan, and ultimately be rewarded for, ambitious proposals that it is unlikely to deliver.

Several respondents were concerned that the quality assessment is overly prescriptive and that we will penalise companies if they do not use our assumptions. Some of these stakeholders considered this may limit their flexibility in developing business plans that are in the best interest of customers and the environment and may undermine the ability of their Board to provide assurance. Additionally, some companies were concerned that we would not consider evidence provided when suggesting alternative parameters.

Some respondents also considered that without further guidance, companies could unintentionally misinterpret our minimum expectations. They considered this risk is heightened because we will determine rewards and penalties based on their first business plan submission.

A few companies considered that they should receive rewards for exceeding our minimum expectations.²

2.3.3 Ambition

Most stakeholders broadly agreed with the scope of our ambition assessment but many called for Ofwat to take account of past performance in this component.³ They said this was important to:

- place greater emphasis on the deliverability of companies' proposals in the ambition assessment (rather than in the quality assessment as described above); or, in two instances
- allow each company's ambition to be assessed relative to its starting position.

2.3.4 Mechanics of the QAA

Finally, some respondents considered that we have provided insufficient detail on the mechanics of our quality and ambition assessments to determine each company's categorisation. Specifically, they asked us to define in our final methodology:

¹ South West Water, Hafren Dyfrdwy and CCWater.

² Wessex Water and United Utilities.

³ Anglian Water, South East Water, SES Water, United Utilities, Yorkshire Water, Portsmouth Water, CCW, Money and Mental Health, Northumbrian Water, Southern Water, United Utilities, Affinity Water, South Staffs Water, Severn Trent Expert Panel.

- any minimum expectations that could be given greater weight in our 'in the round' assessment of business plan quality;⁴ and
- more prescriptive guidance for our ambition assessment, in particular eligibility thresholds for each category.⁵

2.4 Our final decisions and reasoning

In this section we provide our final decisions and reasoning for:

- using the QAA to support the sector to transform its performance;
- the scope of the quality component;
- the scope of the ambition component; and
- the mechanics of the QAA.

2.4.1 Using a QAA to support the sector to transform its performance

We will use a quality and ambition assessment with associated incentives at PR24 because they will encourage companies to:

- provide the regulator with information on what is achievable over the next five years and beyond – supporting the sector to transform its performance; and
- identify information that ensures the best possible outcomes are delivered.

We have received repeated and consistent support for using incentives to drive the quality and ambition of price review business plans and they have improved outcomes for customers and other relevant stakeholders during previous price reviews conducted by Ofwat and other regulators.^{6; 7}

2.4.2 Quality

We expect quality business plans to meet a set of minimum expectations in the round. Our minimum expectations are focussed on areas which:

- are direct inputs to our price control determinations; or

⁴ Affinity, Yorkshire Water.

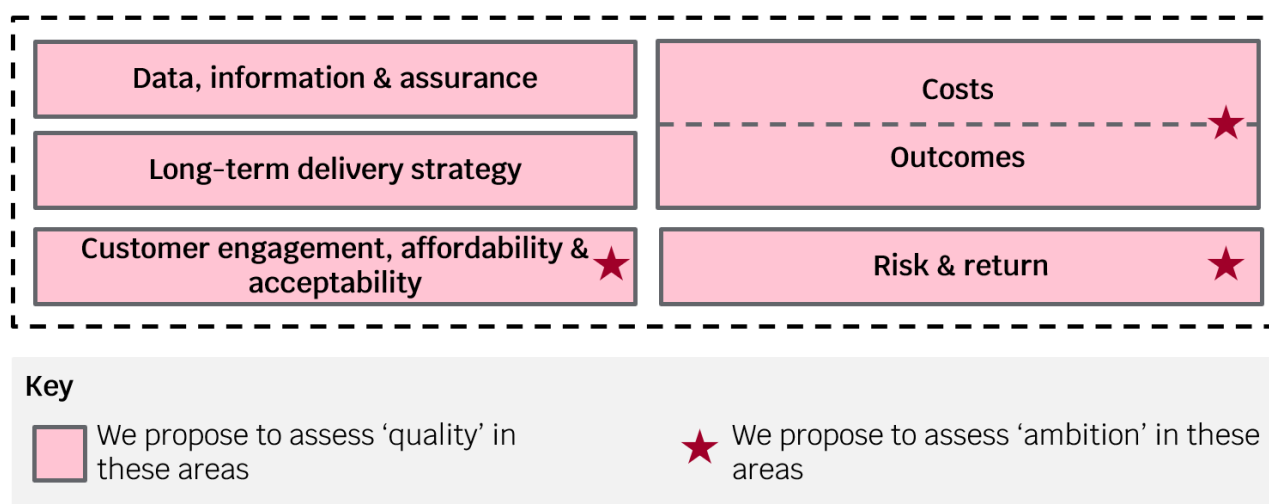
⁵ Anglian Water, Hafren Dyfrdwy, Severn Trent Water, Portsmouth Water, South Staffs Water, Thames Water, SES Water.

⁶ Ofwat, '[PR24 and beyond: our reflections on lessons learnt from PR19](#)', December 2020.

⁷ Ofwat, '[PR24 and beyond: Creating tomorrow together](#)', May 2021.

- we consider are necessary to provide us with confidence that companies intend to act in the best interests of customers, communities and the environment (see Figure 2.1).

Figure 2.1 Scope of the QAA



For final methodology we maintain each of the minimum expectations of a quality business plan proposed in our draft methodology. We disagree with responses that say these are overly prescriptive or reduce companies' flexibility to develop proposals that are in the long-term best interests of their customers, communities and the environment.

Only two of our minimum expectations expect companies to use specific assumptions, which are:

1. our early view of the allowed return on capital; and
2. the ODI rates based on the marginal benefits estimates identified through the sector-wide research project.

Common assumptions in these areas:

- improve the quality and comparability of the information we use in decision making; and
- reduce the risk of duplicated effort across companies and provide a cost-effective way of gathering this information.

For PR24 we are achieving greater agreement and alignment on these assumptions by working collaboratively with stakeholders during their development. Specifically, our:

- early view on the allowed return on capital is informed by draft guidance agreed between regulators and published by UK Regulators Network;⁸ and
- marginal benefit estimates for ODI rates are being informed by collaborative research – companies and other stakeholders were involved in the development of the research which is collecting robust samples for each company.

During the price review we will fully consider evidence provided to us. A company that demonstrates its proposed alternative is justified will pass the relevant expectation and so, contrary to concerns raised in stakeholder responses, their Board's ability to provide assurance of their specific proposals should not be compromised. Specifically, we expect:

- compelling evidence for an alternative view on the rate of return and marginal benefit estimates – this a high bar but nonetheless an option for companies; and
- sufficient and convincing evidence for alternative indicative benefit sharing factors.⁹

Any company that does not meet these requirements will fail the relevant minimum expectation, and we will consider this during our in the round assessment of whether its business plan is of sufficient quality.

The remaining 23 minimum expectations in our final methodology are for business plans and long-term delivery strategies to be consistent, accurate, sufficiently evidenced or developed in-line with broader policy guidance.

For final methodology we include a new minimum expectation in our quality assessment for each company to provide sufficient and convincing evidence that it can credibly deliver the proposals in its plan. The amount of evidence we require from each company will be proportionate to the extent of the gap between its track record of performance, including delivering improvements, and the proposals in its plan. This minimum expectation will provide Ofwat and other stakeholders with greater confidence that plans will deliver for customers, communities and the environment and so supports the credibility of the sector overall.

We have decided to assess credibility of delivery in the quality component of the QAA. This is despite some respondents to our consultation on the draft methodology suggesting it should be considered under the ambition component. We consider the quality component is the best place to assess deliverability because:

⁸ UKRN, '[UKRN guidance for regulators on the methodology for setting the cost of capital – a consultation.](#)'

⁹ Ofwat's view is that the benefit sharing factor should be less than 100% but greater than the cost sharing rate (max 60%) and so we set an assumption at 70%. As it is an assumption, we allow companies more discretion by setting the evidence threshold at sufficient and convincing.

- it is consistent with our aim that the minimum expectations support the confidence we should have that business plans will deliver for customers, communities and the environment; and
- as part of their ongoing operations we expect companies to understand their past performance and how that will inform their future delivery – so we consider companies should be penalised if they cannot do this.

Our minimum expectations aim to ensure that business plans will deliver for customers, communities and the environment and that they can be assessed efficiently and effectively. We consider that every company can achieve these expectations in the round and so we will penalise companies that do not. We encourage companies to go beyond our minimum expectations in our ambition assessment where we provide rewards for companies to exceed our expectations in areas we consider add value for a company's stakeholders and the sector overall.

There have been limited requests for additional detail on specific minimum expectations. We have considered each and have updated our methodology where we consider we can provide greater clarity (see Chapter 11 of [our final methodology](#), Tables 11.2 – 11.7 and references therein). Additionally, we have:

- provided multiple opportunities for companies to influence the development of our price review policy and receive guidance and feedback on the areas included in our QAA; and
- We will provide further opportunities to receive guidance and feedback before business plan submissions.

These opportunities are summarised in Table 4.1 in Section 4. All support our aim for companies to get their business plan right the first time.

2.4.3 Ambition

Our ambition component encourages companies to identify and reveal how they can significantly push forward the sector for the benefit of customers, communities and the environment. It considers the policy areas of customer affordability and acceptability; costs; outcomes; and risk and return¹⁰ (see Figure 2.1, above).

Companies that reveal ambitious proposals will be rewarded because their plans will:

- deliver better value for their own customers;

¹⁰ South Staffs Water asked for clarification on how companies can demonstrate ambition on risk and return – we will assess companies' proposals to voluntarily share outperformance when we consider their ambition on enhancing affordability (Chapter 11 of [our final methodology](#), Section 11.3.2).

- challenge the sector - when we use the information they reveal to set more stretching price controls which benefit all customers, communities and the environment; and
- require limited intervention – allowing companies to reduce their engagement in the price review and focus on delivery.

We will not, as suggested by some respondents, consider companies proposing significant improvements from a poor outturn position to be ambitious unless their proposed improvements are sufficient to be sector-leading or require limited intervention or improvement. However, when determining financial penalty for any company categorised as lacking ambition, we will consider the level of ambition and the degree of improvement or intervention required in their proposals.

2.4.4 Mechanics of the QAA

Our PR24 final methodology does not provide additional guidance on the mechanics or eligibility thresholds of our quality and ambition assessments. We maintain our draft determination approach because:

- we want every company to seek to meet each of our minimum expectations for a quality business plan; and
- ambitious plans are developed when companies explore how, and how much, they can deliver for their customers, communities and the environment instead of these being prescribed - we will not stifle ambition by setting ex-ante thresholds for our ambition categories.

3. Rewards and penalties

The following sections relate to the rewards and penalties we will use to encourage quality and ambitious business plans.

3.1 Our final methodology policies

We will use a strong package of financial, procedural and reputational rewards and penalties to encourage companies to provide quality and ambitious business plans which reveal where the sector can go further to significantly transform its performance and deliver more for customers, communities and environment.

Rewards or penalties will be determined by each company's categorisation in the QAA.

3.2 Changes from our draft methodology

Having considered stakeholder responses, our policy positions on our package of rewards and penalties remains as stated in the draft methodology.

3.3 Stakeholder views

Stakeholders' responses were supportive of using incentives, particularly rewards, to encourage quality and ambitious business plans.

Some stakeholders were concerned that we may be unlikely to award the top categorisation to any company because no company achieved the top categorisation at PR19. Consequently, they considered the incentives to be skewed towards penalties because they are not confident that the higher rewards would be awarded and therefore would not be worth the opportunity cost of trying to develop an ambitious plan.

A small number of stakeholders thought the use of financial penalties for companies categorised as lacking ambition or inadequate was not appropriate because they will limit companies' abilities to attract investors, finance their functions and, consequently, to invest in delivering improvements. Some stakeholders considered that strong reputational penalties will exacerbate these issues.

Some stakeholders were concerned with our expectation that companies should state their categorisation prominently, particularly in communications with customers. They considered there is ambiguity in this expectation regarding how and where companies should display

their categorisation, which could lead to inconsistent approaches. Additionally, some companies were concerned that the categorisation should not be featured in communications with customers, but only with key stakeholders and other companies, as it could be misunderstood.

Some companies called for additional procedural benefits. Specifically, that we should reintroduce early draft determinations for business plans that require little or no intervention. They advocated that this reward would allow eligible companies to get an early start on delivery.

Finally, a small number of stakeholders considered that companies with strong outturn performance should be rewarded with a less onerous assessment. They consider this would encourage every company to improve its outturn performance.

3.4 Our final decisions and reasoning

In the following sections we provide our final decisions and reasoning for QAA rewards and penalties.

3.4.1 A range of business plan rewards and penalties

We will use multiple types of rewards and penalties because companies have told us that different incentive types are important to their internal and external stakeholders. Consequently, a broad package of incentives will optimise PR24 outcomes by maximising company engagement from a range of company stakeholders.

We maintain the use of reputational rewards and penalties because they provide strong incentives for companies to produce quality and ambitious business plans and ensure transparency for customers and other stakeholders. This was demonstrated after PR19 when companies told us they were strongly motivated to achieve reputational rewards and avoid, or improve their plans to reduce the impact of, reputational penalties.¹¹ And, in response to our draft methodology, two consumer groups supported strong reputational incentives.¹² When publishing our QAA categorisations, we will make it clear to companies which communications we expect their categorisation to be stated on to ensure a consistent approach, this will include specific communications with customers. We want companies to communicate with their customers on their plans for 2025–30 and beyond and the outcome of our price review, including our assessments of the quality and ambition of their business

¹¹ Ofwat, '[PR24 and beyond: Our reflections on lessons learnt from PR19](#)', December 2020, p. 92 and p. 94.

¹² Waterwise and Sustainability First.

plans. If companies take their customers on that journey effectively then opportunities for misunderstanding are minimised.

3.4.2 A stronger package of business plan rewards and penalties

We are strengthening the overall package of incentives in response to feedback during our PR19 lessons learnt exercise that the incentives offered were insufficient to encourage companies to push themselves to provide high quality plans which included sufficient ambition and innovation.¹³ Consequently, at PR19 no company qualified for our top categorisation.

The exact value of rewards is dependent on movements in the allowed return and base cost allowances between draft and final determination, although we estimate the reward for an outstanding business plan could be worth up to the equivalent of a 55 basis point return on regulated equity.¹⁴ The customers of successful companies will pay for these rewards (up to ~£4 per year on average)¹⁵ but our analysis of PR19 suggests that they are highly likely to represent good value for all customers. This is because:

- without strong incentives, no company might submit ambitious proposals at PR24; and
- the cost to customers of giving rewards to multiple companies can be more than offset when information revealed in sector leading plans is applied to stretch other companies to deliver more for their customers, communities and the environment.

Although we have strengthened the package of incentives to encourage companies to produce quality and ambitious business plans, stakeholders were concerned we might not award any company with an outstanding categorisation at PR24. We understand that these concerns could discourage companies from focussing on developing stretching and efficient forward-looking proposals. As a result, we assure companies that we are committed to awarding outstanding status to companies that reveal where the sector can stretch to significantly push forward the performance of the sector for the benefit of customers, communities and the environment during 2025–30.

The outstanding categorisation at PR24 is not the same as the top categorisation (exceptional) from PR19. This is because we have made key changes to the scope of the assessment of business plans and the rewards for those that will support the sector to significantly transform its performance. Specifically, we:

¹³ Some stakeholders questioned the role of the QAA incentives within the overall balance of incentives for PR24, this is considered in [Appendix 10 – Aligning risk and return](#).

¹⁴ Comprised of a +30 bps return on regulatory equity and up to + 25 bps for the allowed return and base cost allowances, informed by historical movements in these components.

¹⁵ Dependent on movements in base cost allowances and the allowed return.

- will conduct a more targeted assessment to determine rewards and will use other tools in PR24 and our ongoing work where they provide more effective policy solutions to issues, eg the innovation fund, performance monitoring and targeted engagement; and
- have strengthened the reward package – including reinstating protections from reductions in the allowed return in response to feedback on PR19.

In addition, PR24 will be our third totex and outcomes price review and so companies should have a clear understanding of ambition in relation to service levels and costs. We are also providing considerable guidance and opportunities for feedback before business plans are submitted. Taken together, companies are better positioned than ever to produce an outstanding plan. Outstanding status will provide companies with significant advantages and we strongly encourage companies to focus on developing and revealing stretching and efficient proposals.

3.4.3 Rewards

We will cap direct financial rewards at +30 bps on regulatory equity in each year of the 2025-30 price control. This is slightly lower than the highest direct financial reward offered at PR19 but is only one component of a stronger overall package.

We have reviewed and strengthened our package of rewards using more attractive procedural incentives. This is based on feedback from companies after PR19 that they considered:

- our commitment not to change specified aspects of their determinations between draft and final determinations less desirable than our PR14 commitment to protect them from reductions in the allowed return while allowing them to benefit from any increases;¹⁶ and
- there was little or no benefit from early draft determinations.¹⁷

Consequently, for PR24 we will:

- protect eligible companies from reductions in specified components of their determinations, rather than commit to no changes; and
- reintroduce protection from reduction in the allowed return and, for the first time, supplement this with equivalent protection for base cost allowances.

¹⁶ Ofwat, '[PR24 and beyond: Our reflections on lessons learnt from PR19](#)', December 2020, p. 92.

¹⁷ Ofwat, '[PR24 and beyond: Our reflections on lessons learnt from PR19](#)', December 2020, p. 96.

We will allow companies to benefit from increases in both allowances between draft and final determinations. Companies achieving these rewards should be able to reduce their focus on the price review. Consequently, they can instead focus on delivering for customers and the environment, substantially ahead of final determinations.

In response to our draft methodology, some stakeholders suggested we should reward any company that has performed well during the 2020-25 price control period with a less onerous QAA. Our QAA and associated rewards and penalties are designed to encourage companies to reveal ambitious forward-looking proposals and provide the information we need to have confidence in each business plan. Consequently, we set the same expectations for every company regardless of their historical outturn performance. Companies are encouraged to outperform their final determinations and are subsequently rewarded for their outturn performance in the 2020-25 period through ODIs, cost sharing and our annual categorisation of service delivery.

3.4.4 Penalties

The sector needs to significantly push forward its performance. Strong penalties discourage companies from producing plans which require material improvement or intervention to produce draft and final determinations – these plans do not further this aim. Despite the concerns raised by stakeholders regarding penalties, particularly financial penalties, we consider they are appropriate because:

- every company should be capable of passing our minimum expectations by producing a quality business plan – supported before they are submitted by considerable guidance and opportunities for feedback (see section 4); and
- companies can draw on their knowledge of two previous totex and outcomes price reviews and our considerable ex-ante guidance to inform their ambition in relation to delivering stretching service levels at an efficient cost to customers.

We will use direct financial penalties for companies categorised inadequate or lacking ambition at PR24. This is in place of the greater cost sharing rates used at PR19. Financial penalties expose companies to guaranteed financial adjustments from year 1 of the 2025-30 price control. In contrast, the financial adjustment for cost sharing is made at the end of the price control period and only if outturn expenditure is more or less than the allowance made in our final determinations. We consider that the increased certainty and immediacy of the risk of financial adjustments posed by direct financial penalties should have greater influence on the quality and ambition of companies' business plans at PR24.

The size of the financial penalty will represent the degree of improvement required in each company's plan. Financial penalties may be incurred as an adjustment to RCV that will have the same net present value to investors.

Plans from companies rated inadequate or lacking ambition require material improvements or intervention. This will put those companies at a procedural disadvantage because, unlike like companies with ambitious plans, they will need to maintain intense focus on the price review until final determinations and have less certainty with which to get on with delivering their proposals before then.

4. The QAA and our PR24 timeline

The following sections relate to the QAA and our PR24 timeline.

4.1 Our final methodology policies

We will reserve the strongest rewards and penalties for companies' first business plan submissions. This will encourage them to focus on producing a first submission which is of sufficient quality and will push forward the performance of the sector for the benefit of customers, communities and environment.

Table 4.1 demonstrates the opportunities we have provided and will provide for companies to influence our price review policy and receive guidance and feedback before business plan submissions. Where relevant we have mapped these to the areas of our QAA and provide links to publicly available reference materials.

Table 4.1 Opportunities to engage with our price review policy and receive feedback and guidance ahead of Oct 2023 business plan submissions

	Opportunity	Timing
Data, information and assurance	Query process on business plan tables	Throughout 2023
Long-term delivery strategy	Common reference scenarios development workshops ¹⁸	October 2021 – December 2021
	Discussion paper ¹⁹	November 2021
	Publication of guidance on long term delivery strategy ²⁰	April 2022
	Final guidance clarification workshop ¹⁸	May 2022
	Query process ²¹	Summer 2022
	Development and feedback meetings	Early 2023
Customer engagement, affordability and acceptability	Reflecting customer preferences in future Price reviews – a discussion paper ²²	December 2020
	PR24 and beyond position paper: Collaborative customer research for PR24 ²³	October 2021
	Collaborative customer research steering groups ²⁴	Ongoing since January 2022

¹⁸ Ofwat, '[PR24 long-term delivery strategies – Ofwat](#).'

¹⁹ Ofwat, '[PR24 and beyond: Long-term delivery strategies and common reference scenarios](#)', November 2021.

²⁰ Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022.

²¹ Ofwat, '[Responses to queries on long-term delivery strategies](#)', July 2022.

²² Ofwat, '[PR24 and beyond: Reflecting customer preferences in future price reviews – a discussion paper](#)', December 2020.

²³ Ofwat, '[PR24 and beyond position paper: Collaborative customer research for PR24](#)', October 2021.

²⁴ Ofwat, '[PR24 Collaborative customer research steering group\(s\)](#).'

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	Draft affordability and acceptability research guidance sent to companies	November 2022
	Company feedback sessions on draft affordability and acceptability research guidance	November 2022
	Publication of affordability and acceptability research guidance ²⁵	December 2022
Costs	Working group ²⁹	April 2021 – April 2022
	Discussion paper on assessing base costs ²⁶	December 2021
	Feedback and on draft drainage and wastewater management plans (DWMP) and meetings to discuss	July – September 2022
	Collaboration on DWMP data tables	Summer 2022
	Letters to water company CEOs on concerns around draft DWMPs ²⁷	Summer 2022
	Publication of cost assessment datasets ²⁸	October 2022
	Publication of performance commitment level datasets	Late 2022
	Cost modelling consultation	Spring 2023
	Cost adjustment claim consultation	Summer 2023
	Engagement meetings on WINEP and NEP	Early 2023
	Feedback on water resources management plans	Winter 2023
	Direct procurement for customers guidance consultation and workshop	Autumn 2022 and winter 2023
	Review of final DWMPs	March / May 2023
Outcomes	Working group ²⁹	Ongoing since January 2021
	Discussion paper on performance commitments ³⁰	November 2021
	Discussion paper on outcome delivery incentives ³¹	February 2022
	Publication of indicative outcome delivery incentive rates	Early 2023
	Feedback on bespoke performance commitment definitions	Summer 2023
Risk and Return	Discussion paper ³² and follow-up workshop ²⁹	Late 2021 and early 2022
	Consultation – PR24 and beyond ³³	May 2021

²⁵ Ofwat, [Guidance for water companies: testing customers' views of the acceptability and affordability of PR24 business plans.](#) December 2022.

²⁶ Ofwat, [Assessing base costs at PR24](#), December 2021.

²⁷ Ofwat, [Letter to water companies – Ofwat's industry overview of draft drainage and wastewater management plans 2022](#), October 2022.

²⁸ Ofwat, [PR24 – Cost assessment datasets.](#)

²⁹ Ofwat, [PR24 working groups and workshops.](#)

³⁰ Ofwat, [PR24 and beyond: Performance commitments for future price reviews](#), November 2021.

³¹ Ofwat, [PR24 and beyond: a discussion paper on outcome delivery incentives](#), February 2022.

³² Ofwat, [PR24 and beyond: Discussion paper on risk and return](#), December 2021.

³³ Ofwat, [PR24 and beyond: Creating tomorrow, together](#), May 2021.

Other	Standards for customer research ³⁴	February 2022
	Your Water, Your Say sessions	Late 2022 and early 2023
	Query process on business plan submission	Throughout 2023
	Methodology webinars and associated question and answer sessions ³⁵	July 2022
	Query process on draft methodology ³⁶	Summer 2022
	PR24 Wales forum	Monthly since March 2022

4.2 Changes from our draft methodology

For final methodology, we clarify that when determining the QAA categorisations and associated rewards or penalties we publish at the time of our draft determinations, we will only consider the evidence provided in each company's first submission and responses to clarification questions. However, to make sure that our draft determinations are robust and in the best interests of customers, communities and the environment we will request evidence we consider is missing from a company's first submission as appropriate.

4.3 Stakeholder views

We proposed a two-stage price review – in which most of the QAA occurs alongside our consideration of companies' business plans during the 'draft determination' phase followed by a 'final determination' phase.³⁷ Some stakeholders considered this would require sufficient engagement and feedback opportunities before business plans are submitted to compensate companies for the loss of the feedback they received after the initial assessment of plans at PR19 and so support them to produce quality and ambitious plans.

Some stakeholders highlighted the importance of opportunities for engagement between business plan submissions and draft determinations to make sure that determinations are robust and in the best interests of customers, communities and the environment. Similarly, a few stakeholders considered companies should have the opportunity to submit any evidence we consider is missing between October 2023 submissions and draft determinations.

A small number of respondents were concerned that we will provide little encouragement for companies to improve their business plans between draft determinations and final determinations. This is because companies that do not provide a quality and ambitious plan in their first submission cannot increase or, in extreme cases, achieve rewards.

³⁴ Ofwat, '[PR24 and beyond: Customer engagement policy – a position paper](#)', February 2022.

³⁵ Ofwat, '[Presentations and stakeholder questions – Ofwat](#)', August 2021.

³⁶ Ofwat, '[PR24 draft methodology stakeholder Q&A](#)', August 2022.

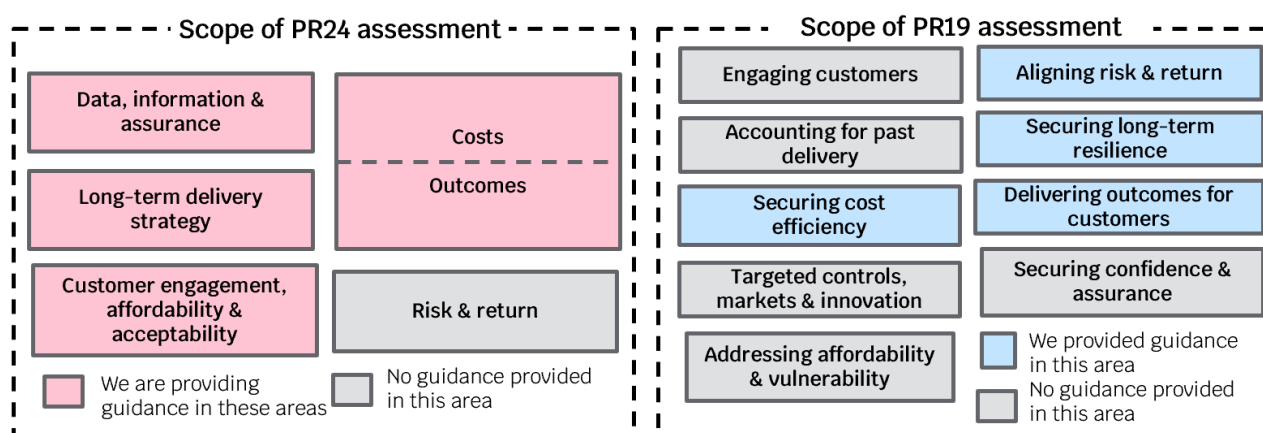
³⁷ Anglian Water, Dwr Cymru, Thames Water, South East Water, South Staffs Water.

4.4 Our final decisions and reasoning

We will conduct a two-stage price review at PR24 with the strongest rewards and penalties reserved for companies' first business plan submissions. We consider this will encourage companies to make sure their business plans are of sufficient quality and will push forward the performance of the sector for the benefit of customers, communities and the environment. We do not consider this disadvantages companies in comparison to PR19, when we had an additional initial assessment stage. This is because at PR24 we have:

- provided – and continue to provide as appropriate – extra opportunities for companies to contribute to the development of price review policy and receive guidance and feedback before proposals are submitted (see Table 4.1) and these cover more of the areas of our targeted business plan assessment (see Figure 4.1);
- set clear minimum expectations of a quality business plan; and
- maintained our totex and outcomes framework for a third price review – so companies have a clear understanding of ambition in relation to service levels and costs; and
- provided more time between final methodology and business plan submissions for companies to produce their business plans.

Figure 4.1 Scope of guidance and feedback opportunities at PR24 compared to PR19



In response to stakeholders concerned about engagement between business plan submissions and draft determinations, we clarify that we want to publish robust draft determinations that are in the best interests of customers, communities and the environment. To support this, we will request evidence we consider is missing from companies' first business plan submissions where appropriate. However, when determining the QAA categorisations and associated rewards or penalties that will be published alongside our draft determinations, we will only take account of:

- the evidence provided in the first submission; and
- responses to any clarification queries (other than new evidence).

Companies in the lowest categories are expected to improve their plans after draft determinations and - in exceptional circumstances - we may move companies out of the inadequate or lacking ambition categories. However, we will not allow companies to achieve financial rewards or increase their reward because of the improvements they make. This is because the strongest rewards are only available for companies that reveal where the sector can push itself to transform its performance and deliver better outcomes for customers, communities and the environment. We see no reason why companies cannot do this in their first business plan submission. Doing so after seeing the proposals of other companies - or after feedback from Ofwat - would be inconsistent with the principle of rewarding companies who reveal where the sector can go further to significantly transform its performance to deliver more for customers, communities and the environment.

**Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.**

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