

Centre City Tower, 7 Hill Street, Birmingham B5 4UA
11 Westferry Circus, Canary Wharf, London E14 4HD

By email

12 April 2023

Dear Regulatory Director,

Ofwat's reflections on development meetings for PR24 long-term delivery strategies

This letter provides our overall reflections on our development meetings with all water companies about how they are developing their long-term delivery strategies. At PR24, we expect companies to develop their five-year business plan in the context of a clear 25-year strategy. These strategies should improve decision-making about how to meet ambitious long-term outcomes and secure long-term resilience.

The challenges facing the water sector require a clearer focus on the long-term needs of customers, communities and the environment. We expect the strategies to represent a significant shift towards long-term adaptive planning in the sector. Delivering against higher stakeholder expectations will require major new investments at PR24 and beyond, creating upward pressure on bills. This underlines the importance of strong adaptive planning, so that the right investments are made at the right time.

We expect the strategy to be developed in the context of a wide range of future scenarios. Through adaptive planning, companies should ensure their actions and investment programmes take account of uncertainty and can efficiently adapt to different futures. This will help to deliver long-term ambitions and targets, for example on leakage, greenhouse gas emissions, and storm overflows, in a way that maximises best value.

Long-term delivery strategies are being produced for the first time at PR24. Our final guidance sets out how we expect companies to develop their strategy, so that it can meaningfully inform decision-making as part of the price review.¹ At the meetings, we asked each company to explain how it is developing its strategy in line with this guidance. While we have been encouraged that our ambition to increase the focus on the long term is widely shared across the sector, some companies have significantly more to do to meet our expectations. In particular, we identified key concerns in the following areas:

¹ Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022.

- **Core and alternative pathways:** some companies need to do more to identify low-regret investment in line with our definition, establishing what activities are needed now, and where decisions can be scheduled later in the timeline.
- **Scenario testing:** companies should ensure their strategy is robust to a wide range of futures. This includes applying the common reference scenarios for technology and abstraction reductions in line with our guidance, alongside other common and company-specific scenarios.
- **Delivering improvements from base expenditure:** we are concerned that some companies are not sufficiently challenging themselves to deliver stretching levels of performance from their base allowance, in the short and long term.

The strategies will inform our assessment of proposals for enhancement investment at PR24. They will be a key part of the evidence to justify the scale and timing of need for investment in 2025-30. They will also form part of the evidence base that the proposed investment is the best option for customers in relation to whether operational, phased or modular, or more flexible options may be more appropriate.

Through this exercise, we expect companies to integrate all their planned activities into a single, holistic, adaptive investment strategy. Our overall reflections are consistent with feedback we have already provided to companies on adaptive planning in their draft drainage and wastewater management plans (DWMPs) and water resources management plans (WRMPs). We expect companies to take account of this feedback in their final plans, which will then inform the long-term delivery strategies.

To help the strategies inform the price review process, we will assess whether each company has developed its strategy in line with our guidance and has taken account of any feedback.² Companies are welcome to go further than the requirements set out in our guidance, for example to cover additional areas as they consider appropriate. Long-term delivery strategies will be assessed as part of our quality assessment at PR24, where submissions that do not meet our minimum expectations will receive financial, procedural, and reputational penalties.³

The annex to this letter sets out our further reflections on the development meetings and the key points of feedback companies need to address as they finalise their strategies. Companies should consider this alongside the individual feedback they have received.

We would like to thank the sector for their engagement and look forward to receiving the strategies in October 2023. We expect that our approach will continue to evolve for PR29 and beyond, as we learn lessons from PR24.

² Ofwat, '[Creating tomorrow, together: Our final methodology for PR24](#)', December 2022, p. 155.

³ Ofwat, '[Creating tomorrow, together: Our final methodology for PR24](#)', December 2022, Table 11.1, p. 151.

Yours sincerely

Aileen Armstrong
Senior Director, Company Performance and Price Reviews

Annex: Our reflections on development meetings for PR24 long-term delivery strategies

Long-term planning has always been part of water companies' legal obligations.

They have general duties to provide and develop water supply and wastewater systems to ensure they will continue to be able to meet their obligations in the future. Alongside our other statutory duties, we have a duty to act in the manner we consider that is best calculated to further the resilience objective.⁴

We must also act in accordance with the UK government's strategic priorities for Ofwat (SPS) and the Welsh Government's strategic priorities and objectives (SPS).⁵ The UK SPS expects the industry to plan in a way which delivers value to customers, the environment and wider society over the long term. This will require companies to shift towards long-term adaptive planning. The Welsh Government's SPS expects us to challenge companies to ensure current and future resilience of water and wastewater services is understood and managed through robust, adaptive, and evidence-based plans.

To help deliver what is needed over the long term, water companies are producing long-term delivery strategies for the first time. In September 2022, we invited each water company to a meeting to discuss the development of its strategy. We asked companies to prepare a presentation demonstrating how they are developing their strategy in line with our guidance, covering:

- **how adaptive planning techniques are being used to develop the strategy**, the use of scenario testing and how this is shaping the company's approach to investment decisions;
- **what evidence is being sought to develop the strategy**, including customer and stakeholder engagement; and
- **an overview of engagement with Board and senior management.**

The best presentations demonstrated that the company's approach is following our guidance most closely. They showed company ownership of the strategy and that adaptive decision-making was being embedded to identify and optimise long-term investment. However, all companies have work to do to fully align with our guidance, and we are concerned that some companies did not demonstrate that they are developing their strategy in line with our expectations.

⁴ The general statutory duties for most of our work as an economic regulator are set out in [section 2](#) of the Water Industry Act 1991. We also have general environmental and recreational duties set out in [section 3](#) of that Act.

⁵ Defra, '[The government's strategic priorities for Ofwat](#)', March 2022; Welsh Government, '[Strategic Priorities and Objectives Statement to Ofwat issued under section 2B of the Water Industry Act 1991](#)', December 2022, p. 2.

All companies have individually received high-level written feedback on their presentation. This document summarises our overarching reflections on the meetings, which are set out according to the key areas of our guidance. This feedback and our company-specific feedback letter are given without prejudice to any subsequent decisions that we make during PR24 in connection with the business plan.

Ambition

Companies should clearly set out their long-term ambition in their strategy, explaining what they want to achieve over the next 25 years. This should be informed by a range of factors.⁶

We did not have any major concerns about how companies are defining their ambition. Most companies are exploring their long-term ambition collaboratively with their customers, including taking steps to understand and respond to the interests of future customers.

Customer engagement to inform the ambition should explore bill impacts

Where companies presented a draft view of their long-term ambition, it was usually informed by engagement on customers' priorities, but not the bill impacts of achieving it.

Companies should provide sufficient and convincing evidence that customers consider the forecast bill impacts of the strategy to be acceptable. Companies should consider the coherency between their proposed performance commitment levels for PR24, their forecast performance commitment levels up to 2050, and the customer evidence used to inform its ambition, and, where appropriate, to explain how and why these differ.

Core and alternative pathways

Proposing well-evidenced, low-regret enhancement investment at PR24 is important given the competing priorities the industry faces in the short term. We expect companies to **set out a core adaptive pathway which includes only low-regret investment**. This should include activities that are required:

- across a **wide range of plausible scenarios**;
- to **meet short-term requirements**; or
- to **keep future options open**, such as enabling work or learning and monitoring, where possible, or to **minimise the cost of future options**.

Where enhancement investment **depends only on certain circumstances, companies should present this using alternative pathways**, with decision and trigger points set.

⁶ Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022, p. 15.

Overall, the adaptive pathways expose the investment that is needed regardless of what future scenarios come to pass, through the core pathway, while providing a framework for assessing the optimal timing for 'higher-regret' investments, through alternative pathways.

The best presentations in this area most closely followed our guidance by explaining how they were embedding adaptive planning principles as part of their decision-making. This includes isolating low-regret investment, identifying where investing to support future options is likely to be cost-effective, and considering the optimal timing and criteria for decisions about 'higher-regret' investments in future.

The core pathway should focus on low-regret, best value investment

Most companies recognised that the core pathway should be low regret, but some companies' approaches may not identify low-regret investment in line with our definition.⁷

Companies should ensure their approach to developing the core pathway does not unduly constrain options. For example, some companies are forming a 'preferred' or 'initial' investment pathway based on a set of defined scenarios, then filtering out the lowest-regret activities to form a core pathway. This may constrain options, because investments that are optimal across a wide range of plausible scenarios may not have been selected in the 'preferred' or 'initial' pathway in the first place.

Similarly, selecting options based on only benign scenarios, then testing against adverse scenarios at a later stage, may unduly filter out options that are optimal across a wide range of plausible scenarios. The first stage of setting out adaptive pathways should be to identify the potential solutions that are likely to be needed under a range of plausible scenarios to meet the ambition.⁸

Some companies are basing their core pathway on benign scenarios only. This approach is not acceptable, as if more adverse futures come to pass, the costs of meeting long-term outcomes could be much higher. The core pathway should include activities required across a wide range of plausible scenarios, or to meet short-term requirements, or to support future options.

Adaptive planning principles should guide decision-making

The best presentations in this area set out how they are routinely exploring wider interventions, beyond large new investments, to meet long-term outcomes in line with adaptive planning principles. However, most did not demonstrate how they were considering the timing, nature, and scale of options to increase their robustness to future uncertainties.

⁷ Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022, section 3.3.2, pp. 21-22.

⁸ Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022, section 3.3.1, p. 20.

We expect companies to clearly explain how their strategy reflects key principles of adaptive planning. The UK Government's Supplementary Green Book Guidance sets out principles for well-designed adaptation measures.⁹ Companies should use adaptive planning principles to consider:

- where there are efficient options to meet long-term outcomes using **flexible, modular or adaptive solutions**;
- where **investments can be scheduled later in the timeline**, when there is likely to be greater certainty about what is needed; and
- where to **bring forward investment to create flexibility**, including to help schedule decision points later on and 'buy time' to create alternative options.

Decision and trigger points need to be evidence-based

Some companies appeared to be simply aligning their decision and/or most likely trigger years with the beginning of price control periods. We expect companies to explain how they have decided on the timing of these points, taking into account factors such as the lead time associated with options and the nature of the uncertainty being mitigated, rather than the timing of price review cycles.

Companies should also clearly identify the circumstances under which the alternative pathway would need to be followed. The level of detail required around decision and trigger points is particularly important where companies request enhancement expenditure at PR24 to support an alternative pathway.¹⁰

Scenario testing

Scenario testing should inform the development of the core and alternative pathways. We expect companies to use scenario testing to help **optimise the selection and timing of activities given future uncertainties**. It will also help identify key uncertainties that need to be managed by alternative pathways so the company can meet its long-term ambition.

The best presentations in this area most closely followed our guidance by explaining how their decision-making process prioritises the investment options that are most frequently chosen across a wide range of plausible scenarios, as well as setting out the criteria applied to select these options.

⁹ These principles include ensuring measures do not foreclose future options or unnecessarily constrain future choice, are efficient, effective and equitable under the widest set of all plausible futures, and enable appropriate modification of policies, plans and projects as the reality of the future becomes known. See UK Government, '[Accounting for the Effects of Climate Change: Supplementary Green Book Guidance](#)', November 2020, pp. 18-19.

¹⁰ In this case, companies should present compelling evidence and align with our key principles for enhancement funding for preparatory work. See Ofwat, '[Creating tomorrow, together: Our final methodology for PR24, Appendix 9 – Setting expenditure allowances](#)', December 2022, pp. 112-113.

Scenario testing should be used to identify the impact of different futures and optimise low-regret investments and alternative pathways

Some companies appear to be using scenario testing only to ensure the strategy is resilient to different futures, and did not demonstrate they were using it to optimise the investment programme against future uncertainty. Using scenario testing to optimise the investment programme is essential to demonstrate that short-term enhancement proposals are low regret. It will not be sufficient for companies to state that the strategy meets the ambition under all scenarios. They should provide sufficient and convincing evidence of scenario testing to support this assertion.

Companies should clearly evidence the impact of different trends and scenarios on their plans and options. They should evidence low-regret, best value proposals by showing that the selected investment and its timing are optimal given a wide range of plausible scenarios and their likely occurrence. We expect all companies to clearly explain their decision-making process, including how they have selected and optimised low-regret investments, and any assumptions made in doing so.

Using only plausible scenarios to develop enhancement proposals is crucial

Most companies set out they were testing the common reference scenarios individually, in line with our guidance. However, we are concerned that, by combining the 'plausible extremes' described by the reference scenarios, some companies risk justifying short-term investment based on very low probability scenarios.

It is essential that all enhancement investment proposed at PR24 is optimal given a wide range of plausible scenarios and their likely occurrence. Companies should provide evidence to demonstrate that the scenarios underpinning their investment programme are possible, if not necessarily the most likely. We expect companies to clearly set out the estimated impact of each individual reference scenario over the full period from 2025 to 2050. When testing each of the reference scenarios, it is for companies to determine the default position for other parameters. These should lie between the 'plausible extremes' described by the reference scenarios.

Technological developments need to inform phasing of activities

While most companies stated they were testing our common reference scenarios for technology, we saw limited evidence that technological development is informing decision-making around how enhancement activities should be phased over the long term.

It is important that an adaptive strategy does not assume technological development is static over time and is informed by scenarios where technological development could be faster or slower than current trends. Technological development and adoption, such as smart

networks and low-carbon innovations, will play a significant role over the next 25 years to reduce costs and improve outcomes. We expect companies to use the reference scenarios to explore the potential impact of technological development on the relative costs and benefits of options.¹¹ Companies should also consider the impact of a wider range of technological developments. This might impact the options selected in the short term, and where decision points may be set in the long term, given uncertainties around how technologies might develop in future.

Companies should account for the full range of uncertainty around abstraction reductions

Several companies told us the scale of abstraction reductions is a significant uncertainty around future enhancement requirements. It is therefore important that companies use the relevant reference scenarios in line with our guidance.

The approach to applying the low reference scenario for abstraction reductions in England, which is to 'assume only currently known legal requirements for abstraction reductions up to 2050', was agreed in April 2022 between Ofwat, the Environment Agency and the regional water resources planning groups. To form this scenario, companies in England should:

- include agreed WINEP changes and licence capping; and
- use the agreed BAU+ scenario to form a long-term view, but use local reviews to remove licence reductions with significant uncertainty, to form a plausible 'extreme low' scenario.

In Wales, we expect companies to test material company-specific or local scenarios, as they deem appropriate, to ensure the strategy is robust. This may include scenarios around future abstraction reductions, if considered a relevant factor to future enhancement requirements.

Delivering improvements from base expenditure

In developing their strategy, we expect companies to consider how performance improvements from base expenditure will help to deliver their long-term ambition.

The best presentations in this area most closely followed our guidance by explaining how they were planning to deliver on these expectations. They set out how they were forming a view of what base delivers over the long term before determining the additional enhancement required to meet the ambition.

Companies should provide an informed and stretching view of what base delivers over the long term

¹¹ Ofwat, ['PR24 and beyond: Final guidance on long-term delivery strategies'](#), April 2022, pp. 37-41.

Companies set out a range of views on what they consider they can achieve through base over the long term. The sector needs to transform its performance to meet the long-term requirements of customers and the environment. We expect all companies to challenge themselves to deliver stretching levels of performance from their base allowance.

The strategy should be built on a good understanding of how the company will effectively manage its assets, both in the short and long term. This should inform a clear narrative for each of the targeted areas of improvement, explaining how the company's approach to base and enhancement activities will contribute to meeting long-term outcomes.¹²

Engagement

We expect companies to engage with customers and wider stakeholders to develop their long-term delivery strategy. To enable a fundamental shift towards a long-term mindset, company Boards need to own and be accountable for their strategies.

The best presentations in this area most closely followed our guidance by setting out how the interests of both current and future customers were informing their strategy. Some companies are publishing a draft strategy for consultation, allowing customers and their representatives to challenge it. They also explained how the strategy would embed a stronger long-term focus across the business, including to drive engagement with their Board and shareholders around decision-making for the long term.

Strategies need to be informed by stakeholder views in a range of areas

The meetings did not raise any major concerns about how companies are engaging with customers, wider stakeholders, their Board, and senior management. However, we consider most companies could have done more to demonstrate how this engagement was driving decision-making and culture change.

We reiterate our expectations that:

- companies should use customer engagement to inform their ambition, the selection and sequencing of key investments, and considerations about affordability and fairness between current and future customers, in line with the standards we have set out;¹³
- the views of wider stakeholders should inform the ambition and the core pathway; and
- company Boards should challenge company management to ensure the strategy is the best it can be, and provide assurance according to our requirements.¹⁴

¹² Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022, p. 16.

¹³ Ofwat, '[PR24 and beyond: Customer engagement policy – a position paper](#)', February 2022, pp. 5-12.

¹⁴ Ofwat, '[PR24 and beyond: Final guidance on long-term delivery strategies](#)', April 2022, section 3.6, pp. 32-33.