

A fresh water future?

Five more wasted years? Missed opportunities in the PR24 Price Review Methodology



Nik Perepelov is Senior Policy Officer for Water at RSPB England. In a detailed assessment of the latest periodic review (PR24) methodology, he argues a root and branch review of the regulatory paradigm is needed to ensure that water companies not only reduce pollution, but become key, active delivery agents of nature recovery.

Introduction

Ofwat published the final Price Review methodology, in mid-December, setting the framework for water company investment from 2025-30, which is expected to see a massive increase in new infrastructure, as well as funding the day-to-day activities of water and sewerage companies. A successful methodology can act as a major driver towards addressing public outrage on sewage spills and meeting nature recovery targets. A continuation of the status quo will likely see aging infrastructure perform ever more poorly whilst patchy, inefficient investment fails to tackle the most pressing issues that our waterways face.

Despite some positive elements, unfortunately the new PR24 assessment methodology does not give adequate weight the need to invest in nature-based solutions (NbS) and too much historic baggage from the existing regime will continue to act as blocker on green infrastructure. The issues with the methodology are compounded by the wider environmental policy landscape and so 2025-30 will struggle to be the transformative period our waterways desperately need. This comment piece summarises some key features and missed opportunities. This is not intended to comprehensively analyse every facet of the methodology. Instead it focuses on three main elements of the Price Review – performance commitments, assessment frameworks and incentives – considering these through a pro-nature lens, concluding with some thoughts on what a deep green approach to regulation could look like.

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Performance commitments (PCs)

Performance Commitments (PCs) form part of the “incentive” bit of the regulatory framework. Water companies commit to certain targets on, elements such as, leakage, and can earn a return (or lose money) for over- or under-delivery. The value of individual PCs varies, though in sum they account for around half the return that a company can earn, so they are a significant driver of water company activities. Ofwat have greatly expanded the list of common environmental PCs (CPCs) for PR24, though it remains difficult to judge how much actual environmental improvement the new PCs will drive¹. PCs common to the whole sector, as opposed to water-company specific bespoke “BPCs”, simplify the regulatory environment, though the RSPB has raised concerns in our consultation that the urgent issues in Cornwall will likely differ from those in Cumbria, both ecologically and in terms of water company land ownership patterns and operations. PR24’s move towards standardisation enables sectoral benchmarking but potentially at the cost of local relevance and priority.

¹ The level of commitment will vary by water company, so we’ll know more when the draft PCs are out for consultation.

The river water quality PC incentivises phosphorus (P) reducing measures, which sits rather obliquely alongside similar requirements in Environment Act targets², WFD objectives, Nutrient Neutrality advice including an amendment in the Levelling-up and Regeneration Bill to tighten Permission standards at treatment works in Nutrient Neutrality catchments³. Disentangling these different drivers to judge how much better off our waterways is challenging.

The Ofwat river quality PC, unlike its legislative counterparts, does however contain a pragmatic option to move away from the use of concrete and chemical dosing at treatment works and agree catchment-based initiatives with local partners via the regulators. Government should take inspiration from this approach in how it allows regulators and the companies to interpret their duties under the Environment Act and associated nutrients policies⁴, on the principle that “when a measure becomes a target it stops being a good measure”. Packaging all the P reduction ambitions into bespoke catchment-based arrangements could be game-changer for NbS and partnership-based innovation to reduce environmental harm, rather than just hit overlapping but inchoate targets.

Performance commitments on biodiversity and operational greenhouse gas emissions may lead to a patchwork of locally significant nature-positive interventions, so long as the PCs are stretching (and the associated financial rewards are sufficient). Ofwat may want to consider being more explicit that the Quality and Ambition Assessment (QAA), a cash and cost benefit-sharing incentive⁵ attached the business plans themselves, will look closely at how the environmental PCs in particular have been defined with local communities and NGOs. Ofwat hints at allowing water companies a handful of bespoke PCs (BPCs) alongside the mandated CPCs. It should clarify that companies who don’t work to define publicly acceptable BPCs covering environmental issues in their operating landscapes will struggle to meet the threshold for “ambition” in the QAA.

² Note that water companies haven’t got a nitrate target under this framework, though account for around a third of emissions

³ For Ofwat acronym lovers, the phosphorus-relevant WINEP schemes are to be delivered by PCDs rather than the PC, which is separate again. See appendix 9 of the methodology.

⁴ These include WFD objectives, Nutrient Neutrality and protected sites objectives where nutrients are an issue.

⁵ This incentive is worth around 5% of the total return that companies can earn, or around £100m sector wide.



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Evolution of *Homo Aquanomicus* and Best Value assessments

Price controls determine how much companies can ultimately charge the consumer. Ofwat in turn requires agreed service levels and other outputs to be delivered. The business plans price up these various activities and yield an allowance that water companies can charge their customers. Ofwat's primary headache has always been to juggle their overarching duties to protect the customer whilst allowing investment to deliver resilient networks and statutory obligations. Many commentators have argued that the scales historically have been too heavily tipped in favour of keeping bills down.

More on that below, but one interesting move in PR24 is an apparent reimagining of what consumers value and the resulting definition of consumer protection. Spending in the past was justified primarily by the narrow metric of efficiency⁶. *Homo Aquanomicus* was only interested in lower bills and steady service provision. But in PR24 *Homo Aquanomicus* has apparently evolved, so Ofwat is in turn evolving its approach to assessing what customers want to see their money delivering.

⁶ Broadly speaking, industry benchmarks +/- adjustments - catch-up/frontier efficiency

In PR24, more weight will be given to a wider set of benefits that investment might deliver. These 'best value' assessments will try to capture, among other things, the environmental benefits of a scheme over 30 years. Where these benefits outweigh the costs and deliver greater value than the least-cost alternative, they should receive approval, tipping the scales somewhat in favour of nature-positive alternatives to traditional solutions. Ofwat have also introduced a new class of regulatory product - the Price Control Deliverable (PCD)- to define and audit the delivery of environmentally positive actions which are funded through the price review. PCDs may prove to be a decent vehicle for characterising outcomes rather than narrower outputs we associated with the WINEP⁷ in particular, which can free water companies to innovate away from traditional grey solutions. We have some promising early evidence of this in the accelerated investment programme of March 2023.

Yet, the push for best value doesn't extend as far as a common framework for assessing natural capital benefits in the round⁸. Instead, metrics developed for measuring the PCs will be used for assessing wider benefits where these are observed. This could prove restrictive, as the river quality PC for example only looks at P loading, best value assessments may ignore scheme features that address the wider set of pressures that our waterways face e.g. biodiversity. Ofwat's requirement that benefits not already captured in PCs or PCDs should not be a significant driver of costs may thus prove to be a significant limiting factor in moving beyond business as usual.

Rigorous assessments?

One continuing barrier to securing greater investment in nature-based over traditional grey solutions is Ofwat's stated requirements for 'rigorous' assessment on environmental benefits. This is a challenge, as the cost-benefit assessment framework has been designed around hard engineered solutions, with environmental metrics added on as something of an afterthought. Hidden deep within the assessment framework are implicit, though untested assumptions and values on what counts, how we should count it and how to handle uncertainties.

Best value is a relative assessment and the comparator for best value schemes (that is, the default) remains the lowest cost alternative. This embeds a largely untested principle that lowest cost is preferable, all other things being equal. Research on willingness to pay consistently shows

⁷ For clarity, reference to the Water Industry National Environment Programme (WINEP) in this piece excludes the Welsh NEP, which is handled differently by Ofwat and NRW.

⁸ Oddly, the WINEP itself *is* defined with reference to such a framework. So water companies and Ofwat are unlikely to be speaking the same language when it comes to justifying non-WINEP enhancement spend, base expenditure and all investment in Wales.

public support for appropriate investment in a clean environment. By extension, *Homo Aquanomicus* may not agree with the regulator on what ultimately counts, even where a wider set of criteria are counted as benefits.

In terms of how its counted and managing risk, the hurdle for most NbSs is their inherent operational variability, which makes performance difficult to assess upfront and introduces novel uncertainties that need to be understood and appropriately handled. Demonstrating technical compliance with legal and regulatory requirements is, the argument goes, less straightforward than with traditional engineered infrastructure. This contrasts with the apparent certainty of traditional infrastructure's performance. However, this distinction is less clear upon closer examination. For example, storage capacity is a good indicator of how a new reservoir is likely to perform, though prolonged dry weather will impact its actual benefits to water security in real-time. Likewise, a new product like wetwipes can fundamentally undermine the operational expectation of otherwise well-performing sewerage assets. The upfront assessment case has to appreciate and internalise these risks to performance, parking those that cannot reasonably be addressed and managing those that can. Other vulnerabilities associated with traditional infrastructure, such as cyber-attacks, power cuts and chemical supply chains are also deemed to be tolerable enough for the purposes of making the investment case in the first place, though all have impacted asset performance in recent times.

This comparison suggests that to some extent variability is the norm, and the challenge is to appropriately characterise (and mitigate) the risks inherent in different classes of infrastructure. The fact we do this well for grey, but not green, infrastructure is an accident of history and so the resulting definition of 'rigour' is cultural rather than strictly technical. In this way, Ofwat's approach to determining best value transfers the old standards of characterising benefits and risk management to a new class of interventions. Given that both the financial profile and the operational peculiarities of NbS differ so much from grey solutions, these benchmarks are surely inappropriate and demonstrates that the move to "best value" assessment is incomplete without a more fundamental review of the assessment framework.

Thus, even the shift to best value assessment sees NbSs compete on the unlevel playing field of a value-laden assessment framework, in an entirely 'bottom-up' fashion. Rather than trying to retrofit these new types of scheme into a framework that is structurally biased against them, Government should empower Ofwat to take more of an upfront view on the types of scheme they would like to see brought forward, and designing

innovative mechanisms to underwrite unavoidable risk and uncertainty⁹. This would add a 'top-down' component to decision-making. If this seems at odds with how we typically determine infrastructure investment ("picking winners"), it is worth reflecting that we already know we need – and are committed to deploying *en masse* – upland peat restoration, wetlands, river restoration and SUDS, among others. These can all play a part in water management too. The real delivery risk is therefore not that NbS may fail to meet a narrow conception of compliance. Instead it is the risk is over-delivering on carbon-intensive infrastructure when we already need green infrastructure that will also do some of the job. Ofwat therefore need to take stock of our existing nature recovery commitments and consider what is left for grey infrastructure to backfill, not the other way round as at present.

Of course, Ofwat's existing models can form a useful part of the overall decision-making procedure, but it is worth recognising that they are a tool to get to a specific outcome: low-cost, low-resilience, grey infrastructure, as it happens. We will need more appropriate tools if we agree that we want different outcomes. And we must lean into and manage the new uncertainties these tools will bring.

There would be a lot of challenges involved with moving to any kind of different model. If companies were perceived as performing well, then the demand for a change would be lower. The work is part of a discussion about what customers want from water utilities in the future. We probably need to have some kind of national conversation about this issue.

Enhancement spending, TOTEX and the WINEP

This takes us to our second bit of the regulatory framework. If water companies can deliver services or outputs more efficiently than the business plan sets out, they get to keep some of the difference¹⁰. This is because the allowance they get is just a total agreed budget for a package of services and outputs, it doesn't generally prescribe how those¹¹ services are delivered, so there is flexibility- and incentive- for water companies to innovate (or, as has too often been the case, sweat assets).

In accounting jargon, this is known as TOTEX allowance i.e. total expenditure, and delivering agreed service levels more efficiently than the TOTEX allowance accounts for around a quarter of the return that a water company can earn. TOTEX in PR19 was around £50bn, of which £10bn was

⁹ This is more or less what the major infrastructure programme RAPID is (in part) set up to do.

¹⁰ How much they keep is informed by the QAA assessment discussed above, with the best plans winning the right to split overspend (and underspend) 50/50.

¹¹ Though see below for a key exception

for investment in new assets (called “enhancement expenditure”¹²). The PR24 methodology mentions a few times that this will almost certainly need to be much larger for PR24 and rumours since suggest a programme of three to four times that of PR19. After decades of under-investment, this is heartening to hear¹³, though naturally raises the question: what will the money be spent on?



Photo credit: Ben Andrew

Here the answer is less than compelling. Typically, the environmental enhancements that English water companies are required to deliver are captured in a formidable spreadsheet called the Water Industry National Environment Programme (WINEP). This is worked up between the water

¹² The rest- operational costs, maintenance, wages etc- are considered “base expenditure”.

¹³ Though consumer bill impacts need to be carefully managed, particularly against the backdrop of wider cost of living concerns. Ofwat and the water companies need to ensure that investment does not push people in water poverty. Use of voluntary “Green Tariffs” should be explored for those able and willing to pay more for environmental improvements.

companies, regulators and Natural England to take high level environmental legal requirements and translate these to investigations, monitoring schemes or works on the ground. Valued at around £5bn in PR19, the WINEP is probably the largest single environmental investment mechanism in England (though ask your friends if they have ever heard of it).

Unlike the rest of the TOTEX allowance, WINEP spend has historically been tightly linked to a specific line on the spreadsheet- *this work here* to address *this issue*. Mere mortals are not privy to the discussions that decide what populates these cells, though a prescriptive and risk-averse approach has made it difficult to reimagine the outputs as outcomes deliverable through non-traditional means. This lack of transparency itself seems something of an oversight, given the massive value that local knowledge can add to figuring how to best achieve our environmental objectives. The WINEP methodology and Ofwat's assurances in the PR methodology suggest a move towards an outcomes-based WINEP, though, as discussed below, in practice many of the targets that WINEP actions are designed to deliver may not readily lend themselves to creative, nature-positive reinterpretation.

The WINEP is intended to reflect collaboratively-produced plans on drainage (DWMPs), water resources (RRMPs, WRMPs), WFD objectives (in RBMPs), floods (FRMPs) and other relevant legislative drivers (e.g. bathing water status objectives). If you're not drowning in acronyms, the point is that there ought to be plenty of opportunities to influence the WINEP and co-develop landscape scale catchment initiatives, which is the sort of thing we'd like to see. But these things take time to design and resource-strapped local stakeholders cannot commit resources to chasing rainbows. The planning process¹⁴ this time round has been a bit of jumble¹⁵. Instead of sustained and sequenced engagement and staged refinement of plans, the WINEP is currently being agreed behind closed doors whilst many of the plans which should ideally inform it are still being consulted on. Ofwat has even sent the DWMPs back for further refinement, ensuring that from the point of view of external stakeholders, the WINEP cart will precede the strategic planning horse¹⁶.

So whilst the methodology has warm words on outcomes, Nature based Solutions, catchment based initiatives and so on, the issue is that from the point of view of many stakeholders, the ship seems to have already sailed. Ofwat and Environment Agency have commendably invited companies to

¹⁴ That is, the suite of strategic planning documents relevant to the PR, not the neighbour's house extension.

¹⁵ Ofwat apparently acknowledge a version of this issue see appendix 9 p135.

¹⁶ Water companies will have been exploring some relevant opportunities in their patches and commendable examples of good practice exist across the country. The issue highlighted here is that such initiatives emerge in spite of the wider planning process, instead of being baked firmly and consistently within it.

produce an “Advanced WINEP” setting out schemes that might not be delivered through the traditional WINEP process, but this too seems to sit within the wider dysfunction of the current planning cycle, so not easily defined with catchment-based partners.

Empowering local stakeholders, including the often under-resourced Catchment Partnerships, to meaningfully influence these planning documents and WINEP should be a first order objective for Ofwat in the next planning cycle. In the meantime, PR24 customer engagement requirements (which water companies also earn a return on via consultation on the plan itself and in-period via the “Measures of Experience”) should redefine water companies’ relationships with their customers, including local environmental stakeholders, who should be involved in the very earliest stages of the planning cycle. A within-period flexibility mechanism to revisit decisions in the PR24 WINEP should also be introduced to address the procedural short-comings of the current planning cycle.

What’s in the WINEP?

Even with better processes, the list of outcomes that the WINEP needs to deliver has ballooned significantly in light of the Storm Overflow Discharge Reduction plan, the Environment Act water target on phosphorous loading and potentially an amendment to the LURB which would see stricter emission standards placed on wastewater treatment works in Nutrient Neutrality (NN) advice areas¹⁷. There is a curious functional similarity of the WINEP itself to the storm overflows it is expected to improve, with Government using the WINEP as an emergency pressure relief mechanism for public anger. This raises mild concerns about the political independence of the regulatory process, which is surely one of its virtues (though investors have so far not cried foul¹⁸).

As with storm overflows, the resulting system may not reliably perform as intended. From a birds-eye view, these objectives are ostensibly pulling in the same direction. In practice, they are not written with the others in mind and therefore risk siloed investment with underwhelming impacts on the quality of our water environment. The sad fact is that we could stop storm overflows and upgrade all the NN treatment works tomorrow, and our waterways (including our most beloved protected sites) would still be close to collapse.

¹⁷ Alongside the small matter of belatedly getting 75% of relevant water bodies into good ecological condition by 2027 and meeting a host of other legally commitments and targets.

¹⁸ Ofwat’s 2022 investor survey, published more recently, showed a fairly significant fall in investor confidence on the question of independence. <https://www.ofwat.gov.uk/wp-content/uploads/2023/02/Investor-survey-results-2022.pdf>

Investment in addressing these issues will inevitably crowd out investment to achieve other goals (WFD 2027 targets anyone?).

In addition, for such investment as is made available, a strategic approach that looks across these targets is needed to maximise the benefits of investment, which is best managed at the catchment level via catchment permitting and nutrient balancing/trading, ensuring that money is spent on the most effective measures, rather than those prescribed up-front and behind closed doors to meet narrowly defined targets.



Photo credit: Ben Hall

Brief Aside on Nutrient Neutrality

Among those narrowly defined targets is yet another bias towards grey infrastructure, shown most clearly by the requirement to upgrade all larger WwTWs within NN catchments to technically achievable limits (TAL) for P removal. Treatment wetlands can be a viable and nature-positive alternative to such upgrades, especially as part of a wider catchment level nutrient mitigation scheme. The NN target is the clearest example of the family of the issues discussed above, namely, that even if a forward-thinking water company (of which there are several) could demonstrate the best value of a catchment-based hybrid approach to removing phosphorus, the NN law would nonetheless require them to bypass this in favour of an inefficient

WwTW upgrade. So in relation to NN as a driver for investment, we are not even operating with the limited conception of best value!

Multi-AMP funding surety

“Regulating for nature recovery (and net zero) presents a challenge that should ultimately see a wholesale reorientation of the regulatory settlement towards nature positive operations and outcomes.”

And so on to the third and final bit of the regulatory framework, namely the regulatory asset base (or regulatory capital value (RCV) in Ofwat’s nomenclature). Water companies are due to earn an inflation-adjusted return of around 3.5% on the value of their assets, measured as the RCV. Enhancement expenditure which is not paid for by customer bills within-period (known as Pay-as-You Go or PAYG) is added to the RCV and earns the Ofwat-determined allowed return for its economic life¹⁹. Growing the asset base is therefore a sure-fire way to profitability²⁰. Giving water companies a TOTEX allowance, alongside the need to recover costs necessary to achieve service level requirements, is a means of overcoming an implicit bias towards capital expenditure (which would go on the RCV and earn a return) versus operational expenditure (which wouldn’t).

Even so, Ofwat highlighted an accounting quirk that maintained a bias against OPEX-heavy enhancement schemes even in a TOTEX world. This arcane accountancy is, I promise, relevant to the environment, so please stay with me. To illustrate the point, consider that a large reservoir in the south of England might cost the best part of £300m to build²¹. This is one-off capital expenditure will be ‘recovered’ in a single AMP as enhancement expenditure²². The reservoir will cost just shy of £2m a year to operate (the OPEX). So the bulk of the lifetime cost is secured within a single AMP allowance and only the relatively small OPEX is subject to uncertainty around allowances in future AMPs. The costs associated with operating the asset would generally be assumed to feature as base expenditure in future AMPs and likely be covered in the TOTEX settlements in any event.

By comparison, nature-based solutions (NbS) tend to be (relatively) CAPEX light, but OPEX heavy²³ i.e. the ongoing OPEX accounts for a relatively high portion of the lifetime cost of the project. And the OPEX for managing a wetland in, say, year 8 will be similar to the OPEX in year 3. On that basis, such schemes require a higher level of funding certainty beyond the period they are initially funded in. Our five-year AMP cycle looks backwards when

¹⁹ The RCV is uprated for inflation every year so earned returns are real. Index-linked debt notwithstanding, this is not bad to be in the current macroeconomic climate. Clever financing strategies might help some companies earn a bit more than this.

²⁰ Though of course water companies need “fast” money coming in too to pay for day-to-day operations, debt repayments and so on, so they need to strike an appropriate balance between these revenue streams.

²¹ <https://www.ofwat.gov.uk/wp-content/uploads/2022/12/Havant-Thicket-CAM-final-decision-document.pdf> This specific scheme may be delivered by a third-party under DPC arrangements, so the example is merely illustrative.

²² Recall that ‘recovery’ means a mix of ‘fast’ PAYG and ‘Slow’ additions to RCV.

²³ <https://www.ecoshape.org/app/uploads/sites/2/2021/05/White-paper-Paving-the-way-for-scaling-up-nature-based-solutions.pdf> This is a fairly broad claim, though costs and profiles will vary depending on the scheme.

determining base costs for the forthcoming price review, and so a new asset classed as enhancement spend in one AMP would not show up as base expenditure in the next AMP, losing that much needed funding certainty for OPEX heavy NbSs.

Ofwat's proposed fix is to give a ten-year allowance for OPEX heavy projects which would "bridge" the gap between their initial allowance and then their appearance as normal base expenditure after the following AMP. This technical fix is important, though whether it will be sufficient to unlock NbS at scale is yet to be seen. The mixed views expressed by water companies on this proposal suggests that whatever its merits, this is not going to be the magic bullet that the sector- and the environment- needs.

Beyond the WINEP to deep green regulation

The WINEP is indeed the largest single investment programme available, but, there are serious question marks over how much environmental improvement it will deliver. The real failure of the PR24 runs much deeper, however. Regulating for nature recovery (and net zero) presents a challenge that should ultimately see a wholesale reorientation of the regulatory settlement towards nature positive operations and outcomes. To clean up the waterways, we need to go beyond the WINEP. We will need to look again at every aspect of the sector and marshal a wide array of solutions-technical, institutional and operational. These concluding sundry remarks set out where to start. None of these are addressable overnight, but set a longer-term goal that a deeper green regulatory approach could take:

General presumption in favour of nature positive operations: currently lowest cost engineered solutions and operations have a de facto preferred status in the current set up²⁴. Ofwat have it within their gift to shift away from this presumption in favour of traditional solutions to a general presumption against them. A presumption in favour of nature positive-solutions should be embedded in all the optioneering and assessment that informs the business plans and statutory planning framework. This would see concrete and chemicals as a last resort where no other viable options exist.

Cost-sharing: the various cost sharing mechanisms throughout the methodology, such as the efficiency incentive outlined above, should be rigged in favour of low carbon and nature positive interventions. In other words, for both base and enhancement expenditure, water companies should be able to keep more of any savings that arise from nature positive measures, further strengthening incentives to get away from traditional concrete and chemicals.

²⁴ The discussion of Ofwat's cost modelling and NbS above is a specific instance of this general malady.

Contestable activities and competition: competition for service delivery should see third parties able to bid to deliver a wider range of regulated outcomes. Ofwat should encourage water companies to be market makers for dynamic markets in environmental services where these can achieve regulatory outcomes on e.g. water quality (through NbS and land management), resources (by expanding shorter term markets in trades, demand shifting etc) or treatment (addressing barriers to nature-based and/or low carbon wastewater solutions via New Entrants and Appointments). Competitive processes that already exist (e.g. Direct Procurement for Customers, sludge) should have strict environmental criteria written into tender criteria, covering scheme design & operations, as well as the credentials of appointees and their contractors. This should include preference for green and ethical investors to help drive the growth of the green finance sector.

Rate of Return: Ofwat administratively sets the rate of return earned on the RCV. Linking the rate of return to environmental performance would send a powerfully strong signal to water companies that the days of lax enforcement and oversight are truly over.

Further evolution of *Homo Aquanomicus*: Ofwat's narrow treatment of customer protection must reflect that where environmental targets and statutory requirements are play, customers are already on the hook for associated costs, whether through water bills, general taxation or some other mechanism. On that basis, the assessment that would otherwise conclude that a certain activity is unaffordable needs to first net off the cost that customers would otherwise be facing for delivery of the relevant target. *Homo Aquanomicus* cares about their overall bank balance, not just their water bill. So in the same way that energy bill levies have funded the low carbon power transition, water bills are an under-used mechanism for getting us to nature recovery, and water companies are in turn an undervalued agent to drive the transition²⁵. Sustained consultation with informed stakeholders is needed to keep consumer priorities at the forefront of water companies' minds, even if there isn't a PR or planning document deadline looming (ideally, in fact, before too many decisions have already been taken).

Assessment and reward: Ofwat are proposing to bring principles on performance-related executive rewards and dividends into the licence itself. This might prove to be a positive first step, though I reserve the right to call for stricter controls on such rewards if even this move fails to improve performance. EA's Environmental Performance Assessment should be

²⁵ They are also a handy way of making investment decisions now and spreading the costs fairly across current and future customers.

expanded in scope and be a material consideration in dividends and rewards policy to incentivise a race to the top.

Conclusion: what do water companies do?

The water companies too need a fresh identity as we face into the nature and climate crises. Observers could be forgiven for thinking that many companies' main focuses are good-enough service delivery, asset management and financial engineering. This more or less follows from the way they were initially privatised and are, to be fair, all important things²⁶. But though you wouldn't know it from this characterisation, their operations consist of abstracting water from the environment, moving it around the environment, treating environmentally hazardous effluent and discharging back into the environment. There are few, if any, any institutions with the same extent of operational dependence and relevance to the environment- from rainfall to coastal outfall and everything in between. This includes impacts from customer behaviour, land-use, urban design and issues below ground too. A cursory search suggests that the word 'cost' features twice as often as the word 'environment' in the PR methodology main document and from the earliest days of privatisation, environment has always been an ungainly bolt-on, rather than a core component of how we regulate. The artificial dichotomy between economic and environmental regulation must surely be the dark matter lurking in the background of the numerous environmental challenges that sector is facing.

But, given the unique position water companies occupy across their patches, who is better placed to address these issues, if properly instructed and incentivised to do so? If the regulatory purpose better matched the operational reality of the sector as environmental agents, and we move away from false-economy arguments pitching consumer interests against the environment, water companies are perfectly placed to deliver (or enable delivery of) some of our most pressing environmental objectives. If this seems a little far-fetched, it's worth reflecting that the low carbon power transition demonstrates clearly how regulated industries can drive transformative change in critical infrastructure sectors whilst enhancing service levels. Like their fossil-fuelled counterparts in the 1990s, water companies today are a significant part of "The Problem". By the 2030s, if we are to meet targets on nature recovery (importantly, not just those relating to water environment) they need to be "The Solution", just as the polluting energy companies of the 90s came to own the green infrastructure of today.

²⁶ Though some historical financial practices are dubious.

Like low carbon power has enabled decarbonisation of other sectors, water companies' enhanced role as catchment operators, or catchment nutrient balancers or ecosystem service buyers will enable landowners and developers to clean up their act too, whilst tapping into secure, bankable revenue streams. People who are minded to respond that "that's not what these companies do", may wish to consider that this was true of the fossil fuel giants and clean power as recently as a decade ago²⁷.

Conclusion

Taking nature recovery seriously is an economy-wide mission. Water companies, suitably reimaged, should be at the vanguard of that effort, though this PR methodology will be at best an awkward shuffle in that direction, maybe even followed by a corrective shuffle backwards once the Government's targets have been fully interpreted. My regrettable conclusion is that we're in for another five wasted years of piecemeal improvement against a general backdrop of overall flatlining or decline of our waterways and wider environment. This is not for a lack of short-term and longer-term potential from the sector. Instead, a lack of imagination seems to be the biggest barrier to doing things differently and, most importantly, better. In thinking about the future role of the sector, we should recall that these are ultimately licenced entities that do what their licence says they should do. If deep reform seems impossibly difficult, we should recall that there is nothing inevitable about the current approach to regulation. Parliament can easily legislate to make environment top of Ofwat's list of priorities, and Ofwat can impose that purpose on the companies with the stroke of a pen²⁸. Everything else necessary for the transition can fall out of these modest actions.



²⁷ We can argue, of course, about the exact role of the regulator Ofgem in *enabling* this transition. Delays with grid infrastructure in particular suggest that there is much more to do, so the point expressed here relates to the possibility of regulated industries refocusing their businesses and thereby achieve public goods, rather than any specific course of action by the regulators themselves. The comparison with water companies and their regulator is therefore not intended to be like-for-like.

²⁸ ...and a consultation exercise. Maybe head-off a CMA challenge too.