INCREASING THE ACCOUNTABILITY OF THE WATER SECTOR FOR ITS INVESTMENT WHILE ALLOWING IT MORE FLEXIBILITY

And how to do that without unmanageable complexity

September 2025

Improving accountability for and assurance of infrastructure delivery

Many of the Cunliffe review's recommendations aim to address a concern that water companies have not been held sufficiently to account for making the right investments at the right time, contributing to an erosion of public trust. Specifically, the review concluded that:

- there is no single overarching view of delivery and a lack of on-the-ground assurance, with PR24 frameworks appearing to be complex, disproportionately onerous in reporting and inflexible. [1]
- base spend (which includes asset maintenance) has seen little direct monitoring by regulators with little assurance that companies have delivered what they committed to in business plans. [2]

And recommended that:

- the delivery assurance frameworks (Delivery Plans and Delivery Monitoring Framework) that cover infrastructure capital spending across England and Wales should be reviewed during AMP8 (i.e., 2025-30) and rationalised. (recommendation 77);
- a review of the current Price Control Deliverable (PCD) framework in England and Wales should be completed before the end of AMP8, to inform a more robust and flexible framework, broadly set at programme level spending. (recommendation 78);
- under the supervisory approach, the regulator in England and Wales should provide assurance on how companies are delivering infrastructure spend (recommendation 79). The activity would be "risk-based, proportionate and informed by company performance" (i.e. using the revised PCDs) and should learn from the Tideway Tunnel's independent assessor.[3]

---

1 https://assets.publishing.service.gov.uk/media/687dfcc4312ee8a5f0806be6/Independent_Water_Commission_-_Final_Report_-_21_July.pdf (pp.406-407)

2 ibid.

3 ibid. (pp.408-410)

Before jumping to detailed solutions, it is worth recalling some of the reasons why the existing regulatory framework developed as it has. The totex and outcomes-based incentive regime was introduced by Ofwat in part because regulation was considered to have become too intrusive and detailed and that companies as a result had become too regulator focused and had a bias towards existing capital-intensive approaches to delivery rather than on innovating.

It is true that some of the totex/outcome freedoms originally given to companies at PR14 have been eroded in a piecemeal way over time (and perhaps that has led to the worst of both worlds?). The context has also changed, with the enhancement expenditure programme required at PR24 many multiples of PR19 and PR14 and expected to remain at elevated levels in future review periods. In any case, we think there is clearly an opportunity now to create a new, more coherent framework that remembers the lessons of the past rather than repeat its mistakes[4].

Expanding coverage of PCDs risks repeating the mistakes of the past

We focus on this note primarily on the Cunliffe review's recommendation to review the PCD framework.

Expanding the PCD framework to cover all spend (including most of base spend) might imply controls against the consumption of day-to-day inputs such as labour, chemicals and power – however, we think this is likely to be of limited value in practice and it is difficult to see how such micro-management would promote innovation, nor that this would be risk-based and proportionate (as the review's recommendation requires) - we therefore hope this will be quickly discounted.

The primary focus of regulatory policy makers will likely be on expanding PCDs into a wider range of expenditure to maintain and renew assets. An approach focused only on maintenance could still lead to worse outcomes for customers and the environment, however, if companies:

- lack sufficient flexibility to deal with risks as they emerge or become better understood or to changing consumer expectations;
- become clogged-up by additional regulatory burden and complexity;
- have perverse incentives to spend (or account for) capex rather than opex;
- can use any flexibility provided to game the system; or
- are left with insufficient incentives to identify alternative value-adding approaches in favour of a quiet life.

---

[4] We note here that PR24 included additional items to plug apparent gaps from PR19 (e.g., PCDs on some base expenditure and delivery assurance frameworks) and the outcomes of PR24 were out of scope of his review, but where Cunliffe does reference these he remains critical that they are insufficient in scope and flexibility.

Some of these are criticisms that appellant companies have made to the CMA about the existing PCD framework.

Our initial ideas for a more robust and flexible PCD framework

Achieving both greater accountability and greater flexibility without an unmanageable increase in regulatory complexity may at first sight look like it requires a regulatory conjuring trick. We think however that a carefully designed supervisory approach may allow these things to be achieved simultaneously. The following are our initial ideas for a future PCD framework.

For enhancement expenditure, an expansion of PCDs should be accompanied by an increase in the flexibility to allow for alternative solutions that are more cost beneficial or that can be achieved more quickly. This could build on the log-up/down process that occurred prior to PR14 where swap ins/outs may require sign-off by regulatory specialists currently part of DWI / EA – in future obviously part of the same regulator. The new supervisory approach could enable a greater level of strategic oversight compared to before, allowing the regulator to judge the extent to which it is fair that the company keeps some of the value it creates, depending on the context and based on a set of principles. Crucially for instance, this could help to ensure customers are not disadvantaged from any "holding-back" of alternative (i.e., cheaper) solutions by the company until after their revenues are set, equally it could also allow the regulator to take better account of the additional risks that these more innovative solutions might impose on the company.

For capital maintenance, we think that regulatory policy makers will need to remember that the term encompasses a wide range of expenditure types, at one end planned site rebuilds and on the other day-to-day decisions around whether you repair/replace with very direct trade-offs between opex and maintenance. It is likely to be helpful to identify these different characteristics and acknowledge that different approaches would be appropriate for different elements.

- **For planned site refurbs/rebuilds and network replacements** - companies could be expected to show that these expenditures are part of a long-term capital maintenance plan where the company sets out ex ante its asset maintenance/health plans across a 25-year timeframe and is held to account for progress against this over the 5 years via a PCD measure (Linked to the Cunliffe review's separate recommendation for a 5-10-25 style price review). To retain flexibility, there should be the possibility of swap/in and swap/out schemes and to find ways of optimising across sites.

- **Planned minor works (high-volume)** - e.g. stop-tap / meter replacements – Here we think it should be possible to estimate volumes ex ante (with a potential for "log-down" and possibly "log-up" ex post via PCD style arrangements) again set-out as part of a long-term asset strategy. There may also be the option to swap volumes between items (subject to supervisory scrutiny to avoid gaming). Above certain levels of materiality these could be linked to uncertainty mechanisms for in-period adjustments.

- **Planned minor works (Other)** – We think this area could most benefit from the supervisory approach, as this may make practical and proportionate:

- Interrogation of ***company asset risk scoring*** - A PCD style target could be to meet a certain aggregate total of risk scores and to remove all 25-scoring risks – the supervisor would need sufficient confidence that risk-scoring is consistent across the company and over time (but not necessarily across all companies).

- Alternatively, the NARMs example in UK energy is more **asset health (rather than asset risk) focused** - Ofgem requires companies to keep a detailed log of the condition of assets on their network, and updates these as assets age and deteriorate, and then as companies intervene to maintain/upgrade/replace assets. The money you are given at a price control then comes with a benchmarked commitment to maintain aggregate asset base within tramlines, but with freedom to trade "work" within that budget as companies see fit.

In our initial view the remaining categories of capital maintenance expenditure may be more problematic.

- **Reactive maintenance** – Here the need for expenditure may be inversely linked to asset health (i.e., better asset health implies fewer reactive jobs) and may be driven by a legitimate and most-economic "run-to-fail" strategy. This means that there is the potential for medium-term trade-offs with all the other categories above. We also note that the detailed accounting rules between opex (i.e., operational maintenance such as minor repairs) and capital maintenance may vary between companies.

- **Other (often called "Management and General")** – e.g., maintaining IT systems, replacing company cars and vans, here there are many choices and trade-offs between opex and capex.

Rather than attaching PCD-style controls to these, one option would be to consider rolling both into opex for regulatory purposes to avoid perverse incentives. The supervisor's role would be one of high-level oversight to ensure these operational maintenance decisions are being made on their true economic merits and not in any way gamed within the wider framework

Key takeaways

There is a need to improve the accountability of water companies for delivering the investments that are required of them but with greater flexibility to respond to new information. If implemented incorrectly this may:

- lead us back towards a pre-PR14 world where companies are not sufficiently able or willing to innovate;
- encourage companies to be simply regulatory contract managers where flexibility is used to game the regulatory system rather than to add long-term value;

Specifically on Price Control Deliverables we think regulatory policy makers should:

- reject PCD approaches that control consumption of inputs such as labour, chemicals and power;
- identify the different characteristics of capital maintenance expenditure and acknowledge that different PCD approaches will be appropriate for different elements – some expenditure could be treated akin to opex to minimise perverse incentives to swap between the two;
- consider how PCDs will fit within a 5-10-25 year approach to future price reviews;
- use the opportunity afforded by a supervisory approach to:
    - allow greater flexibility in PCDs across activities and across time while reducing the risks to consumers of gaming;
    - avoid unmanageable regulatory burden; and
    - give companies greater confidence that where their innovation leads to them bearing additional risk, these risks can be taken into account.

Annex

The following table summarises our initial ideas for future PCDs.

Table 1 Ideas for a robust and flexible PCD framework

Category	Potential PCD Approach	Flexibility	Role of supervisor
Enhancement - Investments to achieve new standards (e.g., WINEP).	Similar to now but increased flexibility within period to allow for alternative solutions that are more cost beneficial or that can be achieved more quickly.	Build from the log-up/down process from PR09. Swaps may require sign-off by regulatory specialists currently part of DWI / EA.	Check customers not disadvantaged by "holding-back" of alternative to after revenues are set. Allow the regulator to take better account of the additional risks that these more innovative solutions might impose on the company.
Planned site refurbs/rebuilds and network replacements – e.g. Water treatment works, and pumping station rebuilds.	Part of long-term capital maintenance plan - company sets out ex ante its asset maintenance/health plans across a 25-year timeframe and is held to account for progress against this over the 5 years via a PCD measure. This can be linked to Cunliffe's recommendation for a 5-10-25 style price review.	Create possibility of swap/in and swap/out schemes and to find ways of optimising across sites.	Would scrutinise swaps to avoid gaming of system.
Planned Minor works (high-volume) – e.g., stop-tap or meter replacements, mains renewals.	Estimate volumes ex ante again set out as part of a 5-10-25 year long-term asset strategy.	Potential for "log-down" and possibly "log-up" ex post – options to swap volumes to avoid log-downs.	
Planned Minor works (Other), e.g., Pump replacements at end of life, Operational Tech. upgrades.	interrogation of company asset risk scoring - A PCD style target could be to meet a certain aggregate total of risk scores and to remove all 25-scoring risks Alternatively, the NARMs example in UK energy is more asset health) focused - Ofgem requires companies to keep a detailed log of the condition of assets on their network, and updates these as assets age and deteriorate, and then as companies intervene to maintain/upgrade/replace assets.	The money you are given at a price control then comes with a benchmarked commitment to maintain your aggregate asset base within risk/health tramlines, but with freedom to trade "work" within that budget as you see fit.	Under both risk or asset health approaches the supervisor would need sufficient confidence that scoring is consistent across the company and over time
Reactive maintenance (fix on fail items).	Align regulatory treatment with rest of Opex	n/a	High-level oversight to ensure decisions are being made in best interests of consumers and not gamed with wider framework.
Management & General (Company vehicles, IT expenditure)	Align regulatory treatment with rest of Opex	n/a	
Opex	No PCDS		

AUTHOR

Phil Wickens

Associate Director

phil.wickens@frontier-economics.com