

Ofwat

Delivering Water 2020: Methodology for the 2019 price review

Background to CIWEM

CIWEM is the leading independent Chartered professional body for water and environmental professionals, promoting excellence within the sector. The Institution provides independent comment on a wide range of issues related to water and environmental management, environmental resilience and sustainable development.

CIWEM welcomes the opportunity to respond your consultation on the methodology for the 2019 price review. This response focusses on the areas that concern CIWEM as in independent body and has been produced with the expertise of our members that work in water resource planning, wastewater management and environmental protection.

Summary

- CIWEM is yet to be convinced that 'markets have a greater role to play' in the water industry. There is little evidence to show that the approach will deliver Ofwat's stated aims and there is a lack of the consideration of its duty to ensure the resilience of the environment upon which the water industry depends.
- Throughout the document environmental challenges are alluded to as threats to the delivery of services to customers, rather than as pressures upon the environment that need to be attended to in their own right. Rivers and groundwater resources are considered as assets, rather than as critical to the health and wellbeing of the water environment. Whilst Ofwat is an economic regulator, it has a resilience duty with environmental components and the importance of good stewardship of the environment on the part of water companies should be emphasised more strongly.
- The idea of customers as active participants is welcome, however there needs to be more consideration of environmental needs, alongside those of bill-paying customers. A separate body may provide a better and more valuable input.
- Ofwat should be more explicit in its encouragement of ambitious action to reduce per capita consumption. Increased metering and smart metering will promote greater customer engagement, better data and enable better management of the water supply network. Water efficiency and smart metering should be aims for all water companies, particularly in light of more frequent and longer droughts.
- CIWEM welcomes the aim for 15 percent leakage reduction but considers this provides less of a challenge to companies with high rates of leakage. Those that are poorly performing on leakage reduction should be expected to deliver a greater improvement.
- We consider the proposition that water companies should bear some of the cost of *deemed* over-capacity to be one that merits wide and detailed consideration. Customers need to be made

aware of the cost of resilience to different risks and of the cost of not having resilience to those risks.

- Ofwat should be doing more to ensure that a waste water management plan (WWMP) process is established as a matter of importance and urgency. Ofwat should urge water companies to produce WWMPs on a voluntary basis (as was the case for Water Resource Management Plans (WRMPs), before they became statutory obligations upon water companies).
- We doubt that the introduction of a separate price control for water and water network price controls will encourage significantly greater trading between water companies over and above those that are already under realistic consideration. We are concerned that it will not be able to deliver water when it is needed most, i.e. during drought.
- We have doubts as to the reliable volumes that might be provided to water companies by non-water company resource owners, particularly in the dry, drought and extreme drought events to which Government expect water companies to be resilient.

General comments

CIWEM considers that this consultation has not been written in plain English and there is little chance of ordinary customers reading and understanding it. We have also found the consultation period to be too short for a matter of this size and difficult to respond to given the timing over the summer.

We urge recognition of the benefit on focussing on managing and regulating for dry events, which are set to occur more often, and with greater impact on the health and welfare of people, business and the environment. It is to those challenges to which market based and other solutions need to be addressed and tuned, not to everyday supply-demand cost questions.

The introduction of markets and controls for water resources and network plus is part of the ongoing dismantling of vertically integrated, catchment-based WASCs, and we consider this is a backwards step, without regard to the hydro(geo)logical and environmental constraints around water resources, or the benefits that the current company structures bring.

The approach seems to run counter to the catchment based approach and will also hamper the technical delivery of water resource management plans. The methodology also places far too much confidence in demand forecasts if it expects to be able penalise companies for over-investment in resources for demands that do not materialise and where are resilience, drought planning and headroom in this context.

It is worth noting that some of the measures do not apply wholly or mainly in Wales, particularly around bi-lateral markets as the rules are different around retail competition/ wholesale. Generally these differences are noted within the document.

Commentary and responses to consultation questions

Chapter 4 Delivering outcomes for customers

Resilience to extreme events (p58). We support the need for the development of resilience to extreme events, and welcome its incorporation into the performance commitments that are specifically designed to deal with extremes, as opposed to the exclusion of extremes from consideration and assessment.

Risk of severe restrictions in drought (p59). We would like to see greater specificity in the common performance commitment on the risk of exposure to severe supply restrictions. We think that there should be a specific commitment on the use of level 3 emergency drought order measures, and another on the use of level 4 measures (e.g. rota cuts, bowser etc. supplies, standpipes).

Environmental performance commitment (p63). We regard the expectation that companies have “one or more performance commitments relating to their environmental impact” as a welcome start. We would like to see balance between managing the environment upon which water and wastewater service provision depends, and the delivery of those water and wastewater services.

Abstraction Incentive Mechanism (AIM) (p63). We welcome the requirement upon companies “to propose a bespoke performance commitment in line with the AIM guidelines” (p63), and to “propose financial incentives to accompany AIM performance commitments” (p63).

Water consumption/ water efficiency commitments (p56) – We support the inclusion of per capita consumption (PCC) as a proposed common performance commitment for PR19.

The calculation methodology for this indicator and target setting based on a frontier or percentage reduction requires further explanation in the final methodology. If it is estimated by dividing total consumption by total household population, as per the WRP tables, both values are estimates, are not measured and are subject to error and there is no correction for rate of household metering. The simple calculation will obscure a number of factors which affect household consumption, in particular occupancy which will vary between and within water companies. There are a wide range of indicators for consumption and “best practice” water efficiency that could be considered for the common commitment or bespoke commitments.

Water UK are currently undertaking work to explore the variation in reported PCC across England and Wales, as part of the Long Term WRP programme. This will provide some useful insights into this complex area.

Leakage performance commitment (p70). We support the need and drive for improved leakage reductions by companies. The ambitious minimum target to reduce leakage by 15 per cent is significant. This, combined with the leakage consistency work is likely to have a fundamental impact on leakage strategy and activity in the ‘baseline scenario’ in water resource management plan terms, and the use of leakage options as a response to supply-demand deficits in the ‘final plan scenario’.

However we are concerned, notwithstanding the use of percentage based reduction targets, that the blanket targets provide a softer challenge to companies with high rates of leakage, compared to those who have delivered recent improvements or who already have low rates of leakage. Those that are poorly performing on leakage reduction should be expected to deliver a greater improvement.

Outcome Delivery Incentives (ODIs) (p71/72). We support the proposal to raise the bar on ODI standards, by imposing penalties on companies that deliver average (and lower than average) performance on their ODI package (p72). We also support the proposal to stretch the range and vary the profile of penalties and rewards for outturn ODI performance (as shown in Figure 4.4 on p76).

Chapter 4, Q3: [Do you agree with our proposals for strengthening outcome delivery incentives?](#)

Yes CIWEM supports strengthening outcome delivery incentives.

Chapter 5 Securing long term resilience

Long-term resilience (p91). CIWEM supports the focus on delivering long-term resilience. However we consider the management of the environmental resource that sustains services to customers has been ignored. The focus is entirely on meeting customer expectations (however realistic or unrealistic), at affordable prices without apparent regard to the need for increased care in the use of water, under threat of increasing scarcity and increasing competition for resources between customers. Nor does it consider the changing needs of nature and the environment.

We support the continuation of (bill-paying) customer-focussed challenge groups, but we think that there should be an equivalent separate group to represent the interests of the environment. Experience to date suggests that environmental perspectives form an all-too-small part of most customer challenge groups, with the result that the perspective is often lost. Environmental externalities need to be reflected in water prices and water customers included in this discussion.

One area where customer engagement is critical is long-term resilience, particularly with regard to ageing infrastructure and the need for replacement. This is in part recognised through the ambitious minimum leakage targets identified. However much higher levels of investment are needed to catch up with the current <1 per cent asset replacement rates, particularly in the water supply network. This runs counter to the implicit expectation that bills need to be managed downwards.

Increased metering and smart metering will promote greater customer engagement, better data and enable better management of the water supply network. It will also go a long way to solving how to measure consumption. We recognise Ofwat is directed by government policy on metering, but when it is shown to deliver reductions in consumption of at least 15 per cent, this seems counter-intuitive. This is indicative of how higher level policies are dictating what can and can't be done, especially in the area of increased role of markets.

Assessment of resilience in business plans (p98). We consider the "specific" focus on companies' operational, financial and corporate resilience to be lacking with regards to their duty to ensure the effect of their operations on the resilience of the environment upon which they depend. We note the advice given on p99, that the "risk assessment should consider the resilience of the ecosystem" and that "firms should have regard to the wider costs and benefits to the economy, society and the environment, including the sustainable use of natural capital – that is, our natural assets such as rivers and groundwater" but we find reference to the environmental imperatives to be too little, and too limited (e.g. to rivers and groundwater as resource assets, rather than to the health and well-being of the water environment *in the round*).

The need for Waste Water Management Plans (WWMPs) (p100). The consultation document notes that there "is no equivalent to the WRMP process for wastewater services." We believe that there should be, that this has been noted for some time and that Ofwat should be doing more to ensure that a WWMP process is established as a matter of importance and urgency. We consider that at the very least, Ofwat should urge water companies to produce WWMPs on a voluntary basis (as was the case for WRMPs, before they became statutory obligations upon water companies).

Partnership working (p101). Mention is made, by way of an example, of the possibility that "water companies may work with other partners, such as local farmers, to decrease pollution and so reduce water treatment." We would like to see greater encouragement from Ofwat to companies on this front.

Environmental benefits from water trading and interconnectivity (p102). We welcome mention of the benefits that greater interconnectivity and water trading might produce for sensitive abstraction from water sources when flows and levels are low. As noted, we support greater awareness of the

opportunity to manage the environmental resource base in a sensitive manner, particularly where and when water is scarce, including through active use of the Abstraction Incentive Mechanism (AIM).

Chapter 5, Q1. Do you agree with our resilience planning principles?

No, we consider that much greater value needs to be placed on environmental resilience. See comments made above.

Chapter 6 Targeted controls, markets and innovation: wholesale controls

Encouragement of a long-term perspective, rather than a five-year one (p109). CIWEM supports this objective.

Water trading incentives (p116). We support the approach taken by Ofwat to encourage new water trades by increasing financial rewards for exporters and lowering the cost of trading for importers. We acknowledge that the extent of trading arrangements (cf. the volumes actually traded in a given year) to date may well understate that to come. In the future a rolling annual account of trades agreed and made, would be helpful, not least to check the actuals against the May 2016 estimate of potential savings from trading (cf other supply-demand balance solutions) of £810 million net present value.

The introduction of a separate price control for water resources (p117). We note the carefully-worded claim that the introduction of a separate total revenue control for water resources “will inform, enable and encourage an effective market for new water resources”. It may, yet as to whether it will deliver reliable new water resources when they are short (i.e. during droughts), is another matter. We wonder whether the cost to companies, and therefore to customers, of operating the water resources function under a separate price control from water network plus, for purposes of “revealing improved information that will enable us to set better targeted incentives” will prove to be worthwhile overall. The premise hinges upon the existence of third parties able to supply new reliable resources where and when they are needed, in the required volumes and at an acceptable price.

CIWEM doubts that the separation of the water resources and water network price controls will encourage significantly greater trading between water companies than those that are already under realistic consideration (including regional collaborations like WRE and WRSE, and inter-basin transfers like the Ely-Ouse and Severn-Thames schemes). We have doubts as to the reliable volumes that might be provided to water companies by non-water company resource owners, particularly in the dry, drought and extreme drought events to which Government expect water companies to be resilient.

Inclusion of raw water reservoirs in the water resources control (p118). We support this decision, in comparison to the option of including storage reservoirs in the water network plus control, based on the point of first abstraction being the boundary between the water resources and network controls.

Use of water resources yield as the proposed capacity measure for distinguishing between pre- and post-2020 investment (p120). We note the recognition on p121 that the average volume of water available from the environment (yield) is “dependent on the service level and the planning period, and is constrained by water resources control assets.” The corollary is that yield will need to be defined by a set of values, not a single one. We also note the consideration of unit cost of yield as an alternative value for the purpose of rating pre- and post-2020 investment based revenue. We think this has attractions, in the specific context and merits further analysis.

Risks of under- or over-investment in long term water supply-demand planning (p122). We concur with the view that supply-demand balance planning involves inescapable risks, and that there are costs

to under-utilisation of developed capacity. However there are also costs to the under-development of capacity, and to more-than-planned use of demand restrictions. We also note that the drive for greater resilience to extreme events is likely to entail the creation of greater headroom in the system (albeit mitigated by inter-connectivity between areas with different exposures to drought). This is a complex issue that will require careful attention.

We consider the proposition that water companies should bear some of the cost of (deemed) over-capacity to be one that merits wide and detailed consideration. Customers need to be made aware of the cost of resilience to different risks, and of the cost of not having resilience to those risks. Their appreciation as to whether the planning risk occurs or does not occur in the defined planning period is a further complication in this regard.

Chapter 6, Q2. Do you agree with our proposals for the form of control for water resources as set out in the Wholesale controls' chapter and appendix 5, 'Water resources control'?

We have reservations, please see comments above.

Chapter 14 The initial assessment of business plans: securing high quality, ambition and innovation

The approach (p258). CIWEM considers the approach to be appropriate, in context. We think the process worked well in the last round and we support its development for PR19.

Chapter 14, Q1. Do you agree with our proposed approach to the initial assessment of business plans?

Q1a: In terms of the nine test areas?

Yes, but see comments above.

Q1b: In terms of the business plan characteristics we want to see? (high quality, ambition and innovation)

Yes

Q1c: In terms of the business plan categories we propose to assign companies to? (significant scrutiny, slow track, fast track, exceptional)

Yes

Q1d: In terms of the financial, procedural and reputational incentives we propose to put in place?

Yes

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?

Not in respect of the environment. Aside from the claims that the environment could be a beneficial receiver of "better services and benefits" brought by innovation (p5) and that "high levels of innovation would result in benefits for customers, companies and the environment" (on p266), the topic receives no material attention. Environmental challenges are alluded to as threats to the delivery of services to customers, rather than as pressures upon the environment that need to be attended to in their own right. The need for maintaining and enhancing the wellbeing of the environment, let alone the means of doing so, receives little attention throughout.