

Response to Ofwat consultation

Water 2020 - regulatory framework for wholesale markets and the 2019 price review

We welcome the opportunity to respond to your consultation on wholesale markets and the 2019 price review (PR19). We are pleased to that you have asked the companies to demonstrate how they are taking account of future pressures such as population growth, improving environmental quality and improving resilience in the face of climate change. We agree with the prominence you have given these pressures. Delivery of Water Framework Directive (WFD) obligations will be central to providing a cleaner, healthier environment for people and the economy.

Reform

We support your proposals to open up markets for water resources and sludge as we believe that it will promote innovation, increase efficiency and reduce overall costs. As it is not yet clear how these markets will work in practice, we would want to ensure that by opening them up there is no additional environmental risks created. Reform needs to align with regulatory frameworks to ensure security of supply, resilience to an uncertain future and ongoing environmental protection. The consultation states that there will be a positive impact on customer bills but does not include the potential impact of additional investment that might be needed over the longer term. We would like to work with you as you develop your proposals for these markets to ensure that any environmental risks are minimised.

Resilience

We welcome the importance placed on resilience and long-term planning. However, it is not clear what you expect companies to do to address these issues, apart from using multi-period Outcome Delivery Incentives (ODIs). We believe that there is more that companies can do, and that your new resilience duty provides an opportunity to ensure resilience across all water company services. We look forward to working with you on the evidence that water companies will need to provide to justify additional expenditure on resilience.

The winter flooding has been a stark reminder of the impact of extreme weather on communities and the environment. We recommend more attention is given to flood risk management and the role water companies should play in better catchment management. PR19 is an opportunity to drive partnership working and innovation to achieve more outcomes for customers.

One outcome of the floods is likely to be a greater focus on integrated catchment planning and management. This should be central to water companies' business planning.

Customers and outcomes

We are pleased to see your continued focus on customers, outcomes and a totex approach to price control. In addition, companies need to deliver their environmental obligations, including Water Framework Directive requirements. We believe that you should propose a set of metrics to enable comparison across water company ODIs.

We seek assurance that any changes to the regulatory cost of capital and inflation indexation does not adversely impact on the scope of water industry ambition when delivering the environmental components of their plans.

Programme and timetable

Lastly, in your consultation you propose that water companies will submit their business plans in July/August 2018. This would mean that business plans would be submitted during the water companies' proposed Water Resources Management Plan (WRMP) consultation period. Hence, neither customer views nor ministerial guidance on WRMPs would be incorporated into business plans. In addition, some new environmental standards for chemicals and the results of ongoing AMP6 water company investigations will not be available to confirm all the statutory improvement measures required by this time. The indicative timetable presents a significant challenge for us; we would like to see an alignment of the PR19 timetable with other planning timetables, particularly the WRMP timeline. We would like to continue discussions on the timetable for business plan submission and the development of a process to handle uncertainty in environmental obligations.

In the attached annex, we have responded to the consultation questions that are related to our role. We look forward to working with you as you develop your proposals.

Further information

Further information or background to this response can be obtained from Richard Thompson, by post at Environment Agency, Kings Meadow House, Kings Meadow Road, Reading RG1 8DQ, by telephone on 07798830078 or by email at richard.thompson@environment-agency.gov.uk

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Annex 1 – Environment Agency response to Ofwat’s Water 2020 strategic level consultation questions

SQ1 Do you agree with our proposals for making a greater use of markets in relation to sludge and water resources?

Yes, we support your proposals for greater use of markets in relation to sludge and water resources. We believe that your proposals should lead to greater innovation, increase efficiency and reduce overall costs. However, opening up these markets has the potential to create environmental risks. Reform needs to align with regulatory frameworks to ensure security of supply, resilience to an uncertain future and ongoing environmental protection.

The consultation states that there will be a positive impact on customer bills but does not include the potential impact of additional investment that might be needed over the longer term.

Given that the detail on how these markets will work in practice is still to be worked out, we would like to help you develop your proposals to ensure they will not create any environmental risks

The potential benefits of £1bn from better sharing of water resources quoted in the consultation document are from 2010. Since then there has been significant further work on assessing the risk of deterioration in Water Framework Directive (WFD) water body status and we are concerned that the potential benefits may not now be so large. We look forward to working with you to understand how greater use of the water resources and sludge markets can be realised without causing deterioration in WFD water body status.

SQ2 Do you agree with our proposals in relation to the future form of regulation for the sector?

We are pleased that you have addressed the challenges of stretched water resources and protecting environmental quality in your summary document. We believe that any future reform of regulation should continue to have these challenges at its heart. We recognise the importance of ensuring that the costs incurred by water customers are fair and proportionate. However, we consider that the stated ambition of ensuring there is ‘no increase in charges for customers’ may not allow these future challenges to be adequately addressed. The scale of investment that is required to protect both customers and the environment could be significant.

We support the concept of taking a longer term approach by encouraging water companies to focus beyond the five yearly price reviews, which they already do in their 25 year water resources management plans (WRMPs). We believe that this will be advantageous both in protecting the integrity of intergenerational assets such as sewers as well as planning for environmental programmes that span several periods, such as River Basin Management Planning cycles. We also support the smoothing of the impact of 5 yearly reviews by the introduction of more in-period adjustments. We welcome further detail on how these adjustments would work and particularly how they may be able to deliver greater environmental benefits by introducing or bringing forward investment within a price review period.

We also welcome the proposed changes to outcomes. We support the use of a comparative approach and would encourage the use of data that we hold, such as the Environmental Performance Assessment, where possible.

SQ3 Do you agree with our proposals in relation to customer engagement and outcomes?

Yes, we agree that building on your 2014 price review (PR14) approach in relation to customer engagement and outcomes would be beneficial. As you recognised in PR14, it is important that water companies give sufficient weight to the environment, taking into account natural capital and the services that a quality water environment provides to society and the economy. In addition, companies need to deliver their environmental obligations, including WFD requirements.

Ofwat's expectations of companies customer engagement is rightly challenging and builds on PR14. We would encourage Ofwat to accelerate its thinking on customer engagement, in particular around resilience and willingness to pay. This will mean companies will have the time to implement the recommendations and enable a two-way conversation that informs their business plans. It takes time to consult on options for partner or community based options such as sustainable drainage. Ofwat could consider sequencing some of the guidance to allow the sufficient engagement on novel or more time consuming issues.

Ofwat and other regulators will have a role to play in providing checks and balances so that statutory duties are met and long term resilience is maintained. Whilst it is important for companies to be able to innovate and to develop their own outcomes to measure their performance, we believe that you should adopt out a core set of outcomes and measures that are consistent across the sector to allow comparisons to be made. These outcomes should be easily understood by customers and allow benchmarking of company performance. For example, reporting leaks as MI/day does not allow customers to understand how their company is performing against other companies and so it is difficult for them to challenge companies to set truly stretching targets. Measures already reported in our Environmental Performance Assessment could form the basis of a standardised set of ODIs. The Environment Agency would like to be involved in the design of any comparative outcomes/measures.

As we shift to a more customer centric approach for the delivery of water services the role of balanced, objective, easily accessible information for company performance is essential. Given this we would expect the standardised set of ODIs to be reported via the water industry strategic dashboard that is currently being commissioned by a cross industry group.

We respond to Ofwat's detailed questions on customer engagement and outcomes below.

SQ4 Do you agree with our proposal to extend protection of the RCV to 2020?

No response

Annex 2 – Environment Agency response to Ofwat’s Water 2020 consultation questions

Consultation questions: sludge treatment, transport and disposal market design – Pages 47/48

Q1 Do you agree with our proposal to have one separate binding price control for sludge treatment, transport and disposal?

In principle, we think that a separate price control for sludge treatment, transport and disposal would be helpful to ensure the development of the market in this area. This will help ensure an integrated, cost effective business unit for sludge treatment, transport and disposal.

Q2 Do you agree with our proposal to make a range of cost, price, capacity and location information available to facilitate the identification of trades?

We agree with your proposal to make a range of cost, price, capacity and location information available to facilitate the sludge market. We believe that this information is essential to assist in the operation of any market. In addition, to the criteria suggested above there may be a continuing and evolving need to provide more extensive data about sludge quality characteristics as defined by the European Waste Catalogue and to consider the outcomes from the Chemicals Investigation Programme. Additional information will be required for sludge spreading to land regarding the land bank, its capacity to accept sludge and its vulnerability to extreme weather. All market participants, i.e., not just the water companies, will need to agree a standards protocol for such data and information.

Do you agree that the data should be published on a STC and STW site level?

We think that this is a decision for the market participants to agree collectively. We agree that information should be at site level.

Do you agree that the data should be published annually?

We think that the data should be published more frequently as some data may change on a more frequent basis. The quality of sludge and the land bank availability will also change seasonally and be impacted by weather. Hence, to meet the market’s needs the data would need to be published and updated more frequently than annually. Therefore a more specific and dynamic approach to data provision may be needed as these factors and elements of sludge treatment and disposal will impact on costs. An example to consider for sludge material quantities, sources and destinations might be the National Operator Waste Returns. These are reported quarterly. <https://www.gov.uk/government/collections/national-operator-waste-returns>

Do you agree with the categories of data that we are proposing are necessary and appropriate, as illustrated in the tables?

See above

Are any missing?

See our response above regarding sludge quality and land bank availability and characteristics. We also consider that for recycling to land contingency storage facilities might also need to be available.

Q3 Do you agree that the information should also contain details of ‘bids’ in from third party providers, and that there should be guidelines for ensuring that such bids are assessed on a level playing field basis?

We agree that certain information should be included in ‘bids’ from third party providers although there are ‘quality’ related factors that will influence bids and will impact on creating a fair market. In addition, to the data set out in the consultation document, there needs to be standards or codes relating to market operation and codes of conduct and/or standards protocols that need further development and agreement from all those involved.

Q4 Do you agree that the data should be made available centrally through some form of information platform?

We agree that providing the data centrally seems sensible. Our main concern would be to ensure that best practice is supported by responsible operators.

Do you have any views as to how this might best be managed?

We believe that this is an issue for the market participants to decide. New entrants outside of the water industry should not be impeded from entering the market. The information platform should be open to all prospective participants.

Q5 Do you agree with our proposals not to make any changes to the status quo in relation to system operation activities?

We agree that the system operation activities can be managed by the market participants. However, it is not clear how those outside the water industry or new entrants will be accommodated without an independent or fully open system operator. Any market system operator approach needs to ensure an open market for any organisation whether they are a water company, waste operator or from outside. We recommend that operators' codes will well need to be developed.

Q6 Do you agree with our proposals not to have any specific financial incentives to support trading in relation to sludge at this time?

We agree that additional financial incentives should not be needed. However, we will need to work with you to ensure that there is transparency and consistency across all waste management operators in the sludge market.

Consultation questions: water resources market design – Page 61

Q7 Do you agree with our proposal to have a separate binding price control for water resources?

We agree that separate binding price controls for water resources and network plus will increase the transparency of costs for all elements of the water resource value chain. We would like to see this information used to set more targeted regulatory incentives to benefit the environment.

Q8 Do you agree with our proposal to implement an offset mechanism to ensure that entrants can recover the cost of new resources appropriately, while also ensuring that prices reflect average costs?

No response

Q9 Do you agree with our proposals to create a market information database and bid assessment framework to allow for the 'bidding in' of third party resource options on an ongoing basis – as set out in the Deloitte report?

We agree with your proposals for a market information database. We would like to make the following comments:

- We collect similar water company data as part of the WRMP and Annual Review processes. We would like to work with you to make sure we can share data by having the same data definitions and that the data sets requested are as consistent as possible to minimise regulatory burden.
- We would like to work with you to define the definitions for the environmental impact and security of supply categories.
- We would want access to the data to cross-check against WRMPs and Annual Reviews, etc.
- The bid assessment process will need to be joined up with, and made on an equivalent basis to the decision making process for WRMPs. If these process are not joined up

there could be different decisions made for the same issue/option, which would lead to inconsistencies between business plans and WRMPs.

- It should be made clear that bids can also include demand management options. This is currently included within the consultation as an option and should be promoted.
- The database should be set up so it is easy for bidders to gain a national and regional overview, and therefore put forward options that may solve more than one resource zones deficit.

Q10 Do you agree that a third party organisation may be best placed to manage the information database?

No response

Q11 Do you agree that measures should be introduced to increase transparency and certainty around security of supply for water trading? How can this objective best be achieved?

Yes, we agree that measures to increase transparency and certainty around security of supply for water trading are absolutely essential. There are risks to the supply demand balance through a more complex market and bilateral trading if measures are not put in place. We would like to work with you to fully explore how these measures can best be achieved. We comment on the proposals put forward by Ofwat in the consultation below.

- *Contract template*

We agree that this could be useful.

- *Mechanisms to help fund interconnector schemes*

We need more details on what these might look like. Ofwat need to be careful that any proposed mechanism does not promote any perverse outcomes. For example, that any proposed mechanisms do not cause deterioration in WFD status, or cause the spread of invasive non-native species.

- *Clearer non-discriminatory rules for supply curtailment*

We believe that these are essential. We would like more detail on what these rules might look like and would like to be involved in developing them.

- *Smarter contracting and hedging*

We are supporting Defra with its abstraction reform programme. The programme focuses on water trading for all abstractors. To achieve the objective of developing a successful trading platform we strongly encourage Ofwat to continue to work closely with the abstraction reform programme.

Key questions regarding allocation of the RCV – Page 69

Q12 Do you agree with our rationale for allocating the RCV?

We seek assurance that any changes to the regulatory capital value does not adversely impact on the scale and scope of water industry ambition when delivering the environmental components of their plans.

Q13 Do you agree with our proposed approach for allocating the RCV for sludge?

No response

Q14 *Do you agree with our proposed approach for allocating the RCV for water resources?*

No response

Consultation questions – Page 74

Q15 *Do you agree with our proposal to address stranded asset risks by extending our commitment to protect efficient investment included in the RCV to 31 March 2020?*

No response

Q16 *Do you agree with our assessment that there is no prospect for stranded assets due to the proposed form of control for sludge and water resources for the 2020-25 period?*

We are not convinced that there is no prospect for sludge treatment and disposal stranded assets as your assessment is based on relatively short asset lives. This might not be the case for some future sludge treatment assets. In addition, there are other elements that may influence the economic viability of sludge treatment and disposal such as: continued government support for electricity generation; current regulatory regime; changing environmental risks and local authority contracts.

Ofwat should minimise any risk of stranded assets to improve efficiency and protect the environment.

Q17 *Do you agree with our proposed approach of an income guarantee recovered through the network plus control for protection against the risk of stranding, if a mechanism is required?*

- How do you consider that such a mechanism could be designed to provide a simple, transparent, largely ex ante mechanism that preserves incentives for efficiency?

No response

Consultation questions – page 82

Q18 *In relation to water resources, do you agree with our proposals to implement an approach based on the average cost of providing ‘network plus’ activities?*

No response

Q19 *In relation to access prices for water resources, do you agree with our proposal that companies should be responsible for calculating and publishing these?*

- *Do you agree they should be published by water resource zone, with network distribution and treatment costs separately identified?*

Water resource zone (WRZ) boundaries are defined by water companies using guidance set out in the Water resources planning guideline based on risk of supply failure for water resources planning purposes. Hence, any use in relation to access pricing would be secondary. We think there could be issues with using WRZs for access pricing, for example:

- Water companies sometimes make pragmatic decisions to combine areas supply areas to avoid creating large numbers of small WRZs. This can create internal network constraints that are not apparent at the WRZ level and could mean that the access price does not accurately represent the access cost at a sub-WRZ level.
- Water companies often revise their WRZ following investment in their network or when they become aware of supply/demand issues at a sub-WRZ level. This would mean that companies would need to redefine the access price for any newly formulated WRZ.

We agree that network distribution and treatment costs should be identified separately as this may help to identify localised differences in water quality.

See also our answer to Q11 about security of supply issues that need resolving for increased third party trading.

Q20 *In relation to water resources, do you agree with our proposals to implement a mechanism that offsets the difference between the LRIC (or potentially the AIC in the absence of LRIC data) of new resource and the prevailing average cost of resource?*

No response

Q21 *Do you further agree that it is the incumbent's, rather than the entrant's LRIC, that should form the basis of the payment, to provide a stronger incentive for entry?*

No response

Q22 *In relation to sludge, do you agree that price and non-price terms should be the outcome of commercial negotiation, supported by the cost or price and capacity information previously set out?*

We agree that price and non-price terms should be determined by commercial negotiation. See also our response to Q2 and Q3.

Q23 *Do you support our proposals to develop high-level guidelines as to how rival offers in relation to sludge treatment, transport and disposal should be evaluated?*

Yes, we think that it is essential to develop high-level guidelines on how rival offers should be evaluated. The development of Best Available Techniques Reference Documents (BREF) notes could help deliver best practice across the sludge sector thus achieving acceptable sludge quality and a fair and equal market environment whilst protecting the environment.

Consultation questions – Page 84

Q24 *Do you agree with our proposals relating to the use of direct procurement on behalf of customers?*

No response

Q25 *Do you have any views on our specific proposal to set a £100 million threshold above which point we would expect companies to procure at market on a standalone basis?*

No response

Consultation questions – Page 94

Q26 *Do you agree that our proposal for four binding wholesale price controls should apply to companies whose area is wholly or mainly in Wales, as well as to companies whose area is wholly or mainly in England?*

No response

Q27 *Do you agree with our initial view that the network plus controls for water and wastewater and the water resources controls should be total revenue controls?*

We believe that it is essential for a pure revenue cap to be retained and any further measures implemented in a way that avoids creating a profit incentive to increase throughput of water that might lead to undue abstraction.

Q28 *Do you agree that future investment in relation to sludge treatment, transport and disposal should be exposed to volume risk and, accordingly, what are your views regarding the appropriate form of control in this area?*

There are potential risks associated with exposing sludge activity completely to volume risks that perhaps need to be considered further and decisions could be deferred until a review of any sludge market has been undertaken. This is because the role and importance of sludge

treatment and disposal as an element of overall sewage management needs to be understood. There are potential environmental risks if any part of this process breaks down locally through asset stranding or any other failure as it will lead to capacity and resilience being compromised.

Q29 *In your view, how should new investments be remunerated in the sludge and water resources controls from 2020?*

No response

Q30 *How can we best ensure that long-term contracting arrangements are not disincentivised – and that any continued application of a return on RCV approach for incumbents is on a level playing field with third party providers?*

Harmonisation of regulatory controls across sludge and waste management businesses needs to be developed before any sludge market is opened.

Consultation questions – Page 97

Q31 *Do you agree with our proposal to retain our RBR approach for PR19?*

Yes, we support your proposal to retain the risk based review (RBR) approach for PR19. This will ensure that you take account of how well companies have delivered on their existing plans when considering their proposed plans. The RBR approach provides an incentive for companies to perform well.

Q32 *Do you agree with our proposal to reflect current performance in our RBR assessment (and for CCGs to consider this as part of their report?)*

Yes, we agree with your proposal to reflect current performance in your RBR assessment.

Q33 *Do you agree that the RBR assessment should consider the extent to which the business plans are part of a longer term plan?*

Yes, we agree that the RBR assessment should consider the extent to which the business plans are part of a longer term plan.

It is clear that the challenges you outline in your consultation document, and faced by the water industry, require a long-term approach. Water companies already plan for at least 25 years in their WRMPs. We believe that there is more that companies can do, and that your new resilience duty provides an opportunity to ensure resilience across all water company services. We support the Resilience task and finish group recommendation that water companies should develop long-term wastewater, sewerage and drainage strategies.

Long-term planning allows companies to better assess and justify the need for investment in assets that will be paid for over and last many years. It encourages more integrated water management and greater efficiencies in delivery, with robust strategies and plans at the catchment scale. The aim should be to better align and manage interactions across planning frameworks including River basin management plans (RBMPs); WRMPs, strategic drainage plans, flood risk management plans and flood risk programmes. We would like to work with you to ensure that integrated catchment management is central to water companies' business planning.

We think that you should include appropriate milestones within each asset management plan (AMP) period so that achieving the longer term outcomes is gradually built up over time rather than towards the back end of any AMP period.

Consultation questions – Page 102

Q34 *Do you agree that the consideration of disaggregated cost models is appropriate given the price control structure proposed?*

No response

Q35 *Do you agree that the development of detailed cost allocation guidelines is appropriate?*

No response

Consultation questions – Page 107

Q36 *Do you agree with our proposal to retain the current timings of our price controls – that is, not change the duration of wholesale price controls, not to stagger wholesale water and wastewater price controls and not seek to further align the timing of controls with other planning processes?*

This is a multipart question. We have answered each part separately.

Do you agree ... not to change the duration of wholesale price controls?

We agree with your proposals not to change the duration of wholesale price controls.

There are advantages to short-term price control periods (such as the current 5 yearly price control) set in the context of longer term planning. Short-term price controls give companies the ability to adapt their plans to customer and stakeholder expectations, government legislation and policy, and environmental and social challenges. They also allow the companies to implement environment improvement solutions, where improved knowledge leads to tighter environmental standards. Short-term price controls should be set in the context of long-term plans, such as RBMPs, WRMPs, national and local flood and coastal erosion risk management strategies and the proposed wastewater, sewerage and drainage strategies.

A longer duration price control could impact on companies' abilities to implement solutions to meet environmental needs and obligations.

Increasing the focus on transition investment may help to combat some of the challenges associated with short-term timescales. We suggest that an early set of transitional allowances should be agreed upfront in the methodology as a proportion of the final PR14 allowance. This could then be adjusted in business plans according to evidence provided to help provide additional certainty.

Do you agree ... not to stagger the wholesale water and wastewater price controls?

We support keeping the wholesale water and wholesale wastewater price controls aligned to maintain an integrated and holistic approach to managing the environment. By aligning timescales there is more chance of finding potential savings and cost effective solutions between partners.

Do you agree ... not to seek to further align the timing of controls with other planning processes?

We believe that the timing of price controls could be better aligned with other planning processes.

Whilst the approach with managing uncertainty worked well for PR14, in PR19 we are further out of alignment with RBMPs. The consequences are that we will have much less certainty at the time of business plan submission. We will work with you and the industry to manage the uncertainty in PR19.

Q37 *Are there any other measures, not considered above that could help to encourage a longer-term approach?*

Ofwat should encourage water companies to include catchment management measures in their plans that provide water quality, quantity and flood risk outcomes as default in their plans.

The WRMP process provides a good example of longer-term planning. The 25 year timescale allows companies to assess need over the long-term and plan in best-value solutions.

Market reform should not make it more difficult for companies to do long-term thinking and planning.

Consultation questions – Page 109

Q38 *Do you agree that we should amend the licence to allow for in period adjustments for some or all of the following: outcome delivery incentives, revenues and cost sharing?*

We support your proposals to amend licences to allow for in period adjustments. This should remove or substantially reduce the need for end of period realignments. We particularly support this in relation to managing the National Environment Programme (NEP), performance, outcome delivery incentives and cost-sharing.

Consultation questions – Page 128

Q39 *Do you agree with our proposal to move to CPI (subject to the UKSA's final recommendations)?*

We note that for other utility sectors that use referenced measures of indexation, CPI is used widely in preference to RPI.

However, set against the environmental challenges that are identified as “known problems” in section 2.2 of the consultation, we would seek assurances that any proposed changes to the indexation mechanisms do not adversely impact on the scale and scope of water industry ambition when delivering the environmental investment components of their plans.

Q40 *Do you agree with our proposal to implement a CPI based approach, for both revenues (prices)? and the RCV, subject to a transition process?*

Q41 *Do you agree with our proposal to transition to CPI over time, both in terms of the overall method and the specific proportions of the RCV we are suggesting would remain indexed by RPI?*

No response

Q42 *Do you agree with our commitment to ensuring that any such change is value and bill neutral in NPV terms over time in nominal terms?*

We do not support the assertion that such a change can be value and bill neutral in the context of price review time frames (5 years) without a squeeze on other elements of the plans. Whilst we support the overall principles of minimising customer bills terms, there may be conflicts to achieving this when known challenges are accounted for.

Q43 *Do you agree that we should calculate the RPI linked element of the RCV based on forecast RPI with a true up at the end of the period to protect companies from changes in the difference between RPI and CPI over the control period?*

No response

Consultation questions – Page 141

Q44 *To what extent does the current balance of risk and opportunities vary across the proposed wholesale controls and how does this impact on the cost of capital?*

Q45 *To what extent would our proposed market and incentive reforms impact on the balance of risk and opportunities and the cost of capital and would this vary across the proposed wholesale controls?*

No response

Consultation questions – customer engagement – Page 155

Q46 What does good customer engagement look like?

Good customer engagement should be timely, transparent and include wide customer representation.

Good customer engagement should be joined up so customers are not asked different questions on similar issues and companies receive different answers on similar issues. Alignment of WRMPs and water company business planning processes would facilitate joined up customer engagement.

What are your views on the principles outlined above?

We were supportive of the approach to customer engagement during the PR14 process and we are encouraged that these principles will again be refined and built upon for PR19.

Section 7.1.1 (Exploring alternatives to stated preference willingness to pay (WTP) surveys) Companies used a mix of evidence alongside stated preference surveys to help inform customer needs and requirements. We support the overall principle of attempting to improve methods of stated preference surveys. We would be very interested in being involved in this area of development.

How could companies draw on good practice from within and outside the sector?

Ofwat could consider a task and finish group to learn from others.

How can companies make use of revealed preference techniques and information obtained in their day-to-day interactions with customers to develop a richer set of evidence of customers' needs and requirements?

The solutions of the future will not necessarily be the same as those in the past. Companies have choices in how they provide resilient services and need to articulate those clearly to their customers.

Standard improvements to willingness to pay (WTP) surveys should be driven by Ofwat led research. WTP surveys need to be more robust and include a wider set of preferences and values, so companies can present the long choices that companies and customers have to tackle the challenges of climate change and population growth.

We agree that companies should use a richer set of evidence of customers' needs and requirements. Information in companies' drainage strategies and stakeholders' plans should be used to help articulate the evidence and choices to their customers and partners. Resilience solutions should consider the cost of water supply and wastewater failure to the wider economy as well as customer preference.

Q47 What are your views in relation to our proposals on future CCG remit; scope; timetable; governance arrangements; and membership?

Section 7.1.5 (role of Customer Challenge Groups (CCG's)) - We support the principle that the role of the CCG is to challenge the company and provide assurance on the quality of a company's customer engagement; and the extent to which the results of this engagement are driving decision making reflected in a company's plan.

Section 7.1.5.2 (Scope of CCG remit) – Any moves to clarify the remit of the CCG should not constrain the potential of CCG stakeholders to contribute to plan areas outside of their primary expertise. Opportunity to contribute across the many facets of plan development is crucial and stakeholders should reserve the right to seek involvement on main bodies or sub-groups accordingly.

Section 7.1.5.3 (Membership) – Due to the identified “known problems” under section 2.2 (Environmental Challenges) we believe that you should recommend that the Environment

Agency and other regulators are invited to join water company's CCGs. In terms of overcoming undue burdens on organisations we are keen to promote a "One Defra" approach with colleagues such as Natural England.

We also support the proposals to build on the PR14 success through a section within the CCG reports setting out whether environmental regulators think that plans meet legislative commitments.

We agree that CCG need to better represent the local demographic. All CCGs would benefit from the inclusion of the stakeholders identified in section 3.6 of the consultation. These include businesses, farmers, householders, developers, central government, local government, risk management authorities, NGOs and different regulators. These stakeholders have a role in either planning or delivery. Their inclusion will help improve the quality of the discussion on shared outcomes and promote working together.

Ofwat should also consider how CCGs can help address the issues and challenges set out in section 3.6.

- ***In relation to the quality of a company's customer engagement, do you agree with the above list of issues that should be covered by the CCG report?***

Yes, the list includes a good breadth of issues for the CCGs to consider. To ensure CCGs challenge companies constructively and consistently they will need a clear framework for assessing companies' performance. Ofwat's should set out their expectation of CCGs in respect of long term planning. This is a potentially challenging area. We want Ofwat to promote best value long-term solutions for water company customers and the environment rather than short-term, 'least cost' solutions, implementing no regrets options and adaptive approaches to managing future uncertainties.

- ***What are your views on the division of responsibilities between CCGs and Ofwat?***

Section 7.1.5.2 (Scope of CCG remit) – We recognise that operating costs, financing costs and scheme efficiency are best challenged on a national basis by the economic regulator. However, CCG stakeholders should not be dissuaded from being involved in or challenging economic assumptions at a company level if that helps build a broader understanding for the betterment of plan development. In addition, PR14 highlighted the "collective responsibility" tightrope when "approving" or "endorsing" plans. This is an area that needs further guidance. Timely and transparent sharing of information is crucial, not just for CCGs, but also for partners wanting to plan with the companies on shared objectives and shared solutions. There should be clarity around what can and cannot be influenced so expectations are managed. For example, statutory environmental duties are an obligation.

The division of responsibility could be made clearer by showing which areas Ofwat lead on and CCG support. For example, Ofwat are responsible for ensuring companies plan for the long term and CCGs can provide evidence on the quality of engagement on long term issues such as resilience and affordability.

Q48 ***What are your views on our proposal to facilitate more collaboration between CCGs?***

- ***What are your views on our aspiration to publish information on the WACC and outcome RoRE ranges early?***

We support Ofwat's proposals to publish early indications of the WACC and outcome RoRE. The issuing of the WACC early is therefore important, especially when understanding the significance to customer led priorities.

- ***Without inserting ourselves between companies and their customers, what else could we do to incentivise and encourage good quality customer engagement?***

In PR14, some of our CCG representatives sat on more than one CCG. This was invaluable in sharing knowledge and experience. It helped to ensure that we provided a consistent input. We would support more collaborative working of CCGs in PR19.

We would support your aspiration to publish information on the WACC and outcome RoRE ranges early to allow proper consideration by CCGs. We would also support early publication of potential comparator ODIs to enable CCGs to benchmark their companies with others.

Consultation questions – outcomes – Page 162

Q49 How can the outcomes framework encourage a longer-term approach? Should we encourage, or even mandate, that certain measures - for example asset health – span more than a single regulatory control period?

Yes, we would support measures spanning more than one price control period.

We believe that there are advantages in encouraging a longer-term approach for some outcomes. For example, ODIs related to RBMPs could be based on these timescales. For some ODIs there will need to be flexibility to accommodate any future willingness to pay. We acknowledge that this will not be a factor for all ODIs. If longer term outcomes are established this should not preclude the company from being able to review and update these, to reflect any change in ambition or customer preferences, at the next price review.

We would not want to see ODIs related to the delivery of statutory environmental obligations. We would however, support ODIs that seek to deliver greater or earlier environmental benefit.

Q50 What are your views on the proposed contents of our November 2016 consultation on outcomes (balance of bespoke versus comparative measures, and role of comparative information)?

We believe that water companies should own their outcomes and performance commitments. We also believe that their commitments should include some comparative measures that allow benchmarking. We would encourage companies to use existing, well-developed and accepted measures such as our Environmental Performance Assessment. Any measure should be easily understood by customers and allow benchmarking of companies so customers and CCGs can truly challenge companies to set stretching targets that are comparable with other companies. For example, total leakage is a commonly used measure but customers and CCGs cannot usefully use the information presented to understand how stretching the companies target is compared to others. Some common measures need to be defined and consistently interpreted to avoid intentional or unintentional misinformation, for example, where performance is assessed for compliance and pollution incidents.

We think that you should consult on:

- a core set of consistent performance commitment definitions, to enable effective cross-company comparisons
- the balance of outcomes that are (a) fully set by a regulator (economic / environmental), (b) outcomes defined by companies but with performance commitments set by a regulator (c) bespoke outcomes set by water companies under broad headings, (d) bespoke outcomes
- a framework that allows companies to balance bespoke and comparative measures.

We would like to be involved in the design of any comparative basket of measures and would be happy to discuss the use of our Environmental Performance Assessment for comparative assessments.

Q51 What are your views on our proposal that companies submit the definitions – but not the targets or any associated incentives - for their performance commitments to us in early 2018 before they submit their business plans?

We support your proposal that companies submit the definitions for their performance commitments to you before they submit their business plans.

We expect companies to consult customers, stakeholders and customers on their ODIs, including both the definition and targets. A phased approach to this development is likely. Submitting definitions first is reasonable and needs to happen in 2017. The targets will describe the ambition of the companies' proposals and these will need to be shared with customers if their customer engagement is to be effective (and meaningful).

We think that it would be useful to have early sight of the definitions that companies associate with their outcomes. For ODIs related to the environment this will allow us to work with a company to ensure that their definition is supported by the most appropriate environmental data, such as that from our Environmental Performance Assessment. There would be additional benefits in having early sight of the targets as this would enable greater consistency in establishing consistency across companies.

Q52 What are your views on our proposal for a licence modification to allow for the in-period payment of outcome delivery rewards and penalties?

We support the proposal for a licence modification to allow for the in-period payment of outcome delivery rewards and penalties. We agree that this would sharpen the incentive approach and may promote better behaviours. It may also facilitate in-period changes required as a result of our rolling NEP.

All regulatory tools that help incentives companies perform for customers and the environment should be used. We think in period changes will allow Ofwat to be dynamic and flexible with their regulation.

Consultation questions – Page 172

Q53 Do you agree with our summary of potential licence changes and the process for achieving these outlined in section 9.1 above?

No response

Q54 Do you agree with the next steps for establishing the necessary data for the 2019 price review outlined in section 9.2?

No response

Q55 Do you agree with our indicative timetable for the Water 2020 programme?

The indicative timetable for PR19 presents a significant challenge for us. Using the proposed timescales would mean that business plans would be submitted during the water companies' proposed WRMP consultation period. Neither customer views nor Ministerial guidance on WRMPs would be incorporated into business plans, which could lead to a mismatch in expectations.

Using the proposed timescales would also create uncertainty around future environmental improvement measures for the companies and their customers as some new environmental standards for chemicals and the outcome of water companies' current investment programme (AMP6) investigations will not be clear by the proposed business plan submission date.

We would encourage you to align the PR19 timetable with other planning timetables, particularly the WRMP timeline. We would like to continue discussions on the timetable for business plan submission and the development of a process to handle uncertainty in environmental obligations.