

NORTHUMBRIAN WATER LIMITED
RESPONSE TO:

RELIABLE SERVICES FOR CUSTOMERS
– CONSULTATION ON OFWAT'S ROLE
ON RESILIENCE

AUGUST 2015

Introduction

Northumbrian Water Limited, representing Northumbrian Water and Essex & Suffolk Water welcomes the consultation on resilience in relation to the primary duty to further the resilience objective afforded to Ofwat through the Water Act 2014.

Our responses are generally supportive and we have added supporting statements where applicable. We would be happy to contribute to further proposals, as they arise, through workshops and working groups.

Northumbrian Water Limited Response

Our commitment to managing for the long-term is led by our Board. Indeed, Andrew Hunter (Chairman) said in his foreword to our Periodic Review 2014 (PR14) business plan *“In developing this business plan, the Board wanted to ensure our proposals for 2015-20 were sustainable for the long-term. We fully recognise that the provision of water and waste water services is a long-term business. Northumbrian Water Limited is responsible for water and waste water infrastructure that is essential to service delivery now and in the future. We have a duty to ensure that these assets are maintained in good health for today’s customers and for generations to come.”*

Below we provide our responses to Ofwat’s questions.

Q1 Is our basic understanding of resilience aligned with your own – are we addressing the right things in the right way?

Resilience definition

“Resilience is the ability to cope with, and recover from, disruption, trends and variability in order to maintain services for people and protect the natural environment, now and in the future.”

We are generally supportive of the Ofwat understanding and definition of resilience as this closely fits with our own current thinking and approach, for example alignment to ‘Keeping the Country Running’ - the UK government’s resilience guidance issued in 2011.

Resilience scope

We agree with Ofwat that the scope of the resilience duty should cover the provision of resilient water and wastewater services to customers whilst protecting the natural environment both now and into the future. We agree that our services will only be resilient if the structures that underpin them are resilient. This means that in addition to the resilience of our assets and systems we have financial resilience and corporate resilience; the ability of the whole organisation to plan, withstand and recover from sudden disruptions. We also need to maintain our strong and effective stakeholder relationships (e.g. with regulators,

local authorities, customers, landowners and contractors) so they have confidence in our resilience capacity and capability.

We agree that there should be no mandatory standard for resilience and that the ownership for delivering resilient services to customers should be with the service providers themselves.

We provide reliable services to our customers in line with our outcomes and measures of success, which are already subject to detailed reporting and financial rules. We believe the resilience of our services, including our ability to 'bounce back' from adverse events and reduce the impact for our customers, is already being reflected in our measures of success and outcome delivery incentives.

Some service providers had specific resilience outcomes in their PR14 plans; we placed resilience in our Asset Health basket measures of success. The outcome for these measures is "*delivering water and wastewater services that meet the needs of current and future generations in a changing world*". Our Asset Health measures provide a better measure of resilience than the previous 'serviceability' measures, for example where we no longer exclude the impact of extreme events (such as severe weather) on our interruptions to supply performance. This ensures we monitor, protect and incentivise the long-term stewardship of our assets. While our Asset Health baskets contain measures of resilience, we will consider developing a specific resilience outcome and measure(s) of success for the 2019 price review (PR19). Any additional outcome will be designed in collaboration with our customers and stakeholders, and approved by customers, to ensure it reflects their needs and expectations.

We welcome Ofwat's recognition that the provision of more resilient levels of service could take companies and partners time. Delivery is likely to extend across a number of financial periods rather than within one five year investment window. We feel this allows investment costs and returns on capital to be spread over a much longer period with customers benefiting from more resilient levels of service against a balanced and fair bill over time.

We believe that customers' perceptions of resilience and risk to service provision are often based on their experience of such events, either directly or indirectly via the media. This can then influence customers' confidence in us and their expectations around our planning for future resilience.

We support the view that all risk cannot be completely removed but that we can better understand and manage it in a more effective way.

We agree that working together with our customers to improve resilience is important. We have had measurable success in many projects where we have worked with our customers.

With reference to Ofwat's statement on p16 - "*we will try and make clear what 'resilience' means for the sector and the types of risks and opportunities that service providers should consider. We recognise the importance of doing this in good time in the run up to the next*

price review (PR19)”. We encourage further timely engagement on Ofwat’s plans to allow for effective preparation for PR19.

Resilience principles for the sector

We are generally supportive of the proposed ten resilience principles for the sector set out in the consultation document and have commented in Q2 on the framework we feel is needed to incentivise resilience. We would add the following comments and observations for Ofwat’s consideration;

Use of outcomes and delivery incentives

We support an Outcomes approach to incentivise companies to deliver more resilient services for customers whilst protecting the natural environment. This approach will need to reflect that some risks may be beyond service providers’ control and the ability to ‘respond and recover’ may be a more appropriate and cost beneficial response rather than trying to eliminate the risk itself.

The use of appropriately set caps and floors around the incentive may be an appropriate lever to protect customers’ interests by ensuring a service provider is not better off incurring a penalty over the cost of reducing or removing a known resilience risk.

Customer support

It is important that companies engage as effectively as we can with our customers. However, we are concerned that solely relying on customer research, and specifically the findings of the willingness to pay and acceptability research, could result in significant inconsistencies in approach to resilience across the sector.

Inconsistency concerns have already been addressed for some other measures by Ofwat in its PR14 horizontal audits. To achieve cross-industry consistency in companies’ approach to resilience Ofwat may find it requires the horizontal audit approach. Within such a framework, service providers could then plan to ensure they deliver the right balance of investment and risk reduction for the benefit of all current and future customers and stakeholders.

Any approach would need to be tested with our customers to see if it was supported. Customers expect us to balance investment between proactive and reactive approaches to resilience. Customers want us to do work now to protect against future risk, whilst having the capability and agility to respond well to any events which occur.

Partnership working

We support the principles of partnership working when developing the most cost beneficial solutions to improve resilience and reduce risk but would highlight that clear ownership of risk delivers more certainty. We have excellent examples of effective partnership working

alongside local authorities, customers, Highway Agency, landowners and householders to address the impact of flooding of our customers’ premises from overloaded sewers caused by surface water run off. The solutions can be innovative, cost beneficial and more environmentally and socially acceptable than traditional civil engineering solutions.

We feel that developing greater trust between customers, partners and service providers could be effective in delivering more socially acceptable solutions to address a risk to service provision and increase system resilience.

Planning

We believe that companies that are good at planning are likely to be more resilient. Planning should be based on long-term targets and result in actions to be delivered over a range of time frames. An assessment of a company’s planning ability could be used as a measure of resilience.

Q2 Do you agree with our view of what Ofwat should deliver, including where we might step in, and what is for others to deliver?

We agree that it is for Ofwat to create a framework that incentivises resilience. This will involve companies making long-term planning decisions in the context of a series of shorter term price controls. As we note in our Water 2020 paper “The Duration of Price Controls, to Change or not to Change?”¹, the 25 year Water Resources Management Plan process has addressed this disparity in terms of water resources and we suggest this would be a good template for other resilience planning.

We also agree that Ofwat should consider both current and future customers in this framework.

We feel the principles below are appropriate:

- the service to our customers will remain at the heart of all decision-making;
- service providers will own their plans and manage their own risk; and
- the focus will be on what service is delivered, rather than the specific activities carried out, or the equipment required to deliver it.

We also agree that Ofwat can serve a useful role in identifying good practice and influencing the debate about how the resilience duty placed on Ofwat can be effectively delivered across the sector.

Ofwat should not assume that the creation of markets alone will deliver resilience. There are many examples of market resilience failures in other sectors. The banking sector was a

¹ [https://www.nwl.co.uk/assets/documents/The duration of price controls a Water 2020 paper.pdf](https://www.nwl.co.uk/assets/documents/The%20duration%20of%20price%20controls%20a%20Water%202020%20paper.pdf)

market with a wide choice of providers and resources that suffered from under-regulation prior to 2008 and thus failed to deliver resilience.

Indeed, one aspect of creating a market is that it must allow for ‘creative disruption’, as companies are allowed to enter, fail, and are replaced. There have already been two company failures in the Scottish retail market. Such failures should not be seen as failures of resilience, as resilience measures are about ensuring customers are not adversely affected by supplier failure.

It is also clear that delivering resilience will often require Government or regulatory support. The Government National Infrastructure Plan 2014 identifies the importance of regulation in ensuring the resilience of water and wastewater networks². It says *“The government’s objectives for the water sector are to secure a fair deal for customers while enabling water companies to continue to attract low-cost investment needed to provide the high quality, resilient water services customers want.”*

Q3 What views do you have on how the water and wastewater sector might measure its performance in delivering resilient services – and the best way for us to demonstrate that we are carrying out our role?

We believe that a system based approach, which considers the relationships between the component parts within water or wastewater networks and other systems, rather than in isolation is more effective at managing long-term risk and delivering resilient services to customers. This approach can be achieved using an outcome (qualitative) approach, delivered by a number of outputs (quantitative). It should be for service providers and their customers to agree what the outputs should be to deliver the outcome. This would allow service providers and customers to agree and deliver an appropriate response to specific regional issues and challenges and is not a ‘one size fits all’ approach.

Outcomes and measures of success should be transparent and this approach is already supported by our stakeholders with suitable financial protection to our customers should we fail to deliver on our commitments.

Subject to the right incentives this approach encourages;

- service providers to invest to reduce risk and deliver more resilient services for customers;
- cost beneficial investment based on risk reduction and increased resilience of services;
- fair returns to be made on that investment;
- current and future generations to share both the costs and benefits from more resilient services within the overall bill they will pay.

² National Infrastructure Plan, HM Treasury, December 2014.

Summary

Ofwat should incentivise the industry to deliver improved resilience but be mindful of a service provider's ability to manage all risks. Therefore any future framework for managing and measuring resilient services should be both fair and transparent across the sector.

We would like to see the use of outcomes, developed for PR14 to support delivery of more resilient water and wastewater services for our customers in the future. We feel this approach to improving resilience will allow for cost beneficial investment, suitable financial incentives and any impact on bills to be spread over the longer term. This approach promotes resilience as a long-term challenge with both current and future generations ultimately seeing the benefit whilst sharing the cost.

Reporting resilience via an outcome approach can be managed and audited within the current regulatory and financial reporting frameworks. This avoids the need for developing a specific reporting tool and the resulting additional costs.

We would be supportive of the use of independent reports on company-specific or cross-cutting sector resilience issues. We feel such reports are vital to promote the development of best practices and learning on resilience related risks and events within the sector. We feel current industry bodies would be suitable forums to promote and fund such reports.

So we believe that Ofwat's role should involve;

- **Promoting, signaling and monitoring** – as the industry develops its measures of success and its plans to secure long-term resilience of service providers' systems and long-term sustainable water supplies
- **Consistency** – in how it proposes to develop its framework to incentivise and measure service providers delivery of more resilient water and wastewater services into the future;
- **Supporting** – all stakeholders to ensure the delivery of more resilient services across the sector are in the best interests of both current and future generations; and
- **Stepping in to protect customers** – when service providers fall short.

We believe that our customers measure us on our ability to provide them with a reliable level of service day to day and expect us, as experts, to invest their money wisely to manage the risk from our ever-changing world. We strongly believe that between the service providers, suppliers, regulators and customers we can deliver this in the future in a fair and balanced way for all.

Northumbrian Water Limited
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