

Resilience Consultation
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By email

Your ref

Our ref

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I am pleased to provide you with Southern Water's response to 'Reliable Services for Customers – a consultation on Ofwat's role on resilience.'

We agree with Ofwat's view that resilience in the provision of water and wastewater services is critical to the level of trust and confidence in the sector amongst all stakeholders. Our own programme of customer and stakeholder engagement, undertaken to support the development of our business plan for 2015 to 2020, highlighted the importance of resilience and it is a key focus of our investment priorities.

We have organised our response into two key areas. In this first section we set out a number of fundamental messages on the definition of resilience and the role of regulators in supporting companies to deliver it. In the second section we provide answers to the three consultation questions posed by Ofwat.

The importance of a broad definition

Previous definitions of resilience applied to the sector have been asset-centric. We believe that in seeking to define resilience in a way that captures fully the priorities of customers and stakeholders, it must be defined more broadly. We therefore welcome the broader definition being proposed by Ofwat which seeks to capture:

- the reliability of both water and wastewater services to customers and their communities
- the protection provided to the natural environment; and
- the sector's ability to deal with the challenges posed both by one-off events as well as to adapt to the longer-term challenges such as climate change and population growth.

We also believe that any definition should seek to capture the financial resilience of companies and their continued ability to attract low-cost finance to support future investment needs at an affordable price for customers.

Regulatory co-ordination

The regulatory framework, and therefore the decisions and actions of the various statutory regulators in the water sector (Ofwat, Environment Agency, Drinking Water Inspectorate, Natural England, Consumer Council for Water) can play a pivotal role in helping to support companies to deliver greater resilience in the provision of water and wastewater services.

It is essential that these regulatory bodies collaborate and actively coordinate their work programmes and policy development. We would like to see the statutory regulators in the sector place far greater weight on ensuring a transparent and co-ordinated regulatory framework which provides sufficient flexibility for companies to respond to local challenges and customer priorities.

Ofwat is well positioned to play a lead role in driving regulatory coordination to support resilience. For example, by ensuring the co-ordination of PR19 with the Water Resource Management Plan timetable, the EA flood risk management planning timetable and the National Environment Programme.

Regulation and innovation

It is not difficult to identify recent examples where regulation has frustrated companies' best efforts to adopt innovative solutions that would increase the sector's resilience. We have set out two examples of this that have recently impacted Southern Water in Annex 1.

We would welcome a more flexible approach from all our regulators that encourages companies to propose and develop new approaches to better support the long-term interests of customers and the environment.

We fully support the move to outcome and totex based regulation, which was introduced by Ofwat at PR14. This has potential to encourage more innovative approaches, but we consider that more can be done.

Regulatory frameworks should be designed to provide flexibility to both enable and encourage innovation. For example, a move towards longer benefit assessment periods (e.g. greater than five years) would reduce the likelihood of companies turning first to tried and tested interventions with known and shorter-term payback periods (e.g. shorter than five years). It would instead provide greater scope for companies to fully embrace approaches like catchment management and integrated water cycle management which often have longer payback periods but can provide for more resilient outcomes for customers and the environment. Lengthening

payback periods would also support the industry's transition to totex by increasing the scope for no-build solutions and interventions.

Regulation and financial resilience

Southern Water believes that the stability and predictability of the regulatory framework applying to the water sector in England and Wales has been very successful in supporting financial resilience.

Some commentators have criticised the emergence of highly-leveraged structures which are seen as being inflexible and acting to undermine the ability of those companies to respond to change. Southern Water does not accept the idea that financial flexibility can be equated to financial resilience. In fact, the disciplines introduced by third party capital, both equity and debt, allow companies to respond to near and long-term challenges at a reasonable cost to our customers.

The stability of the regulatory framework has attracted long-term investors and supported the creation of financial structures that enable access to low cost finance. As a result, the sector has delivered over £100 billion of investment to improve the reliability and resilience of the service provided to customers and the protection of the environment whilst keeping customers' bills affordable.

We would emphasise the need to consider the impact that any regulatory changes would have on the availability and cost of financing for the sector.

Given the level of investment since privatisation, customers' bills are impacted significantly by the cost of capital. This could increase if companies are exposed to increasing market risks or asked to disaggregate their Regulatory Capital Value. We do not believe that financing should be an impediment to change. However, it is essential that the risks and benefits of any moves to fragment the value chains of currently integrated businesses are assessed fully and that regulatory change is well trailed with significant information on both the need and benefits for customers and stakeholders.

Section 2

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

We are in broad agreement with the working definition of resilience presented in the consultation document. However, we note that the Resilience Task and Finish Group have recently slightly modified their working definition to resilience to:

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

Southern Water is a member of the Resilience Task and Finish Group and has played a full role in contributing to and helping shape the proposed definition.

We welcome the adoption of a broader definition of resilience, avoiding the previous asset-centric approaches. We believe this establishes a clear focus on the reliability of service provision to customers and the protection of the natural environment now and in the future.

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 are in broad agreement with the definition of what Ofwat should deliver.

It is clearly for companies to take the lead role in the delivery of greater resilience regarding their service provision to customers and the environment. However, Ofwat also has a central role to play supporting companies to deliver greater resilience by ensuring its regulatory framework provides both the right incentives and flexibility to respond to local pressures and customer priorities now and in the future.

To enable companies to invest with confidence to drive improvements in resilience, Ofwat must develop and publish a transparent decision-making framework, which sets out how it will consider resilience when it is assessing companies' business plans.

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?*

The accurate measurement of resilience is complex.

The broad definition of resilience, which is necessary to capture the relevant range of service reliability valued by customers and the environment, means that no single measure of resilience could reasonably be constructed. Furthermore, the need for the services provided by water and wastewater companies to be resilient to extreme but relatively infrequent events means that meaningful measurement of resilience in the short to medium term, even over the five years of a standard regulatory cycle, is unlikely to be achieved with accuracy.

We therefore recommend, that instead of focussing on the measurement of resilience in service provision, the focus should be to place the onus on companies to demonstrate the reliability of their services in the areas most valued by their customers and stakeholders.

Ofwat is already pursuing this approach through its requirement for companies to provide clear reporting on business plan delivery and the associated requirement for companies to consult with stakeholders on the assurance plan for business performance data. This approach is central to building increased trust and confidence



in the sector. By placing the onus on companies to provide clear and accessible information on their performance trends linked to their investment priorities, this approach will give customers and stakeholders clear unambiguous information about whether an individual company's performance is improving in terms of the reliability of its service provision and protection of the natural environment. It will also allow for meaningful cross-industry comparisons.

Yours sincerely

A handwritten signature in black ink that reads "S. E. Oates".

Simon Oates
Director of Strategy

Annex 1

Water resources management planning

We operate across a water-stressed area and are leading the industry in water resource planning to ensure our network is resilient, flexible and environmentally sustainable.

In developing our Water Resource Management Plan (WRMP) 2014 we were the first company to apply a more resilient approach to future resource planning by introducing new stochastic modelling techniques that enabled us to plan ahead for drought events which may be more serious than those we've experienced before. This approach built greater resilience into our 2014 Water Resources Management Plan.

This methodological improvement required considerable focus and engagement in order to persuade statutory regulators to accept a departure from existing methodologies. The principal concern of the regulators appeared to be the overriding desire to see a consistent planning approach applied across companies. Thinking like this risks a lowest common denominator approach that perpetuates the status quo and stifles innovation.

Groundwater inundation

The management of groundwater inundation of the sewer network is another area where a more receptive regulatory approach to new methods of intervention would help facilitate and encourage innovation.

Groundwater flooding has been increasingly prevalent over recent years and, accordingly, is an issue which we are monitoring closely and working to develop new ways of tackling.

Southern Water has faced problems in specific areas of Kent where, despite the sealing of significant points of infiltration in to the public sewerage system, infiltration is still occurring with negative impacts on service to our customers. To continue with the same remedial measures will follow the law of diminishing returns, where we will incur significantly increased costs locating and addressing ever smaller and smaller infiltration points.

So, to reduce the customer impact further, we are faced with incurring escalating intervention costs via infiltration reduction with reduced benefit. This also leaves customers incurring costs, which can run into thousands of pounds, to address infiltration into their drains. Faced with this unsatisfactory outcome, we investigated sustainable alternatives and have concluded that the use of control structures can provide a sustainable long-term solution which will benefit companies and customers.

These control structures manage free flow within the sewer system. They remove a minimum amount of the excess flow of heavily diluted wastewater, screen it to remove solids and treat it with ultra-violet light to sterilise it. The treated water can then be released into an unlined bio-retention pond from where it soaks harmlessly into the ground. We believe that this is an appropriate and sustainable solution. However, its implementation, needs to be legally approved by the Environment Agency via a Discharge Permit. Without regulatory endorsement of such innovation, we and our customers have to rely on more costly, and ultimately less beneficial, measures to tackle groundwater flooding.