

28 August 2015

Resilience Consultation
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Dear Sir

Consultation on Ofwat's Role on Resilience

Sutton and East Surrey Water appreciate the opportunity to contribute to the development of Ofwat's plans for fulfilling its new primary duty to further the resilience objective. We consider the consultation timely because it coincides with the development of initial thoughts on the framework for future price reviews (the Water 2020 programme) and other measures planned to enhance trust and confidence in the industry. The linkages to these and other relevant initiatives are, with a single (but significant) omission, well signposted in the consultation.

The consultation quite rightly acknowledges that, while the resilience objective is for the first time a primary objective for Ofwat, the sector has always considered resilience. Indeed the reliable provision of clean, safe drinking water now and in the future has been the core purpose of water supply companies from long before the current regulatory arrangements were established.

The significant linkage omitted from the consultation is the role of company boards in enhancing trust and confidence in the industry. Recent emphasis on company boards taking lead responsibility for the governance of their medium and long-term plans, and actual performance against those plans, has helpfully highlighted the respective roles of companies and regulators. Companies, governed by their boards, have always had primary responsibility for the provision of service in accordance with customer and other stakeholders' expectations and regulatory requirements, and will continue to do so in the future. Regulators primary duties relate to ensuring that companies are able to carry out those functions, stepping in when fulfilment of those responsibilities may be at risk. Ensuring the resilience of service provision is not an exception: it is the primary responsibility of companies (governed by their boards). Whilst focusing on Ofwat's role on resilience, this consultation tends to understate the primary responsibility of companies for ensuring that service provision is reliable and resilient to short-term shocks or long-term trends.

We have never lost sight of the importance of long-term resilience in the provision of clean, safe drinking water. Our current five-year business plan includes a number of measures targeted at the resilience of our services and systems – both in the short-term and longer term. These include:

- increasing the number of our customers that can be supplied from more than one treatment

- works;
- further reducing leakage;
 - increasing the proportion of our customers who have a metered supply; and
 - providing free water efficiency measures to our customers and continuing our leading edge environmental education programme.

We also continue to work with other water companies in the South East, through the Water Resources in the South East Group, to explore further opportunities for sharing resources across our region.

Making sure we are resilient to a wide variety of potential impacts, whether they are systems related, environmental or for wider economic reasons, is core to the way we make decisions and plan for the future.

Understanding resilience

Your understanding of resilience is generally aligned with ours but we think that the working definition¹ could be improved by including reference to the role of mitigating actions.

The definition covers what we would term the “day-to-day” range of outcomes, e.g. being able to deal with a burst water main or managing demand through our metering programme, and extreme “one-off” events, e.g. a flood at a treatment works. The definition focuses on how a company deals with an event when it occurs – whether that is a one-off event or more gradual change. We think it is equally important that resilience captures the actions needed to plan for, and where possible mitigate the likelihood or severity of, an event. While the consultation discusses such situations, the definition is a little weak in this area.

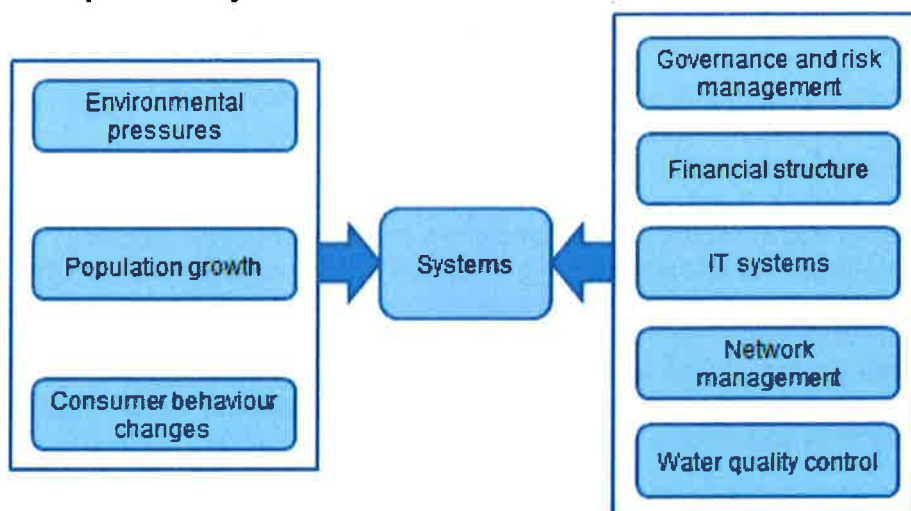
As suggested above, the working definition covers a wide variety of potential events. We have considered whether this is appropriate or whether it goes beyond the role envisaged for Ofwat when Government included this new duty. We have concluded that it is appropriate. Below we explain what we understand to be Ofwat’s role. Clarity on whether our understanding is correct would be welcome as part of your decision.

The primary duty talks about resilience to systems as regards “environmental pressures, population growth and changes in consumer behaviour”. We interpret this as meaning companies must make sure that they are resilient to these pressures that are often outside of their control.² The consultation focuses on those factors that are within companies’ control: for example, having an appropriate risk management process. Clearly there are interactions – if we do not have appropriate control of those factors we can influence then we will be less resilient to uncontrollable shocks. Figure 1 is a simple representation of these different factors.

¹ “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.”

² By this we mean that while we can exert control over the magnitude of the impact of such events we are unable to control the underlying cause, i.e. we cannot control population growth.

Figure 1: impacts on systems



We have represented it in this way as we think it is helpful to consider the left and right-hand-side of Figure 1 separately. We have the ability to make choices about how the right-hand-side functions. The choices we make in these areas will influence our ability to manage impacts from the left-hand-side.

Ofwat's role in resilience and measuring performance

We absolutely agree that it is up to companies to deliver a resilient sector. Ofwat's role is to create the right environment for us to be able to do this. This should be done by:

- encouraging water companies to maintain the resilient services and systems that their customers want; and
- ensuring they are appropriately funded to do so.

It is primarily for boards to ensure that companies have measures in place to manage impacts of events outside their control. If Ofwat's new primary duty requires the regulator to obtain assurance that companies do have such measures in place, this ought in the first instance to be obtained by seeking assurance from the board. Only where there is evidence that the assurance may have failed to cover particular risks should Ofwat require more specific evidence or performance measures.

Encouraging companies to maintain resilient services and systems

The resilience principles you set out are helpful and reflect how we already operate and make decisions. They will continue to provide a useful reference point going forward and we believe are appropriate for encouraging the right behaviour.

We agree that mandating a single National approach with a measured baseline performance or minimum standards will not work – what is appropriate for one company may not be appropriate for another. That is not to say that we cannot learn from each other and adopt best practice. The right environment should be maintained for us to do this.

Ofwat, customers and other relevant bodies already have access to valuable information about the sector's resilience, including:

- Water Resource Management Plans (WRMPs);
- Drought Plans;

- 25-year Strategic Direction Statements;
- five-year business plans, including the outcomes being delivered specifically to improve resilience;
- annual performance reports, including water quality and environmental legislation reporting;
- assurance and financial monitoring statements; and
- certificates of adequacy.

The information listed above allows Ofwat to make an assessment of the sector's resilience. We see no immediate gaps in information that might require additional reporting. For this reason we do not see any need for an additional independently verified report on our resilience as suggested in the consultation. The need for a specific independent assessment is something for boards to determine as part of their on-going assurance process. To follow a different approach undermines board ownership of assurance and individual companies' commitment to do what they see as best for their customers.

A review of the interactions between the different forms of reporting, listed above, would be beneficial. There are interactions between the different reporting requirements and naturally some duplication: for example our WRMP was referenced extensively in our business plan for 2015-20. Duplication itself is not an issue but the framework should ensure that the information is as accessible as possible and that the interactions can be appropriately managed, e.g. the timing of the various reports are appropriately aligned. By conducting such a review gaps in information may be identified which the industry can work together to find the best way to close.

Indicators are not appropriate for measuring all aspects of resilience. The outcomes based approach is useful in providing quantitative information on some aspects, e.g. supply interruptions and leakage. Many other features of resilience are not so easily measurable. The difficulty in testing and therefore reporting on such aspects of resilience is that a result is only available when we have faced a shock. For example, how a company responds to a flooding event provides real information on how resilient it is. These events, while unwelcome, provide a good opportunity to learn and build on the plans already in place, but do not lend themselves to regular reporting.

Funding delivery

The price control framework must account for the potential that short-term costs will be incurred in delivering long-term benefits. Your second resilience principle puts this across clearly – “mitigating risk can cost money – but it can also save money in the long term”. Equally, and as you acknowledge, there is no one-size-fits-all approach to resilience. These two features point to a more sophisticated approach to determining project funding than purely comparing approaches and costs across companies. Flexibility to adapt our approach to resilience within a price control period may also become increasingly necessary as the trends we have seen in the past, e.g. the impact of climate change, could accelerate.

We need to strike a balance between ensuring we are resilient to potential changes to the external environment and making sure water is affordable for current and future customers. In our view this further supports each company being given the flexibility to evidence what it needs to do to manage the risks it faces and proposing how it intends to do it. Resolving how the price control framework can adequately capture this needs further thought, engagement and development. We suggest the industry takes this forward as part of the Water 2020 programme.

Concluding Remarks

In summary, we support much of the discussion on resilience so far and Ofwat's direction of travel on this topic. We believe that resilience cannot be considered independently from the evolution of economic regulation of the sector being considered and progressed through the

Water 2020 programme. There are clearly crosscutting considerations and we therefore encourage you to progress further engagement on resilience through that programme. Nothing should be put in place that undermines or cuts across companies' primary responsibility for ensuring that services remain resilient. In the short-term, it would be helpful if the focus of your forthcoming decision is on the information that you currently receive, as outlined above, and identifying any gaps that we as an industry can work together to find the right way to close.

Please get in touch if you would like to discuss any of the points raised or if you would like clarification. In the first instance please contact Joanna Campbell, Economic Regulation Manager (JoannaC@waterplc.com, 01737 785 692)

Yours faithfully

A handwritten signature in blue ink, appearing to read 'J Chadwick', written over a large, stylized blue loop.

John Chadwick
Finance and Regulation Director

