

Drinking Water Inspectorate comments on the OFWAT consultation on “Delivering Water 2020: Consulting on our methodology for the 2019 price review”

Thank you for the opportunity to comment on Ofwat’s approach to delivery of the Periodic Review 2019 price review. We welcomed our various meetings and telephone conversations on this matter, and summarise below our comments on some specific points. This note is supplementary to our guidance note on long term planning for the quality of water supplies, which we have shared with you separately. We would welcome further discussion to explain our observations in detail.

As the drinking water quality regulator, our interest in this paper concerns the statutory provisions necessary to enable water companies to protect the health of their consumers, and to maintain consumer confidence in the supplies and services provided. Companies do this by using a source to tap approach to mitigating risks using drinking water safety plans, with the aim of proactively protecting public health, and the wholesomeness and acceptability of supplies.

1. Catchment management:

We strongly welcome Ofwat’s continuing support for catchment management approaches as a core element of all risk assessment and mitigation measures by water companies. This is also an important part of companies’ resilience planning for drinking water supplies. For these approaches to be successful, they need to be considered as long term sustainable alternatives and/or complements to treatment solutions. In this regard, we have some concerns about the current and proposed arrangements for the sustainability of the financial provisions made for catchment management solutions.

Current funding regimes were designed for capital and operational expenditure on schemes where there is limited uncertainty of the outcome as water companies are in control of the specification and delivery of the work. In these cases, good practice in the investigations to define a solution, followed by well proven implementation routes using a skilled and well-resourced in-house or supply chain deliverer carry little risk, and uncertainty over delivery of the required outcomes is limited.

Catchment management schemes differ from these traditional approaches. They usually require a different skill set to deliver multiple small contributions to achieving the outcome desired. They are usually of longer duration; are often focussed on behavioural change in exchange for recurring financial compensation; require continuous and persistent resource allocation to sustain; and often are delivered by third parties with a greater element of uncertainty about the scale and timing of benefits. Also, the field of catchment management is a developing one and

incremental upgrades to existing catchment management schemes are likely, as learning is put into practice.

We are concerned that the current funding arrangements may act as a constraint to innovation and development in catchment management approaches if companies are expected to finance these incremental upgrades from their TOTEX allowances. This has obvious implications for the long term sustainability of catchment management techniques, as well as increasing the likelihood that companies opt for expensive treatment options where outcomes are within the company control and hence less uncertain.

For example, a case in point being metaldehyde, where voluntary measures to promote behavioural change have been pursued by companies over the past years (e.g. encouragement of farmers to switch to ferric phosphate slug control; improved application etc). Whilst this has delivered some notable successes, a significantly increased effort is now required to deliver the outcomes for consumers at least cost. This will require companies to improve current practices in many areas; develop and put in place new innovative solutions; and to commit to the long term sustainability of the schemes, which is costly and recurring.

Catchment management approaches are at the heart of government policy going forward, and included in governments' draft proposed strategic policy statements to Ofwat. These approaches are also a fundamental part of good water supply practice, both in the UK and internationally. They are a core element of the statutory requirement for drinking water safety planning for consumer protection. They are also a lower cost solution to pollution problems for bill payers, and deliver multiple additional social and environmental benefits. We would welcome a discussion with you to seek ways to provide sufficient and sustainable financial provision for catchment management schemes going forward.

2. **Drinking Water Quality indices:**

It is a primary duty of water companies to meet their statutory obligations, and amongst these for drinking water quality is the requirement for their water supplies to be wholesome. Wholesomeness is demonstrated by 100% compliance with the Water Supply (Water Quality) Regulations 2016. You confirmed this minimum expectation clearly in your methodology statement for PR2014, and we would welcome a similar statement in your methodology statement for PR2019.

Regarding the measurement of company performance in delivering these requirements and others, we welcome the proposals for 14 common performance commitments as an aid for transparency and comparability of company performance, including the new resilience PCs. The common PC of most interest to us is, of course, the Compliance Risk Index, and we welcome your inclusion of this index in the basket of common PCs. This is *in lieu* of the current MZC as Amendment Regulations 2017 make provision for companies to move to a risk based sampling regime, which will impact on the MZC calculation as it allows for efficiencies based on risk analysis. We would welcome discussions with you on the details of how CRI might be used to best effect going forward.

We are also developing an Events Risk Index (ERI) - see accompanying definition at Annex A (please note draft status), which will complement the CRI, and will be useful in monitoring another important aspect of company performance over the PR19 period and beyond. We would promote the inclusion of the ERI in the list of mandatory common PCs. The index is still under development, and is currently being assessed in detail with the industry. We anticipate its use starting in 2018.

As the CRI and ERI measures are new it might be useful, if possible, to utilise these as PCs as an alternative option to MZC during the latter stages of the PR19 period, as we have discussed. This would enable us to review and utilise learning about how the measure drives behaviours in the early years of its use. We believe that such dynamic adjustments are unlikely to dampen incentives for the best performing companies to improve.

We agree that asset health PCs should be included in the list of common PCs, and that not allowing aggregation of these measures is helpful as regards transparency and understanding.

Regarding accounting for delivery in AMP6: we have discussed with you, and we believe, that the use of MZC after 2018 is inappropriate as the efficiencies in monitoring programmes allowed will corrupt the value of any MZC data produced, as these data will be incomparable to previous forecasts and targets. As most improvements are programmes to be completed by 2018 we believe that the final determination of ODIs based on 2017-18 data may be appropriate to avoid confusion on drinking water quality performance.

We agree that PC levels should be set by companies (with challenge from CCGs and scrutiny from you) for 10 years after the 5 year AMP7 period to illustrate resilience and long-term planning from companies. We also agree with your proposals that companies should demonstrate their use of available alternative and complementary information to set PC levels that are stretching (including setting the initial service level).

We believe that comparative information such as that provided by the DiscoverWater dashboard are powerful incentives for reputational ODIs, and we would welcome further development of the functionality of DiscoverWater to enhance this.

For CRI, as with MZC, we would propose a penalty only ODI. As every compliance failure (or event) represents a failure of the company to meet their statutory obligations it is not appropriate to offer rewards. As such, in terms of a target, companies should aim for CRI (and ERI) scores of zero and thus aspire to continuous improvement and results of at least at a level that is equal to or below the national average.

We note that there are a number of other Drinking Water Quality measures on the "long list" for PCs in Appendix 3 that companies can select, as well as the possibility of new bespoke measures. Whilst we agree with the principle of the long list of PCs with standard definition that companies can choose from (and new bespoke PCs as are relevant) we believe that many are obsolete in the light of our new CRI and ERI measures – please see Annex B for our detailed comments.

3. **Long term planning and resilience:**

We welcome the focus of the draft methodology statement on both long term planning principles, and on its emphasis on making water companies and water supplies more resilient. The inclusion of response and recovery is an important aspect.

We will be looking for evidence of long-term planning in company's submissions. As you are aware, we have asked companies to confirm that they comply with their duties on drinking water quality matters in their broader resilience and resource planning arrangements. Long term resilience planning should extend across all areas of company activity, not just resource management. We expect companies to plan to meet all their statutory obligations to maintain wholesomeness, and our long term planning guidance note expands on this.

With reference to water trading incentives described in Appendix 7, we are clear that water quality aspects must be considered when determining the viability of any trading opportunities. We have published our advice during the recent Water Resource Plan consultation (January 2016) and our guidance is copied in Annex C below.

We would welcome further discussions with you on the details of drinking water quality requirements for long term planning and resilience.

4. **Direct procurement:**

We will be looking to ensure that use of direct procurement maintains controls for safeguarding drinking water quality, and we have had preliminary discussions with you about this.

Responsibilities and accountabilities for drinking water quality will remain with the incumbent water companies. Safeguards regarding the maintenance of customer benefits for the life of the asset will need careful attention. We especially believe that highly integrated projects are unsuitable and that projects should be as discrete as possible. We would welcome a continuing dialogue with you to better understand your proposals in this area.