

Delivering Water 2020: Consulting on our methodology for the 2019 price review

Consultation response from WWF-UK

Catherine Moncrieff and Colin Fenn, 30th August 2017

1. Introduction

1.1 We note that the consultation document is exceptionally long (280 pages, plus 15 appendices of varying length e.g. 60 pages for Appendix 5), whilst the consultation period was set short (at 6 weeks ending 30 August 2017). Responding to consultations of this length places an unduly heavy load on consultee resources.

1.2 Most of our comments are confined to the following areas (particularly those shown in **bold**), in line with our primary interests and concerns:

- Chapter 4 – outcomes for customers
- **Chapter 5 – on long-term resilience**
 - Appendix 4 to Chapter 5
- **Chapter 6 – wholesale controls (water resources)**
 - Appendix 5 to Chapter 6
- Chapter 14 – assessment of business plans

1.3 Our response does, however, include overview comments and specific-issue comments on the key issues as we see them, presented in chapter by chapter order, and by reference to the generic questions posed in the consultation document. The key issues for us are those that are material to our environmental care and resilience agenda.

2. Overview comments

2.1 **Environmental resilience is neglected.** We note and regret the limited definition of resilience adopted by Ofwat, which includes financial, corporate and operational/systems resilience, but which excludes environmental resilience from its ambit, notwithstanding the claim that the focus is on resilience ‘in the round’. All too often, environmental matters are relegated to secondary status and occasional mention, notwithstanding the centrality of the need for careful, long-term management of the environmental base that provides the raw water resource to and takes the waste discharges from the household and non-household customers upon which Ofwat’s attention focuses. We take the view that the economic regulator of the water industry – and particularly one that seeks to be regarded as a modern regulator - needs to embrace care for the water environment as a core concern and priority.

2.2 **Environmental subordination to water and wastewater services to customers.** We note the absence of good husbandry of the water environment as a central objective, as a pre-requisite of the continued existence of the healthy resource base upon which the water industry depends. Up-front (on p8), environmental challenges are introduced as threats to the delivery of services to customers, rather than as pressures upon the environment that need to be attended to in their own right, if a healthy and sustainable environmental resource base is to be secured for its own sake, as well as to support services to people and business. Such occasional and seemingly

after-thought mention of environmental protection and enhancement as does occur tends, instead, to be introduced in the context of the environment as a beneficial receiver of “better services and benefits” brought by innovation (e.g. p5).

2.3 Environmental performance commitment. We regard the expectation that companies have “one or more performance commitments relating to their environmental impact” (p63) as a welcome start, but a small one. We are disappointed to see that there was not a common performance commitment relating to the health of the environment. We’d like to see balance between managing the environment upon which water and wastewater service provision depends, and the delivery of those water and wastewater services. We consider that this should be a matter of relevance to the economic regulator, as well as to the environmental regulator.

2.4 Rewarding successful innovation, without penalising good attempts that don’t deliver success (aka failure). We are of the view that innovation needs to be encouraged by an asymmetrical balance favouring rewards for successful innovation over penalties for lack of success on potentially promising attempts. Innovation often delivers dead ends; but that is in the nature of scientific endeavour, and both successful and unsuccessful endeavour can lead to subsequent good ideas, and to success. A valiant attempt on a worthwhile project that turns out to prove unsuccessful (as opposed to it being judged a failure) should not be penalised.

3. Specific-issue comments and responses to general questions, chapter by chapter

Chapter 2

We believe that customers want and are willing to pay for high environmental achievement, even if there is uncertainty over the future. However, we believe more accurate and comparable assessments of customer willingness to pay are required.

Chapter 3

Q1. Do you agree with our approach to assessing abstraction charges?

We support the proposal for separate assessment of abstraction charges. However, we are concerned that the assertion that pricing relates to environmental sensitivity fails to recognise that differences in prices are related to season and to an abstraction use/loss factor, rather than to the sensitivity of the water source. As a result, abstractions for the same purpose, at the same time of year, in the same region, will attract the same charge irrespective of the environmental damage being done. In addition, abstraction charges from “supported” sources attract a price premium, even if they are significantly less environmentally damaging (which they are, sometimes, but not always).

Chapter 4 – Outcomes for Customers

Environmental performance commitments (p63).

We’d like to see balance between managing the environment upon which water and wastewater service provision depends, and the delivery of those water and wastewater services. We are

disappointed to see that there was **not a common performance commitment relating to the health of the environment**.

Instead, the draft methodology suggests that **companies choose just one, or maybe two, bespoke performance commitments on the environment**. As a result, we are concerned that the broad range of tangible environmental outcomes that customers care about, and that were captured by company PCs in PR14 (e.g. river water quality, bathing water quality, SSSI status, SuDS, catchment management, natural capital, WFD status), will be dropped.

Ofwat should require companies to have **more than one performance** commitment on the environment. In the Blueprint for Water Coalition's [submission](#) to the OFWAT Outcomes consultation earlier in 2017, we suggested a common composite environmental performance measure, which would provide a more rounded view on the environmental performance of companies. We remain committed to this concept.

Resilience metrics

Resilience to extreme events (p58). We fully support the need for the development of resilience to extreme events, and welcome its incorporation into the performance commitments that are specifically designed to deal with extremes, as opposed to the exclusion of extremes from consideration and assessment.

Risk of severe restrictions in drought (p59). We would like to see greater specificity in the common performance commitment on the risk of exposure to severe supply restrictions. We think that there should be a specific commitment on the use of level 3 emergency drought order measures, and another on the use of level 4 measures (e.g. rota cuts, bowser etc supplies, standpipes). In addition, simply applying a standard of supply threshold in terms of "severe supply restriction", without reference to the environmental impact of meeting that standard, fails to protect the environment. The evaluation of Water Resources Management Plans (WRMPs) might achieve baseline environmental compliance, but will not differentiate between those companies who invest to minimise the environmental impact of drought and those who rely heavily on drought orders/permits that exacerbate harm.

Risk of flooding of wastewater systems (p59). The focus on flooding reflects only one aspect of the service that customers and society expect from the sewerage system, the other being environmental protection. This could be addressed by amending the risk calculations to reflect the environmental vulnerability (and societal use of) of waterbodies impacted by sewer overflows and the wider environmental and social benefits of SuDS and Natural Flood Management techniques.

Asset Health

The proposed performance commitments focus on current serviceability, rather than condition. As such, they will do little to incentivise long-term wastewater planning. Current performance commitments could be achieved by further 'sweating' of assets, and leaving asset renewal and the associated costs to future price reviews/generations.

We also recommend additional measures for catchment health, reflecting the role that natural assets play in securing services for customers. Such investment should be treated equitably with built infrastructure, in order to avoid the risk that short-term cost savings come at the expense of long-term resilience.

Regarding the ‘long list’ of asset health performance commitments that companies can choose from, whilst we welcome the inclusion of Category 1&2, and Category 4 Pollution Incidents, we feel that **companies should not be rewarded for performance which is not compliant with legislation**, even if this represents an improvement on past performance. A Category 1&2 Outcome Delivery Incentive (ODI) should be penalty-based or reputational only.

AIM (p63). We welcome the requirement upon companies “to propose a bespoke performance commitment in line with the AIM guidelines” (p63), and to “propose financial incentives to accompany AIM performance commitments” (p63). Actions under an AIM performance commitment should include the progression of demand side solutions, such as local incentive schemes, as well as the improved management of water resources themselves; this is recognised in section 2.4 of Appendix 2, and should be more widely promoted.

Leakage performance commitment (p70). We support the need and drive for improved leakage reductions by companies. However, we are, concerned, notwithstanding the use of % based reduction targets, that the blanket targets defined on p70 provide a softer challenge to companies with high rates of leakage, compared to those who have delivered recent improvements or who already have low rates of leakage. The more distant from the frontier, the larger should the expectation of improvement be upon an operator. In addition to the factors listed that Ofwat believe companies should consider, we suggest that ‘the value of water left in the environment’ should feature in any considerations, particularly where abstraction is from environmentally-sensitive sources, such as chalk streams.

ODIs (p71/72). We support the proposal to raise the bar on ODI standards, by imposing penalties on companies that deliver average (and lower than average) performance on their ODI package (p72). We also support the proposal to stretch the range and vary the profile of penalties and rewards for outturn ODO performance (per the profile shown in Figure 4.4 on p76).

Responses to questions: Chapter 4

Q1. Do you agree with our proposals for common and bespoke performance commitments?

See comments above

Q2. Do you agree with our proposals on setting performance commitment levels?

See comments above

Q3: Do you agree with our proposals for strengthening outcome delivery incentives?

Yes

Chapter 5 - Resilience

Long-term resilience (p91). We support the focus on delivering long-term resilience. But we note (and are disappointed by) the absence of consideration of management of the environmental resource that sustains services to customers, with the focus being entirely on the latter; and on meeting customer expectations, however realistic or unrealistic, at affordable prices, without apparent regard to the need for increased care in the use of water, under threat of increasing scarcity, and increasing contestation of resources between customers, net of the changing needs of nature and the environment.

We are concerned that the potential metrics being considered reflect a narrow definition of the term 'resilience', looking primarily at operational and infrastructure resilience. They also fail to reflect the fact that operational resilience starts with a consideration of how natural assets are managed.

Resilience principle 2: a naturally resilient water sector (p97). We should have liked to have seen this as principle number 1. We are pleased to see acknowledgement of the fact that "resilient ecosystems and biodiversity underpin many of the key services provided by companies." And of the recognition that this "should be considered as part of the decision-making process for ensuring resilient services." But we are disillusioned to see the addition of the caveat, "as far as this is consistent with companies' role as providers of water and wastewater services", the effect of which is to reveal a somewhat one-eyed, customer-centric perspective that bodes ill for sensitive management of the providing environment by an industry that depends upon it.

During 2017, we (through the Blueprint for Water Coalition) worked with Ofwat and WWRAG to develop an **environmental resilience metric** that reflected the health of the environment that the companies depend on to operate, proposing using **WFD Good Ecological Status as an overall indicator metric of the health /resilience of the ecosystem** at water company interfaces. We are disappointed this work was not referenced or included as one of the two potential resilience metrics described in the methodology consultation document. We still feel it could be included as part of the risk assessment process linked to Principle 2 and would be happy to work with Ofwat and others to develop it further.

Furthermore, at the launch of the Blueprint for PR19 in May 2017, we proposed a **joint project** between the environmental NGOs and water companies to consider the linkages between **environmental resilience and water company resilience** with case studies and practical examples of what both sectors can do together and separately to enhance resilience. We are currently looking for financial support to enable this project to proceed, but feel that it would be useful underpinning information in support of achieving Principle 2.

Assessment of resilience in business plans (p98). We consider the "specific" focus on companies' operational, financial and corporate resilience to be lacking in the consideration of their duty to ensure the effect of their operations on the resilience of the environment upon which they depend. We note the advice given on p99, that the "risk assessment should consider the resilience of the ecosystem" and that "firms should have regard to the wider costs and benefits to the economy, society and the environment, including the sustainable use of natural capital – that is, our natural assets such as rivers and groundwater" but we find reference to the environmental imperatives to be too little, and too limited (e.g. to rivers and groundwater as resource assets, rather than to the health and well-being of the water environment in the round (as it were).

The need for Waste Water Management Plans (WWMPs) (p100). The consultation document notes that there “is no equivalent to the WRMP process for wastewater services.” We believe that there should be, that this has been noted for some time, and that Ofwat should be doing more to ensure that a WWMP process is established as a matter of importance and urgency. We consider that at the very least, Ofwat should urge water companies to produce WWMPs on a voluntary basis (as was the case for WRMPs, before they became statutory obligations upon water companies), prior to directing them to produce WWMP’s on a statutory basis thereafter.

Partnership working (p101). Mention is made, by way of an example, of the possibility that “water companies may work with other partners, such as local farmers, to decrease pollution and so reduce water treatment.” We would like to see greater encouragement from Ofwat to companies on this front.

Environmental benefits from water trading and interconnectivity (p102). We welcome mention of the benefits that greater interconnectivity and water trading might produce for sensitive abstraction from water sources when flows and levels are low. As noted, we support greater awareness of the opportunity to manage the environmental resource base in a sensitive manner, particularly where and when water is scarce, including through active use of the Abstraction Incentive Mechanism (AIM).

Responses to questions: Chapter 5

Q1. Do you agree with our resilience planning principles?

See comments made above. The need for and the value of environmental resilience is under-rated, and under-played, in our opinion.

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?

The tests on securing long-term resilience do not currently adequately ensure that Principle 2 is followed.

Chapter 6 – Wholesale Controls

Encouragement of a long-term perspective, rather than a five-year one (p109). We support this objective.

Water trading incentives designed to encourage new water trades by increasing financial rewards for exporters and lowering the cost of trading for importers (p116). We support the approach taken by Ofwat. And we acknowledge that the extent of trading arrangements (cf. the volumes actually traded in a given year) to date may well under-state that to come, for the reasons stated. We should, though, like to see a rolling annual account of trades agreed and made, going forward. Not least to check the actuals against the May 2016 estimate of potential savings from trading (cf. other supply-demand balance solutions) of £810 million NPV.

The introduction of a separate price control for water resources (p117). We note the carefully-worded claim that the introduction of a separate total revenue control for water resources “will inform, enable and encourage an effective market for new water resources”. It may. As to whether it will deliver reliable new water resources into play, when they are currently short (i.e. in droughts), is another matter. And we wonder whether the cost to companies - and thence to customers - of operating the water resources function under a separate price control from water network plus, for

purposes of “revealing improved information that will enable us to set better targeted incentives” will prove to be net worthwhile. The premise hinges upon the existence of third parties able to supply (and guarantee to supply) new reliable resources where and when they are needed, in the required volumes and at an acceptable price. We don’t believe that the separation of the water resources and water network price controls will encourage significantly greater trading between water companies than that now under realistic consideration (including regional collaborations like WRE and WRSE, and inter-basin transfers such as the Essex-Ely-Ouse and Severn-Thames Transfers). And we have doubts as to the reliable volumes that might be provided to water companies by non-water company resource owners, particularly in the dry, drought and extreme drought events to which Government expect water companies to be resilient.

Inclusion of raw water reservoirs in the water resources control (p118). We support this decision, in comparison to the option of including storage reservoirs in the water network plus control, based on the point of first abstraction being the boundary between the water resources and network controls.

Use of water resources yield as the proposed capacity measure for distinguishing between pre- and post-2020 investment (p120). We note the recognition on p121 that the average volume of water available from the environment (yield) is “dependent on the service level and the planning period, and is constrained by water resources control assets.” The corollary is that yield will need to be defined by a set of values, not a single one. We also note the consideration of unit cost of yield as an alternative value for the purpose of rating pre- and post-2020 investment based revenue. We think this has attractions, in the specific context, and merits further analysis.

Risks of under- or over-investment in long term water supply-demand planning (p122). We concur with the view that supply-demand balance (SDB) planning involves inescapable risks, and that there are costs to under-utilisation of developed capacity. But there are also costs to the under-development of capacity, and to more-than-planned use of demand restrictions. We also note that the drive for greater resilience to extreme events is likely to entail the creation of greater headroom in the system (albeit mitigated by inter-connectivity between areas with different exposures to drought). This is a complex issue, that merits careful attention. We consider the proposition that water companies should bear some of the cost of (deemed) over-capacity to be one that merits wide and detailed consideration. Customers need to be made aware of the cost of resilience to different risks, and of the cost of not having resilience to those risks. Their appreciation as to whether the planning risk occurs or does not occur in the defined planning period is a further complication in this regard.

Responses to questions Chapter 6

Q2. Do you agree with our proposals for the form of control for water resources as set out in the Wholesale controls’ chapter and appendix 5, ‘Water resources control’?

We have reservations. See comments above.

Chapter 7

No comments, no responses.

Chapter 8

No comments, no responses.

Chapter 9

No comments, no responses.

Chapter 10

No comments, no responses.

Chapter 11

No comments, no responses.

Chapter 12

No comments, no responses.

Chapter 13

No comments, no responses.

Chapter 14

The approach (p258). We consider it to be appropriate, in context. We think the process worked well in the last round, and we support its development for PR19.

The test areas (p259). For information, the Blueprint for Water Coalition will again be making its own assessment of company plans for PR19 (2020 ~ 2015), measured against the environmental ‘asks’ we discussed with companies in 2016/17 and published in May 2017. There is limited overlap with the nine key tests proposed for use by Ofwat, with outcomes for the environment (cf for customers) and resilience (for the environment, including for water resources and water quality, as opposed to for water and wastewater services to customers) being those with some degree of joint interest. We wish that it could have been more.

Under Appendix 14, Table 2 gives details regarding scoring business plans, and the environment is only specifically mentioned under innovation. It is disappointing to see that it is not even mentioned under resilience, as the definition of “resilience in the round” in the methodology does not currently encompass the environment. There is also no mention in this appendix on assessing business plans around natural capital assessment.

Responses to questions Chapter 14: The initial assessment of business plans: securing high quality, ambition and innovation

Q1. Do you agree with our proposed approach to the initial assessment of business plans?

- Q1a: In terms of the nine test areas?

We do not agree with the current approach as it does not adequately assess environmental commitment under the majority of the test areas.

- Q1b: In terms of the business plan characteristics we want to see? (high quality, ambition and innovation)

Yes

- Q1c: In terms of the business plan categories we propose to assign companies to? (significant scrutiny, slow track, fast track, exceptional)

Yes

- Q1d: In terms of the financial, procedural and reputational incentives we propose to put in place?

Yes

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?

Not in respect of the environment. Aside from the claims that the environment benefits indirectly through "better services and benefits" brought by innovation (p5) and that "high levels of innovation ... would result in benefits for customers, companies and the environment" (on p266), the topic receives no material attention. Environmental challenges are alluded to as threats to the delivery of services to customers, rather than as pressures upon the environment that need to be attended to in their own right. The need for maintaining and enhancing the well-being of the environment, let alone the means of doing so, receives scant attention throughout.

Appendix 5: Water resources control

We suggest that **environmental cost data** should be included in the cost data. They have been absent, or dreadfully under-scored, to date, and it is high time that environmental externalities are brought into the analysis in an effective way. The continued absence of such a data requirement could encourage companies to prioritise abstraction from cheap but environmentally sensitive sources. This could happen as a consequence of companies seeking to appear efficient against Ofwat benchmarks, or because of competitive forces felt by the new market.

We recommend a shadow environmental price of water. This could be seen as a "pro-market" approach to securing environmental outcomes, as it would encourage new entrants into the market to displace damaging (and therefore high-cost) abstraction.

We are concerned at the lack of content regarding demand management and leakage. This section should recognise the potential for new entrants to displace the need for water resource investment through greater demand management and reduction in leakage