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Secretary of State for Environment, Food & Rural Affairs
Water resources management plan consultation
Area 3D
Nobel House
17 Smith Square
London
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25 May 2018

Dear Secretary of State,

South West Water – draft water resources management plan 2019

South West Water published its draft water resources management plan 2019 on 5 March 2018 for consultation. This letter provides a summary of our assessment of the draft plan. It is our statutory consultation response, produced in accordance with our statutory duties and the Government's strategic policies and objectives for Ofwat. These views are without prejudice to any subsequent decisions that we may make at the next price review (PR19) in connection with the business plan that the company is scheduled to provide to us in September. Our assessment has considered:

- how adequately the draft plan follows the requirements of the Water resources planning guideline and Defra's guiding principles for water resources planning; and
- how the draft plan helps achieve our vision of ensuring trust and confidence in the sector through the delivery of our key themes for PR19 of great customer service, affordable bills, resilience in the round and innovation.

Long term water resources planning is a key part of company business activities. We expect companies to integrate the development of their water resources management plans into their business plans which they submit to Ofwat. We also expect them to adopt the 'twin track' approach to improve water supply resilience through both increased supply and reduced demand. We will continue to work closely with Government and the other regulators in both England and Wales to ensure that a long term secure and sustainable supply of water is achieved.

South West Water supplies water to a population of approximately 2.2 million across the south west of England, covering Devon, Cornwall and small parts of Somerset and Dorset. Its water resources are planned on the basis of three water resources

zones. Since the publication of the previous plan in 2014 South West Water has acquired Bournemouth Water and the draft plan covers the combined company.

South West Water predicts that two out of its three water resource zones will be in surplus for the duration of the planning period. This means that there would be sufficient water to maintain supply to customers in severe drought conditions. The remaining zone (Colliford) enters a very small forecast deficit by the end of the planning period.

The South West Water draft plan demonstrates good practice in terms of the scale and breadth of its customer participation activities and its consideration of innovative demand management options. While the majority of South West Water's plan is in line with our expectations and good practice, there are areas of the plan where we are not convinced, on the basis of the evidence so far provided, that the plan delivers in the best interests of customers. In particular:

- The short term leakage reduction in the draft plan is one of the lowest in the industry: 5% by 2025 and rising to 20% by 2045. There is no evidence that customers support this level or that it reflects the evidence of the high importance that customers place upon leakage reduction. The level of leakage reduction needs to be considered further and justified in the final plan.
- The Bournemouth water resource zone is in surplus and there is the potential to trade water with Southern Water, who face a significant supply-demand balance deficit. A 20 MI/d transfer has been tested as a scenario, however, it is not a preferred option in the draft plan. From the evidence provided it is unclear why a larger transfer is not being considered and we expect the companies involved in this transfer option to continue to actively engage on progressing its assessment and feasibility.

Further details on these points are outlined in the annex to this letter alongside more detailed comments on different areas of the draft plan.

I look forward to seeing these points addressed in South West Water's statement of response and final plan.

Yours sincerely



David Black

Senior Director, PR19

Annex

In this annex we outline further details on the points raised in our main letter alongside more detailed comments on different areas of the draft plan. Our points reflect our assessment approach and cover:

- 1. Plan building blocks:** The overall approach to the development of the draft plan in line with the technical guidance and broader resilience issues.
- 2. Customer participation:** The type and quality of interaction with customers and the impact this has had on the draft plan formulation and proposals.
- 3. Demand forecast:** How the company has considered the impacts of population growth, leakage and water efficiency in its demand forecast.
- 4. Supply forecast:** How the company has considered climate change, abstraction licences changes and transfers in its supply forecast.
- 5. Forecast uncertainty:** The robustness of the draft plan in accommodating uncertainties in the demand and supply forecasts.
- 6. Supply-demand balance:** The robustness of the overall need for water, if any, and the scenario testing applied to this assessment.
- 7. Options:** The approach taken to identifying and screening options for both supply and demand, including identification of trades and third party options.
- 8. Decision making:** The decision making tools, preferred programme development process and accompanying assurance processes.
- 9. National and regional considerations:** The interaction and consistency with national studies and regional groups (where relevant).

1. Plan building blocks

South West Water has explained its approach to draft plan development well and adopted methods and used data appropriate to its problem scale and complexity. The company has identified additional non-drought resilience hazards that could impact its supply system which is an example of good practice. Greater clarity should be provided in the business plan on proposals for future resilience investment. Further specific comments:

- South West Water has identified resilience metrics for testing, such as flooding, asset failure and water quality, which is an example of good practice. However, it will be useful to understand how these hazards impact supply

system resilience as part of the draft plan and how it has considered wider events, such as the impact of freeze-thaw.

- The draft plan states that additional investment is required to address residual risk beyond drought which could impact the supply system. It is stated that this will be considered as part of the PR19 business plan and we expect this will clearly quantify these risks and identify mitigation activities and their costs and benefits.

2. Customer participation

South West Water's draft plan is comprehensive and accessible. There is good evidence of customer participation in the development of the plan through a wide range of approaches, including the innovative use of an interactive personal video to gather information from a wide spectrum of customers. However, we have concerns over the clarity and application of the willingness to pay research. Further specific comments:

- The draft plan is clearly written, well structured, and easily accessible. A separate non-technical summary is published for customers and non-technical stakeholders which is helpful.
- The research suggests that customers appear satisfied with the current levels of service for drought restrictions. Further considerations:
 - This has been quantified in terms of a cost per property for each service improvement that customers are willing to pay for. Whilst this is useful for presenting the outputs of the research, further explanation should be provided regarding how this valuation has been undertaken and how it influenced the draft plan service levels.
 - The company is currently resilient to a 1-in-200 year drought and customers perceive potential restrictions as a low risk and are unwilling to fund further improvements in the demand restriction frequency. However, it is unclear how the level of service was presented to customers and whether comparative resilience to neighbouring companies was used. This should be clarified in the final plan.
- Feedback from customer research has influenced the selection of options, in particular the leakage programme. However, greater clarity is required on how the willingness to pay values have been determined as these will have influenced option selection. For example, adding in willingness to pay values can make some options appear to have negative delivery costs.
- South West Water's Customer Challenge Group (CCG) has been involved in the development of the plan. The draft plan provides a description of this and we expect this to continue for the final plan.

3. Demand forecast

South West Water's aggregated demand forecast approach is in line with relevant guidance. The company has also engaged with non-household retailers which is an example of good practice. However, we have concerns around the approach to population forecasts and trends in per capita consumption (PCC). Further specific comments:

- The company has consulted local authority plans in developing its demand forecast. Greater clarity is, however, required on some of the early differences between these and the company forecast, which, although small and not material, need to be justified.
- Greater clarity needs to be provided on trends for baseline PCC and how these have changed since the previous plan. For example the company's baseline PCC is forecast to increase by 1.8% over the planning period, compared to a 9% reduction in the previous plan. While it is noted that this is due to a "change in trend" in 2011-12, the explanation for the change is limited and we would expect further assessment of this change to be undertaken to improve confidence in the forecast consumption values.
- South West Water provides evidence of engagement with retailers supplying non-household properties, which is a welcome approach. However, the response rate was relatively limited and engagement with larger users appears missing both of which would help validate the demand forecast.

4. Supply forecast

The draft plan follows the relevant supply forecasting guidance and the outputs appear reasonable and aligned with historical trends. The approach to supply reductions and outage all appear appropriate, however, greater clarity is needed on the level of operational losses in the Bournemouth water resource zone. Further specific comments:

- The draft plan incorporated the available information contained in Water Industry National Environment Programme 2 and the final plan will use the next data release (WINEP3). We expect the final plan to explain any changes between these two releases and how the programme has changed as a consequence.
- South West Water has a very low outage allowance (1.7% of supply) relative to the other companies (industry average of 6%). This appears to have been determined in line with the relevant guidance and will be further validated by the proposed automation of the recording of outage events.

- Operational losses (sum of raw water transport and process losses) are substantially greater at 8% in the Bournemouth zone across the planning period than industry average of 1.6% of supply. Greater clarity on the reasons behind this is required in the final plan.

5. Forecast uncertainty

We have concerns around South West Water's approach to forecast uncertainty as it has changed significantly since the previous plan and is above industry average. Greater clarity is required on this area in the final plan to assure us that the approach is robust. In particular:

- The target headroom allowance at 11% of supply is larger than the industry average of 8%. It has also significantly increased from 7% in the previous plan.
- Surface water flow measurement accuracy appears to account for 40% of headroom derived from the assumption of flow measurement inaccuracy of 10%. South West Water should consider if this is appropriate and justified for its dataset and set out further details on its reasoning in the final plan.

6. Supply-demand balance

The supply-demand balance profile presented is in line with the assumptions of the individual supply and demand components and it appears to be consistent with the guidance. The baseline scenario chosen for planning is well justified and we have no concerns around the approach, subject to our comments above which seek further clarification on the approach to headroom.

7. Options

South West Water appear to have identified appropriate assessment criteria and has considered a number of demand-side options. Innovative water efficiency options focusing on issues such as holiday rentals have also been selected. However, the company should provide further details regarding its leakage options and the consideration of third party options. Further specific comments:

- The screening criteria used by South West Water generally appear to be appropriate. However, it is not clear why failing to be innovative should be grounds for screening out a demand management option and this should be explained in the final plan.
- The draft plan provides evidence that South West Water considered the potential for third parties to provide solutions at a lower cost than its own, but no such options were included. The focus of this was on supply-side options

and the company should provide clarity on its approach to demand-side options and consider what it could do in order to promote them.

- South West Water has the potential to export water to Southern Water from its Bournemouth zone. A 20 MI/d transfer has been tested as a scenario, however, it is not a preferred option in the draft plan. We expect the companies involved in this transfer option to continue to actively engage on progressing its assessment and feasibility prior to the final plans being published. Further considerations:
 - It is stated in section 7 of the draft plan that a 20 MI/d transfer could not be sustained without placing the Bournemouth zone into deficit. However, this is not justified in the draft plan, for example the planning table shows a surplus greater than 30 MI/d across the planning period.
 - Linked to this, given the size of the baseline surplus in Bournemouth, there is the potential for transfers larger than 20 MI/d to be considered. These could be supported by the exploration of options that either reduce the headroom allowance or the level of operational losses.
 - A larger transfer is also supported by the work of the Water UK national project. This work had transfers of up to 40 MI/d featured in several of the portfolios by 2040.
 - We recognise there are potential issues with the proposed transfer route through the New Forest. Greater clarity should be provided on how these could be mitigated and if there are alternative transfer routes that can be used.
- The company has selected a significantly lower level of leakage reduction than other companies; 5% by 2025 rising to 20% by 2045. Further considerations:
 - While the programme has been justified on cost-benefit ground, there is only limited information on the rationale and justification for the preferred leakage strategy. For example from the draft plan it is not possible to determine what the preferred options comprise of in terms of leakage reduction measures.
 - It is unclear how the proposal reflects the high importance that customers place upon leakage reduction, which are shown in the significant willingness to pay estimates. Further clarity is required on how customer preferences were reflected in the preferred programme.
- Metering is forecast to increase by 3% by 2025 as a result of maintaining current optant strategies. Over the long term, the metering forecast appears to be well justified, and the preferred strategy chosen based on cost-benefit analysis.

- We note that South West Water's average PCC is relatively high at 139 l/h/d in 2020 compared to other companies with a similar level of meter penetration, and the national average at 136 l/h/d. Although the company has forecast a reduction in its average PCC across the planning period through delivery of water efficiency programmes, it needs to consider further ambition in this area, particularly where this can generate wider benefits, such as opportunities for regional trading.
- We welcome South West Water's trials of innovative approaches to demand management. These include partnering with a specialist demand management company, the "Greenredeem" rewards scheme and holiday home rental water efficiency. As currently the impact of schemes is based on evidence from other companies, the company should provide plans for monitoring the impact of the water efficiency option benefits in its final plan.
- No supply-side options were selected for the preferred plan as expected for a company with minor deficits. However, given the potential scope for trading we expect South West Water to assess whether supply options could reduce its levels of operational losses and headroom to increase the surplus available for trading.
- Across the options it is unclear how values for willingness to pay have been derived. As noted in section 2 these are significant and the company should provide further explanation of how these were calculated.

8. Decision making

Consistent with having a surplus South West Water has not used a decision making tool for its baseline planning problem though greater clarity is required in the final plan on the approach to trading and demand management selection. Reflecting this we welcome the company's intention to develop a new financial decision making tool for the next plan to help inform investment to mitigate uncertainty. The internal and external assurance process for the plan is also clearly specified, and the Board was updated monthly regarding the draft plan development.

9. National and regional considerations

We welcome that South West Water is participating in the recently formed West Country Water Resources Group which will help shape future water resources management plans. The company has also considered a Bournemouth zone to Southern Water transfer as a scenario in the plan on the basis of the Water UK national project findings.