

July 2019

Trust in water

PR19 draft determinations

**Dŵr Cymru – Targeted controls, markets
and innovation actions and interventions**

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PR19 Draft Determinations: Dŵr Cymru – Targeted controls, markets and innovation actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised actions, a summary of the company’s response to the action, our assessment of the company’s response, and any further interventions we are making as part of the draft determination.

Each action has a unique reference. The prefix ‘WSH’ denotes the company Dŵr Cymru. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Actions whose numbers are preceded with an ‘A’ denote required actions and actions whose numbers are preceded with a ‘B’ denote advised actions.

Table 2 below sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix ‘WSH’ denotes the company Dŵr Cymru. The central acronym references the test area where the action has been identified, please see the ‘PR19 draft determinations: Glossary’ for a key to these acronyms. Intervention numbers are preceded with a ‘C’.

For all other documents related to the Dŵr Cymru draft determination, please see the [draft determinations webpage](#).

Table 1: Dŵr Cymru’s response to required actions and interventions for draft determinations

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Targeted controls, markets and innovation	WSH.CMI.A1	Required	<p>The company’s bioresources plan assumes growth rates lower than historical trends and highlights that at trend growth rates operational headroom eroded in the price control period triggering the need for additional treatment capacity. The company proposes to address the risk by pursuing a trading strategy.</p> <p>The company should provide further evidence around how the sludge volume forecast was calculated, including any assumptions made or adjustments to model outputs. The company should also provide evidence of its engagement with other companies and other waste operators to ensure there will be sufficient capacity available in the market to address the potential operational needs.</p>	1 April 2019	<p>The company has satisfactorily addressed our concerns with respect to the growth rates. Dŵr Cymru has provided further evidence on the growth rates in its plan and on the calculation of the growth forecasts. The company intends to rely on the market for additional capacity going forward. The company provides further evidence of its engagement with other companies.</p> <p>Their sludge volume forecast takes account of lower dry solids per population equivalent and an increase in sludge due to P-removal schemes. The company</p>	No intervention required.	N/A

					also addresses engagement with other companies on trading.		
	WSH.CMI.A2	Required	The proposed split of fixed and variable revenues for the bio-resources revenue control has not been sufficiently evidenced, particularly where cost lines are partly incremental and partly fixed. We are also intervening to ensure that the bioresources revenue adjustment is set on a broadly comparable basis to avoid setting revenue controls that may distort the development of trades. We will set out our view in the draft determinations based on the updated tables Bio1, Bio3 and Bio4. We will treat the funding of the 2020 RCV (run-off, returns and tax) as fixed for these purposes, along with revenues to recover local authority rates; some fees; and a proportion of direct and indirect costs of bioresources treatment and transport.	1 April 2019	We issued an industry query response in March 2019 setting out further details about the broad approach to be followed consistent with the methodology that would be applied to the fast track companies. Dŵr Cymru provides further evidence on the proposed split of fixed and variable revenues.	Intervention required. We are intervening because our assessment of the companies' business plans revealed an inconsistent approach between companies in their calculation of the bioresources revenue requirements to recover fixed and variable costs. This resulted in a wide range of suggested splits between the fixed and variable revenue component. As with fast track companies, a consistent approach to the fixed/variable split is essential to ensure that the company is correctly remunerated by our modified average revenue control for outturn sludge volumes that differ from its original forecasts.	We are intervening to set the level of the split between fixed and variable costs. Our detailed approach is set out in 'Our methodology for the classification of bioresources costs'.
	WSH.CMI.A3	Required	The company should provide a commitment to provide a detailed work programme by end August 2019 to assure us that the company will deliver appropriate drainage and wastewater management plans. The programme should ensure that the company can prepare and consult on its first drainage and wastewater management plan no later than the summer of 2022 to enable revised plans to be prepared in early 2023 to inform PR24 business plans.	1 April 2019	The deadline for the detailed work programme is the end August 2019.	No intervention required.	N/A
	WSH.CMI.A4	Required	The company has provided a bid assessment framework that does not meet the principles set out in the price review methodology. These include, but is not limited to, lack of detail to demonstrate that the approach is non-discriminatory and set out detail on how the company with manage commercially sensitive information that it receives. We require the company to revise its bid assessment framework document to address our feedback.	15 July 2019	Dŵr Cymru have submitted a revised Bid Assessment Framework.	No intervention required. However, the company may wish to consider if it would be useful to have a review of the bid assessment process on a periodic basis, to check that commercially sensitive information has been properly protected and used correctly.	N/A

WSH.CMI.A5	Required	<p>Merthyr Water Treatment scheme</p> <p>A full explanation and supporting risk analysis for the Dŵr Cymru Board's decision to reject the Merthyr Water Treatment scheme as suitable for DPC on the grounds of "unacceptable risk to our customers". This should include, but not be limited to, the risks to customers in the event of default or financial difficulty of a third party operator and the areas where there was insufficient risk management available to the Board.</p>	1 April 2019	<p>The company provided a reassessment of the Merthyr Water Treatment Works which included a revised technical and financial assessment. The company included an updated risk assessment.</p> <p>In addition, the company provided an updated Net Present Value analysis and sensitivity analysis for the scheme. The company rejected the scheme on technical and financial grounds.</p>	<p>A review of the revised technical and NPV analysis for the Merthyr Water Treatment Works scheme was carried out on the decision to reject the scheme under DPC. The technical detail was sufficient but unconvincing as to why this scheme was less suitable for DPC.</p> <p>The NPV analysis provided sufficient information to allow a high-level review but insufficient detail to be able to confirm the absolute values.</p> <p>The company's decision that this project was likely to offer the best value for money for customers through in-house procurement was unconvincing as the NPV and sensitivity analysis indicated a potential better value outcome may be achieved through DPC within the regulated company. We were unconvinced that the net benefit would be outweighed by the incremental long-term indirect benefits that Dŵr Cymru suggested a traditional in-house procurement would deliver through customer dividends because any such benefits are less certain</p>	Dŵr Cymru to reassess the Merthyr Water Treatment Works scheme for suitability based on market testing prior to procurement
WSH.CMI.A6	Required	<p>Gwili Gwendreath Wastewater Treatment scheme</p> <p>A full explanation as to why under the DPC assessment the gearing level for Gwili Gwendreath Wastewater Treatment works was considered "optimal" despite being lower than for Merthyr Water Treatment scheme.</p> <p>For Gwili Gwendreath Wastewater Treatment works, an economic analysis of the scheme including a Net Present Value analysis using the same gearing assumptions as the Merthyr Water Treatment scheme assessed under the DPC scenario. The analysis should clearly identify any additional benefit to customers of progressing this scheme outside of DPC.</p>	1 April 2019	<p>The company provided an explanation for why the gearing level provided for the Gwili Gwendreath was different to that used for the Merthyr Water Treatment scheme.</p> <p>The company did not provide an updated economic analysis based on the same gearing used in the Merthyr Treatment works.</p>	<p>No interventions required.</p> <p>There was sufficient evidence to explain why the gearing level for the Gwili Gwendreath Wastewater Treatment works was selected.</p> <p>The reasons for not providing an updated Net Present Value analysis were not convincing.</p>	N/A

	WSH.CMI.B1	Advised	The company should consider how it can collaborate with other companies to maximise the opportunities for research to address common challenges (eg leakage detection, water efficiency and wastewater treatment processes) rather than companies progressing research independently.	1 April 2019	The company has provided a list of partnerships and memberships, however there is limited or no evidence regarding the parties involved, outcomes, investment or resources committed.	No intervention required. We remain concerned that the company is not maximising the opportunities available from collaborating to address common challenges. We will promote innovation in the sector as part of our on-going work on innovation.	N/A
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Table 2: Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
N/A	N/A	N/A

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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