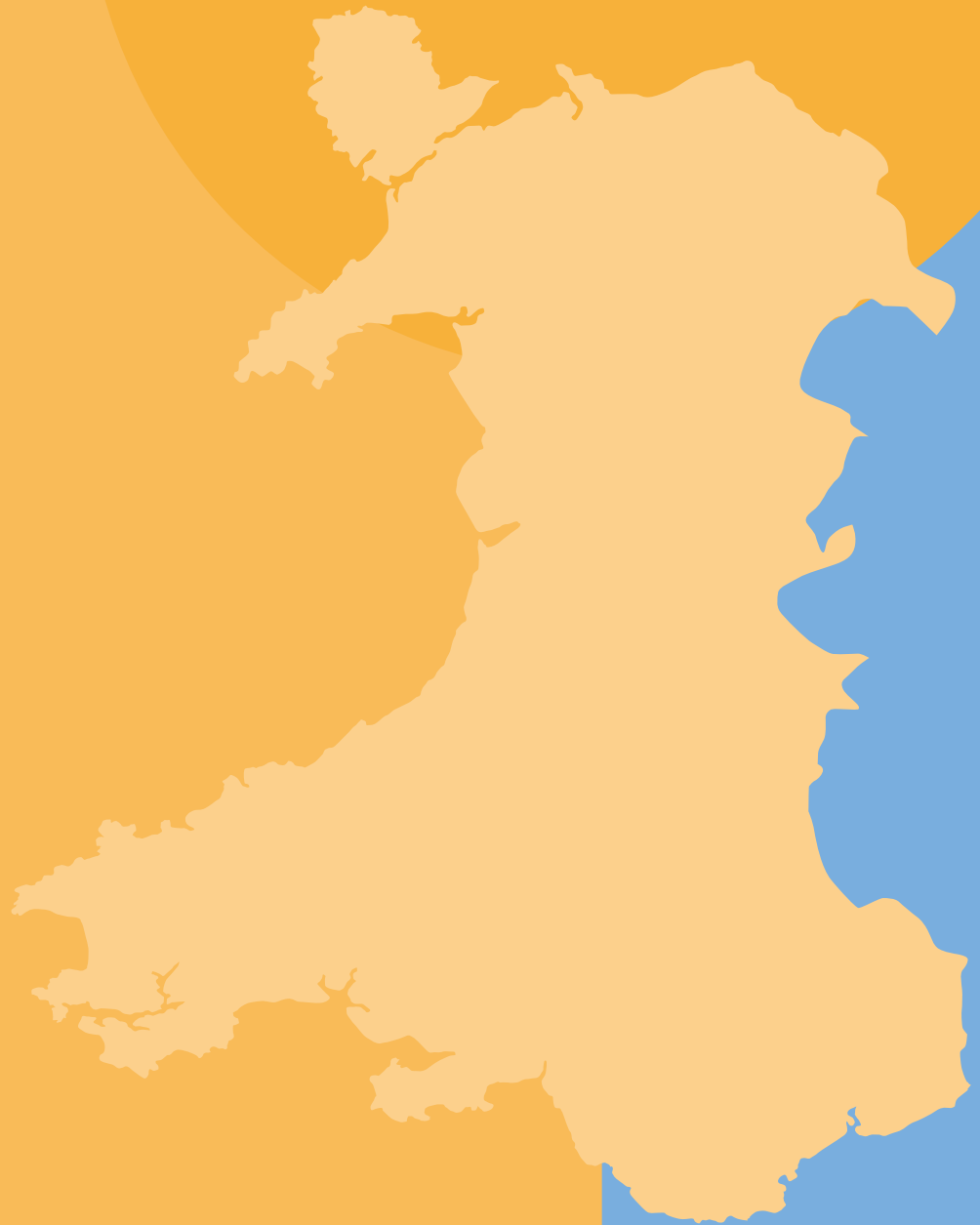


July 2019

Trust in water

PR19 draft determinations

**Welsh Government priorities and our
2019 price review draft determinations**



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Welsh Government priorities and our 2019 price review draft determinations

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1. Introduction

The 2019 price review (PR19) draft determinations play an important role in contributing to the delivery of the Welsh Government's strategic priorities and objectives.

The Welsh Government has set out [strategic priorities and objectives](#) for us,¹ which were adopted in January 2018. We are required to act in accordance with these priorities and objectives in carrying out our relevant functions relating wholly or mainly to Wales. In this document, we discuss how the PR19 draft determinations for 'Welsh companies' (companies whose areas are wholly or mainly in Wales) support the achievement of those priorities and objectives (which we refer to as the Welsh Government's 'strategic policy statement').

The Welsh Government has set five **objectives** for Ofwat that are relevant to this document:²

1. We expect Ofwat to develop the regulatory framework as applicable to Wales on the basis of sound evidence relevant in a Welsh context. It must demonstrate how it has taken into account the specific circumstances of Wales when developing and consulting on new proposals relating to Wales. Where appropriate it should adopt a different approach for UK Government and Welsh Government regulated undertakers.
2. We expect Ofwat to challenge companies to deliver for customers on the basis of comparison across companies in Wales and England, and across sectors where appropriate, while making appropriate allowances for differences in the operating and legal environments of companies in Wales, and taking into account variations in the priorities of customers and other stakeholders
3. We expect Ofwat to take due account of current and future differences in both policy and law between the UK and Welsh Governments including where new obligations on water companies in Wales emerge.
4. Ofwat should have regard to how it can enable or incentivise companies to contribute to the delivery of Welsh Government policy and strategies. Ofwat

¹ It has done so under section 2B of the Water Industry Act 1991, as amended by section 24 of the Water Act 2014.

² The final objective states that Ofwat should submit an annual report to Welsh Ministers. This is outside the scope of the PR19 draft determination and so is not covered here.

should set out clearly how any of its major decisions are consistent with the Welsh Government's strategic priorities and objectives, for example when establishing the methodology for price reviews, presenting proposals for changes to the regulatory framework such as modifications to undertakers' conditions of appointment, or publishing determinations.

5. Ofwat should consider the clarity and cohesion of its regulatory framework taken as a whole and in a specific Welsh context. Ofwat should have regard to the desirability of a simple, effective and efficient regulatory framework. Ofwat should seek to maintain a transparent regulatory framework that allows companies, investors and customers to plan for the long-term, whilst incentivising efficiency improvements.

The Welsh Government has also set **priorities** for the economic regulation of the water sector in Wales under the following seven headings:

- affordability;
- innovation;
- long-term;
- markets and competition;
- resilience;
- strong customer focus; and
- sustainable management of natural resources.

The Welsh Government's objectives and priorities have played an important role in shaping the decisions we have made throughout the price review process. When we published our final PR19 methodology, we **set out how** that methodology would contribute to the delivery of the Welsh Government's strategic priorities and objectives. Our initial assessment of business plans evaluated company plans against that methodology. Now, we are making our draft determinations. This means we implement our methodology and act in accordance with the government's strategic priorities and objectives.

This document begins by outlining how our approach to the PR19 draft determinations aligns with the Welsh Government's objectives for Ofwat. The rest of the document outlines how our draft determinations for Welsh companies support the achievement of the priorities of the Welsh Government.

2. The Welsh Government's objectives for Ofwat

Objective

We expect Ofwat to develop the regulatory framework as applicable to Wales on the basis of sound evidence relevant in a Welsh context. It must demonstrate how it has taken into account the specific circumstances of Wales when developing and consulting on new proposals relating to Wales. Where appropriate it should adopt a different approach for UK Government and Welsh Government regulated undertakers.

Our PR19 methodology takes full account of the specific circumstances in Wales, including the specific legal requirements in Wales. It requires Welsh water companies to develop business plans to address the needs of their customers and the environment in Wales. The PR19 methodology provides considerable scope for Welsh companies to develop business plans and make performance commitments that reflect the particular needs and preferences of Welsh customers. We have assessed Welsh companies' business plans against how they propose to deliver for Welsh customers and the environment during 2020-25 and in the long term.

In making our draft determinations, we have considered the specific circumstances of Wales. We have also taken into account existing Welsh Government policy. For example, in our approach to markets in Wales, we have considered the Welsh Government's view that the development of markets should maintain overall accountability for the delivery of excellent services to customers and the environment, as well as the integrity and efficiency of the management of the network systems as a whole.

Our draft determinations also take into account specific areas that the Welsh Government has prioritised. For example, following evidence of strong support from Hafren Dyfrdwy customers, and need for investment from Dŵr Cymru, we are allowing increased funding for both Welsh companies for the removal of lead pipes from the water supply network; this is in line with the Welsh Government's prioritisation of addressing the risks of lead as set out in the [Water Strategy for Wales](#) (2015). In addition, we are allowing Dŵr Cymru and Hafren Dyfrdwy investment to enact enhanced safety standards arising from the Reservoirs Act (1975) (as amended by the Flood and Water Management Act 2010) at the pace expected by Natural Resources Wales.

Objective

We expect Ofwat to challenge companies to deliver for customers on the basis of comparison across companies in Wales and England, and across sectors where appropriate, while making appropriate allowances for differences in the operating and legal environments of companies in Wales, and taking into account variations in the priorities of customers and other stakeholders

Our PR19 approach has placed a strong emphasis on comparative analysis of companies' plans, where appropriate. In order to establish truly stretching targets, Welsh companies' business plans have been compared to:

- English companies – Our price control has the same broad structure across England and Wales. This has allowed Welsh companies to be compared against a wider range of companies, allowing more stretching targets to be set, benefiting Welsh customers. Two areas where cross company comparisons have been particularly important are:
 - common performance commitments – allowing customers and stakeholders to compare individual company performance with the rest of the sector; and
 - cost benchmarking – we have used data from all companies to set stretching cost baselines, while taking account of legitimate differences in scale and operating environment.
- Other sectors – During the period 2020-2025, the customer service performance of Welsh companies will be compared to that of companies in other sectors through the PR19 incentive mechanisms called the Customer and Developer Measures of Experience (C-MeX and D-MeX). In order to achieve higher performance payments, companies will have to demonstrate equal performance to the best companies in the wider economy (as measured by a cross-sector threshold).

Through these comparisons we have made robust assessments of the relative strengths of the Welsh companies' plans.

Hafren Dyfrdwy continues to demonstrate sector-leading performance on costs, with a total expenditure (totex) allowance at draft determinations that is £4.9m above the proposals included in its April business plan. While the outcomes package that the company proposed in April included improved performance on reducing per capita consumption and removed some outperformance payments, we consider

interventions are required. In particular, we are intervening to increase outcome delivery incentive rates (both underperformance and outperformance rates where relevant) for a number of performance commitments including leakage, sewer collapses, pollution, discoloured water contacts and internal sewer flooding.

Dŵr Cymru's September plan stood out as sector-leading in the confidence and assurance test area during our initial assessment of business plans, which considered areas such as financial resilience and board oversight. In particular, it proposed an ambitious bespoke sharing mechanism under which it committed to share half of all performance commitment rewards with its customers. It also proposed to contribute £85 million to support social tariffs, and to make additional contributions to hardship funds. However, in its April business plan the company continued to propose significant enhancement funding and, in some cases, rejected upper quartile commitments. We are therefore challenging Dŵr Cymru's enhancement expenditure on the basis of the scope of work, evidence provided, and the efficiency of delivery. We are also intervening to require the company to meet upper quartile performance levels for per capita consumption, water supply interruptions, pollution incidents, and internal sewer flooding, and to require Dŵr Cymru to commit to a 25% improvement in external sewer flooding, aligned to other companies.

Our draft determinations are based on company business plans, which were developed by Welsh companies through engagement with Welsh customers and stakeholders. Our approach, therefore, encourages the business plans to reflect the distinct needs of Welsh customers and the environment. Where plans fail to deliver for Welsh customers and the environment, we are intervening.

Our [customer engagement policy](#) sets out expectations that companies will share comparative information on company performance with consistent definitions. Consultation in 2016 led to implementation of the [Discover Water](#) dashboard, delivered by Water UK. The Discover Water members are UK water and wastewater service suppliers for England, Scotland, Wales and Northern Ireland.

We have pushed companies to demonstrate that they are putting their customers at the heart of their business planning through a step-change in the range and quality of customer engagement. This focus on customer engagement has led to the Welsh companies taking into account the variations in the priorities of their customers.

Finally, we looked for independent assurance from customer challenge groups on the quality of each companies' customer engagement and the extent to which customer views are reflected in company plans. The membership of Welsh companies' customer challenge groups include organisations and individuals that

have a specific understanding of Welsh customers and Welsh issues. These include Natural Resources Wales, the regulatory body and principle advisor to the Welsh government on environmental issues, as well as the Consumer Council of Water, the statutory representative of water consumers.

Objective

We expect Ofwat to take due account of current and future differences in both policy and law between the UK and Welsh Governments including where new obligations on water companies in Wales emerge.

Our PR19 draft determinations take due account of differences in both policy and law between the Welsh and UK Governments. For example, public authorities, including Ofwat and Welsh water companies, are subject to a biodiversity duty under the Environment (Wales) Act 2016 in relation to Wales. The biodiversity duty under this act is different from the biodiversity duty that applies under the Natural Environment and Rural Communities Act 2006 in relation to England. Hafren Dyfrdwy, for example, are proposing a bespoke performance commitment around hectares managed for biodiversity.

Both Welsh companies are proposing bespoke performance commitments around the provision of Welsh language services. This is in line with the Welsh Government's policy aim, set out in their [Cymraeg 2050 Welsh language strategy](#), of increasing the range of services offered to Welsh speakers.

We have also required company boards to provide assurance that their company will continue to comply with their statutory and licence obligations, now, and in the future. Our draft determinations will help companies to manage future change to statutory obligations so that companies remain able to finance their functions, while protecting customers.

Our draft determinations are consistent with the Welsh Government's policy regarding competition. For example:

- We have not extended business retail competition to wastewater customers and customers who use less than 50 million litres of water a year – so we will protect these customers by setting an average revenue control based on net margins.

- We have not introduced upstream competition – this allows us to avoid placing an additional regulatory burden on Welsh companies that would not have been merited in the circumstances (for example, we did not include the bilateral market entry adjustment and access pricing reporting requirements).

Objective

Ofwat should have regard to how it can enable or incentivise companies to contribute to the delivery of Welsh Government policy and strategies. Ofwat should set out clearly how any of its major decisions are consistent with the Welsh Government’s strategic priorities and objectives, for example when establishing the methodology for price reviews, presenting proposals for changes to the regulatory framework such as modifications to undertakers’ conditions of appointment, or publishing determinations.

This document sets out how our approach has taken account of the Welsh context. In addition, we have carefully considered the wider context of Welsh Government policy objectives, such as those put forward in the Well-being of Future Generations (Wales) Act 2015. This was reflected in our PR19 final methodology, in which we emphasised our approach to long-term resilience. This approach is also reflected in the seven resilience principles that we expect companies to include in their business plans. In our draft determinations we have intervened, where necessary, to make sure that our approach to resilience is adopted. We will continue to receive revised resilience plans from companies in the summer.

A number of the common and bespoke performance commitments we want companies to commit to are designed to incentivise a long-term approach to resilience, in line with the Well-being of Future Generations Act (see ‘Long-term’ priority below).

In addition, our approach to environmental sustainability has been informed by relevant Welsh policy, including Natural Resource Wales’s [State of Natural Resources Report](#) and the Welsh Government’s [Water Strategy for Wales](#).

Objective

Objective: Ofwat should consider the clarity and cohesion of its regulatory framework taken as a whole and in a specific Welsh context. Ofwat should have regard to the desirability of a simple, effective and efficient regulatory framework. Ofwat should seek to maintain a transparent regulatory framework that allows companies, investors and customers to plan for the long-term, whilst incentivising efficiency improvements.

Our draft determinations reflect our enduring price control principles, which we set out at the last price review. These principles include:

- the better regulation principles of targeted price controls;
- proportionate price setting;
- effective incentives; and
- transparency and predictability.

From our initial consultation, ‘Delivering Water 2020’, to our draft methodology; and, now, in our draft determinations, we have placed in emphasis on transparency and consultation in our approach to PR19. The consultations on our draft determinations are public consultations and open to all stakeholders.

Throughout the PR19 process, we have engaged Welsh stakeholders in order to fully consider the specific context of Wales. These stakeholders include:

- the Welsh Government;
- Natural Resources Wales; and
- other Welsh companies.

We have also engaged with company and NGO stakeholders in Wales as part of the Welsh Government’s PR19 Forum. We would like to thank them for their contribution.

As set out in the section on the Welsh Government’s ‘Long-term’ priority below, we are challenging companies to plan on a long-term basis. We expect companies’ business plans to reflect longer-term strategies and their water resources management plans.

Finally, we are incentivising companies to be more efficient by considering wider evidence of efficiency gains and frontier shift, to drive a step change in efficiency

across the sector. We develop our view of the efficient total expenditure (totex) allowance by benchmarking water companies to the most efficient companies within the sector. We are challenging companies' investment proposals to make sure customers pay only for efficient investment and that they are protected if the investment is not delivered.

3. The Welsh Government's priorities for the water sector

Priority

Affordability

Affordability is one of the key themes of PR19. The Consumer Council for Water reports that 77% of customers of Welsh companies agree that their water and/or sewage charges are affordable.³ For those Welsh customers who do not find their bills affordable, we are going further than any other price review to make sure they are protected. We consider affordability in both the short and long term (see 'Long-term' priority below).

In our final methodology for PR19, we set out the five principles against which we would assess companies' plans on improving affordability:

- customer engagement;
- customer support;
- effectiveness;
- efficiency; and
- accessibility for customers who are struggling to pay.

We are pushing companies to improve their efficiency to make sure that Welsh customers are paying a fair price for the service they receive. We are benchmarking companies (within the sector and against other sectors, where appropriate) to assess cost efficiency and set efficient and stretching cost baselines. We are also challenging Welsh companies' service quality commitments through our outcomes assessment, so customers receive good value for money. And we are setting a record low cost of capital for the sector, which will help to reduce bills before inflation.

³ [Water Matters](#) 2019, p. 47

Our draft determinations make water services more affordable, through:



A 14% fall in bills before inflation for customers in Wales: By reducing the average bill, we are making water more affordable for customers, including for those struggling to pay. This is driven by our lower cost of capital and our efficiency challenge.



Additional support measures for those who find their bills unaffordable: Companies in Wales have engaged their customers on the benefits of social tariffs and are planning to increase the numbers of customers supported. By 2025, 164,000 customers in Wales should receive help through social tariffs and WaterSure Wales.



New approaches to dealing with problem debt: In relation to dealing with debt, Hafren Dyfrdwy states it will offer 'payment matching', whereby the company forgives debt for customers who make regular payments.

Priority

Innovation

Innovation is one the key themes for PR19. Innovation is critical to enabling Welsh companies to deliver against the ambitious policy goals for Wales, as well as delivering benefits to customers, the environment and wider society. Throughout the PR19 process, we have sought to incentivise companies to produce ambitious and innovative plans through financial and reputational incentives.

When analysing all the company business plans, we found some examples of ambition and innovation, but overall the evidence presented by companies was limited. However, Dŵr Cymru showed an embedded innovation culture and demonstrated a high quality, ambitious and innovative approach to managing drainage and wastewater in an integrated and sustainable way for example through their RainScape strategy in central Llanelli, where 20% of the urban drainage area has been diverted into natural watercourses using green infrastructure such as roadside planters, trees, larger basins and swales. Similarly, in Cambrian North, Dŵr Cymru has diverted the highway and roof runoff into a new basin which controls a slow release to the natural environment. The company has also used partnership working and markets to support the effective delivery of outcomes.

Innovation will play an important role in enabling Dŵr Cymru and Hafren Dyfrdwy to deliver against the strong efficiency challenge and stretching performance commitments we propose as part of the draft determinations to reduce leakage, reduce per capita consumption and replace lead communication and customer owned supply pipes to reduce the amount of lead in drinking water at customers' taps where lead concentration is detected above 5 µg/l.

Our draft determinations support innovation in the water sector in Wales, through:



Outcome-focused incentives framework: Water companies will need to innovate to meet the challenges facing the sector in Wales from climate change, while improving affordability. Our outcomes framework provides flexibility and freedom to innovate and to develop solutions reflecting the preference of their customers and communities. By setting stretching outcome performance commitments, we challenge Welsh companies to innovate and to go further for their customers. This will encourage companies to look for innovative ways to deliver better services to customers and improve the environment.



Going further: In addition to our existing package of measures, which encourages companies to innovate individually, we are considering more widely how we can stimulate innovation within the sector. We have identified a number of potential interventions in our [emerging strategy document](#). We are [currently consulting](#) on a competitive funding mechanism to support collaborative innovation initiatives and provide long-term benefits to customers. The level of proposed funding is yet to be determined but, as an early indicator, is likely to be in the region of up to £200 million spread across all customers in England and Wales for 2020-2025 period. The total contribution per company will, therefore, be much smaller. Companies would return this to customers if it were not spent on innovation. We will set out the outcome of this consultation when we make our final determinations.

Priority

Long-term

In our final methodology, we challenged companies to plan on a long-term basis and for their business plans to reflect longer-term strategies and their water resources management plans.

We pushed companies to consider the appropriate balance between short-term affordability and long-term affordability, resilience and performance.

Our challenges have been reflected in positive examples of long-term planning presented as part of companies' business plans, such as the Welsh Water 2050 strategic vision, which provides a high level assessment of future trends that will have an impact on the resilience of the business.

Our draft determinations support a long-term approach to planning and delivery, through:



Investing to meet the water supply needs of future

customers: Our draft determination provides funding for new water supply solutions and programmes to manage water demand that are consistent with the needs identified in the water resources management plans, which account for climate change, environmental protection, and population growth. These include solutions for severe drought resilience and water efficiency activities to support customers reduce their water consumption.



Promoting long term sustainability in wastewater planning:

We have welcomed the scope of the National Environment Programme developed by Natural Resources Wales. We are scrutinising companies' plans to make sure that they deliver the programme efficiently. In addition, we have challenged companies to deliver a detailed work programme to deliver appropriate and timely drainage and wastewater management plans. These plans will, in turn, inform their PR24 business plans. Our draft determination also introduces a separate control for bioresources. This control is designed to encourage management focus on bioresources activities and so encourage companies to use and trade this resource in a more efficient and sustainable way, such as by increasing the transformation of waste to energy.



Maintaining high standard of drinking water quality over the long term:

We are placing a common performance commitment on Welsh companies regarding the quality of the water supply. Quality will be measured against the compliance risk index, which the Drinking Water Inspectorate has developed in consultation with the industry. As noted above, we are also allowing increased funding for both Welsh companies for the removal of lead pipes from the water supply network.



Engaging customers on long term issues: In developing their plans, we expected companies to engage their customers on longer-term issues, such as resilience, and take into account the needs and requirements of future customers. This included, but was not limited to:

- independent evidence from their customer challenge groups on the quality of engagement; and
- the extent to which customer views are reflected in company plans.

For example, Hafren Dyfrdwy explained that it conducted specific asset health and resilience research, which shaped performance commitments and investment decisions. Dŵr Cymru explored long term and intergenerational issues with future customers by using its Youth Board. Their views helped to shape the Welsh Water 2050 strategy document and the business plan for 2020-2024.

Priority

Markets and competition

Our regulatory approach is consistent with the Welsh Government's policy not to extend retail competition or introduce upstream competition.

In line with the Welsh Government's policy, we have sought to consider opportunities where the promotion of markets can help to achieve other priorities of the Welsh Government, such as:

- affordability;
- innovation;
- resilience and;
- a strong customer focus.

In assessing Welsh companies' proposals in this area, we have also been mindful of the Welsh Government's view that any competition should not undermine the integrity of the water supply and sewerage network, nor the accountability of undertakers.

The Welsh Government has decided not to introduce upstream competition. The bilateral market model for water resources that we are putting in place for companies whose areas are wholly or mainly in England will, therefore, not apply to incumbent companies whose areas are wholly or mainly in Wales.

Our draft determinations promote the development of markets in Wales, to the extent that this is consistent with Welsh Government policy, through:



Creating new markets in bioresources: By allowing companies to procure bioresources services from a range of suppliers, we will unlock efficiencies that can be reinvested in the areas that customers value most. Dŵr Cymru provided a good example of how to conduct an initial assessment of market opportunities, carrying out geospatial analysis using publically-available bioresources market information. The company showed that it has 21 raw sludge producing sites that are closer, by road distance, to the treatment centres operated by other water companies than they are to its own treatment centres. This analysis provided an initial indicator of the scale of possibilities and where it should look to undertake further work.



Implementing our new framework for direct procurement:

Direct procurement for customers promotes innovation and resilience by allowing new participants to bring new ideas and approaches to the delivery of key projects where it can deliver greater value for customers. We encourage water companies to competitively tender for the financing, design, build, and operation of appropriate large-scale enhancement projects. This can reduce the costs customers pay for the largest or most expensive new assets, by increasing competitive pressure on project and financing costs, and driving innovation through greater choice. In our draft determinations we have identified Dŵr Cymru’s new Merthyr treatment works as best value for money if delivered by a ‘direct procurement for customers’ approach. The construction of the new treatment works spans the 2020-25 and 2025-30 price controls, so a ‘direct procurement for customers’ approach will provide greater long term certainty for the delivery of this scheme. We will also make sure sufficient controls are in place to safeguard that a ‘direct procurement for customers’ delivered scheme shall in no way whatsoever compromise the integrity of the network nor the accountability of undertakers.

Priority

Resilience

Resilience is vital to current and future Welsh customers. The water sector faces serious resilience challenges including climate change and population growth, which present real threats to the resilience of assets, water resources and services to customers. The combination of these threats and changes in people’s expectations – including about how we treat the environment itself – makes tackling these resilience challenges urgent.

This is a key priority for the Welsh Government and us, and long-term resilience is one of the key themes for PR19.

Customers expect reliable water and wastewater services that can avoid, cope with and recover from disruption, as well as protect the natural environment. This means

in order to make decisions about their operations, maintenance and investment in the short and long term, water companies need the right:

- information;
- systems;
- processes;
- governance;
- capabilities; and
- finances.

They need to have operational, financial and corporate resilience: to be 'resilient in the round'.

In our initial assessment of business plans, we tested companies to apply our seven resilience planning principles in their business plans, which reflect our resilience duty:

- Principle 1: Considering resilience in the round for the long term
- Principle 2: A naturally resilient water sector
- Principle 3: Customer engagement
- Principle 4: Broad consideration of intervention options
- Principle 5: Delivering best value solutions for customers
- Principle 6: Outcomes and customer-focused approach
- Principle 7: Board assurance and sign-off

It is important that company proposals to spend customers' money to improve resilience are grounded in an understanding of the risks to resilience and how these can be best mitigated. In some cases, companies have:

- not provided a clear line of sight between their proposals and improved resilience for customers; or
- attempted to justify additional spending where these are measures they should be implementing anyway as part of their day to day operations.

In these cases, we have intervened in plans and invited companies to:

- provide better evidence of their understanding of risk; and
- justify proposed additional spending in response to draft determinations.

We also wanted companies to engage and work with customers on their approach to resilience and be innovative in how they manage and address risks by, for example:

- exploiting opportunities to collaborate with third parties and other water companies; and
- better integrating water and wastewater resources.

We expect companies to identify and act on the risks of flooding, including the additional challenges created by climate change, and ensure these are reflected in their investment and delivery plans. Integrated approaches to wastewater flooding are supported by the development of drainage and wastewater plans.

Asset health⁴ is an important element of operational resilience and central to the long term delivery of services to customers. We have required companies to make a set of performance commitments reflecting asset health of water and wastewater services, as part of their business plans.

We have pushed companies to take a ‘twin track’ approach to improving resilience of water resources, with investment in new water supplies complementing measures to reduce the demand for water. In our final methodology, we expected companies to consider a wide range of options to achieve long-term resilience in water supply, including:

- new supply investment;
- demand management;
- water efficiency measures;
- leakage reduction;
- water trading; and
- solutions that extend beyond traditional boundaries.

We have worked closely with Natural Resources Wales and the Welsh Government during the consultation and assessment of companies’ draft water resources management plans, which help define the need for investment to maintain the supply-demand balance during a drought. This collaboration has aimed to make sure that the plans meet the needs the environment, accounting for climate change, as well as the expectations of customers for best value resilience. We take into account the identified needs and preferred solutions in the latest water resources management plans but undertake a more in depth analysis of the proposed solutions when assessing the business plan. This assessment usually includes additional and revised information, before making our decisions. Our assessment approach aims to make sure investment is planned to secure drought resilience in the short term (2020-25) and longer term (beyond 2025). In some instances, we have accepted

⁴ The maintenance of physical items, such as pipes and sewers, that allow companies to provide water and wastewater services.

water resources solutions that may not deliver benefits straight away but are important for long term drought resilience.

In line with our resilience planning principles, we expected companies to consider 'resilience in the round', taking an objective and comprehensive view of the risks they face. We consider whether companies have taken a systematic and integrated approach to identifying and assessing all the diverse risks to the resilience of systems and services across the business. We also expected companies to apply a robust, objective, comprehensive and well evidenced assessment of priority risks to the delivery of the services their customers depend on, over the next five years and over the longer term.

This assessment was required to include the consideration of risks to:

- infrastructure;
- systems;
- processes; and
- people.

It should also consider hazards and threats, such as

- physical and cyber-attacks;
- extreme flood events; and
- disruptions to energy supplies.

While some of these individual aspects have been considered by companies' plans, they need to do more to make sure 'resilience in the round' is embedded across the whole of the business. As a result, we are asking companies to develop action plans for implementing a systems-based approach to resilience. We want companies to demonstrate that they are adopting an integrated resilience framework that underpins their operations and future plans.

Finally, companies are responsible for ensuring that their financial structures will be resilient for 2020-2025 and for the long term. We expected them to assess their financial resilience using both prescribed and company-specific stress tests covering cost and revenue shocks. We also expected companies to demonstrate that they have appropriate risk management and mitigation approaches in place.

Our draft determinations will enhance the sector's resilience in the round, through:



Investing in resilience and sustainability: During the 2020-2025 period, Welsh companies will invest £8 million to improve resilience in water and wastewater. We are also allowing Welsh companies a total of £32.8 million to invest in measures to maintain supply-demand balance for drought resilience. We are challenging companies to demonstrate the resilience benefits of their investment proposals and our allowance is for well-evidenced proposals.



Incentivising companies to prevent sewer flooding and pollution incidents: Welsh companies are committing to a 37% reduction in pollution incidents by 2024-25, as well as a 27% and 26% reduction of internal and external sewer flooding incidents, respectively.



Security funding: We are providing funding of £11 million to protect against physical and cyber threats in Wales. This builds on the physical security funding provided during the 2015-20 period to make sure companies are compliant with the Security and Emergency Measures Direction (SEMD). We are also providing funding to improve cyber security in the sector. This includes compliance with the Security of Network and Information Systems (NIS) Directive.



Challenging companies' plans on asset health: We have intervened in Welsh company asset health performance commitments where these commitments do not improve their asset health during the 2020-2025 and where they are not competitive with other companies' performance commitments in Wales and England. Both companies will be required to maintain performance of the sewer network in line with their best historical performance. Both companies are committed to a small improvement in performance of the number of mains repairs that are undertaken. For treatment works, both companies will be required to ensure their treatment works meet compliance requirements all of the time.



Incentivising investment in assets: We have also made sure that asset health performance commitments are backed by appropriate financial incentives. Welsh companies have our four common asset health performance commitments alongside their bespoke asset health performance commitments. These will make sure that companies have the incentives to invest in and maintain their assets so that they will be able to provide services now and into the future, which is what matters to customers.



Assuring financial resilience: Both Hafren Dyfrdwy and Dŵr Cymru have provided Board assurance that they will remain financeable and be able to maintain financial resilience on the basis of their financial structures through the 2020-2025 period. However, as for all companies, we seek further Board assurance on long term financial resilience in the context of a further reduction to the cost of capital since our PR19 final methodology and our interventions in their business plans.

Priority

Strong customer focus

Great customer service was one of four key themes of our PR19 final methodology, reflecting the importance we place on companies responding to the identified preferences and priorities of their customers. When operating their businesses, and developing their business plans, we expect Welsh companies to actively, meaningfully and effectively engage with their customers and stakeholders. This will help them to develop an in-depth understanding of customers' preferences for services, outcomes and investment, and of the affordability of their plan over the long term.

During our review of business plans, as part of our initial assessment and during development of our draft determinations, we tested the quality of Welsh companies' customer engagement, including their approach to customer participation and how well their customers' views were reflected across their business plans. Although we found areas of concern in both Welsh companies' plans, we consider that Dŵr Cymru has provided evidence of high quality customer engagement during our initial assessment of plans. Both Dŵr Cymru and Hafren Dyfrdwy submitted additional and satisfactory evidence of their customers' views in support of each company's response to our initial assessment of the company plan.

Two of our 14 common performance commitments directly relate to customer experience, with one commitment on residential retail customers' experience and one on developer services customers' experience. Our customer measure of experience (C-MeX) will include the experiences not only of customers who contact their companies, but also of customers who do not, so that companies are incentivised to deliver for all their customers.

For developers, the new developer services measure of experience (D-MeX) will incentivise companies to deliver excellent customer service to new connections customers. In addition, Welsh companies must have at least one bespoke performance commitment on the quality of the retail services they provide for their business customers.

We set out in our '[Putting the sector in balance](#)' position statement that we required companies to set out clearly in their business plans how their dividend policies and performance related executive pay policies for 2020-25 will align the interests of company management and investors with the interests of customers. Both Welsh companies have taken steps to demonstrate that they are moving towards meeting

our expectations, though both still have some more to do to demonstrate they fully meet our expectations, acknowledging that Dŵr Cymru is a company limited by guarantee. Our draft determinations identify areas of best practice amongst the Welsh companies we regulate and we expect them to continue to take steps to improve legitimacy in these areas.

Our draft determinations incentivise companies to have a strong customer focus, through:



Delivering excellent service and experience for current

customers: By taking forward a wide range of measures to boost resilience, Welsh customers should benefit from upper quartile performance for water supply interruptions greater than 3 hours, and a 27% reduction in internal sewer flooding incidents in the 2020-2025 period. Companies will also be incentivised to deliver excellent service to their current customers through our new customer and developer experience measures, C-MeX and D-MeX.



A step change in customer engagement: We used evidence presented by each company and its customer challenge group (CCG) to assess the quality of the company's customer engagement and participation⁵ and how well customers' views are incorporated in to the company's business plan and ongoing business operations. In total, Welsh companies engaged with about 45,000 customers during the development of their PR19 plans.

⁵ See [Tapped In](#) report



Reducing the impact of droughts on customers: In the event of future droughts, companies will do more to make sure that the impact on customers is as low as possible. Our common performance commitments on reducing the risk that customers will be impacted by drought should make sure that under 5% of customers are at risk of experiencing severe restrictions, e.g. standpipes or rota cuts, during a drought.



Increased take-up of priority service register support: We introduced a common performance commitment on priority service registers (a record of consumers who have expressed a need for specific help or service) – this will incentivise companies to:

- make sure that at least 7% of customers are on the priority service register by 2025; and
- make sure the register is accurate and up to date.

As a result of our actions, the number of customers registered for priority services in Wales is set to increase by 81,000 in the years 2020-2025.



Additional support measures to help customers in vulnerable circumstances: Dŵr Cymru is planning on rolling out its place based approach to supporting vulnerable customers, trialled in Rhondda Fach, to five more locations in the period to 2025.

Priority

Sustainable management of natural resources

The importance of investing in natural resources and making our ecosystems more resilient is recognised by Natural Resource Wales's [State of Natural Resources Report](#) and Welsh Government's [Water Strategy for Wales](#). Our approach to Welsh companies in the price review process has encouraged companies to engage with customers and stakeholders on sustainable management of natural resources and sought to incentivise companies to manage natural resources in a way which is sustainable for the long term.

In our final PR19 methodology, we required companies to have comprehensive coverage of their environmental challenges in their bespoke performance commitments and to take into account customers' preferences and, where appropriate, the environment, biodiversity and natural capital when setting their performance commitment levels and outcome delivery incentives.

These bespoke environmental performance commitments sit alongside the abstraction incentive mechanism (AIM), on which all companies have a bespoke performance commitment. The AIM incentivises water companies to reduce the environmental impact of abstracting water at environmentally sensitive sites during defined periods of low surface water flows.

Our draft determinations support the sustainable management of natural resources in Wales, through:



Promoting sustainable management: We are supportive of the adoption of 'sustainable drainage' approaches to surface water management to reduce spill from combined sewer overflows, for example, Dŵr Cymru's Menai Straits programme. More broadly, environmental resilience and natural capital valuation appear to be at an early stage within companies' plans.



Reducing water wastage: Both Welsh companies are committing to a 15% reduction in annual average leakage over the price review period. This should save 25 million litres of water per day in Wales during the 2020-2025 period.



Reducing water consumption: Welsh companies will take forward a range of measures to reduce overall household consumption of water by 30 million litres of water per day as a result of helping their customers use water more efficiently. This ought to further reduce the burden on water supplies. Per capita, consumption is set to be reduced to 136 litres per person, per day in Dŵr Cymru's region, and to 135 litres per person, per day in Hafren Dyfrdwy's region. This is as a result of water efficiency activities and educational campaigns. We have accepted the commitment made by Hafren Dyfrdwy, but intervened to tighten Dŵr Cymru's commitment from 138 to 136 litres per customer, per day, matching the upper quartile of reductions promised by companies in Wales and England.

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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