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Natural Resources Wales' response to Ofwat's consultation 'PR24 and Beyond: Creating tomorrow, together'

Natural Resources Wales welcomes the opportunity to comment on the consultation.

As the principal environmental regulator in Wales, our purpose is to both: pursue sustainable management of natural resources (SMNR) in relation to Wales, and apply the principles of SMNR in the exercise of our functions, as set out in the Environment (Wales) Act 2016. The Well-being of Future Generations (Wales) Act 2015 also places a duty on NRW to apply the principles of sustainable development in our work.

Our response is made within the context of Wales' legislative framework, which places sustainable development at the heart of decision making across the public sector in Wales, including Welsh Ministers.

Key issues:

Climate change and the nature emergency

The environment needs to be central to the economic considerations of PR24, which must drive investment to address both climate change and the nature emergency; and incentivise and promote preventative actions and nature-based solutions that address the root cause of problems. The response to climate change must be integrated with a response to protecting and restoring biodiversity. There are numerous examples of the water industry delivering significant and wider benefits through collaborative, community and catchment scale projects and we would welcome Ofwat using PR24 to facilitate this on a larger scale. We believe that there is customer support for these measures, and that the industry will benefit reputationally from the engagement and trust it will build with communities.

Promoting long term planning and sustainable outcomes

We support the promotion of long term and sustainable outcomes, collaborative and integrated working, and building ecosystem resilience, in line with Welsh legislation, coupled with best practice and innovation. Addressing the root cause not just the problem

should be encouraged and incentivised. The focus on outcomes must consider the immediate, medium and long-term impacts of investment decisions as well as wider benefits in order that sustainable solutions are promoted. Investment in catchments and communities to restore a functioning water cycle and to influence customer behaviour are long term programmes which will deliver over multiple business plan periods. The PR24 framework must not present barriers to long term delivery projects and outcomes, that may by nature require collaboration with multiple partners and ongoing adaptive management, as well as risk sharing between regulators and partners.

Statutory environmental obligations

We agree that all performance commitments must be compatible with statutory obligations. All companies should aim for 100% compliance with environmental permits and licences, and zero serious pollution incidents. We feel it is also important that companies are not unduly rewarded for delivering statutory requirements. Ofwat could consider the case for allowing financial rewards only where the company delivers progress towards compliance alongside wider delivery of goods and services in line with SMNR.

Customer knowledge

We note Ofwat's review of the role of Customer Challenge Groups and proposals for PR24. Over the last decade the water industry has increased its involvement of customers in both water company planning and delivery, and we believe this has been a valuable exercise. Knowledge of customer views, expectations and behaviours is critical to delivering sustainable water services, and we support a continued focus on both customer research and customer participation in decision-making. We welcome proposals that will improve the quality, transparency and transferability of customer research during PR24.

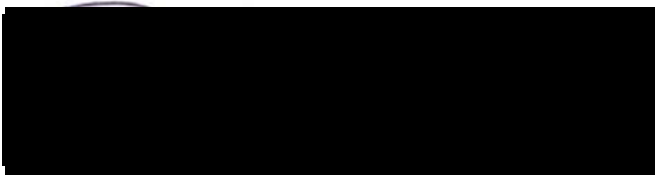
Wales and England

In 2020 we welcomed the appointment of Ofwat's Head of Wales, and over the last year believe this has made an important contribution to the discussion at a national level. The current consultation makes numerous references to Wales and Welsh specifics. However this is not consistent throughout and ideally should be addressed in order to ensure that key policy requirements are highlighted equally for Wales and England (e.g. figure 2.1).

In Annex 1, we provide a detailed response to the consultation chapters.

We look forward to continuing to work with Ofwat during the review process. Should you wish to discuss our response, please contact Ruth Johnston on 07814 294352 or ruth.johnston@cyfoethnaturiolcymru.gov.uk.

Yours sincerely,



Ruth Jenkins
Head of Natural Resources Management Policy

Annex 1 - NRW response to PR24 and Beyond: Creating tomorrow, together

Chapter 2 Ambitions for PR24

We note the reference to climate change. This should be broadened to acknowledge both the climate and nature emergencies. Climate change will impact both the water supply and wastewater aspects of water companies work. Yet the emphasis seems to be on protecting customers' supply expectations. To achieve SMNR and protect our water resources for the future the focus needs to be holistic, encompassing the water cycle in its entirety, the habitats and species it supports, as well as how it meets society's needs for water supply and wastewater disposal. Whilst we acknowledge that the price review focus is customers' bills and service provision, this must be balanced with the needs of the climate and nature emergencies. Water company business plans must be developed on the basis of both a clear understanding of environmental requirements, and customer views and expectations.

The outcomes-based approach needs to have a broad focus and ensure the wider impacts and consequences are understood and considered appropriately, in particular in terms of meeting any statutory obligations.

Evaluation of impact must be incorporated into the price review process and resultant investments by water companies. This feedback loop is important in identifying the most effective interventions and providing evidence to inform future plans.

Chapter 3 How we regulate

We encourage Ofwat to facilitate companies to explore the full range of solutions and to develop evidence to identify the best value approach for the environment, customers, and society. We must ensure the regulatory framework promotes nature-based and collaborative solutions, which may deliver better value than traditional solutions over a longer time period, and with inherently greater uncertainties and risks. This is more important than ever given the climate and nature emergencies.

It is unclear how the catchment system operator model would work for the different regulatory regimes in England and Wales. Nor how the differing needs would be prioritised to ensure fairness but also protection of the environment as opposed to customer expectation.

Chapter 4 Increasing focus on the long term

We welcome the proposal to increase the focus on planning for the long term. Both the climate and nature emergencies are long term problems which will require sustained investment over multiple planning and delivery periods, short term objectives and ambitions should be set within the context of the long term outcome we are seeking to achieve. Water Resources Management Plans and the first round of Drainage & Wastewater Management Plans will provide an important context and evidence base for the development of business plans in PR24. We encourage Ofwat to assess the ambition and affordability of business plans against the long term outcomes we are

seeking, in order to further our understanding of future investment requirements, and the potential impacts on customer bills.

NRW notes the proposed collaborative approach for Wales and welcomes the opportunity to participate as a stakeholder.

Chapter 5 Strengthening incentives

We welcome the focus on planning for PR24 and beyond. This will enable larger scale (cost and spatial) improvements to be planned for in a more comprehensive way, provided funding beyond PR24/AMP8 can be secured in principle. This longer-term focus should also put emphasis on SMNR and addressing the climate and nature emergencies, not just customer expectations. We note that water efficiency is highlighted, this should be linked to demand reduction and changing customer behaviours. With respect to 'harm caused by discharges from the wastewater network' this must be considered alongside how to improve the efficiency of existing infrastructure by reducing infiltration and removing surface water connections. We encourage Ofwat to incentivise and further promote upstream solutions, addressing the root cause of surface water entering the sewer, rather than just the end of pipe problem.

The innovation fund should also promote improvement towards achieving SMNR and addressing the climate and nature emergencies.

We note the commitment to explore ways for companies in Wales to develop their plans collaboratively with their stakeholders. We welcome the opportunity to work with the companies and Ofwat in Wales to do this.

Chapter 6 Reflecting customers' preferences

We support the need for water companies to work in partnership to secure improvements such as co-creation of Sustainable drainage schemes (SuDS).

Table 6.1 shows a need to engage customers to value impacts of their water use that are wider than those that directly affect their ease of living whether through cost (leakage) or inconvenience (supply interruptions). This will be critical to create behaviour change to achieve SMNR and action to halt the nature and climate emergencies.

The increase in non-discretionary projects due to the Environment Agency's (EA) increased statutory requirements is likely to be mirrored by NRW requirements. This picture for both England and Wales should be made clear.

We note the proposal to explore a collaborative approach to customer research. It will be important to ensure this can still capture any regional variations particularly between England and Wales. We note it is proposed to ensure customer samples are robust at a company level if a standardised approach is used. If this is not possible with a nationwide approach, then NRW would have concerns that Welsh specific customer issues could not be extracted.

We welcome and support the commitment to NRW and WG to be part of the Welsh Steering Group.

Chapter 7 Planning together for PR24

We note the reference to the Environmental Land Management System (ELMS) for England. The equivalent for Wales, the Sustainable Farming Scheme (SFS) should also be referenced for completeness.

We welcome the opportunity to work with Ofwat to ensure the water companies' plans fulfil their relevant statutory obligations.

RAPID involves Welsh Government (WG) and NRW as well as the Environment Agency (EA) and Drinking Water Inspectorate (DWI), this should be made clear. They are involved equally in RAPID, the Gated process, SROs and Regional planning (parts of Wales are covered in Water Resources West and WG policy/governance regulate these areas). Figure 7.2 needs to reflect the Welsh involvement in RAPID/Regional planning. It is unclear where conflict between water users' best interests and those of the environment occur, how RAPID will resolve these. The balance of this consultation is very customer/water user focussed but decisions on this basis will not be compatible with SMNR and addressing the nature and climate emergencies.

We welcome the proposal to have a PR24 Challenge Panel. It will be key to ensure that this equally balances Welsh and English representation. Alternatively, this could be achieved through separate Wales and England panels, potentially building on the work of the Welsh Government PR19 Forum.

The stated next steps should also acknowledge the Welsh stakeholders and National Environment Programme (NEP).

Chapter 8 Design and implementation of price controls

Figure 8.1 includes sludge disposal but not wastewater disposal on the right-hand side. Or is this intrinsic within the wastewater treatment (and disposal) icon?

We note that Ofwat maintain 'financial incentives to support trading of water between companies when in customers' best interests. In the context of the climate and nature emergencies, decision-making must integrate environmental and species requirements with customers' interests. This will require engagement with customers to ensure they understand and value where their needs sit in the requirement to manage resources sustainably and protect the environment and species now and for the future.

Water Resources Management Plans (WRMPs) need to move to promoting the sustainable management of water resources including pushing customer behaviour change to reduce demand, preventing leakage and increasing efficiency of water use, not prioritise securing supply. The

climate and nature emergencies mean there is the need for a shift change in what is the lead incentivised action to meet customer expectations. This is compatible with the stated expectation ‘to see a greater level of ambition from companies in the way customers’ needs for new water resources can be met in an environmentally sustainable way’.

References to RAPID must acknowledge the equal role of WG and NRW. Development of RAPID and its decisions must reflect Welsh as well as English requirements.

We note the references to WRMPs, however there is a lack of reference to Drought Plans and the messages linked to ensuring drought resilience. Planning for the UK Climate Projections 18 climate change scenarios is not sufficiently emphasised in its importance considering the climate and nature emergencies we are facing. Water companies must be pushed to achieve drought resilience as part of PR24.

NRW, as the regulator, requires water companies to consider wider benefits (to other water users) and the economy when considering options that affect the environment and society. Both the Environment Agency (EA) and NRW have environment and society decision making documents. These should be referenced.

We note the wish to enable and incentivise the bioresources market. In addition to enabling greater generation of renewable energy, water companies should be looking at how to extract specific nutrients such as phosphorus, as a viable product by further treatment of digestate. It must be noted that co-digestion of sludge with other organic waste will mean it is subject to Environmental Permitting (England and Wales) Regulations 2016, not the Sludge (Use in Agriculture) Regulations 1989. This will bring it under the waste regulation framework and require an EPR permit.

When considering the bioresources market it will be critical to consider related drivers, such as the emerging land management systems for England and Wales (ELMS and SFS respectively). These drivers may affect:

- Cross border movements of bioresources between England and Wales
- Land use practices affecting the type, use and demand for bioresources. A requirement to only apply to meet crop need (agricultural benefit) may impact spreading times, locations and storage
- Land use controls may vary across the UK affecting the ability to trade and move bioresources.

The use and regulation of bioresources to ensure appropriate use and environmental protection will need to be considered as part of any developing market.

Chapter 9 Outcomes

We would not wish to see the number of performance commitments (PCs) reduce to only focus on ‘delivery outcomes of enduring interest to customers’, if this does not allow existing or emerging environmental issues (such as micro-plastics in sewage sludge) to receive due and timely prioritisation. Outcomes of enduring benefit to the environment should also be part of the PCs focus.

Maintaining asset health is important to avoid asset failure and the resultant impacts on customers and the environment (e.g. pollution incidents). The principles of Wales' Wellbeing of Future Generations Act and Environment Act highlight the need for preventative action, and we would welcome Ofwat incentivising avoidance of asset failure through maintenance investment. This could also help to avoid the need for significant capital costs for replacement due to failure.

We welcome the commitment to work with Welsh stakeholders on the development of Wales' National Environment Programme (NEP). We note the shift from outputs to outcomes. As part of the NEP discussions it will be valuable to develop a common understanding of the environmental destination we aim to deliver in the long term, in order to achieve the sustainable management of natural resources (SMNR), Biodiversity and Ecosystems Resilience Duty and the requirements of the Well-being of Future Generations (Wales) Act 2015. We believe that in order to measure and demonstrate progress towards a long term environmental destination there will be a need to identify both output and outcome measures.

It would be beneficial to clarify that when aiming to ensure 'customers get the level of service they pay for' that this also includes the environmental protections that they should expect, not just the services at their property.

Whilst we accept that the purpose of the price review is to ensure that customers' bills are proportionate, the purpose of the framework is to deliver 'things that really matter to customers and the environment'. Restricting the setting of outcome delivery incentive (ODI) rates purely on what customers value may not allow enough flexibility to secure investment to address the nature and climate emergencies that are not on customers' horizons. As an alternative ODIs rates could be 'based on how customers value a change in service' and/or the level of environmental or nature benefit secured.

We welcome the opportunity to work with Ofwat and the Environment Agency to consider how to introduce common environmental Performance Commitments (PCs) across all companies.

Chapter 10 Cost Assessment

NRW welcome the opportunity to work with Ofwat on determining the role of nature-based solutions and green/blue infrastructure in the future delivery of water companies' investment and improvement works. We note the need to seek cost efficiency but believe the price review must also drive investment in best value solutions, that may deliver long-term and wider benefits such as mitigating the climate and nature emergencies, sometimes at additional cost. Wider benefits should be considered as part of any assessment to determine the sustainable 'whole life solution'. We encourage Ofwat to explore the role of Natural & Social Capital Accounting tools in developing the underpinning evidence for these assessments.

As well as increasing productivity and efficiency, companies should be incentivised to change customer behaviour to reduce demand and consumption to move towards sustainable management of water resources.

We note that it is the intention to collect historical data regarding phosphorus removal. NRW would welcome working with Ofwat to understand the value of the historical data, in particular in relation to our ongoing work to address nutrient enrichment in Special Area of Conservation (SAC) rivers. We would also welcome Ofwat's involvement in developing Wales' approach to utilising the phosphorus resource from sewage sludges in a way that is compatible with the emerging land management system (i.e. Welsh Government's Sustainable Farming Scheme - SFS).

We welcome the clear message that actions should look long-term, so beyond 2030 and potentially across more than one Asset Management Plan (AMP) period. As well as increasing flexibility, we hope that this will secure greater benefits by allowing longer term planning with the security of being able to secure the required funding.

We fully endorse the push to ensure water and wastewater services achieve decarbonisation rather than just offsetting the impacts by alternative measures. This is compatible with the circular economy.

With the acknowledged risk that transition to net zero may increase costs of service, we would be interested to better understand the potential impacts on customer bills versus environmental benefit.

It is noted that it is a criteria for companies to demonstrate customer support where they go beyond the standards in their statutory obligations. Where this exceedance in obligation relates to environmental benefit rather than customer gain, would it be appropriate for regulator support to be of equal standing to customer support provided the customer cost impact is not detrimental?

We note that it is stated that 'the environment is at the heart of everything we do', however the language and tone of the document is biased towards the customer and meeting customer expectations. With the climate and nature emergencies, customer expectations and behaviours will have to change, and water efficiency linked with demand reduction will have to occur. Without significant intervention by the water industry and others we will face future detrimental impacts to the water environment its habitats and species. We support the acknowledgement that nature-based solutions coupled with improved consideration of environmental and social benefits will be key to developing best value business plans.

Promoting the need to consider 'the best whole life solution' and 'best value' to deliver long-term ambitions is supported. This is compatible with the circular economy, green recovery and Well-Being of Future Generations (Wales) Act 2015.

We welcome the proposal to incentivise sustained outperformance improvements, particularly where they secure environmental protection such as reduced pollution incidents.

The strategic planning frameworks such as water resources management plans and drainage and wastewater management plans (DWMPs) are a good strategic baseline. In Wales, we would wish to see the current round of DWMPs completed before they are evolved.

It is stated that common assumptions can be made around population growth and climate change. These are likely to be variable across England and Wales so the risk created by making these assumptions must be highlighted or mitigated by using regionally relevant data.

Chapter 11 Risk and return

This section is focussed on the interests of companies, investors and customers with a clear drive to incentivise efficiency and service quality. This seems to be out of balance with the climate and nature emergencies. This focus needs to acknowledge and give value to the need to achieve environmental protection and improvement through efficiency and service quality, not just meeting customer demand. Without setting the environment as equal to (if not greater than) customers historic expectation, then consumer demand and expectations will not be changed to a level that matches the sustainable management of our water resources (quantity and quality) now or in the future.

It is stated that Ofwat is interested in identifying areas where allocation to the risk allocation framework may be beneficial for customers, could this also be applied to benefits for the environment?

This consultation is seeking to promote longer term planning, it is unclear how this aspiration sits with the setting of an allowed return on equity which is commensurate with the risk faced by an efficient company over 2025-30. Should this time period be longer for outcomes planned to go beyond 2030?

It would be good to broaden the consideration of financial protection for existing and future customers to also cover environmental protection, to ensure that the investment is holistic in its aspirations for the well-being of current and future generations.

We note that there is a 'desirability of a larger equity buffer to weather shocks'. Climate change means that weather shocks are likely to become more frequent and/or extreme. Planning for the future change now to ensure resilience for the industry, customers and the environment is key.

To ensure a holistic consideration of risk, this programme of work should require that investment for environmental benefit is also protected, along with customers, from the financial decisions companies make.

Chapter 12 Next steps for PR24

NRW has no comment to make on the proposed timetable but welcomes the opportunity to work closely with Ofwat to ensure the process meets its objectives.

Appendix Examining the boundary of the targeted control of water resources

Please note that definitions of all the abbreviations used in the document are not provided, for example WACC and CPIH.