
south east water

**PR24 and beyond: Long-term
delivery strategies and common
reference scenarios**

South East Water response

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1. Introduction

Overall, we welcome this paper and we think it represents a significant step forward in the water regulation regime.

We support the focus on the long-term that this paper promotes, we agree with the principles of adaptive planning and the use of trigger points, and we agree that it is useful to have common reference scenarios.

The adaptive planning approach with trigger points are not totally new concepts to the industry and similar ideas can be observed in the WRMP and RAPID planning processes.

We have some concerns about the detail of Ofwat's proposals, mainly around the potential complexity that they promote and the lack of consideration of some factors in the scenarios – we provide further detail on this in Section 4.

2. Overall context

There are a range of long-term challenges and changes in society which are going to shape the future of the industry over the next 25 years. The investment decisions that are made at PR24 will play a critical part in how these challenges are addressed.

There are a number of factors driving change, but the principal ones as we understand them are:

1. Climate change – in particular, increasing temperatures in the UK and more variable and extreme weather patterns are likely to impact resilience, lead to an increase in demand and to seasonal, or overall reductions in available water.
2. Increasing customer expectations – we believe that customer expectations of service standards are likely to continue to increase over time. This is a generally observable trend in societies, as incomes rise over time.
3. Environmental resilience – we believe that environmental improvement is a question of public choice. Water company assets were designed to operate within the environmental constraints that existed at the time of their construction. In our case, for example, we operate assets which extract water from chalk aquifers and the public choice seems to be that this should be reduced. These sources can be replaced, but their replacement is likely to lead to higher opex and capex costs, with their own associated environmental consequences.
4. Population growth – this is particularly relevant in South East England, where we operate.
5. Customer Demand – this is another factor that is particularly relevant in South East England where there is higher per capita consumption and impacts due to customer behaviour have been more pronounced (for example during the COVID-19 pandemic). We comment on this further in section 4.

All of these factors are likely to increase the 'portfolio' of water assets which are required to meet the needs of society and stakeholders. Some of these factors are generic to the industry, but others are more specific to South East England.

The paper also focuses exclusively on enhancement expenditure, but the changing industry environment may also place increased demands on capital maintenance. An increase in resilience for example may require an increase in maintenance expenditure, and we shouldn't always assume that solutions can only be delivered by capital enhancement expenditure.

Given these challenges, it seems likely that the overall costs of providing a reliable water supply that meets customers' and society's expectations will increase over the next 25 years, and that

improvements in efficiency and technology are unlikely to completely negate the need for more investment.

Of course this raises affordability concerns, but we think that the industry can build on its existing work to support vulnerable customers and minimise the impact on those least able to pay.

In many respects, Ofwat's paper accepts the need to increase investment in the next 25 years, and we welcome this. It appears to us that Ofwat is rightly seeking to 'rightsize' that investment and, in particular, to guard against the possibility of over-investment at the expense of the customer. This is a right and proper role for a regulator to take, but we would also suggest that Ofwat should be mindful of the danger of under-investment and short-termism.

In some ways, the dangers of under-investment are greater than those of over-investment. A scarcity of water, poor infrastructure performance and environmental harm are threats to the strategic infrastructure of our nation. It should also be considered that if any over-capacity is created this will create more natural capital and the additional capacity is likely to be useful to society in the long term anyway as demand eventually grows into it.

Figure 2.1 actually illustrates this point well. Just because the three smaller projects selected in this example deliver less capacity, doesn't mean that they were cheaper to deliver. The larger project may well still be the most efficient solution, even with the green demand line. It should also be noted that eventually the progress of the green line at the end of the period covered in this illustration, does justify the larger investment.

An example of this is the intercepting sewer system built in Nineteenth Century London by Joseph Bazalgette. This system was designed to meet double the expected demand of Nineteenth Century London. As a result, the project was marginally more expensive to deliver than it needed to be. However, the foresight of this capacity provision meant that there was no need for further major investment in the London system until the early 21st Century (Tideway). In the long to medium-term, the capacity decision represented good value for customers.

Care must also be taken when assessing risk. Difficult choices must not be avoided because there is a remote possibility that they will not be required. Resilience and long term strategies must be underpinned with the high quality management of risks. We believe that a risk based approach should be taken to long term planning and this reflected in no-or-low-regret investment.

3. Complexity

We are concerned by the potential for the approach outlined to become overly complex.

For each of the four scenarios categories presented, there are two possible outcomes. This gives us eight possible scenario outcomes (high and low for each one). There are 28 different possible combinations of these scenario outcomes.

This is before we even consider the possibility that there may be other important scenarios to consider. In our case, such a scenario might be high or low availability of water from neighbouring companies, or raw water deterioration. In the general case, Covid-19 clearly proves the potential for unanticipated disruptor events. We might also consider that there are more than two possible outcomes to some areas, such as climate change, where there is an enormous difference between the high and low scenarios, and there may be a strong case for considering a 'central case'.

Overall, the level of complexity almost guarantees that 'reality' will be significantly different from any assumed scenario, regardless of how many scenarios are modelled.

The paper that Ofwat has published does recognise some of the limitations observed above. We think the concept of the 'core pathway' is particularly helpful in this context.

We welcome the efforts that Ofwat has made to clarify their intentions following this paper, both at the workshop held on 17th December 2021 and the subsequent email from Tim Griffiths.

We would welcome further industry discussion with Ofwat on this issue and how companies can use the scenarios in a consistent way so that an appropriate number of adaptive pathways are modelled.

4. Comments on the scenarios

Demand scenario

As noted in our introduction, we are concerned by the demand scenario. Section 3.2.3 opens with the following statement:

In the common reference scenarios for demand, we include the main drivers of uncertainty around demand that we consider are beyond company control. Therefore, for example, we do not include future changes in consumer behaviour, as companies have the ability to influence reductions in household demand and improved consumer flushing practices.

We agree that companies have some ability to influence consumer behaviour but ultimately companies cannot control demand for water from consumers. It is important this issue is recognised by Ofwat and that the demand scenario includes changes in demand due to consumer behaviour.

This issue has been particularly demonstrated during the COVID-19 pandemic where household demand has significantly increased in the short term, and is likely to increase over the longer term as well due to the changes in how people work (from home / office etc.).

As written, the scenario basically only looks at new properties (through housing construction and building regulations), which is a relatively small element of demand. The behaviour of existing consumers is by far the most significant factor in determining demand over the next 25 years. It is not right to assume that this demand is fully within the control of water companies. There are many other factors which will affect this demand, and the labelling of white goods is only one of these. If these factors are ignored, then a major element of the medium to long-term risk faced by water companies is completely overlooked.

Environmental scenario

The environmental scenario section is a little simplistic with it covering only a narrow part of the Industry's environmental remit along and makes no mention of wider expectations of Natural England for the management of a long term resilient environment. It is our view that a high environmental ambition scenario would be one that covers groundwater and surface water catchments to ensure that both customers and the wider environment have a sustainable water supply (quantity and quality) into the long-term. There are many factors affecting current and future abstraction and for this reason as a company we are developing our own 25 year environmental framework in conjunction with our customers and stakeholders. It is our view that a high environmental ambition scenario will need transparency to show the environmental trade-offs being made as part of any long-term planning as it is imperative that we make the right long term decisions for our customers at the right pace.

It is our view that the high environmental ambition scenario should be much wider in its approach than just chalk streams as our obligations under the Environment Act are much more far reaching.

One significant omission in the environmental section is the impact of water abstracted by other abstractors, particularly during low flows. Further focus on how this impacts environmental resilience will be a key cornerstone to ensuring that our own resources are protected and enhanced in the future. Other important factors for water companies to consider are: priority habitats; biodiversity net gain; raw water quality deterioration (resulting from the actions of third parties); landuse change and how resources can be operated conjunctively to optimise environmental benefits. The scenarios should also refer to the recent Environment Act, the WISER guidelines and the input of other environmental stakeholders such as Natural England.

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