

March 2022

Consultation under section 13 of the Water Industry Act 1991 on proposed modifications to Condition B of the licence of Hafren Dyfrdwy

Ofwat

About this document

This document invites comments on our proposal to modify Condition B: Charges of the appointments (**licences**) of Hafren Dyfrdwy Cyfyngedig (**Hafren Dyfrdwy**) as a water undertaker and a sewerage undertaker¹. Our proposed licence modification would change the price control for bioresources activities that applies to the company for the 2020-25 period.

Under section 13 of the Water Industry Act 1991 (**WIA91**) we can modify the conditions of Hafren Dyfrdwy's licence if it agrees to the change that we are proposing to make.

Responding to this consultation

Representations or objections with respect to the proposed modification may be made **no later than Tuesday 19 April 2022**. We also ask Hafren Dyfrdwy to confirm by that date whether or not the company consents to the proposed modification.

Please email representations or objections to alex.whitmarsh@ofwat.gov.uk or post them to:

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Birmingham B5 4UA

We intend to publish responses to this consultation on our website at www.ofwat.gov.uk. Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

¹ Unlike other water and sewerage companies, Hafren Dyfrdwy has a separate Instrument of Appointment ("licence") for each appointment because they were made at different times. Like other water and sewerage companies, the conditions of both appointments are currently the same.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our [privacy policy](#) explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

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1. Background, effect and reasons

1.1 Price controls for bioresources activities

At the 2019 price review ([PR19](#)) we set separate binding price controls for bioresources activities² for the first time. These price controls apply to Hafren Dyfrdwy and the other regional water and wastewater companies for the period from 1 April 2020 to 31 March 2025 ([the 2020-25 period](#)).

Our bioresources controls take the form of average revenue controls (based on the volume of sludge produced in terms of tonnes of dried solid ([TDS](#))) with an adjustment to protect customers and companies from over or under-recovery of fixed costs. A company's allowed revenue is therefore increased if its actual sludge production is higher than its forecast sludge production to reflect the anticipated additional variable costs the company would incur.

We incentivise companies to accurately forecast sludge produced by in-area wastewater treatment by applying a forecasting accuracy incentive, based on the variation between volumes forecast in companies' business plans and actual volumes over the 2020-25 period. This is an end of period incentive we will apply as part of the reconciliation of the 2020-25 period.³

While we consider that companies should bear risk from forecasting error, we recognised in our [PR19 methodology](#) that the definition of sludge volumes, and measurement at the proposed price control boundary, was new. We therefore said in our final methodology that:

"[...] We will consider representation from companies within the first two years of the control period, where there are [material changes](#) as a result of:

- measurement improvements; and/or
- WINEP's phosphorus removal requirements.

We expect that most companies should be able to manage the impact of both these issues. However, we will consider adjusting the way the forecasting accuracy incentive is applied, where companies can provide compelling evidence. We expect to make few

² Bioresources activities are, in summary, activities carried out in relation to the transport, treatment and disposal of sewage sludge.

³ Our [PR19 reconciliation rulebook](#) provides the current guidance about how PR19 reconciliations should be implemented during, and at the end of, the 2020-25 period.

adjustments, given our widening of the deadband, which allows for greater variance between forecast and recorded volumes before the penalty applies.

Companies will only be able to make such representations within the first two years of the control. In doing so, companies must consider the combined impacts of both measurement improvements and WINEP's phosphorus removal requirements. Companies must also demonstrate that the impact is materially greater than the deadband."⁴

1.2 Hafren Dyfrdwy sludge production forecast

In November 2021 Hafren Dyfrdwy informed us that there is a material difference between the original sludge production forecast we used in making our PR19 final determination and its assured outturn data. The company's updated model forecast is for TDS volumes in the 2020–25 period to be about 60% higher than the forecast included in its price control for bioresources activities.

The company asked for the price control forecast figures to be amended to reflect its updated forecast. This would have the effect of reducing the revenue that Hafren Dyfrdwy could recover from customers in the 2020–25 period for bioresources activities.

Hafren Dyfrdwy considered that there were three main reasons why its outturn TDS is higher than the original forecast:

1. **Separation of business and understanding of sludge** – in 2017–18, its initial understanding was that 'sludge' was anything received into the digestion route and not the cross-border trades received at the inlet. This led to an under-recording of the base volumes for Hafren Dyfrdwy compared to the eventually agreed definition.
2. **Investment in new logging equipment** – the company invested in new, more accurate, logging equipment during 2018–19 and 2019–20.
3. **Cultural change** – the company said that it had boosted training for tanker drivers to emphasise the importance of logging the volumes and the associated discharge and spent time on embedding best behaviours.

1.3 Proposed changes and reasons

We are proposing a licence modification to adjust Hafren Dyfrdwy's 2020–25 price control for bioresources activities by changing the forecast volumes of sludge (the **FTDS_t** term in the price control formula) for each charging year. The new forecast volumes are based on outturn

⁴ "[Delivering Water 2020: Our methodology for the 2019 price review Appendix 6: Bioresources control](#)" (Ofwat, December 2017), page 57.

data for 2020-21 and the company's updated forecasts for the remaining 4 years of the 2020-25 period. The text of the proposed modification is set out in Chapter 2. Although our proposed licence modification sets out a complete new table for ease of reference, it is only the **FTDS_t** row in the table that is changing. The form of the price control, and the other elements of the price control, will remain as set out in our December 2019 determination.⁵

The effect of these changes is that the revenue that Hafren Dyfrdwy will be allowed to recover for its bioresources activities over the 2020-25 period will now be based on its updated and more accurate sludge volume forecasts. This has the effect of reducing the revenue that Hafren Dyfrdwy can recover from customers in the 2020-25 period for bioresources activities, but it is the revenue that it would have been allowed to recover if we had had the updated forecasts when we determined the price control in 2019.

Hafren Dyfrdwy's reported sludge production to date has exceeded its original forecast sludge production by a material amount because of more accurate measurement and recording, rather than an increase in actual sludge production. The company explained that its sludge production is now measured accurately and that appropriate steps have been taken to assure their updated data.

In these circumstances, we think it is appropriate for the company's price control for bioresources activities to be changed to reflect the measurement improvements and the updated and more accurate forecasts it has now provided. This potential issue was foreseen in our PR19 methodology and it is in customers' interests that the maximum amount of revenue Hafren Dyfrdwy is allowed to recover reflects the material changes in sludge production data as a result of measurement improvements.

In order to provide an appropriate incentive for Hafren Dyfrdwy's updated forecast to be accurate, we have also informed the company that we are minded to change how the bioresources forecasting accuracy incentive applies to the company. The amended penalty calculation would be based on the last four years of the 2020-25 period using the updated sludge production forecasts. The company agreed that this approach would provide an appropriate incentive for the updated forecast to be accurate.

⁵ "[Notification of the final determination of price controls for Hafren Dyfrdwy](#)" (Ofwat, December 2019), see pages 8-10.

2. Proposed modification

We are proposing to make the following modification:

At the end of Condition B after Part IX insert:

"Part X Changes to Price Controls for the period from 1 April 2020 to 31 March 2025

21. The determination made by the Water Services Regulation Authority under sub-paragraph 8.4 of the Price Control for Bioresources Activities for the five consecutive Charging Years starting on 1 April 2020 shall have effect from **[date on which the modification takes effect to be inserted here]** as if the table entitled "Table 5: Price Control for Bioresources Activities numbers" was the following table:

Charging year beginning 1 April	2020	2021	2022	2023	2024	Total for all five charging years
Unadjusted revenue, UR_t (£ million, 2017-18 FYA CPIH deflated prices)	0.754	0.761	0.769	0.776	0.784	3.843
Forecast volume of sludge, FTDS_t (TDS)	784	1079	1090	1137	1152	5242
Variable revenue, VR (£/TDS, 2017-18 FYA CPIH deflated prices)	N/A	N/A	N/A	N/A	N/A	823.912

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