

Notice

August 2022

Reasons for the modification of Condition B of the licences of Hafren Dyfrdwy

This notice explains the background and reasons for the modification that the Water Services Regulation Authority (**Ofwat**) has made to Condition B: Charges of the appointments (**licences**) of Hafren Dyfrdwy Cyfyngedig (**Hafren Dyfrdwy**) as a water undertaker and a sewerage undertaker.¹ This modification came into effect on 1 August 2022 and has been made under section 13 of the Water Industry Act 1991.

Modification

Following the notice of the [proposal to modify the licences of Hafren Dyfrdwy](#) (published on 21 March 2022), this notice confirms that Ofwat has modified Condition B of the company's licences. The modification adjusts 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 wording of the modification is the same as that set out in the notice of the proposal.

Background and reasons

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

¹ Unlike other regional 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.

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

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.

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 would consider representations from companies within the first two years of the control period where there were **material changes** as a result of measurement improvements and/or phosphorus removal requirements.

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 was for TDS volumes in the 2020-25 period to be about 60% higher than the forecast originally 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'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 its updated data.

In these circumstances, we thought it was appropriate to change the company's price control for bioresources activities to reflect the measurement improvements and the updated and more accurate forecasts it had 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 will change how the bioresources forecasting accuracy incentive applies to the company. The amended penalty calculation will 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.