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RSPB and RPBS Cymru response to Ofwat's PR24 draft methodology consultation. September 2022

Overarching comments:

- This PR is being conducted against an unprecedented level of public focus and scrutiny on the water companies. CSO discharges and more recently the drought have shone a spotlight on the industry and its role in environmental protection. Water company dividends have been contrasted with perceived poor performance levels (on leakage and the environment) and a narrative of long-term underinvestment. Dealing with the issue of sewage pollution is important but needs to be considered within a broader approach which recognises the need for water company investment to drive improvements in biodiversity, habitat enhancement and development of NbS.
- Ofwat have 5 enforcement cases open against water companies for sewer discharges and OEP is investigating Defra, the EA and Ofwat in relation to their performance in enforcing pollution controls on the sector. Currently under the enforcement system it can be cheaper for companies to fail and be fined than to do the right thing. Outside of extreme events, such as investigations into illegal activities, share prices and other key financial indicators, long term dividend policies and rewards do not seem to be particularly sensitive to environmental performance. This suggests that environmental priorities remain somewhat marginal in the overall structure of the price review regime.
- The EA's annual review of the environmental performance of the water companies concluded that "In 2021, the environmental performance of England's 9 water and sewerage companies was the worst we have seen for years... We would like to see prison sentences for Chief Executives and Board members whose companies are responsible for the most serious incidents"
- We therefore need to consider the current PR methodology against the backdrop of enhanced customer expectations on environmental performance and acknowledgement by the environmental regulators and others that the current system for incentivising environmental outcomes is failing on its own terms. There is, in addition, a further question of whether even meeting the current set of performance indicators would be sufficient to put the water environment into the urgent recovery needed.
- Ofwat's methodology does not take into account sufficiently the different legislative and policy positions in the devolved nations. For example, whilst Ofwat's methodology highlights the collaborative approach in Wales, the wider implications of The Well Being and Future Generations (Wales) Act 2015 and The Environment (Wales) Act 2016 are not seen to be reflected in the methodology. These Acts focus attention on recognising the importance of a healthy environment to people's well-being and achieving ecosystems resilience through

RSPB Headquarters
RSPB The Lodge
Potton Road
Sandy
SG19 2DL

Tel: 01767 680 551
Facebook: @TheRSPB
Twitter: @TheRSPB
Instagram: @RSPB
Web: rspb.org.uk



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Patron: Her Majesty the Queen **Chair of Council:** Kevin Cox **President:** Miranda Krestovnikoff **Chief Executive:** Becky Speight
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Registered address: The Lodge, Potton Road, Sandy, Bedfordshire, SG19 2DL

maintaining and enhancing biodiversity to which water companies in Wales have a duty to contribute. Further details can be found in [Blueprint Wales for PR24: Environmental Outcomes for the Price Review](#)¹. This sets out the Wales' Environment Link's ambition for PR24, and the action required from Government, regulators, and water companies, to ensure the Price Review meaningfully delivers for people and for nature.

- We are signatories to the UK Blueprint response to the PR24 methodology and support the points raised therein. We have produced this supplementary response to expand on specific views we have in addition to these or highlight any alternative arguments that should be considered.

Consultation response:

Q2.1: Do you agree with the challenges facing the sector and the ambitions for PR24 we have identified?

We welcome Ofwat's inclusion of environmental & social outcomes as a key ambition for the sector alongside planning for the long-term, focus on customer needs and driving improvements through efficiency and innovation.

The challenges of environmental protection and climate change are urgent and should therefore be reflected as such in the PR methodology. Further guidance on how to balance the urgent need to invest in solutions to these issues with consumer bill impacts is needed.

Q2.2: Do you agree that continuing to use our three building blocks helps push companies to meet our ambitions for PR24?

Many of the environmental improvements are expected to be achieved by means of the performance commitments (outcomes) building block. Outcomes will therefore need to be sufficiently incentivised to achieve the desired behavioural changes or investments required to achieve environmental outcomes. Early evidence from PR19 via Environment Agency's most recent assessments suggests that Common Performance Commitments on total pollution and discharge permit compliance (reported in the EPA) are having, at best, an ambiguous impact on environmental performance. We would therefore encourage Ofwat to provide further evidence that the outcomes approach can incentivise the necessary behaviours and/or investments needed.

Q2.3: Do you agree that we have struck the right balance between what's in and what's outside of the price control?

It is not obvious that the scale and urgency of the nature and climate crises has been fully internalised into the design of the PR, which expands upon (helpfully in some places) the current regime, and which in many places is failing with respect to environmental performance. The inclusion of environmental outcomes and

¹ [\[1\] Blueprint Wales for PR24: Environmental Outcomes for the Price Review, Wales Environment Link, September 2022](#)

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Sandy
SG19 2DL

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long-term planning are helpful, but the balance that Ofwat expects water company to strike between these is difficult to gauge from the draft methodology. Improving performance- operational and environmental- will need to be balanced against consumer bill impacts and it is not clear from the PR methodology how Ofwat expects this balance to be struck. Without explicit steer to this effect, PR24 will be a missed opportunity for water companies to make serious contributions towards achieving our environmental targets and wider goals. Recognition of the urgent nature of these crises is important in justifying and incentivising actions taken now to address further decline. Out performance in the PR24 period should be particularly incentivised where this reduces future burdens, in line with the mitigation hierarchy i.e. the principle that avoidance is preferable to mitigation or offsetting.

Q2.4: Do you have any comments on our approach to evaluating progress? What specific evaluation questions

The EA's Environmental Performance Assessment process should be more deeply aligned with the various environmental commitments in the business plans as required by the PR methodology. EPA should therefore report on all relevant environmental metrics every year.

Along with the rest of the regulated utilities, the water industry needs to pivot towards being a net positive contributor towards nature recovery and environmental health. With many environmental indicators in sustained decline since the era of privatisation (many, indeed, before then), it would be difficult to conclude that the regulated sector as a whole has been adequately playing its part (though individual company performance is varied). The PR should therefore be fully aligned with the 25 Year Environment Plan goal of putting nature into recovery and evaluated against a wider macro-scale assessment of the state of the environment (specifically, the state of receptors relevant to the operations of the water sector). Assessments should enable consumers and others to simply and clearly understand whether the sector as a whole is playing its part in reversing the decline of the natural environment and whether consumers' money is being appropriately invested in this regard. With the adequacy of current targets under close scrutiny, water companies and Ofwat, for their part, may wish to be able to put individual pollution events or poor performance years within a wider context and give confidence that the regulatory approach as a whole is meeting environmental expectations.

Q3.1. Do you agree that in our final methodology we should commit to introducing either an adapted water trading incentive or a new water trading incentive at PR29? If you have a preferred approach, please provide reasons, including any thoughts on how the options we set out in Appendix 2 could be improved.

Strong incentives for trading water could be a useful tool in increasing the resilience of the water system, so long as bulk trades support wider environmental goals and do not exacerbate local water resource issues during times of water stress. Long term bulk supply contracts can help ensure strategic resilience over the longer term. Ofwat should explore the role for shorter term (e.g. seasonal), lower volume trades in providing local resilience during drought conditions and incentivising investment in on-farm and nature-based storage solutions.

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RSPB The Lodge
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Sandy
SG19 2DL

Tel: 01767 680 551
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Physical trades of water through the existing open channel network represents a water quality risk that must be strictly controlled for e.g. invasive species. At times of stress, however, such trades could help maintain healthy river levels. Any future incentive should therefore seek to encourage environmentally beneficial trading relationships between water companies and diverse suppliers across water resource zones. Enhanced incentives should encourage the use of nature-based and nature-positive suppliers.

The current drought illustrates that many preventative actions to avoid the critical conditions currently faced in England are under-valued or not valued at all. Shorter-term trading mechanisms should be assessed for their potential in helping avoid the slide into drought and bridge seasonal and regional disparities in water availability. Ofwat should therefore also explore opportunities for further market-creation in relation to shorter-term demand reduction during dry weather years (or, conversely, increased uptake/storage during times of excess) to better manage seasonal supply and demand mismatches. One approach may be to set financial performance commitment (PC) in relation to drought status, with appropriate incentives for short-term trading to avoid or reverse the slide into drought. Ofwat should consult on an equivalent of Ofgem's Value of Lost Load (VoLL) to set a ceiling on the overall value of such trades and thereby underpin a market for short-term trading. Unlike VoLL, which prices customer disconnections, the equivalent undesirable actions to price should be imposition and duration of TUBs and drought permits/orders. The PC should set an underperformance penalty based on the price of the VoLL-equivalent where such actions are taken. Water companies should thereby be incentivised to use short-term trades to maintain water resource resilience well ahead of drought conditions to avoid the need for costlier actions as water availability deteriorates and drought conditions approach.

Q3.6. Do you have any views on any other aspect of our proposals in relation to:

h) Direct procurement for customers?

DPC projects constitute significant national infrastructure and it is therefore crucial that they are delivered to impeccable environmental standards. Ofwat should strengthen the DPC guidance to enhance environmental outcomes from the DPC regime as whole and use the regime as means of achieving a wide range of public environmental goods. DPC bidders should be assessed against environmental metrics as well as financial ones. DPC projects should therefore be assessed as providing more sustainable solutions than self-delivery and there should be a presumption in favour of nature-based solutions. Competitively Appointed Providers (CAPs) should be required to submit robust sustainability plans alongside other procurement documents. Appropriate weighting should be given to the environmental performance of potential CAPs, and some weighting/preference should be given towards ethical investors, BREEAM (or equivalent) certified sub-contractors etc. and the environmental record of tier 1 contractors and their supply chain.

Ofwat should fund and incentivise water companies to introduce a parallel DPC process to procure nature-based ecosystem services from third parties, as well as large scale infrastructure. Such services would be procured in pursuance of relevant environmental performance commitments (see below) and ODIs, as well as WINEP tier 2 goals and/or tier 3 outputs. Co-developing WINEP solutions for PR24 business plans has proven difficult within the timescales of the price review¹, so an early signal that third parties may be able to bid for delivery of those services will buy time for options to be developed in parallel with the regulatory

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Sandy
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framework and business plans. The procurement principles and institutional arrangements (including any necessary funding) for enabling DPC could thereby be extended to ecosystem services.

Given the required lead-in times, we would still expect initial uptake and competition for such services to be somewhat weak in PR24, but such a mechanism under PR24 would act as useful discovery exercise for developing more robust markets for ecosystem services in future price reviews. Longer-term, Ofwat should work towards increasing the competitive pressures on water companies to deliver for the environment by making more of the WINEP tier 1 outcomes (and any other relevant business plan incentives or outcomes) contestable by nature-based service providers, and working to introduce appropriate market arrangements to encourage bidders.

Q4.1. Do you agree with our approach to making sure that companies' price review submissions and our determinations reflect an understanding of customers', communities' and environmental concerns?

The timescales for developing the various components of the PR creates a significant barrier to meaningful public engagement. Public engagement should therefore be an ongoing commitment throughout the PR to build local networks and help customers understand the opportunities that the PR presents for place-making in their local areas i.e. beyond the traditional customer service aspects of the water company-public relationship. This should include co-design of locally informed Bespoke Performance Commitments with eNGOs and local community groups (see section below), and co-design of future solutions to meet WINEP outcomes. Public confidence in the sector has suffered in relation to CSOs and the drought and a step change in public engagement on, and delivery of, environmental enhancement will be needed to earn this confidence back.

Alongside a social tariff, Ofwat's research should examine customers' attitudes towards a voluntary Green Tariff. Before the current energy crisis, voluntary green tariffs were a growing segment of energy supply markets. They provide a direct mandate from customers for enhanced spending on environmentally beneficial schemes, so in the future could be a useful tool in bringing forward urgent actions that communities support. Such tariffs would need to be structured and designed to meet objectives relevant to water company operations and local environmental priorities. Inflation and cost of living concerns will likely dominate customer engagement for this suite of business plans, so research/engagement on the principles and design of any voluntary Green Tariff need to be sensitive to these conditions. For example, Ofwat may wish to conduct desk-based research on the principle and design options for a voluntary green tariff, to inform future water company engagement with their customers when economic conditions are more favourable.

Q5.2. Do you agree with our proposed guidance for bespoke performance commitments?

We would suggest that Ofwat reconsider their approach to Common Performance Commitments (CPC) in achieving environmental outcomes. Many environmental issues are highly locationally specific, so CPCs may often be a blunt way of incentivising improvements. The design of CPCs involves benchmarking against existing company performance, which, as we highlight above, may not be in keeping with customer expectations in relation to environmental quality. In many cases, therefore, performance needs to be

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Potton Road
Sandy
SG19 2DL

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assessed against the urgent need to halt and reverse the decline in biodiversity and make space for nature, rather than inter-company performance.

Rather than wider use of CPCs, greater flexibility on the use of bespoke Performance Commitments (BPC) allows water companies to work with local environmental groups and customers to understand the issues affecting their local environments, and their willingness to pay to address them, and capture these in appropriate bespoke BPCs. For environmental PCs, we therefore suggest that Ofwat incentivises water companies to consult on and develop BCPs and provide evidence that local environmental and community stakeholders agree with their proposals. Outcome Delivery Incentives (ODIs) can also be informed by this consultation process. Where a water company fails to bring forward such proposals, or community/environmental stakeholder consent cannot be sufficiently evidenced, then blunter CPCs and Ofwat's standard ODIs can act as a backstop. This would give rise to a two-tier system in respect of those PCs that are not best measured by means of cross-company benchmarking, with more dynamic water companies rewarded for identifying and pursuing BCPs that have local consent and demonstrably improve their local environments. The current proposals to limit the number of BCPs and early submission of BCPs works against this proposal.

The proposal to make outperformance and underperformance rates symmetrical implies that do-nothing is neutral. This is clearly not the case in relation to environmental PCs, so the penalties for under-delivery should exceed the rewards for delivery, strengthening the incentive to achieve the necessary improvements.

Q5.8. Do you agree with our proposed approach to selecting performance commitments for enhanced incentives

Given the scale of the nature emergency, water companies should be incentivised to over-deliver against all environmental PCs. Over-delivery within the PR context would still only constitute incremental progress towards the 25 Year Environment Plan objectives, whilst exploiting economies of scale and the wider benefits of earlier delivery. Enhanced ODIs in relation to biodiversity and nature should therefore be structured to incentivise oversizing in achieving conservation at scale, i.e. larger schemes or those contributing towards an ecologically coherent network, as opposed to disconnected smaller scale improvements across a patchwork of sites.

Q5.16. Do you have any wider comments about the ODI framework at PR24?

Annual payments of ODIs may not best reflect the way that environmental activities yield benefits (some of which may not be realised for several years). Whilst we generally agree with an outcomes-based approach to PCs and the WINEP, given this dynamic, actions/outputs may be more appropriate to specify in some cases. These outputs should be informed by an assessment of the outcomes/benefits they are expected to yield (something like an environmental benefits Net Present Value)

Q6.1. Do you agree with our proposed approach to setting efficient expenditure allowances at PR24?

Efficiencies in baseline expenditure that deliver carbon saving or nature protection benefits should be rewarded more than those which are neutral or harmful. Water companies should therefore be able to keep a greater proportion of baseline efficiencies that have delivered by low carbon or nature positive actions.

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The case for any enhanced expenditure should be considered against a presumption in favour of nature-based or nature-positive solutions. Water companies should be expected to demonstrate engagement with eNGOs and local environmental groups in developing their proposals for enhanced expenditure PCDs.

Q6.7. Do you agree with our proposed approach to incentivising and funding efficient investment in reducing greenhouse gas emissions and reducing the use of storm overflows?

Awards for enhanced spending on net zero actions should embed a preference for cost effective nature-based solutions, so assessments should reflect metrics other than lowest cost.

The principles of competitively awarded enhancement spending should also be considered for actions that contribute towards urgent priorities in nature protection. As noted above, these are often better defined with reference to local conditions and priorities. GHG mitigation or adaptation benefits may also be considered in assessing the value of such schemes. Particular emphasis should be placed on the desirability of enhancing water company SSSIs/SACs and SPAs and recreational/well-being benefits of accessing nature. Such schemes should encourage partnership working at scale and co-financing with e.g. BNG habitat banks or other funding streams.

Q6.8. Do you agree with our proposed approach to implementing nutrient neutrality in the PR24 regulatory framework?

Water companies are well-placed to take an active role in dealing with nutrients issues. Such issues need to be considered at a catchment scale, with a focus on dealing with pollution issues at source and maximising the use of Nature Based Solutions. Nutrient Neutrality (NN) is a means of avoiding further net deterioration in the quality of protected sites. Water companies should consider opportunities to exploit economies of scale and 'oversize' any WWTW upgrades or NBS interventions to help drive net *improvements* in site quality and the funding settlement should enable this. In some locations, solutions in upper catchments can help avoid impacts on important unprotected sites and features en route to protected estuaries. Opportunities to deliver large-scale nature-based solutions with wider benefits and stacking different funding streams (net gain, carbon credits etc) and delivering with partners should be fully explored as part of water company consultations on their draft plans. NN should therefore be considered as part of a wider opportunity to deliver much more than avoiding further net deterioration in the state of protected sites.

Several unknowns remain, such as the interaction of the emerging duty to upgrade WWTWs, Natural England's Nutrient Neutrality scheme and the growth and role of private nutrients markets. Nutrients issues are also locationally specific, so the impact of water company plans will vary depending on the nature of nutrients issues in each location. At one extreme, water company plans, for example, could dampen the signals for private markets to emerge. This would be regrettable if water company approaches were less environmentally ambitious than those private arrangements would bring forward. On the other hand, water company plans could take a central role and act as market-makers for multi-benefit nutrient mitigation schemes, where these are co-designed and delivered with third-parties. Wide-ranging consultation in the affected catchments will be important in ensuring that water companies therefore maximise the opportunities from NN. Ofwat should consider making dedicated funding available for such consultation activities in affected NN areas where water companies wish to take a more leading role in addressing NN and

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Sandy
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coordinating efforts within a catchment. Given the current uncertainty of how much mitigation will be brought forward through regulation, LPA activities and private markets, appropriately flexible funding mechanisms should be introduced to ensure that water companies can both fund their own works, recoup funding from developers (as described in the annex) or, as appropriate, purchase or partner with schemes that are brought forward within-PR period by private providers.

.9. Do you agree with our proposed approach to encouraging companies to deliver best value through our cost assessment?

Whilst we welcome the principle of moving towards assessing best value, the proposed approach to assessing value retains a default preference for least cost. The assessed value of wider benefits *is* highly sensitive to factors such as discount rates and uncertainties in truly understanding the value of the disparate and dynamic components of the environment. Cost benefit analysis does not provide a level playing field for assessing the true value *of* green infrastructure against grey. It may therefore act as a barrier towards developing innovative, multi-benefit projects. The proposal to benchmark against least cost suggests that delivery of least cost options has been successful to date. EA's EPA assessments and public concerns about the water industry indicate that this is an increasingly difficult position to maintain, so we would suggest that this assumption is revisited. This may involve a rebalancing of the relative emphasis on customer bills, shareholder returns and environmental protection.

Given these concerns, we recommend that Ofwat develop an appropriate metric to establish when a scheme constitutes *good value* as opposed to best value, which is likely to remain too high a threshold for nature-positive schemes to meet in cost-benefit analysis terms. Impacts on consumer bills should be controlled within this process, though we would suggest that the balance between customer bills, shareholder returns and environmental protection has significantly disadvantaged the latter in previous price reviews, and the effects of this are under increasing amounts of public scrutiny. A rebalancing of these priorities is therefore needed.

Opportunities for third-party collaboration is welcome and RSPB benefits from several valuable relationships with water companies across England and Wales. Getting partnerships together and co-developing options can be difficult in the cycles of the PR process and against a shifting regulatory framework. Future PRs should allow for earlier clarity and a greater lead-in time to allow for meaningful discussions and further partnership opportunities to develop (see section on consultation above)

Q6.10. Do you agree with our proposed approach to removing the potential disadvantage that nature-based operating expenditure solutions may face in relation to the treatment of enhancement operating expenditure?

Yes, NbSs should benefit from bespoke treatment in relation to enhanced operating expenditure. Ofwat should consider introducing both the 10 year OPEX allowance and the capitalised OPEX proposal to give maximum flexibility to water companies in proposing NbSs.

APPENDIX 6

5. Do you agree with our proposed definition for the biodiversity performance commitment?

RSPB Headquarters
RSPB The Lodge
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Sandy
SG19 2DL

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Without worked examples it is difficult to assess the efficacy of using the BNG metric for this purpose. The metric was primarily designed to measure changes to habitats associated with significant land-used changes and development, active restoration and so on. At best, therefore, it would capture the biodiversity value of changes associated with new infrastructure. Many less visible and longer term operational impacts are not likely to be picked up by assessments using the metric, which in turn introduces risks of 'gaming' to meet the CPC without maximising the benefit to the local environment.

Ofwat may wish to consider encouraging water companies to work with local NGOs and communities to develop a list of priority habitats & species, or known pressures e.g pollutants, chemicals, in key locations in the vicinity of their operations, and undertake more specific assessments of the effect of water company operations on those receptors. This can make use of existing baseline data, citizen science etc. The performance commitment would therefore target those receptors that matter most to local communities and environmental stakeholders. As suggested above, a generic biodiversity PC could be used where water companies are unable to identify or sufficiently justify a bespoke environmental PC.

Recognition needs to be given to a different approach in Wales, namely 'Net Biodiversity Benefit' This approach seeks to deliver and overall improvement in biodiversity from land uses. This approach is not proposing to use a metric, rather it puts the emphasis on the consideration of biodiversity and wider ecosystem benefits in the early stages of a proposal development process. The Welsh Government are still developing this approach with others but it is likely to use DECCA: Diversity, Extent, Condition, Connectivity and Aspects of ecosystem resilience. The attributes provide a framework for considering the state of ecosystem resilience in Wales.² Flexibility needs to be built into water companies business plans in Wales to enable them to respond to the emerging framework, measures and targets as they develop. Notwithstanding this, water companies should be required to have up-to-date condition surveys of all the designated sites on their land holdings so that any measures and targets can meaningfully demonstrate progress towards 'favourable site condition'.

6. Do you agree with our proposal to have separate operational greenhouse gas emissions performance commitments for water and wastewater, which are based on a normalised measure?

[Blueprint]

7. Do you agree with our proposal that the performance commitment on serious pollution incidents should only apply to water and wastewater companies?

[Blueprint]

² [Welsh Government's Approach to Net Benefits for Biodiversity and the DECCA Framework in the Terrestrial Planning System CIEEM Briefing Paper September 2022](#)

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8. Do you agree we should focus the bathing water performance commitment on the outcome that customers have received and should continue to develop an alternative definition to do this?

[Blueprint]

9. Do you agree with our proposal for the river water quality performance commitment to measure the reduction of phosphorus entering rivers?

Ofwat states in appendix 6 that “we do not consider that an outcome has to be fully within a company's control for it to be worth incentivising”. On this basis Ofwat should include PCs on nitrates, pesticides and chemical pollutants³, encouraging water companies to take a more holistic view on the health of waterways and ensuring that actions taken to address one source of pollution are not undermined by failures to address a wider range of pressures on water body quality and health.

If you have any queries regarding our comments, please let me know.

Regards

Senior Policy Officer – Water - UK Land Sea & Climate

e-mail:

or for Wales specific queries please contact

. Policy Officer (Land Use)

e-mail

Policy Officer (Land Use), RSPB Cymru

tracy.nettleton@rspb.org.uk

³ [Chemical Pollution The Silent Killer of UK Rivers](#)

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Sandy
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