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By email

Secretary of State for Environment,
Food & Rural Affairs

24 February 2023

Dear Secretary of State,

South Staffs Water – draft water resources management plan 2024 consultation response

Long term water resources planning is a key business planning activity and essential for the efficient delivery of resilient water services for customers and protecting and enhancing the water environment. Ofwat has a key role to play in enabling this by funding through the 2024 price review (PR24). Therefore, it is vitally important that we consider whether water companies are identifying the best value approaches and delivering these, to ensure the best outcomes in terms of targeted investment to address challenges. The water resource management planning process is essential to helping Ofwat and water companies get this right. As a statutory consultee, we welcome the opportunity to comment on South Staffs Water's draft water resource management plan (WRMP), which it published in November 2022. This letter should be read alongside our letter setting out the wider context of our review and the general approach to the assessment of companies' draft WRMPs.

South Staffs Water supplies drinking water to approximately 1.3m people, and approximately 35,000 commercial customers, over 1,500 square km in the West Midlands, South Staffordshire, South Derbyshire, North Warwickshire and North Worcestershire areas. Its water resources are planned on the basis of one water resources zone. South Staffs Water has identified key challenges in its water resource forecasts that require action to reduce demand or provide additional supplies.

There are some limited aspects of South Staffs Water's draft WRMP that are in line with our expectations for this stage of a draft WRMP. In particular, it delivers on expectations by:

- providing clear links to the Water Resources West regional plan and how this has helped build a consistent approach across the companies involved,
- clearly presenting the WRMP problem statement and describing key changes to the planning problem.

However, overall, South Staffs Water's plan falls below our expectations for this stage of a draft water resource management plan. We are concerned that there are several material areas we have identified from our assessment where the plan does not yet provide sufficient and convincing evidence that the company will need to address to deliver the best value, low regret plan in the interest of customers and the environment. The annex to this letter provides detail on the specific areas of the company plan that we consider need further work and evidence. In particular, in its final WRMP South Staffs Water should:

- quantify and justify the reasoning for changes in water needs between the end point of WRMP19 and the starting point for WRMP24, and that PR19 schemes are being delivered as planned and accounted for appropriately in the supply-demand balance;
- consider a larger range of supply and demand options. There are only 17 preferred options presented in the plan which is a very small number compared to other companies with a similar supply demand balance deficit. Further work is required for the final plan to include a wider range of options;
- clearly state the objectives of the plan and provide clear line of sight from the best value metrics to the plan objectives;
- provide clear evidence for what constraints have been imposed on decision making, why the company has imposed any policy/decision making constraints to its decision making process or why these are appropriate and in the interests of customers and the environment;
- discuss how sensitivity tests show that these constraints do not limit the cost benefit or value of the potential programmes;
- provide robust and clear supporting evidence for its data tables. We are concerned about the level of detail and accuracy applied to the WRMP data tables. The tables had missing, incomplete, and resubmitted data which led to some difficulties in assessing the plan.

We thank South Staffs Water for its hard work and effort in producing a detailed draft WRMP, and responding to queries throughout the consultation process. South Staffs Water should now focus on delivering the expected outcomes of the current plan (WRMP19 funded via PR19), and consider all the responses to this draft consultation in its final plan. We look forward to continuing to work together as final WRMPs are prepared, to protect water resources now and in the future.

Yours sincerely

Aileen Armstrong

Senior Director, Company performance and price reviews

Annex

In this annex we outline further details on the points raised in our main letter alongside more detailed comments on different areas of the draft plan. Our points reflect our assessment approach and focus on:

- **Demand management ambition and outcomes** - alignment with government targets and statutory requirements for water demand.
- **Assessment of water needs** - including key drivers for WRMP24 and the supply demand balance forecast and the need for enhancement investment.
- **Options to meet water needs** - the approach taken to identifying and screening options for both supply and demand, review of demand management and supply side proposals including sensitivity testing for key areas, sufficiency of options and option utilisation under normal and peak scenarios, including scalability and modularity.
- **Decision making and prioritisation** - best value decision making for customers and the environment, how the company has approached strategic planning frameworks and alignment with Ofwat's long-term delivery strategies and common reference scenarios[1].
- **Long term best value programme** - cost efficiency, bill impact and affordability of the plan.
- **Customer and stakeholder engagement** - the type and quality of interaction with customers and stakeholders and the impact this has had on the draft plan formulation and proposals.
- **Board assurance** – company assurance and governance processes, including Board engagement and sign-off.

Demand management ambition and outcomes

The Government's strategic priorities for Ofwat states reducing demand for water can relieve pressures on water supply and increase our resilience to extreme drought. Water companies must act to reduce demand for water in a way that represents value for money in the long-term. We expect all companies to use their WRMPs to show how they will meet long term water demand targets including:

- halving leakage across the industry by 2050, in comparison to 2017-18 levels[2];

[1] Ofwat, PR24 and beyond: Final guidance on long-term delivery strategies, April 2022
[2] For example, February 2022: The government's strategic priorities for Ofwat - GOV.UK (www.gov.uk)

- reduce per capita consumption (PCC) to 110 litres per head per day (l/h/d) by 2050[3].

A further target is now set in the Environmental Targets (Water) (England) Regulations 2023[4] for the reduction of potable water supplied by water undertakers in England to people in England. This is that the volume supplied per day per head of population is at least 20% lower than the 2019-20 baseline by 31 March 2038. We expect companies to demonstrate how they will deliver against this target in their final WRMP.

We welcome that South Staffs Water has set out its plans to reduce leakage by 50% from 2017-18 levels by 2050. The company also indicates it will deliver a dry year annual average (DYAA) PCC of 110 l/h/d by 2050, meeting industry targets.

The company's final WRMP should also reference the target to reduce distribution input by 20% by 2037-38 and demonstrate how it plans to deliver this through a combination of reductions in the key demand components, leakage, household consumption and non-household consumption.

Demand reduction strategy

As we outlined in November 2021[5], we expect near-term interventions being identified in WRMPs to deliver long-term targets such as a 50% leakage reduction and 110l/h/d PCC to be set in the context of the optimum long-term strategy. Setting a glidepath to meet long-term targets and outcomes should enable an efficient and deliverable long-term programme to be identified. The company's plan only considers linear leakage reduction profiles, with the 50% leakage reduction by 2049-50 profile selected as the preferred option. The company has not considered alternative investment profiles such as one that considers non-linear reductions. The company should provide sufficient and convincing evidence to justify why a linear profile – rather than doing more or less in the near term – is optimal from a timing of investment perspective.

The company has looked at a limited range of demand management options and provides insufficient evidence for how it optimised its demand management strategies. We expect the company to explain and provide sufficient and convincing evidence for how the strategies were devised and how the preferred strategy represents the best value approach to meet a supply-demand balance in its final WRMP.

[3] For example, February 2022: The government's strategic priorities for Ofwat - GOV.UK (www.gov.uk)
[4] Defra, Environment Act 2021: environmental targets December 2021
[5] Ofwat, Ofwat's expectations for strategic planning frameworks at PR24, November 2021

Delivery of PR19 performance commitments and WRMP19 targets

We are concerned that based on the draft WRMP data tables the company does not forecast to deliver its PR19 performance commitment level for PCC by 2024-25. We expect the company to deliver its PR19 and WRMP19 targets. Companies should not expect additional customer funding to address deficits resulting from under delivery in the current or previous periods. We expect the company to review its proposals in these areas for its final WRMP.

Leakage

We welcome that South Staffs Water has set out it plans to reduce leakage by 50% from 2017-18 levels by 2050 and that its proposed rate of reduction of 16%[6] across the 2025-30 period exceeds its 2020-25 ambition. However, although the company tests two scenarios, both aim to achieve the same target reduction of 50% and the company does not test achieving other targets nor it is clear how the testing has influenced the selected target presented in the draft plan.

The company chooses proactive trunk mains leakage reduction with a high cost for the near term (including for 2025-30). This is partially the result of the company assuming that some lower cost options require the smart metering rollout to be fully completed before they can start. This results in a leakage reduction enhancement expenditure unit cost of 4.6 £m/Ml/d for the 2025-30 period. This unit cost is eight times greater than that requested by the company at PR19. We expect the company to review its leakage reduction proposals and provide sufficient and convincing evidence it is presenting a best value solution based on efficient activity costs and optimum activity scheduling.[7]

South Staffs Water appears to have assessed the customer supply pipe repair or replacement (with and without smart networks) options but has not discussed its policy with regards to customer supply pipe leakage. We are encouraging companies to evaluate the benefits of a common industry approach to addressing leakage on customers own pipes. We expect companies to provide a view on the benefits of a common industry approach in their statements of response and final WRMPs. We will support companies in the development of a common approach but expect the industry to lead on the development. The Water UK leakage routemap to 2050[8] committed to an informed debate on customer supply pipe strategy by December 2022.

Per capita consumption (PCC)

[6] From 2019-20 three-year average baseline.
[7] Note the Ofwat analysis undertaken adjusted all costs to the 2020-21 price base.
[8] Water UK, 'A Leakage Routemap To 2050', March 2022.

South Staffs Water has set out it plans to meet the per capita consumption (PCC) target of 110 l/h/d by 2050. However, the company proposes a three-year average PCC increase of 0.5% across the 2025-30 period which shows lack of ambition in comparison with the 2020-25 period. We expect the company to justify its chosen glidepath for 2025-30 in comparison to 2020-25 in its final WRMP.

Business demand

We are concerned that in the draft WRMP data tables the company does not forecast to reduce non-household demand and, across its both operating areas, forecasts a 9.4%[9] increase by 2029-30 based on its draft WRMP. In response to a query regarding demand values the company has confirmed that all demand numbers are being refreshed between draft and final WRMP to ensure they include the latest data available and therefore this may lead to some slight variations of this data as a result. We expect the company to set out and clearly justify an ambitious strategy for non-household demand reduction in its final WRMP. We also expect the company to explain how the revisions it intends to make to its non-household consumption trend have impacted the optimisation and best value option selection in its preferred plan.

Metering

The company considers the implementation of smart networks (including household smart metering) to be a key enabler in delivering the demand reduction options proposed in its draft WRMP. However, the company assumes that smart metering on its own does not deliver demand reductions but facilitates demand reduction across households, non-households and leakage. South Staffs Water selects a universal smart metering programme, using advanced metering infrastructure (AMI) technology, delivered to reach full meter penetration of 100%, or as close to this as feasibly possible, by 2035. The company should provide sufficient and convincing evidence that this rate of metering is optimal over the long-term. The company states it aims to use AMI meters wherever possible as the cost difference between AMI and AMR meters is minimal. As described in the PR24 final methodology[10] the company's decision to install AMI meters over AMR meters should include compelling evidence that justifies why this represents the best value approach to meeting a supply-demand balance or delivering long-term strategic outcomes. The company also needs to provide sufficient and convincing evidence that the unit costs of its AMI meter installations are efficient.

[9] From 2019-20 three-year average baseline.
[10] Ofwat, PR24 final methodology – Appendix 9: Setting expenditure allowances, December 2022

Assessment of water needs

A robust assessment of current and future water needs is critical as it drives the gap between supply and demand and therefore drives the scale of investment required for the 2025-30 period and beyond.

We provided detailed feedback on South Staffs Water's assessment of water needs in our pre-consultation feedback in 2022. Some of our feedback has not been appropriately and/or fully addressed in the draft WRMP, and has been raised again in amongst points in this section. South Staffs Water should provide sufficient and convincing evidence that the feedback has been addressed in the final WRMP.

The company's supply demand balance starting point for the draft WRMP24 is significantly lower than its forecast for the same point in the final WRMP19. The reduction in available water for 2025-26 is equivalent to 21% of company water demand (distribution input). Although some of the changes are due to supply-demand balance reporting updates, there is still insufficient evidence to understand changes in some areas. In some areas, the evidence suggests that non-delivery or underperformance is the cause. This includes not meeting expected WRMP19 PCC levels, and increased outage and process loss allowances. This means that there are significant concerns whether the overall outcome of the WRMP19 as funded at PR19 has been delivered in the round. The company should fully quantify and justify the reasoning for changes between WRMP19 and the starting point for WRMP24 at a supply-demand balance component level with sufficient and convincing evidence in its final WRMP.

The key drivers for the planning problem are described as being due to growth and long-term environmental destination. South Staffs Water has provided assurance that abstraction reductions are not double counted when licence capping is combined with environmental destination scenarios. We expect South Staffs Water to clearly explain the rationale for the chosen planning horizon in its final WRMP.

South Staffs Water's raw water losses allowance is very high compared to most other companies', at over 10% of the company distribution input. This planning assumption contributes significantly to the company supply-demand balance and any need for investment. The company needs to present sufficient and convincing evidence that the raw water loss allowance is appropriate in both the short and long term, is not driving unnecessary and high regret investment and how the company has considered options to reduce its raw water losses.

There is limited evidence provided that the benefits of funded PR19 activities have been appropriately factored into the draft WRMP24 baseline supply-demand balance. South Staffs

Water should provide granular details of the benefits of funded schemes and how and when these have benefitted the baseline supply-demand balance. Where a step change in supply-demand balance between WRMP19 and WRMP24 is not sufficiently justified by scenario drivers, and may instead be as a result of non-delivery or underperformance, considerations will be made at PR24 in the assessment of enhancement funding.

Options to meet water needs

Identifying an appropriate number and range of options to meet water needs is essential to ensure that customers and stakeholders have confidence that the preferred programmes are optimal. We are concerned that South Staffs Water has not considered a sufficient range of supply and demand options given the challenges it faces. Although the preferred plan includes options that cover water needs between 2025 and 2050 only 17 options are selected and these are all demand side. We also have concerns that the lack of divergence between the options selected in the least cost and best value plans suggests there are insufficient options to give the decision-making tool the flexibility to optimise for alternative programmes for least cost compared to best value. South Staffs Water should address this in its final plan by providing a greater number, range and scale of options to its decision-making process, or by providing robust evidence why there are no feasible options that provide better value to the wider set of metrics compared to the options that are selected for the least cost plan.

South Staffs Water relies on 61 Ml/d of drought measures as listed in its table 6. It is not clear whether these have been appraised against alternative water resources options and the drought measures are not listed as options in the data tables or included in the responses to our queries. In its final plan, South Staffs Water should clarify its approach to appraising the use of drought measures and how they compare to alternative options for balancing supply and demand. South Staffs Water should also consider how to manage the uncertainty presented by relying solely on demand side options.

A total of nine third party feasible options were considered but none have been selected as preferred options. South Staffs Water should explain in its final plan why no third party options have been selected.

The draft WRMP discusses catchment management options although the preferred plan does not appear to include catchment options that would provide a water available for use (WAFU) benefit. We remind the company that all options included in the preferred plan should provide some benefit to one or more components of the supply demand balance and South Staffs Water's final WRMP should explain how any catchment management options that are included benefit the supply demand balance.

The information South Staffs Water provided on options contained gaps concerning both the volume of water provided and its cost. For the final plan and PR24, we expect all options to be

developed to the same level of detail in order to allow the decision making tool to select an unbiased preferred best value plan from the options available and for all option data to be completed to a high standard.

Decision making and prioritisation

The explanation around decision making is reasonable and demonstrates how the WRMP is linked to the WRW regional plan. We would like the final plan to clearly state its objectives and provide a clear line of sight from these to the best value metrics. There is no clear evidence what constraints have been imposed on decision making, why the company has imposed any policy/decision making constraints or whether these are in the interests of customers and the environment. There is no explanation of how sensitivity tests demonstrate that these constraints do not limit the cost benefit or value of the potential programmes.

In its best value analysis, the company has considered the carbon impact (operational and embedded) of its options. It has also considered natural capital benefits and a range of other social and resilience metrics.

South Staffs Water has not referred to Ofwat's public value principles, although the plan adheres to most of the principles. We would like South Staffs Water to reference Ofwat's public value principles within its best value planning process in its final plan and provide narrative on how the principles have been used to inform its decision making.

South Staffs Water has not produced an adaptive plan. This is because the preferred plan is shown to deliver a surplus under all the scenarios tested. The company sets out that it has tested its preferred plan against compound versions of the common reference scenarios, as well as a situation where only half the planned demand reductions are achieved. In response to queries, the company makes clear what the scale of these impacts are and sets out that they do not cause a deficit in the planning period. The company sets out a number of assumptions made in its plan, beyond those accounted for in scenario and/or sensitivity testing. Even if South Staffs Water concludes that alternative pathways are not required, the company needs to demonstrate in its final plan that scenario testing, including the common reference scenarios, has been used to identify low-regret investment that is required in all or most plausible futures.

The company should clearly compare the Ofwat common reference scenarios to the 'most likely' scenarios on which the preferred plan is based. This should include quantifying the impact on demand of the low and high scenarios for climate change, demand and abstraction reductions across the planning period. The company should also quantify the estimated impact on the expenditure requirement of:

1) planning based on the high scenarios for climate change, demand and abstraction reductions, and the slower scenario for technology; and

2) planning based on the low scenarios for climate change, demand and abstraction reductions, and the faster scenario for technology.

This will allow for improved understanding of the drivers of investment, the sensitivity of the plan to future scenarios and confidence in the investments being proposed. The company should use the results of this testing to identify and justify, with sufficient and convincing evidence, low regret investments rather than just those that meet both high and low planning needs in a non-adaptive way.

As part of its further scenario testing, we expect South Staffs Water to test the Ofwat common reference scenario for low abstraction reductions, which is to 'assume only currently known legal requirements for abstraction reductions up to 2050'. Following the approach agreed between Ofwat, the Environment Agency and the regional water resources planning groups, companies should include agreed water industry national environment plan WINEP changes and licence capping and use the agreed BAU+ scenario to form a long-term view, but use local reviews to remove licence reductions with significant uncertainty, to form a plausible 'extreme low' scenario.

South Staffs Water has concluded that all its planned investments are required in all plausible scenarios, and therefore that its preferred plan meets our definition of the core pathway. We expect the company to present a core pathway in its final plan in line with the WRPG definition, which includes low-regret investment to meet future uncertainties and additional option value to allow further flexibility in the future.

Long term best value programme

The company has identified £99 million of enhancement expenditure relating to the delivery of its WRMP24 in the 2025-30 period. Over the 2025-50 period the company has identified a requirement for £204 million of enhancement expenditure.

For this investment, South Staffs Water plans to deliver around 18 Ml/d of supply demand benefit in 2025-30. The company proposes to deliver benefits at a higher cost than other companies over this period[11]. The company's enhancement investment in the 2025-30 period presents approximately 35% expenditure related to demand side improvements (excluding leakage and metering). South Staffs Water proposes to deliver demand side improvements

[11] Based on the data submitted by companies in their draft plans and comparison against the industry median

(excluding leakage and metering) at a unit rate of 4.6 £m/Ml/d, which is significantly higher than the industry median of 0.7 £m/Ml/d. The company needs to demonstrate its costs are efficient in its final plan.

Whole life unit costs are more reasonable when compared to the industry, South Staffs Water identify £188 million investment over preferred plans. But the company should provide sufficient and convincing evidence that the preferred options being selected, across all areas of its plan, are best value in its final WRMP24 and ensure costs are reliable, efficient and appropriately allocated.

Stakeholder engagement

Stakeholder and customer engagement has been undertaken to inform South Staffs' draft WRMP. Feedback from engagement to seek customer preferences on demand management, supply options and the scale and timing of investment have informed best value decision making in the draft WRMP.

Engagement with retailers has been carried out as part of a non-statutory stakeholder plan. The views of retailers were sought during pre-consultation webinars and roundtable events, and the comments received have been considered in the draft WRMP.

Engagement with neighbouring water companies and the Water Resources West (WRW) regional group has been undertaken and is well described. South Staffs collaborated with WRW members to carry out stakeholder engagement, share resources and avoid duplication of effort. This regional engagement sought to ensure a consistent approach in the development of the regional plan and draft WRMPs of WRW members. Effective engagement with regulators has been undertaken and has been used to refine the draft WRMP.

South Staffs Water included only limited information around bill impacts and did not provide sufficient detail of opportunities identified to enable co-funding or co-delivery, or investigation into commercial models. We expect further investigation of partnership opportunities for co-funding and co-delivery with stakeholders should be undertaken and set out in the final WRMP.

Assurance

A statement of assurance from the Board has been provided, as well as a supporting statement, confirming the engagement and support of the Board with the plan. The governance and decision making process used in developing the plan was provided in a query response, showing evidence of the decision making processes and this should be included in the final plan, alongside the Board's signed statement of assurance, accompanied by a supporting statement.

In the final plan, we expect to see evidence of assurance on South Staffs Water's understanding and acceptance of the approach to licence capping. This is to ensure the risk and impact this imposes to South Staffs Water is fully understood in the context of the largest drivers of future investment in the plan and the uncertainty that still surrounds this.