

Delivering Water 2020: Consulting on methodology for the 2019 price review

August 2017

Blueprint for Water is a unique coalition of environmental, water efficiency, fisheries and angling organisations, part of the wider environmental NGO coalition, Wildlife and Countryside Link. Blueprint members come together to form a powerful joint voice across a range of issues.

This response is supported by the following organisations:

- Amphibian & Reptile Conservation
- Angling Trust
- RSPB
- Salmon & Trout Conservation
- The Rivers Trusts
- The Wildlife Trusts
- Waterwise
- Wildfowl & Wetlands Trust
- WWF-UK
- Zoological Society London

Summary

Our headline comments are summarised below, with more detailed comments provided on a chapter-by-chapter basis.

- We welcome the further development of common performance commitments, which will provide clarity and comparability for customers and stakeholders.
- We are concerned that the absence of a Common Performance Commitment on the environment, combined with the weakly-worded steer from Ofwat which appears to imply that companies could adopt just a single bespoke environmental Performance Commitment, represents a significant retrograde step from PR14. This steer needs to be reframed.
 - The composite environmental Performance Commitment that we previously put forward should feature on a menu of bespoke environmental Performance Commitments from which companies can pick.
- Water efficiency is a key contributor to resilience. We suggest that Defra's requirement that Ofwat 'promote ambitious action to reduce leakage and per capita consumption' is made clearer in the methodology. The proposed per capita consumption targets should be treated in a similar way as the leakage targets, using a 'frontier' approach to push innovation across water company plans.
- We welcome the messages supporting catchment management and provision of green infrastructure but recommend that they should be strengthened to encourage greater ambition. We urge Ofwat to encourage water companies to invest in ambitious, long-term, landscape scale projects, which help to deliver a resilient environment as well as a more resilient water sector.
- We welcome the inclusion of a resilience planning principle for a naturally resilient water sector, and the requirement for water companies to include environmental resilience and



Wildlife and Countryside Link
89 Albert Embankment
London
SE1 7TP

T: 020 7820 8600
E: enquiry@wcl.org.uk
W: www.wcl.org.uk

'Wildlife and Countryside Link is a unique coalition of voluntary organisations concerned with the conservation and protection of wildlife and the countryside.'
Chair: Dr Hazel Norman Director: Dr Elaine King

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natural capital in their risk assessment processes. We propose slight rewording of the second test and a number of environmental questions for this assessment.

- We welcome the further development of resilience metrics, although we are disappointed that our proposal to the Water and Wastewater Resilience Action Group (WWRAG) and Ofwat for an environmental resilience metric based on Water Framework Directive (WFD) good ecological status is not referenced or reflected in the document. We would be pleased to work with Ofwat and others to develop this idea further.
- We welcome stretching Outcome Delivery Incentives (ODIs) and encouraging innovation, particularly regarding demand measures. However, water companies should not be rewarded in PR19 for pollution.
- We have concerns that the combination of greater focus on built asset health and separating off water resources price control may lead to reduced incentives for companies to invest in catchment management.
- We note that the consultation document is exceptionally long, whilst the consultation period was set at only six weeks. As such, the demand on consultee resources is heavy and Ofwat will find only limited ability for interested parties to respond. We would welcome the opportunity for further discussion with Ofwat on the points we have raised before the final methodology is published.

Chapter 2: Customer Engagement

We welcome the shift in emphasis towards customers as **active participants**, rather than passive recipients of a service. We understand that **customer legitimacy is key** to ongoing environmental investment and we are confident that customers want and are willing to pay for high environmental achievement, even if there is ambiguity over the future. However, we are concerned that there is no framework to test whether differences in willingness to pay (WTP) reported by water companies reflect real customer preferences, or an artefact of the method/wording of engagement. We recommend **a national reference study** to better understand whether attitudinal differences are genuine. Such an approach would not be designed to second-guess or replicate company studies, rather it would provide a stable baseline that would allow the veracity of bespoke, and potentially more nuanced/accurate studies, to be tested by customer challenge groups (CCGs), Ofwat & stakeholders.

We support the proposal to **engage customers on longer-term issues** such as resilience, security of services and long-term affordability of bills. Water companies could learn from other sectors who face similar challenges and already have to communicate complex risk issues, such as around flood risk, nuclear decommissioning and health.

On the opening of the retail market, it is important that wholesalers do not lose touch with their ultimate customers. We recommend that Ofwat consider requirements on wholesalers to engage with business end-customers on the wholesale service and what this service should look like.

Chapter 3: Affordability and Vulnerability

We support measures to address vulnerability and affordability for customers. Ofwat and water companies should be tracking **uptake of support** by eligible customers as a performance metric as it is a measure of an effective outcome, rather than focussing on the availability of support.

Q1. Do you agree with our approach to assessing abstraction charges?

We support the proposal for separate assessment of abstraction charges. In principle, it seems appropriate that abstraction charge costs are not simply passed on to customers, as this does nothing to encourage efficiency of water use. Customers will simply pay for companies to hold on to unused/under-used licenses, perpetuating problems with over-allocation.

However, we are concerned that the characterisation of the abstraction charging systems presented in appendix 12 is inaccurate. In particular:

- The price differential relates only to seasonal changes and abstraction use/loss factor, rather than the sensitivity of an abstracted water body. The pricing does not therefore reflect the full environmental impact of abstraction. As a result, abstractions for the same purpose, at the same time of year, in the same region, will attract the same charge, irrespective of the environmental damage being done;
- Abstraction charges from “supported” sources attract a price premium, but may be significantly less environmentally damaging;
- Regional differences in unit charges reflect administrative costs, rather than environmental sensitivity/resource scarcity.

Chapter 4: Outcomes for Customers

Q1. Do you agree with our proposals for common and bespoke performance commitments?

We are **fully supportive of the use of common performance commitments (CPCs)** complemented by bespoke commitments. CPCs improve clarity and comparability for customers and stakeholders.

Environmental Performance Commitments

We are concerned to see that there was **no common performance commitment relating to the health of the environment** underpinning water company operations.

In our [submission](#) to the Ofwat Outcomes consultation earlier in 2017, we suggested a common composite environmental performance measure (see Figure 1 below), which would provide a more rounded view for customers and stakeholders on the environmental performance of companies. We remain committed to this concept and query why such an approach appears to have been ruled out.

Instead, the draft methodology comes across as suggesting that **companies choose just one, or maybe two, bespoke performance commitments on the environment**. We do not believe it was Ofwat’s intention to limit the scope for adopting a range of bespoke environmental PCs but discussions with a number of water companies suggest this is how it has been perceived.

As a result, we are concerned that the broad range of tangible environmental outcomes that customers care about, and that were captured by company PCs in PR14 (e.g. river water quality, bathing water quality, SSSI status, SuDS, catchment management, natural capital, WFD status, water efficiency), will be dropped. This would not be acceptable, nor would it reflect customer priorities, and could lead a race to the bottom. Ofwat should also consider how water company business plans sit within a wider strategic boundary and help towards a sustainable agriculture system, and the Defra 25 year plan for the environment.

We therefore urge Ofwat to reword this text, so that it better reflects the broad range of environmental aspects that should be covered by bespoke PCs, which are captured in appendix 2 of the draft methodology. We propose that (as for Asset Health metrics) a 'menu' for bespoke environmental PCs is provided, with common units of measure, containing the metrics previously put forward by Blueprint following the Outcomes consultation (see Figure 1 below). This approach would increase comparability and transparency and ensure that environmental outcomes that customers value are reflected in the commitments companies make.

Potential Basket of metrics for the Environmental Composite measure (brackets show companies where a similar measure exists within PR14)

- a. WFD water body status improvement (Severn Trent, Yorkshire)
- b. Kilometres (km) of river with water quality improved as a result of wastewater investment (Yorkshire, United Utilities, South West)
- c. Kilometres (km) of river with improved flows (Wessex)
- d. Proportion (%) of total abstraction that is from environmentally sensitive sources (WFD Band 1 to 3 surface water bodies and poor quantitative groundwater status) (Affinity, Southern Thames and others)
- e. Proportion (%) of total wastewater discharged into water bodies failing to meet environmental water quality standards
- f. Proportion (%) or area (ha) of SSSI land owned in favourable condition (Anglian)
- g. Catchment area (ha) under better stewardship as a result of investment (Yorkshire, South West, Severn Trent)
- h. Proportion (%) of total investment delivered through third sector partnership projects or number of partnerships (Yorkshire, Severn Trent)
- i. Natural capital account created and commitment to grow it through investment period.
- j. Proportion (%) of bathing waters meeting good and proportion (%) meeting excellent water quality standards (Southern, Anglian and others)
- k. Contributing area (ha) disconnected from combined sewers by retrofitting sustainable drainage solutions and/or proportion (%) of drainage schemes with sustainable solutions incorporated (Thames, Anglian)
- l. Volume of untreated wastewater discharged and/or number of CSO spills per year (South West)
- m. Per capita consumption compared with best practice for similar Water Resource Zones and companies
- n. Energy intensity for water produced/carbon emissions

Figure 1: Taken from Blueprint response to Ofwat's Outcomes for PR19 consultation.

Per Capita Consumption Targets

Blueprint agrees with Ofwat's proposed approach to set targets for per capita consumption (PCC). Additionally, indicators for leakage, PCC, and a risk based resilience metric (ie. drought risk) should be used to enable Ofwat to demonstrate its delivery of the Defra target to promote ambitious action on leakage and PCC.

Per capita consumption represents the best indicator available for Ofwat and water companies to base ODIs for demand reduction. We support PCC as a common PC as it will enable better

comparison between companies, as well as target setting based on frontier companies. Based on the performance indicators from PR14, the use of a PCC as a common PC will require further definition and discussion around the following points:

- How maximum likelihood estimation is used;
- How PCC is calculated between measured and unmeasured households;
- The interaction of PCC with leakage components of the water balance and how to ensure transparency in reporting;
- What decimal place companies report to.

Resilience Metrics

We welcome the **inclusion of CPCs for resilience** and the use of leading rather than lagging indicators. We support the requirement for companies to supplement their performance commitments with **longer-term projections** of performance for at least 10 years beyond 2025. This will encourage companies to take a longer-term, strategic view.

However, we are concerned that the potential metrics being considered reflect a narrow definition of the term 'resilience', looking primarily at operational and infrastructure resilience. By contrast, Ofwat's Chief Executive Cathryn Ross recently said, "*Ecosystems are part of operational resilience - we depend as much on them to supply clean water and absorb waste water as we do on pipes and treatment works.*"¹

During 2017, Blueprint worked with Ofwat and WWRAG to develop an **environmental resilience metric** that reflected the health of the environment that the companies depend on to operate. This paper looked at how WFD water body status could be used as an environmental resilience metric. We are disappointed this work was not referenced or reflected in the consultation document. We would be happy to work with Ofwat and others to develop it further.

With regards the **resilience to drought metric** we are concerned at the proposal to simply apply a standard of supply threshold in terms of "severe supply restriction", without reference to the environmental impact of meeting that standard, fails to reflect customer/wider society interests in protecting the water environment. Basing the evaluation on Water Resources Management Plans (WRMPs) does offer some comfort around baseline environmental compliance. However, it will not differentiate those companies who invest to minimise the environmental impact of drought, from those who will rely heavily on drought orders/permits that exacerbate harm. We believe this loophole could be addressed by tightening the definition of the metric to exclude the population that will rely on enhanced abstraction (drought orders etc) to meet the 1:200 standard of service.

With regards to the potential **resilience metric for wastewater flooding**, we again welcome the development of a forward-looking metric given that other CPCs already look at current failures of the wastewater system.

We support the use of Metric 3 (retrofitting of Sustainable Drainage Systems (SuDS)), but appreciate that this provides a picture of only one aspect of wastewater flood mitigation. Despite this, we do not accept that SuDS are purely about the "resistance" element of resilience. A well-designed SuDS should offer an opportunity to ensure that even during adverse situations, there is reduced risk and impact to the environment or people, therefore facilitating more rapid recovery.

¹ <http://www.ofwat.gov.uk/publication/cathryn-ross-speaking-notes-british-water-annual-lunch-14-june-2017/>

Keeping water above ground also provides visual cues as floods reach critical levels, giving customers and communities time to respond in a way that traditional sub-surface systems don't.

Metric 1 (wastewater system at risk of flooding), could provide a more comprehensive means of encouraging improvements to the resilience of the wastewater network, but this may drive companies towards traditional grey infrastructure options, given the inherent cultural engineering bias we see in option design and appraisal. We also note that the narrow focus on flooding reflects only one aspect of the service that customers and wider society expect from the sewerage system, the other being environmental protection. These issues could be ameliorated by amending the risk calculations discussed in table 2.3 of appendix 2 to ensure i) environmental vulnerability of watercourses impacted by sewer surcharge is captured in the risk assessment, and ii) the wider environmental and social benefits of SuDS and Natural Flood Management techniques are captured in the appraisal process. **If these changes were made, we would support the use of Metric 1.**

We reject Metric 2 (Combined Sewer Overflows (CSOs)), because of a lack of reliable data and the risk that the narrow focus could drive companies to default to hard engineered options.

The consultation document notes on p100 that there is “no equivalent to the WRMP process for wastewater services”. The need for such a process has been noted for some time including by Defra, most recently in the draft Strategic Policy Statement. We believe Ofwat should be doing more to ensure that a **long-term Wastewater Management Planning (WWMP)** process is established as a matter of importance and urgency. The WWMP would pull together the various strands that make up wastewater resilience (including making use of the wastewater resilience metrics above) and would provide a more transparent strategic assessment of, and plan for, the health of the wastewater system now and into the future.

WWMP should encourage investment in resilience, increase capacity required to reduce the risk of pollution and flooding to customers and the environment, and offer best value for current and future customers.

We understand the reasons behind the removal of the **Abstraction Incentive Mechanism (AIM)** from the CPCs, so welcome the strong steer from Ofwat that all companies should retain/adopt the AIM (or similar) as a bespoke PC. This will help to protect some of our more vulnerable waters from unsustainable abstraction during dry periods, and ensure that the achievement of WFD targets are not jeopardised. This option allows companies the flexibility to adapt the AIM to their own specific circumstances, whilst ensuring that all companies are taking action on damaging abstractions. Actions under an AIM PC should include the progression of demand side solutions, such as local incentive schemes, as well as the improved management of water resources themselves. This is recognised in section 2.4 of appendix 2, and should be more widely promoted. We also support Ofwat's preferences on setting financial rewards / penalties on the AIM, with natural capital value followed by willingness to pay being preferred to difference in operating costs.

We note that Ofwat are cautious about requiring companies to have financial ODIs on these resilience metrics for several reasons, including that they are at relatively early stages of development. However, we welcome Ofwat's steer that companies should propose financial ODIs on these CPCs if they reflect the particular resilience challenges facing them, and are supported by their customers.

Asset Health

We **welcome recognition that asset health is an indicator** of a company's ability to continue to perform its functions for the benefit of the environment as well as for customers. The asset health common performance commitment proposals are valuable, as failure to maintain asset condition is a key risk factor for pollution and leakage, and for ensuring short-term "efficiency" does not come at the expense of long-term resilience.

We welcome the standardisation of asset health metrics as both CPCs and as a 'menu' for bespoke PCs. This will help increase comparability and transparency, whilst also allowing companies to develop their own bespoke metrics, which will enable companies to innovate.

However, the proposed performance commitments focus on current serviceability, rather than condition. As such, they will do little to incentivise long-term wastewater planning. Current proposals could be achieved by further **sweating of assets**, and potentially leaving asset renewal to future price reviews/generations. We recommend an **asset condition indicator** similar to that used by EA in flood risk management, whereby assets are assessed in terms of how critical they are and their condition. This would allow targeted investment before failure occurs, giving an indication of how the burden of renewal is being shared between current and future customers.

We recommend additional measures for catchment asset health – reflecting the role that natural assets play in securing services for customers. As Ofwat's Chief Executive, Cathryn Ross, recently said, ecosystems are, and should be recognised as, part of operational resilience. However, the current proposals put forward do nothing to capture the value of investment in catchments as a critical asset for the systems and services customers rely on.

This risks reintroducing a form of CAPEX bias, as companies inevitably seek to meet/outperform those things they are measured on and simultaneously seek to cut back on those things they are not, in order to make efficiency savings. This is exacerbated by the EA's driver guidance, which makes it clear that ongoing catchment spend carried forward from PR14 will be treated as part of the companies' base costs.

We are not arguing that catchment spending shouldn't be subject to efficiency challenge. However, such investment should be treated equitably with built infrastructure, in order to avoid the risk that short-term cost savings come at the expense of long-term resilience.

We welcome the inclusion of Category 1&2, and Category 4 pollution incidents in the 'long list' of asset health performance commitments that companies can choose from. However, **companies should not be rewarded for performance which is not compliant with legislation**, even if this represents an improvement on past performance. Pollution is illegal and should not be rewarded through increases in customers' bills. Any pollution ODI should be penalty-based or reputational only.

Q2b. Do you agree with our proposals on setting performance commitment levels?

We welcome the measures proposed to ensure that **performance commitments are stretching**. We also support taking account of a wider evidence base to gauge customer support, and that companies must challenge their proposed commitment levels against each of the approaches listed – i.e. companies will not be able to rely on Cost Benefit Analysis alone.

As a principle, we welcome the approach of **minimum acceptable performance commitment levels** for key CPCs, with more challenging targets to be accepted if there is support from customers.

We recognise that the alternative option of dynamically adjusting commitment levels could encourage innovation and the sharing of best practice within the industry and this has some merit. However, such an approach could act as a disincentive because any improvement will lead to a tightening of the commitment. We would encourage Ofwat to consider whether there is a means of promoting better collaboration within the industry, by amending such an approach to get around this disincentive.

With regards to **leakage targets**, we agree that the sustainable economic level of leakage (SELL) has limitations, and we welcome moves to refine the approach to setting leakage targets. We suggest that 'the value of water left in the environment' should feature in any considerations, particularly where abstraction is from environmentally-sensitive sources, such as chalk streams.

As highlighted earlier, we welcome the requirement for company performance commitments to be supported by longer-term projections of performance for at least 10 years beyond 2025. We also support proposals that water companies must include commitments with respect to the environment and AIM within their bespoke performance commitments. We are pleased to see a number of Blueprint's suggestions for environmental commitments included in appendix 2.

We support Ofwat's requirement for stretching common performance commitments so that they meet "at least the forecast upper quartile in 2024-25". However, we do not agree with the current proposals to setting performance commitment levels for PCC.

The common performance commitment level for PCC should be treated in a similar manner to leakage targets. Higher ambition on water efficiency can be delivered by ensuring performance commitments are linked to financial penalties and rewards.

We agree with the approach to setting initial service levels (2019-20) and for CCGs to challenge companies on their proposals. For PCC, the initial service level should reflect water efficiency programmes that are expected to be delivered through PR14. The current framework also requires companies to get to the frontier on day one, which will require greater ambition from water companies during the current period, and could ensure smoothing of effort across periods. However, this could also be a disincentive to implementing longer-term demand management programmes, where the benefits are not seen up-front.

We believe companies should set stretching PCC performance commitment levels in the same manner as has been outlined for leakage targets:

- Achieve forecast upper quartile performance (in l/h/d), where this is not being achieved, or justify why this may not be appropriate
- Achieve ambitious PCC reductions. Companies will need to achieve the following minimum reductions, or justify why these could not be achieved:
 - One percentage point more than largest reduction commitment at PR14 - the largest forecast reduction in PCC in PR14 based on performance outcomes was 10% by Southern Water. Encouraging companies to target a 10% PCC would result in an average reduction in water use of 13.28 l/p/d across all water companies
 - Largest actual percentage reduction achieved by a company since PR14.

- Justify their performance commitments relative to the minimum level of water use achievable (best practice/ high ambition water efficiency).

Using a percentage reduction based on the frontier could ensure a consistent approach across demand management, rather than a direct PCC target or per property target.

Ofwat should require companies to cost (including using value of water left in the environment) options that include smart metering, retrofit and engagement with every domestic customer, also providing the mechanisms for how such values were produced. This will unlock further ambition on water efficiency, ensuring that companies have at least considered what ambitious looks like.

Q2c. Do you agree with our proposals to setting leakage performance commitment levels?

We agree with Ofwat's proposals to setting leakage performance commitment levels.

Taking a frontier approach to leakage management was considered for PR09 ([Environment Agency and Ofwat, 2008](#)). However, this modelling approach was more complex than the approach being suggested for PR19. We support a simplified approach where the focus is on driving levels of leakage down, rather than focussing on explanatory factors alone. This has been one of the challenges of using the SELL.

Q3. Do you agree with our proposals for strengthening outcome delivery incentives?

We broadly **welcome the proposals to strengthen ODIs**, providing more incentive for companies to fulfil their service commitments to customers, and more penalties for those that do not, albeit with the caveats and recommendations we have noted under chapter 14 (assessment of business plans) and those above in mind (i.e. that companies should not be rewarded for performance that is not compliant with legislation).

We support Ofwat's rationale that an average company with average performance would expect to incur penalties on its ODI package rather than rewards, as this should encourage ambition and innovation. However, it is important that the strength of different incentives does not drive bias towards delivering those targets at the cost of others and the environment.

We agree that calculating rewards and penalties based purely on customer valuations does not take into account wider benefits that customers should see from shifts in industry performance. We therefore welcome encouragement for companies to set higher rewards for very high levels of performance for CPCs. This will set new leading performance levels in future price controls to benefit all customers. In turn, this could encourage innovative and industry-leading performance, whilst providing checks to protect customers from excessive financial burdens.

Although we welcome the emphasis on reducing pollution incidents, as highlighted earlier, **companies should not be rewarded for pollution incidents** or for legal compliance. Instead, we would like to see reducing penalties as companies reduce the number of pollution incidents.

We have been pleased with the development of the **Discover Water dashboard**, which provides a useful hub for customers and stakeholders to find company performance data. This enhances customer and media scrutiny of company performance, enhancing the reputational impact of ODIs.

Chapter 5: Securing Long-term Resilience

We support the focus on delivering long-term resilience. However, we are concerned at the focus on sustaining services to customers and on meeting customer expectations, however realistic or unrealistic, at affordable prices. It is important that trade-offs are made explicit and that these objectives are viewed in the context of delivering water efficiency, increasing scarcity, and competition for resources by various users together with the needs of nature and the environment.

Despite planning principle 2, we note that not until section 5.4 does any mention of resilience include a mention of the environment, and even at this point, it is not included within the definition of “resilience in the round”. We suggest that “resilience in the round” should incorporate environmental resilience as well as corporate, financial and operational resilience. If not, the definition of resilience - “*the ability to cope with, and recover from, disruption, and anticipate trends and variability in order to maintain services for people and **protect the natural environment now and in the future***” is not adequately integrated into the methodology. A healthy environment is core to resilience in the water sector and Ofwat should ensure that it is an integral part of water company resilience, and not simply a tag on. We support the advice that the “*risk assessment should consider the resilience of the ecosystem*” and that “*firms should have regard to the wider costs and benefits to the economy, society and the environment, including the sustainable use of natural capital – that is, our natural assets such as rivers and groundwater*”.

The focus of Ofwat’s definition of the approach to “Operational Resilience” on “infrastructure” is at odds with Ofwat’s wider strategy of focussing on systems and services rather than assets. In addition, it does not reflect the fact that operational resilience starts with a consideration of how natural assets are managed. We recommend that Ofwat re-define operational resilience along the lines of “the ability of an organisation to avoid, cope with, and recover from, disruption to the systems and services it provides to customers and wider society.”

Q1. Do you agree with our resilience planning principles?

We are pleased to support the inclusion of Planning Principle 2 “**A Naturally Resilient Water Sector**”. However, we feel that adding to it the rider “*as far as this is consistent with companies’ role as providers of water and wastewater services*”, is unnecessary, and does not need to be restated here.

Q2. Do you agree with our approach to assessing resilience in the initial assessment of plans?

The tests on securing long-term resilience do not currently adequately ensure that Principle 2 is followed. We recommend the **second test** be fine-tuned as follows:

How well has the company objectively assessed the full range of mitigation options and chosen the interventions that represent the best value ~~for money~~ economically, socially and environmentally over the long-term and support from customers?

We support statements around the value of **collaboration with partners** on resilience and better integration of water and wastewater resources. We welcome the statement that “*Resilient ecosystems and biodiversity underpin many of the key services provided by companies. This should be considered as part of the decision-making process for ensuring resilient services*”.

The United Utilities approach to characterising and assessing resilience risks, linking them to the 4Rs (redundancy, resistance, reliability, recovery) and to mitigation measures, looks useful. We agree that the resilience risk assessment should be publicly available to provide greater transparency to stakeholders. Where appropriate, it should be mapped so that cumulative risks are more evident and/or opportunities for action with multiple benefits are more evident.

We agree that that resilience risk assessments need to include Principle 2 and the resilience of the underpinning environment, focussing on the key interfaces between company operations and the environment such as abstraction reaches or aquifers, discharge points and reaches. Questions to ask should include; *What is the status/condition of the environment at these points? What is its natural capital? Has it been deteriorating? What are the vulnerabilities and future threats? What interventions can be made to increase resilience and its ability to cope with or recover from dry periods/abstraction, pollution, flooding?*

Linked to the use of Principle 2, we proposed in March 2017, through WWRAG, using **WFD good ecological status as an overall indicator metric of the health /resilience of the ecosystem** at water company interfaces. Although disappointed that our proposal was not referenced or included as one of the two potential resilience metrics described in the methodology consultation document, we still feel it could be included as part of the risk assessment process linked to Principle 2. We would be happy to work with Ofwat and others to develop it further.

At the launch of the Blueprint for PR19 in May 2017, we proposed a **joint project** between the environmental NGOs and water companies. This project would seek to better understand the linkages between **environmental and water company risk and resilience** with case studies and practical examples of what both sectors can do together and separately to enhance resilience. We are currently looking for financial support to enable this project to proceed, and feel that it would be useful underpinning information in support of achieving Principle 2.

We agree that there is a gap around **strategic wastewater planning** and the sector has failed to take up, in a consistent and coherent manner, the recommendations of the drainage strategy framework (2013). Engagement with stakeholders is limited and partnership opportunities are being missed. We welcome Ofwat's statement that *"companies should take the lead on long-term wastewater planning...should engage with stakeholders...and ensure that they bring forward well-developed long-term wastewater plans to support their business plans"*, however we would like Ofwat to take a more directive approach in this area.

We support Ofwat's statement that water companies should consider appropriate management across water company borders, regionally and nationally, and an expectation that water companies work more effectively at integrating drainage and water resource management.

Chapter 6: Targeted Controls, Markets and Innovation: Wholesale Controls

Although a "decision" already made, it is worth noting that the boundary of control definition for water resources implies that investment in water safeguarding/catchment management activities will be part of "network plus". However, this is not acknowledged in Section 2.2. of appendix 7: *Wholesale revenue incentives*, which states that network plus will include anything that is not captured in "water resources", and goes on to say:

"We therefore expect the activities covered by the network plus water control to include:

- *raw water transport;*

- *raw water storage;*
- *water treatment; and*
- *treated water distribution.”*

We are concerned at the absence of any explicit mention of catchment management and safeguarding action. Ofwat must ensure that the interaction between costs to reduce water quality problems, and benefits to reduce treatment costs, are accommodated in the water and network plus price controls. However, if this is not the case, companies could be benchmarked for efficiency under the “water resource” price control, irrespective of the quality of water produced and benchmarked for efficiency under “network plus”, irrespective of the quality of the water being received by the treatment works. In turn, this would create an illusion of an efficiency frontier, made up of cheap dirty water resources and treatment costs associated with clean water, without the cost (and value) of successful catchment management being captured.

We would favour investment in safeguarding, with the subsequent value of clean water captured in the Water Resource control. This would more closely reflect a truly competitive market, where one would expect “clean” water to attract a premium from the network plus side of the business as it is easier to treat and more reliable.

This approach would also align more closely with Ofwat’s ambitions for water trading where, presumably, water companies will pay less for water that requires higher levels of treatment.

Chapter 7: Targeted Controls, Markets and Innovation: Direct Procurement for Customers

We welcome proposals to encourage innovation. However, it is important that innovation is not suppressed through penalties for lack of success on potentially promising ideas. Innovative proposals may not be successful but are nevertheless worthwhile and can lead to further innovation and to success.

The guidance fails to highlight that companies could play a greater role in championing their customer interests by **promoting new regulatory approaches and tools** that could be used more effectively to increase operational resilience in the sector (and benefit customers) such as :

- Stronger planning and building regulations that require enhanced water efficiency to be built into new homes in water scarce areas, or sustainable drainage techniques to be used to reduce flood risk,
- Introducing spatially targeted restrictions on chemical use to protect water company customers from expensive treatment for chemicals such as metaldehyde.

We support the objective to encourage a long-term perspective, rather than a five-year one.

Chapter 9: Securing Cost Efficiency

Q3. Do you agree with our proposals to funding unconfirmed environmental requirements? Which of the two options do you consider is more appropriate, and why?

We believe **both of the options presented will limit ambition for WFD delivery.** A conservative approach will severely limit delivery up until the third River Basin Management Plan (RBMP) round. Consequently, this would increase the scale of change required in the last few years of the AMP period, increasing costs to scale up ambition, more likely resulting in disproportionate costs, which

may not have been the case if proposals had been forthcoming prior to 2021. A unit price approach is preferable as it offers greater scope for developing and presenting scenarios, and this could be linked to customer WTP, with Ofwat requiring companies to consult on a range of “glidepaths” to good ecological status. Engagement should include a discussion about risks of leaving investment late.

We are also concerned at the wording around the final bullet of this proposal “...to fund unconfirmed environmental requirements in a way that better protects customers”. This suggests that customers need protecting from environmental improvements, rather than the need to protect customers from companies being allowed expenditure that never materialises because the drivers turn out to be lower than anticipated. This is a subtle but important difference.

Chapter 14: Assessment of Business Plans

Q1. Do you agree with our proposed approach to the initial assessment of business plans?

Q1a: In terms of the nine test areas?

We reiterate the importance of **test questions on the environment** being included under the following test areas:

- engaging customers on environmental risk and resilience
- delivering outcomes for customers including performance commitments and ODIs on environmental performance that reflect the wide range of environmental aspects impacted by company activities and valued by customers
- securing long-term resilience with specific reference to environmental resilience and ambitious demand management
- targeted controls, markets and innovation to innovate natural solutions and minimise environmental impact
- securing cost efficiency which includes environmental cost benefit analysis and natural capital assessment
- aligning risk and return to understand water company activities on environmental risk, and the return of a healthy environment on water company performance.

We would be happy to work with Ofwat in due course to develop appropriate environmental test questions for the initial assessment of plans.

Under appendix 14, table 2 provides details regarding scoring business plans, with the environment only specifically mentioned under innovation. It is concerning to see that the environment is not even mentioned under resilience. As above, the definition of “resilience in the round” in the methodology should encompass the environment. A narrow definition means that schemes, which deliver environmental resilience and other multiple benefits, are likely to be under-valued and ruled out. There is also no mention in this appendix on assessing business plans around natural capital assessment. As such, we do not agree with the current approach as it does not adequately assess environmental commitment under the majority of the test areas.

Assessment of business plans should ensure that companies engage effectively with their customers on environmental issues and opportunities. This should include better understanding of the role that a resilient water environment has on ensuring a resilient water sector. If companies fail to communicate effectively with customers on the environment, customers may be unclear of the need for investment in the environment. As the methodology requires support by customer

valuations this may result in low penalties and rewards on environmental aspects and limit innovation.

Q1b: In terms of the business plan characteristics we want to see? (high quality, ambition and innovation)

There is significant emphasis on the assessment of business plan quality. The Environment Agency and Natural England WISER guidance provides a clear indication of what differentiates mere compliance with environmental obligations from best practice. As such, it provides a template for assessing the quality of environmental ambition, which should be included in assessment of business plans.

Q1c: In terms of the business plan categories we propose to assign companies to? (significant scrutiny, slow track, fast track, exceptional)

For a water company to be assigned as exceptional it should show clear commitment to environmental aspects. This should include a number of bespoke Performance Commitments on the environment, and ambitious catchment management and demand management proposals. It should seek to optimise opportunities for the environment and incorporate environmental resilience into its plans. Exceptional plans should propose clear communications to customers making the case for environmental expenditure, setting out environmental and social cost benefit as well as financial.

Q2. Do you agree with our proposed approach to assessing a company's ability to deliver results for customers and the environment from innovation?

The approach taken assumes that the environment benefits indirectly from innovation through “better services and benefits”, and that “high levels of innovation...would result in benefits for customers, companies and the environment”. Delivering for the environment through innovation must be considered as a direct, rather than indirect outcome, and be factored in from the start to optimise the outcomes. Innovation should be directed towards relieving pressures upon, and enhancing, the environment in its own right.

Appendix 5: Water Resources Control

Although we acknowledge the potential benefits of benchmarking on water resources, it is important that this does not encourage silos within the industry where in fact further encouragement for integration and joined up thinking is needed.

We suggest that **environmental cost data** should be included in the cost data. The absence of such a data requirement could encourage companies to prioritise abstraction from cheap but environmentally sensitive sources. This could happen as a consequence of companies seeking to appear efficient against Ofwat benchmarks, or due to competitive forces felt by the new market. We recommend a shadow environmental price of water. This could be seen as a “pro-market” approach to securing environmental outcomes, as it would encourage new entrants into the market to displace damaging abstraction.

We are concerned at the proposal to link “equalisation” of water resource costs that new entrants have to beat, to the marginal cost of new capacity identified in WRMPs. This could have perverse consequences for the environment/customers unless costs are assessed on a like-for-like basis. This is because WRMP guidelines encourage companies to take a broad view on the costs/benefits

(including natural capital/non-monetary) of different options, and assess costs over a long time horizon. If new entrants simply quote prices in over a price review period with no reference to environmental or wider impacts, they may well appear cheaper.

We support the proposal that companies should bear the risk of losing money if they are out-competed by innovative entrants, provided the environmental and economic incentives align.

We are concerned at the lack of content regarding demand management and leakage. This section should recognise the potential for new entrants to displace the need for water resource investment through greater demand management and reduction in leakage. This points to competition in network plus price control impacting the water resource price control.

We support the inclusion of raw water reservoirs in the water resources control. However, we are not clear where catchment management investment would fall – would it be part of water resources or network plus? Clarification on this decision, and the rationale behind it, would be useful.

Appendix 12: Cost Efficiency

We were pleased to see that impact on natural capital and ecosystem services were listed as reasons for why cost-adjustments might be required. However, we are concerned that cost adjustments for natural capital and ecosystem services are framed in terms of “best for customers”, without any recognition that water companies have legal duties reflecting the pivotal role they play in delivering for wider society. This is reflected in other language around the Ofwat methodology and should be made explicit in this part.

In addition, while we accept Ofwat should subject any claims over and above modelled efficiency to rigorous scrutiny, it should be noted that some elements of natural capital and ecosystem services cannot be monetised. As such, although valuable, they will not be amenable to cost benefit analysis or direct measures of cost-efficiency.

As a result, Ofwat should signal its willingness to accept a broader range of evidence for additional costs supported by customers and/or consistent with legal duties.

Furthermore, we have noted above (in our response to chapter three), that we are concerned that the characterisation of the abstraction charging systems presented in appendix 12 are inaccurate.