Blueprint for Water – Submission to the CMA on Water Company Re-determinations.

Blueprint for Water is a unique coalition of environmental, water efficiency, fisheries and recreational 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 water-based issues.

This response is supported by the following organisations:

- Amphibian & Reptile Conservation
- Angling Trust
- Rivers Trust
- RSPB
- The Wildlife Trusts
- Waterwise

The principle of redetermination

As the Water Industry economic regulator, a key part of Ofwat's role is to ensure that companies are investing funds efficiently. Efficiency challenges are right and just. But the Final Determination decisions issued by Ofwat place at risk a number of schemes which would ease pressure on the environment and in some cases deliver significant environmental benefit in line with sustainability principles and customer desires. We question whether in this instance, Ofwat has got the balance quite right.

The unprecedented level of challenge to the industry regulator that this redetermination represents can also be taken as a sign. That four companies have taken the major step of challenging their final settlements is testament to the serious concerns held not just by those companies involved, but across the industry, that the line taken by Ofwat in curtailing long-term investment is so significant as to be damaging to the long term resilience of the industry.

Throughout our submission we highlight examples shared with us by the water industry to illustrate particular points or principles. Without the detailed knowledge of these schemes it is not our place to provide support for either Ofwat or the water companies' positions on individual points of disagreement, but we use these examples to highlight what we consider to be potential flaws in Ofwat's decision making process.

The value of Water

A number of the decisions taken by Ofwat appear to place greater value on the bill reductions to customers than on the investment that is needed now to prevent longer-term bill increases. This is troubling on two key fronts. Firstly and most critically, we believe that to deliver a reduction in bills sends a message to customers that is fundamentally flawed; water is cheap, and getting cheaper. Whilst it is important to remain mindful of the financial pressures that customers face and to offer social tariffs that ensure water remains accessible to all, particularly in the light of the Covid-19 pandemic, Ofwat must consider

whether the savings that can be made now are truly in the best interest of the customer. Ofwat note that for many customers, and particularly for those for whom affordability isn't an issue, value and price do not always correlate - that is to say that for these customers, higher bills will not translate to valuing water. Value must instead be instilled through greater customer awareness; - yet for that argument to hold stead, there needs to be sufficient investment in communication, engagement and education.

For example, cuts to water efficiency and metering programmes are a false economy, as highlighted in research by Blueprint member Waterwise which found that reducing water consumption by around 20% could cut UK household water and energy utility bills by £36bn over the next 25 years (£40 per household per year). To prioritise a short term bill reduction now reduces the long-term saving potential associated with metering and water efficiency, removing the potential for customers to better manage their own water use, eliminating the associated savings on energy bills (linked to water heating) and carbon emissions, limiting the reach of engagement and education work that will help to instill the value of water, and sacrificing the ability to reduce abstraction pressures on the environment.

Secondly, it goes against the recommendations of numerous reports and publications which all align around the need for increased investment and activity to secure sustainable water supplies. Most prominent of these is the National Framework for Water Resources, which highlights in Appendix 4 the significant scale of abstraction licence reductions that will be needed to deliver protection for the water environment. Water companies need to invest in both demand management and supply development, taking a twin-track approach to meet even current projections for licence reductions, let alone those which consider more pronounced impacts of climate change, higher levels of population growth or more ambitious environmental protection.

Whilst the above points question the approach taken by Ofwat, the role of the companies is also a consideration here; Ofwat rightly note that they cannot approve schemes that are not put forward, so the onus here must be on the companies to develop and promote efficient and well-reasoned schemes to deal with the scale of the challenges ahead.

The Resilience Duty

Recognition of the need for investment in water supply resilience prompted inclusion of the 'Resilience Duty' in The Water Act 2014; a new primary duty on Ofwat *to "secure the long-term resilience of water undertakers' supply systems and sewerage undertakers' sewerage systems"* including by promoting long-term planning and investment and supporting companies to take *"measures to manage water resources in sustainable ways, and to increase efficiency in the use of water".*

At the time, Blueprint for Water questioned whether this resilience duty sufficiently considered the role of the environment, framing it as a pressure to be resilient to, rather than a critical asset upon whose health the very functioning of the sector relies.

Ofwat set out in their draft methodology for the Price Review a set of principles clarifying their expectations for resilience planning in PR19 business plans. Blueprint proposed an

additional principle which would focus on ensuring the resilience of the natural environment and ecosystems on which water companies' operations depend. Ofwat agreed with this suggestion and therefore included a further principle emphasising the role of the environment in sustaining the resilience of systems and services.

However their decisions to reduce the budgets available for certain schemes for AMP7 appear to contravene this principle.

For example, restrictions to Anglian Water's strategic pipeline will mean that the system has in-built bottlenecks, reducing the resilience of the system by limiting the volumes of water that can be accommodated and meaning that it will likely need to be upgraded in the near future to rectify this. Ofwat's cost reductions for this scheme are comprised of efficiency reductions (which should of course be considered) as well as questions on scope, which appear to hinge on differing assessments of capacity needs, how best value was arrived at, and whether the company will indeed deliver the proposed works. In cases like these, it would seem possible to take a 'no regrets' approach to awarding funding, and to deal with concerns over likelihood of delivery via an increased 'uncertainty mechanism' award, instead of by restricting scope.

Northumbrian Water's water transfer scheme in Essex was developed with long-term resilience in mind, enabling intra-company water transfers and providing resilience to weather, pollution events and other threats to security of supply. In the context of increased regional water resources planning to ensure the most sustainable use of water resources, this kind of scheme will surely become more necessary.

Northumbrian Water's proposed sewer flooding prevention scheme would use nature-based solutions to ensure that rainwater is kept out of sewer systems, preventing distressing instances of sewer flooding that damages homes, risks customers' health and pollutes the environment. The scheme would protect not just areas currently at risk of this, but additional areas predicted to be at risk soon due to climate change and increasing urbanisation. Such schemes are valuable on a number of fronts, easing pressure on stretched systems, (or better, creating additional headroom), providing biodiversity and amenity benefits, and preventing the need for alternative 'grey' infrastructure further down the line which is more costly to install and maintain in terms of both capital and carbon. Ofwat have welcomed this commitment, noting that Northumbrian Water's past performance in this area has been poor, but state that their base cost allowance for all companies includes an allowance to address the risk of sewer flooding. Northumbrian Water say that with the level of investment needed, it isn't feasible to undertake this work with base funding alone. Whilst Ofwat's implicit allowance for sewer flooding for Northumbrian Water is similar to the requested allowance for the scheme of £86M, with Ofwat taking the position that the scheme is therefore affordable from base funding, this suggests that the company and regulator have significantly different understanding of what base funding can and should cover. In future Price Review periods, earlier discussion on the scope of base funding may avoid such differences.

Indeed, a number of the points of disagreement between Ofwat and the referring companies appear to relate not to whether a scheme is necessary, but whether it should be funded from base allowance or enhanced funding. See for example Anglian's smart metering proposals.

Whilst on the face of it this could appear to be the regulator taking a rightly-tough line on the industry, holding companies' feet to the fire via performance commitments and at the same time protecting customers by disallowing high costs or double counting that would result in customers over-paying, we also need to be sure that companies are awarded sufficient costs to deliver environmental outcomes to a high standard, and are not pushed to make efficiency cuts that impact the quality of delivery.

We accept Ofwat's premise that 'Just more money won't deliver more outcomes', but believe this needs to be balanced with ensuring that there is at least *sufficient* money to deliver proposed schemes. If, as some companies have suggested, they will genuinely be pushed towards delivering mediocre performance due to the need to deliver the lowest loss from the balance of expenditure, penalties and rewards, there needs to be a mechanism of looking again at the funding awards or incentives structures. Again, greater use of an uncertainty mechanism could play a role here.

On the other side of the argument is Ofwat's position on the degree of stretch and/or strength of incentives relating to environmental outcomes. It is concerning that some companies appear to be arguing for reduced targets, for example, Anglian Water's proposals on leakage are less challenging than Ofwat's final determination performance commitment level. We support Ofwat in pressing the industry to go further on these challenges, and in cases where outcomes are genuinely unaffordable we would always argue for increased funding as opposed to reduced targets.

In developing proposals, the onus rightly falls to the water industry to set out a reasoned case for proposed resilience schemes, describing a specific programme of delivery to deliver specific environmental (and therefore business) resilience outcomes. It may be a just criticism to say that not all have necessarily justified their proposed schemes fully enough. But it does *not* therefore follow that Ofwat should reject these costs outright.

The value of Environmental investment, Cost Benefit Analysis & Natural Capital

An area that has seemingly proved difficult for Ofwat to square is the desire to support innovative, nature-based solutions, against the need to enforce a time-constrained rewards and penalties approach in order to encourage plans that provide a sufficient level of certainty around environmental compliance.

Yorkshire Water suggest, for example, that their desire to utilise catchment schemes to enhance water quality through their WINEP programme was curtailed by the need to avoid penalties that would be associated with failing to deliver the required outcomes within a 5yr period, particularly since penalties are more severe for AMP7 than they have been in the past. This has prevented the company taking forward catchment solutions since these require a longer timeframe to deliver the same level of performance as traditional civil engineering solutions such as end-of-pipe treatment. That the requirement to achieve environmental outcomes prevents the use of techniques which are environmentally beneficial, is an irony not lost upon the environmental NGO community.

The cost allowance awarded for Yorkshire Water's WINEP programme has potentially damaging environmental effects. The WINEP targets are statutory requirements and so, the targets will still need to be met. However, cutting costs might mean choosing the cheaper delivery method, for example using chemical dosing such as the introduction of ferric sulphate into wastewater to remove phosphorus. This is concerning due to (i) the impact of discharging ferric sulphate into rivers; (ii) the extensive use of noise- and emission-polluting tankers to deliver ferric sulphate to the sewerage works; and (iii) the storage of the chemical at the relevant sites. Furthermore, ferric sulphate is becoming increasingly difficult to source and is likely to increase in cost as a result, leading to higher costs for future customers.

We are aware that similar conversations are underway across the industry regarding the use of treatment wetlands as an environmentally beneficial means of dealing with wastewater discharges. What these kinds of solutions typically have in common is that they are often cheaper to construct or maintain and so represent short and / or long-term cost savings, deliver meaningful non-financial savings such as around carbon emissions, can make significant contributions to the provision of wider ecosystem services, particularly biodiversity, and are keenly supported by customers. Working against them is the reduced certainty of outcomes compared to engineered solutions.

Again whilst we do not feel we have sufficient knowledge of particular schemes to agree or disagree with Ofwat's conclusions on them (whether part of this re-determination or for companies who have chosen to reluctantly accept their settlement), what concerns members of Blueprint for Water is the apparent mismatch between rhetoric and reality; Ofwat's broadly positive position on nature-based solutions and other environmentally-beneficial approaches does not appear to have followed through to the schemes ultimately being taken forward.

However, whether this is as a result of the methodology and Price Controls for PR19, or is related to other aspects of the regulatory framework, is a valid question.

In terms of Price Controls, more comprehensive consideration of the benefits of such schemes could be achieved by taking a Natural Capital approach to the assessment of plans, building on work being undertaken already by several companies. It should be remembered that in reaching investment decisions, least financial cost or greatest value for money in purely financial terms are certainly not the only reasonable outcomes to aim for - and certainly not when only considering these over relatively short time horizons. A natural capital approach could identify the greatest *overall* benefits to be delivered by a scheme, finding ways of adequately factoring in those benefits which cannot easily be considered in financial terms, and should additionally consider how to give extra weighting for schemes with considerable customer support.

Irrespective of the outcome of this re-determination process, this is an area that we would like to see given much greater attention for PR24; we will want to see assurances that the internal practices and processes in place do not *prevent* Ofwat supporting the kinds of schemes that it states it wants to see the industry delivering.

We do however welcome changes already delivered that enable greater uptake of nature-based solutions. For example, amending the outcomes framework to give companies the freedom to innovate and to take forward the most cost-effective means of meeting their performance commitments, (rather than a system which specifies and funds particular stated

outputs). Ofwat noted in their final determinations that whilst catchment management is becoming more of a mainstream activity, it is still only 'scratching the surface' of what is possible. Ofwat accept that there are still a number of barriers to nature-based solutions to work through and Blueprint for Water would be pleased to discuss this issue further with Ofwat.

In the meantime however, companies report that the price settlements received mean that they must curtail their ambition, focussing on achieving the statutory minimum and delivering those against those targets which have associated financial penalties. We are concerned that this leaves them little flexibility to amend their activities over the course of the AMP period to respond to local opportunities, such as through collaborative working with catchment partners, to achieve their objectives in more environmentally beneficial ways.

Customer Preferences

Finally, it is a concern that many of the schemes downscaled or underfunded by Ofwat are schemes the companies had demonstrated that there was particular customer support for.

Northumbrian Water's two resilience schemes (one on sewer flooding in the north east, the other on water resources in Essex) had strong customer support, despite this meaning sacrificing a bill reduction, and indeed many customers wanted these schemes to go further still. Customers have told Anglian Water that they want to see investment now, not 'kicking the can down the road and requiring us to pay more later', and customer support for the plan as a whole was within the context of supporting a long-term strategic direction that requires early investment for later benefit. Yorkshire Water have highlighted a significant increase in support for environmental schemes within their PR19 plan compared to PR14, reflecting the shift in environmental awareness and concern across society as a whole. Yorkshire Water gained a 97% customer approval for environmental services within their PR19 business plan; having a seperate strand focussed on the environment was seen as a positive, giving this element a prominence and a greater level of importance.

Ofwat's methodology for the Price Review discusses that there may be a need to 'intervene in … plans to ensure that companies deliver the step change required by customers', yet these examples suggest almost the opposite, with schemes that could deliver protection or enhancement of the environment, and have strong customer support, being curtailed.

As a whole we feel that some of Ofwat's decisions risk undermining significant gains made by the water industry and the third sector in communicating to customers and society the true value of water, and the need to actively invest in its future if we are to create a truly sustainable water industry.