

Blueprint for Water coalition response to Ofwat's Forward Programme for 2014-15

1. Introduction

This is the Blueprint for Water coalition's written response to the draft forward programme for 2104-15 issued for consultation by Ofwat in January 2014. Representatives of the coalition provided initial verbal responses to the proposed programme at a meeting held with Ofwat on 27 January 2014.

We look forward to continuing to work constructively with Ofwat, other regulators and government, and with the regulated water companies, on all matters relating to the environmentally-sensitive delivery of water and wastewater services. We seek to bring informed, committed and pragmatic opinions to bear on the means to deliver long-term resilient and sustainable water and wastewater services. Together with protecting and nurturing the environmental assets that support water companies' businesses, and the well-being of people, society, the economy and the environment in general.

The Blueprint for Water coalition is a unique coalition of environmental, water efficiency, fishing and angling organisations which call on the Government and its agencies to set out the necessary steps to achieve "sustainable water" by 2015. The Blueprint for Water is a campaign of Wildlife and Countryside Link. More information is available at www.blueprintforwater.org.uk.

This response is supported by the following five organisations:

- Angling Trust
- Salmon & Trout Association
- Waterwise
- Wildfowl & Wetlands Trust
- WWF-UK

2. Overall comments on Ofwat's draft programme for 2014-15

We welcome the opportunity to comment on Ofwat's plans for the future, and to provide general support for outcome-based delivery of the long-term resilient services that customers want and the environment needs. We commend Ofwat's drive to place the long-term needs of customers, broadly-defined, at the heart of water services delivery, and welcome the assurance from Ofwat that the natural environment is included in that broad definition of 'the customer'.

We welcome the majority of the proposals set out in the draft programme. In other areas, we believe that the draft proposals could be amended in ways we suggest to good effect for the environment, and other customers. In most such cases, we consider the required amendments to be matters of emphasis that could be accommodated quite easily.

We set out our position on specific proposals, making suggestions for positive change as we consider could and should be made, in the following section.

3. Specific comments on Ofwat's draft programme for 2014-15

For ease of reference, we make comment upon particular extracts from the consultation document where we have comments of support, query or challenge, and note the page number of the extract in question.

Page1, point 1. We support the attention placed on putting the needs of customers at the heart of company business plans for 2015-20, knowing that Ofwat's view is that the environment is included in the definition of customers, in all regards. We would welcome some statement to that effect being made in the document, at an appropriate point, to ensure that the intended meaning is made known to all interested parties.

Page 6, bullet point 2. We support Ofwat's focus on outcome-focused and risk-based approaches to regulation.

Page 7, bullet point 5. We welcome the statement that Ofwat's strategy will drive regulated companies to 'reflect the needs of everyone who benefits from water and wastewater services, including current and future customers, and wider society.' The section we have underlined is particularly welcome, in its recognition of the need for services and outcomes to take account of the needs of tomorrow's customers, not just today's, and of the needs of society as a whole.

Page 7, bullet point 6. We are also pleased to see that Ofwat's strategy will 'address the relationship between water and wastewater services and the wider environment.' We consider the need to manage the well-being of the environment to be an integral and inseparable element of the provision of long-term resilient and sustainable water and wastewater services. The natural environment is the base asset in water and sewerage, and water only, companies' businesses. To deliver reliable water and wastewater services companies need to manage the environment for current and long-term health and resilience. It is from this standpoint that we consider the business of water companies to be the delivery of water, wastewater and environmental services (and not just the first two of the trilogy).

Page 8, Q1, item 2. We welcome attention being placed on company board leadership, transparency and governance issues. Highlighting best practice by some does tend to prompt action by others. Governance is, in our opinion, an area where improvements are overdue.

Page 9, Q4, item 6. We note the intention to establish a roadmap and approach for conducting licence review work, and support the need for best principles and practice in this regard to be established.

3.1. On the 2014 Price Review

Page 10, bullet point 1. As noted earlier, we are pleased to see Ofwat's focus on the need for companies to 'deliver what customers want in an efficient, sustainable and long-term way.' The efficiency imperative has of course been a long term staple for Ofwat's attention. The need for effective and sensitive management of the environmental resource from which companies take their water and return their wastewater emerged as a focus for Ofwat over the last price round. The introduction of a long-term focus in delivering services and managing assets, including the environment, chimes, of course, with the new resilience duty placed upon Ofwat in the Water Bill now in front of Parliament. We welcome this balanced focus, and stand ready to support its delivery in practice.

Page 11, item 3. We support the principle of Outcome Delivery Incentives (ODIs) and the menu of rewards and penalties that companies can choose to accept in relation to their delivery. We are pleased that such rewards would only be on offer to companies that deliver all of their baseline services to the required standard, and we trust that the delivery of environmental obligations and duties would be regarded as falling within those base services. We continue to have concerns, however, about the composition of the ODIs proposed by companies, in light of the low representation of environmental 'extras' in offered ODIs. We would like to see a requirement that at least 25% of all ODIs should focus on the delivery of (customer-supported) environmental gains.

Page 11, bullet point 2. We are pleased to see focus on the benefits expected to arise from 'protecting the needs of future customers by ensuring companies plan how they will deliver secure and sustainable supplies over the long term.' The push on companies to consider resilience and sustainability in their planning process is welcomed.

Page 11, bullet point 3. That said, the proposed encouragement to companies to produce high quality plans based on their legal obligations could, in our view, be significantly strengthened. We acknowledge that the proposal enables companies to develop plans above those legal minima, but

we would like to see more positive encouragement to companies from Ofwat to secure customer support for schemes that enhance the environment and the long term resilience and sustainability of supplies and discharges, above and beyond legal obligations. Pitching at the legal obligations level is too unambitious a target for companies whose future ability to meet the needs of customers, society and the environment depends on them taking a positive and protective attitude to environmental management.

Page 11, bullet point 4. The proposed challenge to companies to keep costs low and to deliver improved value to customers and the environment is welcome. That said, we note that improvements in water efficiency could, through reduced consumption, deliver lower bills to customers even with some rise in unit prices, and with resilience benefits to customers and the environment. Trade-offs are not the only solution to be pursued. Embedding efficiency into practice and behaviours can deliver win-win solutions. Innovating to provide enhanced value at low overall cost requires positive support, including high rewards for success and the absence of penalties for heroic failure. In situations where enhancements come at a higher cost, a net benefit outcome supported by customers deserves support and encouragement from the regulator.

Page 11, bullet point 5. We are delighted by the support given to 'protecting the environment by encouraging companies to use scarce resources carefully and consider more sustainable solutions for delivering services.' This cuts to the essence of modern regulation and resource management. It recognises that environmental needs are greatest where and when resources are scarce and the environment is under strain, and it promotes consideration (and re-consideration) of sustainable solutions for long-term gain on all fronts. This has our enthusiastic support.

Page 12, priority 4. We applaud the move to the new total expenditure (TOTEX) mechanism for defining regulatory asset values and returns on investment, which we hope will encourage companies to adopt operational expenditure (OPEX) solutions over capital expenditure (CAPEX) ones more enthusiastically than they have previously.

Page 12, priority 4. We also welcome the move to outcome-based regulation, in place of the input-based approach of previous years. Input-based approaches – like the base service water efficiency targets of yore – were blunt and ineffective ways of promoting better practice. We look forward to seeing better outcomes from the outcomes approach; and if not, to revision of the process.

Page 12, priority 5. We are not wholly convinced of the success to date of the asserted record of 'encouragement to companies to plan for the long term', and 'to make better, more sustainable use of water resources through targeted rewards and penalties.' The Abstraction Incentive Mechanism (AIM), for example, fell short of all expectations, and has survived in a pale and limp form only, for PR14. Ofwat needs to deliver upon such approaches, and to develop some real success stories.

Page 12, priority 6. The same criticism can be levelled at the claim that '[new regulatory] methodology has encouraged companies to consider innovative, long-term solutions for delivering services to their customers and the environment – including catchment management.' Beyond catchment management, there are few success stories to cite. And catchment management approaches might be 'upstream thinking', but they are not new thinking, and they have not been delivered in sufficient volume yet to substantiate a claimed record of distinguished success.

Page 12, priority 8. We fully support the need for companies to develop and launch water charging tariffs that meet the needs of vulnerable and needy customers. But social tariffs need to be coupled to tariffs that encourage and incentivise the efficient use of water by all, and to dis-incentivise high consumption for discretionary purposes. We have argued the need for companies to develop, test and launch suites of tariffs that deliver affordable bills for all essential water consumption, with sharply escalating tariffs being applied for discretionary consumption. We look to Ofwat to encourage companies to develop tariff baskets that meet the essential needs of all at affordable prices, and incentivise careful consumption by all.

3.2. *On Choice and Trading Arrangements*

Page 13, bullet point 3. We support the provisions in the Water Bill to place a primary duty on Ofwat to further the resilience of water, wastewater and environmental service provision. We argued previously for the need for a primary sustainability duty to be placed on Ofwat, to bring environmental considerations into parity with customer and financeability ones in situations where a balance between interests needs to be drawn. We are now content with the resilience duty, following amendment of the definition of resilience to include environmental resilience.

Page 13, bullet point 5. We acknowledge that the motive to produce 'a roadmap for introducing markets for wholesale water and wastewater services to increase the scope for entry and more efficient outcomes and innovation' is to enable such upstream competition as might develop, rather than to promote it. We accept the merits of doing so, albeit from a point of view that considers the scope for upstream competition from new entrants offering new sources of supply to be limited, at least currently. At present, most regulated companies have water supplies in plenty under normal conditions, so taking account of the limited need for new water in most years and the infrequency of co-incidence of need (from shortage) on the part of one party and of surplus in another (nearby) party, the scope for new entrants appear limited. The situation may change if the existing resource base (of individual companies, and in aggregate) was to be significantly reduced by climate change and/or by pollution or environmental protection obligations. But even then the pinch and need would be felt in drought spells rather than on an annually recurrent basis. Under such terms, we cannot see those with spare resources (which, critically, must be available in drought periods) being able to run a viable business in providing guaranteed supplies when they are likely to be required. This is regardless of whether the charge is levied only in years when supplies are made, or over a contract term to guaranteed levels of supply in drought spells. We see the introduction and trading of new supplies as being a distant, and slim, possibility. Enabling costs should be considered carefully, against the likely benefits.

Page 14, bullet point 2 of column 2. We support the drive to increase companies' accountability to customers, in principle. We do, however, have nagging doubts as to outcomes for the environment if and when customers' willingness to pay for environmental gain is low, particularly when the environmental regulator considers the need for investment to be strong (such as under abstraction licence reviews) but customer support is lacking. With compensation for lost resources to restore abstraction to sustainable levels being removed under the Water Bill, companies' abilities to substitute demand and/or supply side replacements under price limit funding will rely upon customer approval, unless the situation has a statutory driver. If that customer support is insufficient, the resultant stalemate will prejudice the needs of the environment (perhaps by the determination of need for abstraction licence reductions being disputed on cost-benefit and willingness to pay grounds). We accept that Customer Challenge Group (CCG) and customer survey support for soundly-based environmental protection schemes has thus far been good; but the risk remains, for the future. Customers and CCGs need to be provided with good environmental advice, to be able to make informed decisions on environmental needs vis-à-vis costs and service. We need to see companies 'doing the right thing' for the environment, and we need to see greater representation of environmental needs and expertise on CCGs, on Company Boards, and perhaps even on Ofwat Boards and Advisory Groups.

Page 14, bullet point 6 of column 2. We agree that liberalisation of wholesale water services could enable companies to use environmentally-benign 'new' water instead of continuing to take water from existing sources to a point where adverse environmental impacts could occur. Companies can, of course, choose to substitute between sources on environmental impact grounds already. However, so long as environmental externalities are in play (as they surely are now), there will be a cost incentive to companies to use cheaper licensed supplies that may nonetheless have adverse environmental impacts, rather than using environmentally-kinder options that are costlier to operate. The AIM could have provided – and could still provide, with appropriate reinvigoration – real incentives to companies to include environmental sensitivity alongside cost and stocks motives in

managing abstraction from their licensed sources. Having new water supplies to hand from a more liberated wholesale regime would increase the substitution options open to companies, and strengthen the argument for providing the right incentives to use the resource base wisely, to net best effect.

Page 15, priority 4. We would welcome any increased water efficiency by non-household customers, consequent on retail market liberalisation. The creation of Business Stream as a retail market supplier in Scotland does seem to have produced some efficiency benefits there, though to a limited extent, compared to the enhanced service standards that seem to have been most welcomed by non-household clients there. We would be pleased to see early and enthusiastic adoption of retail competition opportunities being taken up in England and Wales; but we suspect that first phase uptake will be conservative.

3.3. On Board Leadership, Transparency and Governance

Page 16, paragraph 1. We fully support the need for company Boards to consider their composition, modus operandi and agenda on public interest, environmental interest and customer interest matters. Company Main Boards and Sub Boards do appear to have thin representation of customer and environmental expertise. They would do well to expand the range of experience and expertise of their Board members.

Page 16, Priority 5. We also fully support the need for Boards to focus on the long-term sustainability of the sector, and of the assets upon which the services provided to customers depend. Condition deterioration can all too easily be masked by currently acceptable serviceability measures. Managing assets for the long term is a key area for improvement across the sector.

3.4. On Licence Review

Page 19, bullet point 1 in bottom section. We welcome any improvement in clarity to customers on 'the services they can expect from the companies that supply them.' Customer involvement in choosing the services they value, and the level of service they support and are prepared to pay for in areas such as drought management (particularly the level of service for temporary use bans) and environmental management (including upstream thinking and catchment management initiatives) is becoming increasingly important; it is vital that customers know what is on offer, and at what price, to help them to make informed decisions. As noted above, we are keen that customers can see the options in front of them clearly, and that they receive good advice on the benefits as well as the costs of all options, including those around water efficiency and environmental enhancement.

3.5. On the Thames Tideway

No comments.

3.6. On Casework

Page 25, priority 7. We are pleased to see that casework will be targeted on evaluation of the net benefits of the regulatory approach (incorporating the new elements proposed) and particularly on the resilience of the sector and sustainable water resources management. We support early and continuous examination of the costs and benefits arising from the retail and upstream water competition initiatives, to assess the extent to which the theoretical benefits expected are delivered in practice, and represent good value for money in light of the costs expended.

3.7. On Special Administration Arrangements

No comments.

3.8. On Ofwat's New Strategy

We look forward to early discussion on its direction and contents. As always, we would be pleased to be involved in helping to shape the strategy.

**Wildlife and Countryside Link
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