



the water forums

**Northumbrian Water and Essex & Suffolk Water
Water Forums' Draft Determination response**

29 August 2019

Water Forums' response to Ofwat's Draft Determination on NWL's Business Plan, 29 August 2019

Executive Summary

We have had the opportunity to read Ofwat's Draft Determination (DD) on Northumbrian Water Limited's (NWL) revised Business Plan for 2020-2025, which the company submitted to the regulator in April 2019. As the independent Customer Challenge Group, we have had a number of opportunities to discuss the DD in detail with the company.

Our role throughout the PR19 business planning process has remained to provide challenge to the company – to ensure that its customer engagement activities were appropriate, inclusive and well-constructed to represent NWL's diverse customer base; and to ensure that its plans reflect the findings of that engagement activity.

This document constitutes our response to Ofwat's DD for NWL. In overview:

- We believe that NWL's Business Plan for 2020-25 balanced the return to investors (in the form of reducing shareholder returns by making more investment where needed) and the return to customers (in the form of reduced bills) and we would like to see that the plans remains balanced at the Final Determination (FD).
- We welcome Ofwat's focus on reducing bills for customers. However, during NWL's research customers were clear – they wanted to see some of the cost savings reinvested in enhancement projects that will improve resilience, rather than in a bill reduction beyond that which they gave support for. We heard this many times at the engagement events we attended and are concerned that short-term bill reductions could lead to higher risk exposure, more unplanned costs and hence longer-term bill increases.
- Implementing the DD would deliver a plan that is different in some fundamental ways to the one that customers gave very strong support for (91%), and that they are expecting to be delivered – particularly in terms of resilience for the future.
- Our view is that the regulatory emphasis has moved too far towards bill reduction; and we therefore remain concerned about the 'in the round' impact that this will have. Some of the variances to the original business plan as a result of the DD would bring increased risk to NWL customers and the communities and environment they live in. The reallocation to base costs for the Flood Risk Reduction Enhancement with no corresponding uplift in funding gives us particular cause for concern.
- We welcome the fact that the balance between potential rewards and penalties has swung towards the latter in the DD, as this means that customers are less exposed to bill increases driven by a company's high performance.
- We reviewed the areas of the DD where NWL has decided to accept Ofwat's challenge, and are comfortable from a customer point of view with the approach taken.

We note that there are a number of documents that the company submitted to Ofwat after 1 April 2019, which we have had the opportunity to read and which provide additional evidence and rationale for some of their proposed plans. The regulator has not yet had chance to review and reflect upon this work, rather this will be done as part of the FD in December 2019.

The customer context

Climate change and the challenges it brings were high on the customer agenda during the research and engagement activity that the Water Industry undertook when preparing business plans. Furthermore, investment in assuring the resilience of national infrastructure is an increasingly important topic of conversation amongst, and demands for action by, the British public – recent, high-profile infrastructure failures, such as the dam at Whaley Bridge and National Grid’s power outage, have further put the spotlight on the need for continuous, proactive risk identification and investment in key assets. In short, NWL’s customers expect the company to build future resilience into its water and sewerage networks and demonstrated high levels of willingness to pay for this resilience through their bill.

Efficiency focus

When reviewing the DD, we note that Ofwat has sought efficiencies in three distinct ways. We describe each one below and provide commentary that builds on what we have covered in our previous PR19-related reports¹.

1. Unit cost reductions

Firstly, real efficiencies – where the costs of supplying water and sewerage services are demonstrably higher than elsewhere and therefore where opportunities should be taken to do things more cheaply. We are in favour of these, as they will give better value for money to customers.

The only specific comment we have in this area pertains to the WINEP – we continue to expect the full WINEP to be delivered, despite any efficiency requirements on the company.

2. Business as usual or enhancements?

Secondly, there are improvement proposals that the company included in its plans as ‘enhancements’ rather than part of its core, ‘business as usual’ expenditure. Ofwat has determined that some of these enhancements should be delivered within base costs rather than through additional investment.

This will be particularly challenging when trying to deliver an upper quartile performance irrespective of the starting point when compared to others in the industry – an example for NWL is the Interruptions to Supply measure.

NWL has accepted a number of these efficiency challenges, but has continued to push back to Ofwat on others. When reviewing the company’s responses, we urge Ofwat to consider the cumulative effects, in terms of increased risk to the customer, of all the changes to the original plan. Past industry experience has demonstrated that if a water company has to strive to deliver the impossible from a cost perspective, we can anticipate that there will be a financial ‘squeeze’ on generic maintenance activity. And although regulation penalises a water company for failures that may result from such a squeeze, customers want them to avoid failures in the first place because of the impact on their lives, homes and environment.

We have specific comments to make on three areas, as follows:

¹ <https://www.nwl.co.uk/your-home/water-forums.aspx>

Flood Risk Reduction enhancement scheme: Wastewater resilience is an area of significant importance to customers – they seek a higher level of performance, and NWL’s proposed £86m enhancements to proactively reduce flood risk received very strong customer support of 71%. Our view is that the proposed enhancements were focused on reducing long-term risk of sewer flooding, rather than driving the shorter-term Internal Sewer Flooding Incidents performance measure for 2020-25.

Our view remains that a suitably funded enhancement, which is not part of NWL’s base costs, is what customers want – it is an enhancement that responds to increasing flood risk levels that are expected as a result of emerging climate change trends and urban creep. We are aware that the company submitted additional climate data and evidence to Ofwat, in support of this scheme, but that this is yet to be reviewed as part of the Final Determination (FD).

Howdon Sewage Treatment Works (STW) resilience scheme: When this specific scheme was tested with customers it got 55% support (with 27% unsure) because they felt that NWL should prepare for the future in terms of improving resilience at Howdon in order to protect the river environment. With this level of customer support, we continue to support the company’s stance in challenging Ofwat’s draft determination. We note that most of those who were unsure or who did not support the scheme lived outside the area that would be impacted and would therefore not benefit from the investment. When all customers are consulted, it is not unusual for lower customer support for a specific, localised project/investment – this should be taken into account when evaluating a scheme and does not negate the need for the scheme itself. A good example is the Thames Tideway, which benefits only some customers but is paid for by all.

Drainage and Wastewater Management Plan: the DWMP is a new statutory requirement that each water company has to deliver – we note that whilst Thames Water has had its DWMP costs funded as enhancements, Ofwat has determined that NWL’s £9.2m funding to improve wastewater resilience be disallowed, stating that this important extra activity be delivered within base costs. The effect of this inconsistency would be to further increase risk to NWL’s customers.

3. Enhancements not deemed necessary

Thirdly, there are elements of NWL’s proposals that Ofwat has deemed unnecessary for inclusion. We do not understand the regulator’s rationale for excluding these, as the company did excellent customer engagement and got high levels of support for all elements.

Abberton to Hanningfield transfer main: This scheme offers more resilience benefits for customers of Essex & Suffolk Water (ESW), in terms of mitigating the effects of drought and of improving raw water connectivity. Along with the scheme at Layer, the Abberton to Hanningfield transfer main is integral to the long-term resilience and supply of water to the ESW region.

This is not an either/or situation; having discussed the two schemes and challenged the company about them, we accept that they meet different but complementary needs and are supportive of both – this reflects the 89% acceptance of the schemes that the company received during its customer engagement.

Suffolk resilience schemes: These very specific schemes were tested with customers and achieved 100% acceptance. Given the rigour of the approach, we continue to support the

company about the need for these enhancement schemes and note that they have provided more information to Ofwat since the Initial Assessment of Plans (IAP), which is still to be taken into account before the Final Determination.

In conclusion

At the outset of the PR19 price review process, Ofwat was very clear about the need for effective NWL customer engagement, and as the Water Forums we have maintained our customer-focused challenges throughout. Indeed, the Aide Memoire was clear that the water companies' business plans needed to reflect what their own customers said.

Our experience of NWL's engagement activity was that when their customers have the opportunity of understanding the issues, through a well-designed and thorough engagement process, they understand the issues and want to re-invest some of the efficiency savings in a more resilient network that will stand up to the challenges that climate change will bring as well as reducing the environmental impact of its operation.

When Ofwat makes its Final Determination, we therefore expect that the result is a plan that fully reflects what NWL's customers have said and delivers positive outcomes for them, their communities and their environment.