



# the water forums

## **NORTHUMBRIAN WATER AND ESSEX & SUFFOLK WATER WATER FORUMS' SUPPLEMENTARY REPORT**

To accompany NWL's business plan 2020-2025 resubmission

1 April 2019

# **Water Forums' Supplementary Report to accompany Northumbrian Water Limited's business plan resubmission, 1 April 2019**

## **1. Introduction**

This document is a Supplementary Report to accompany Northumbrian Water Limited's (NWL) resubmission of its business plan, in which the Company addresses Ofwat feedback from the Initial Assessment of the Business Plans (IABP) in January 2019.

We published our original Water Forums' Report to Ofwat on 3 September 2018, to accompany the NWL PR19 Business Plan submission. Our focus was upon customers – both the quality of engagement and the extent to which the business plan reflected the findings from that engagement. NWL largely embedded the findings. Indeed, its business plan clearly showed how the company had listened to customers and then reflected priorities to a significant extent. We believe this is reflected in the high score of 91% for customer satisfaction with the proposals.

During the two-month resubmission process, we have sought to maintain the position that the customer should be at the heart of the business plan and have provided challenge accordingly – our belief is that the customer should be central to everyone's thinking.

As such, there are elements of the IABP feedback in which we are disappointed that Ofwat does not appear to have taken customers' views fully into account in its assessment of the plan – we cover these in this report. We hope that Ofwat will give customers priority in the next stage of the PR19 process.

Our response in this Supplementary Report examines the 'in the round' effect on customers of the resubmitted business plan as well as the individual component actions that Ofwat gave to NWL. The purpose of this report is to provide commentary on both.

For ease of navigation, our report is structured around the customer-relevant IABP areas and references the NWL Action Tracker. In the instances where we have not included comment on an action in the tracker, it is simply because it was not necessary or appropriate, given the role of the Water Forums.

## **2. Our involvement in the Business Plan Resubmission**

The Water Forums were determined to give the best possible customer-centric advice and challenge to NWL in the compressed timetable between Ofwat's IABP announcement on 31 January 2019 and the resubmission of NWL's business plan on 1 April 2019. We therefore took a pragmatic, start-and-finish sub-group approach (i.e. using one, two or three of our members) to cover all the areas we needed to. We then all met together to discuss the issues before compiling this report. The table below shows our key activities:

Date	Activity	Water Forums' involvement
4-Feb-19	Supporting the Company on designing its deliberative engagement approach	Steve Grebby (CCWater)
Feb-19	Attending some of the deliberative events to get first-hand experience of the customer engagement	James Copeland (NFU), Graham Dale (CCWater), Richard Powell (Independent) Roger Martin (EA)
6-Feb-19	Update for the Water Forums, arising from the Company's Periodic Review Board Sub-Group meeting on 4-Feb-19, where the main items were totex, the positions it wanted to stand by, the positions it wanted to review again and the approach it was taking to resubmission.	Bernard Crump (CCWater), Melanie Laws (Vice-Chair)
7-Feb-19	Update from Company, discussion and Water Forums' challenge about the customer-related actions that the Company is taking in response to Ofwat's initial assessment, and an update on the outcome of the post-IABP customer engagement	10 members and author
15-Feb-19	Review and challenge of the Company's revised wastewater resilience proposals to prevent sewer flooding, via telephone conversation with Richard Warneford (Wastewater Director) and Richard Murray (Head of Wastewater Treatment & Bioresources).	Roger Martin, John Giles (EA), Steve Grebby (CCWater)
19-Mar-19	Water Forums' quarterly meeting with the Company, including the CEO and one of the Independent non-Executive Directors. Focused on getting under the skin of the Company's business plan resubmission and developing this report.	13 members and author
22-Mar-19	Telephone call where NWL's CEO updated our Vice-Chair about the decisions taken at the Board Sub-Group the previous day.	Melanie Laws (Vice-Chair)
22-Mar-19	A paper summarising the decisions taken by the Board Sub-Group was prepared and shared with all members, giving us the opportunity to ask questions to understand the Company's plans, including any changes to the details shared with us on 19 March	All members
29-Mar-19	The Company shared the key messages from the Board meeting on the same date, confirming the decisions taken at the Sub-Group. This enabled us to finalise our report.	All members

The Company willingly shared its thinking with members of the Water Forum as it was developing its response and kept us abreast of changes as they happened. The Company's due governance process meant that the resubmitted business plan required Board sign-off on decisions. This was done in two stages: at the Board Sub-Group on 21 March and then at the full Board on 28 March. Our last full Water

Forums' meeting was on 19 March, which posed a challenge to finding a way to ensure all members could understand, consider and comment on the Board's decisions prior to the submission of this report.

The Company fully recognised the need to find a solution to this and provided the resources to share updates, both verbally and in writing. Our Vice-Chair had a telephone call with the CEO to understand the detail of the Board decisions following the meetings on both 22 March and 29 March. After the former had taken place, NWL wrote a summary paper about decisions made – this was shared with our members and specific items debated by those with expertise in the associated areas.

During the telephone call on 29 March, it was confirmed that the Board decisions taken were in line with what had been indicated the previous week. This enabled our Vice-Chair to send a confirmation email that there had been 'no change'.

We believe that we have been able to take a well-informed view of the resubmission but note that we may submit further comments to Ofwat after this report is submitted on 1 April 2019, if there are issues which we think require specific comment.

### **3. Customer involvement in the Business Plan Resubmission**

Customer engagement was a real strength of the originally submitted business plan, with no actions required or advised by Ofwat to address shortcomings or gaps. Having a blend of quantitative and deliberative opportunities for customers to get involved was both appropriate and valuable.

We are pleased that the Company continued its commitment to customer engagement, despite the challenging timescales of the resubmission. A total of 167 customers took part in six deliberative events across the two geographical areas. Of course, these numbers cannot provide statistical validity, but they do give a clear direction that the Company was then able to support by using the rich sources of research previously done and included in the original submission. We support this pragmatic approach.

We have taken the time to review and assure the elements of research that the Company is relying on in its own response, which are:

- Enhanced multiplier rates for penalties and rewards
- Discoloured water definition and whether issues relating to water entering the home should be considered separately to those issues caused by in-home plumbing fixtures and fittings
- The relative inconvenience of short water supply interruptions (1-3 hours) compared to those greater than 3 hours
- External sewer flooding and whether a reward should be available if the Company exceeds its performance commitment (PC)
- Void properties and whether the Company should introduce a 50:50 sharing mechanism with customers
- Future (2025 to 2030) bill profiles

Whilst we were able to assure the quality of engagement, the impact of any risk to customers as a result of changes to the business plan is a harder aspect for us to ascertain in the timescales. We would have welcomed the opportunity for the Customer Challenge Groups to have additional time to reflect on this matter after the Company resubmission date of 1 April 2019; but as this was not made available by Ofwat, we find ourselves limited in how we can provide this aspect of assurance and add the value that Ofwat asks of us. We will return to this issue following publication of the Draft Determination.

## 4. Addressing affordability and vulnerability

The issues of affordability and vulnerability were high on the Water Forums' agenda during the preparation of the PR19 business plan, remained so as the Company refined its plans for the resubmission, and will continue to do so as the Company implements its plans from 2020 to 2025. The comments below relate to NWL's affordability and vulnerability actions required by Ofwat.

NWL was required to undertake customer engagement on long-term bill profiles for 2025-30 and provide sufficient evidence to demonstrate customer support for profiles tested. Ofwat requires us to confirm that we assured the testing. (action tracker ref: [NES.AV.A1](#))

Given the tight timescales involved, we are pleased that NWL decided to get face-to-face with its customers using deliberative events, rather than relying on online or electronic means. This gave them the opportunity to get a deeper understanding of customers' views.

Prior to testing profiles and other areas with customers, Water Forums member Steve Grebby, from the Consumer Council for Water (CCWater), worked with NWL as it developed its engagement strategy and approach. We are satisfied that Company incorporated his feedback into its approach.

Several Water Forums members then attended the deliberative research events. We would like to comment positively about the way that the Company used the experience of the first event to adapt subsequent ones, making it easier for customers to access the subject matter and understand the approach.

The Company tested two bill profiles with customers – a one-off increase followed by a flat bill and an increase spread between 2025-2030. The majority of customers preferred the second option.

In terms of the bill profiles themselves, we are pleased that NWL is one of the few water companies whose bills will actually be lower in both nominal and real terms throughout AMP7, on current forecasts of CPIH.

The Company was required to undertake further social tariff testing with customers to provide sufficient evidence to confirm that the proposed cross-subsidy of £2.92 is acceptable to customers. (ref: [NES.AV.A2](#))

We commend the Company on its commitment to continuous customer engagement, rather than just doing so for Periodic Review. Social tariff testing is a great example of this, as they undertook it prior to Ofwat's Initial Assessment because it had identified a potential new social tariff scheme – for low-income pensioners – and wanted to test customers' willingness to contribute to such a scheme.

Members of the Water Forums worked with the Company to develop the research material and interpret the findings. The Company also involved the senior social policy advisor at CCWater.

We are pleased with the outcome of the research and satisfied that customers support the level of contribution of £2.85 in total towards NWLs social tariff structure/offering. We also note in the Company's Business Plan resubmission that it would look to flex other elements of its plan if it needs to close the gap between this and the originally proposed cross-subsidy of £2.92, including by increasing numbers of customers supported by the company-funded scheme.

Ofwat has proposed introducing a Common Performance Commitment on the Priority Services Register (PSR) and has stipulated its reach and frequency of data checking. (ref: [NES.AV.A3](#))

We support the Company's proposal to have a more challenging PC level of customers registered for priority services than the minimum level indicated by Ofwat: it has proposed 7.6% by 2020/21 rising to

10% by 2024/25. This will deliver a better outcome for more customers.

We would like to note that we share NWL's concerns about Ofwat's proposed approach to data checking and agree that there is a need to find a customer-centric, pragmatic and cost-effective way to check data. There are customers whose enduring needs mean that they should always be on the PSR, and regular contacts from the Company to check this is still the case would be at best inconvenient, and at worst could worsen their vulnerability. Our CCWater members would like to note that they are supportive of Ofwat's PSR approach apart from this specific problem.

NWL is proposing to focus its activity on checking the details of those customers with transient vulnerability, combined with contacting a small sample of long-term vulnerable customers to verify that they are receiving the right level of service. We support this approach and have challenged the Company to carefully consider how it defines transient and non-transient circumstances, and how this information will be recorded, so that customers get the help they need when they need it.

We have offered to work alongside NWL to refine its approach over time, including CCWater undertaking some work on which categories of customer to include.

Ofwat challenged NWL to propose a PC for achieving and maintaining the BSI standard for Inclusive Services (BS18477) (ref: [NES.AV.A4](#))

The Company's commitment to achieving BS 18477 is a good opportunity to build on the positive steps that NWL has made to-date, such as raising all staff's awareness of the services that the Company can offer those customers who need extra support.

## 5. Delivering outcomes for customers

With regards to the changes made to PCs and Outcome Delivery Incentives (ODIs), we note and welcome the fact that, overall, the changes will mean that NWL's business plan will be more favourable for customers. There are, however, nuances within this overall picture and we cover these below.

Ofwat required NWL to undertake 74 actions to ensure its PCs, ODIs and ODI risk/return package will deliver outcomes for customers (ref: [NES.OC.A1-74](#)). We have commented on those that are relevant for us to do so.

### **Adopting upper quartile targets for interruptions and internal flooding**

We support the move to national benchmarks for both interruptions to water supply and internal sewer flooding, as this will drive even better outcomes for customers in these areas. We are encouraged that the Company will respond positively to Ofwat's challenge by adopting PCs which reflect Ofwat's analysis of upper quartile performance.

### **Adopting upper quartile target for pollution**

As described in our original report (challenge #75), we challenged the Company to perform better than it had originally proposed on avoiding pollution incidents. Our challenge was based on customer research, which showed that customers value the environment and want the Company to reduce pollution. NWL responded very positively to this challenge and tightened its targets, which we were very pleased with.

Having successfully championed customers and the environment in this way, we are disappointed that Ofwat is asking NWL to be less stretching in its targets than those proposed in the original PR19 business plan – the Regulator has appeared not to take into account the strength of customer feeling

about the importance of this issue. This is on the basis that the PC originally proposed by the Company was for better performance than the upper quartile threshold calculated by Ofwat. As this will deliver less favourable outcomes and more risk for NWL’s customers, we have urged the Company to retain their original target.

Where the Company accepts the need to deliver improved performance, or indeed needs to proceed with an investment, which is judged to need to be funded from base allocations, there may be a risk that this will result in pressure on maintenance spend. Given that, to date, the Water Forums is largely unsighted on this aspect of modelled expenditure as it has not been one of our areas of focus, we feel some additional scrutiny from us would be useful. We have therefore requested that once a year the Water Forums review maintenance figures with NWL – the Company is supportive and has agreed for us to do so as part of our Annual Performance Review scrutiny.

**PC: Discoloured Water**

Ofwat asked NWL to consider a broader measure of water appearance than the ‘Discoloured Water’ PC it proposed in its original business plan submission, which was a continuation of its AMP6 measure of brown/ orange/ black discolourations.

Customer feedback in post-IABP engagement revealed that 64% think NWL should keep its current measure.

We note that about 10% of calls about discoloured water are linked to issues with customers’ own plumbing; and that the broader measure could create perverse effects of a water company being less likely than it is today to advise customers with plumbing problems because there is a disincentive for it to do so. That said, NWL has a strong, proven track record of supportive customer service (in NWL’s post-IABP engagement, 99% of customers thought it was good the NW offers free advice on internal plumbing issues to customers) and we therefore have every reason to trust that it would continue to do so with this new measure – we therefore support its adoption and do not believe it will have an adverse effect on customers of NWL.

Ofwat has also asked NWL to review the service levels in this area to take into account population growth and ensure that they are stretching. For 2020-25, the Company now proposes to tighten its current PC levels from 987 contacts in 2019/20, to 957 contacts across 2020-2025. The Water Forums understand that this will keep the Company close to the frontier and better than the forecast industry upper quartile in 2024/25; we are supportive of this approach.

**PC: Sewer collapses**

The Water Forums note that in its resubmission NWL recorded 11.95 collapses per 1,000km of sewer 2018/19 (its baseline) and targets 6.32 by 2024/25. This compares with a baseline 2017/18 figure of 17.63 in the original plan with a target of 10.44. We understand this change is due to “improved data recording/reporting, site survey work and understanding of the revised definition” rather than a decision to improve the target following Ofwat’s challenge – the percentage improvement on the baseline is the same in the resubmitted plans. We are also surprised that the data has changed to this degree since the plan was submitted.

We note that the Company states that despite “*some uncertainty over where industry upper quartile lies...we believe that this level of improvement in our data, along with the proposed PC levels for AMP7, will raise our chances of being well placed*”. Our members are aware that original PR19 business plan submissions by other water companies indicate a frontier performance level of around 3.8, which is significantly better than NWL’s proposed 2024/25 target. The Company has committed to achieving and maintaining upper quartile performance in the longer-term, so once the upper quartile figure is clear, we will be challenging NWL about how it is going to achieve this.

**PC: External Flooding**

Customers often put more importance on internal over external sewer flooding until they understand the reality and the impact it has on both the individual householder and the wider community. The number of customers who are directly impacted by external flooding in the NWL area remains higher than the industry average.

NWL's proposed percentage reduction is significant and is above what some other companies proposed in their original PR19 plans. The Company's performance would, however, be about average by the end of the price control period and not upper quartile. We would therefore still like to see the company assess the impact of external flooding on transport networks and places of restricted access, e.g. schools and public spaces.

We also note that NWL is focused on delivering its bespoke PC, which it considers is very stretching.

We would certainly want to monitor progress in the area of external flooding to ensure that the company takes prompt and effective action to drive improvement.

**PC: Compliance Risk Index (CRI)**

The Water Forums accept that the Company will respond positively to Ofwat's proposal on the CRI. In so doing we note that, on the basis of the experience of the use of this measure to date, the measure may show considerable volatility, with consequences for ODIs.

We understand that the CRI has many benefits over the previous measure for drinking water quality, but it is not a measure that customers will understand in its current form. We therefore continue to urge that DWI take steps to create a narrative that will aid customers' understanding; and would also like to see NWL lead the industry to translate this into a meaningful measure for customers.

**PC: Treatment discharge compliance**

We support the Ofwat move to a 100% target for this PC, which aligns with our original challenge to the Company on this measure (see challenge #74 in our original report)

**Justification of rewards for Voids**

The Company should be commended for engaging with customers on this complex issue. We note that this resulted in 83% of customers who expressed a view (8% stated that they did not know) being in support the idea of a 50:50 sharing mechanism, to share the net consequences of bringing voids into payment between the Company and customers. In practice this would mean 50% of the net financial benefit of reducing voids resulting in an ODI reward to the Company with the balance being used to reduce bills. Having scrutinised the estimated cost of securing the target reduction in voids (£320,000 over 5 years for a 0.54% reduction), we are reassured that this seems fair from a customer perspective; an issue which we were asked to pursue by customers at the deliberative events.

We also discussed the matter of 'gaps' with the Company, i.e. "voids for business customers) to understand plans to reduce them, and we will discuss this further at subsequent meetings.

**Justification of rewards for interruptions of 1-3 hours**

The Water Forums strongly supported the introduction, by a company with very strong performance on the Common PC used to monitor interruptions to supply, of an additional measure to incentivise the avoidance of shorter interruptions. Members know from customer engagement activity that customers are often confused and can be angry when they understand that the published measures only relate to interruptions lasting longer than three hours. There is clear evidence across the sector of managing to the "cliff edge" of the artificial cut-off point of three hours.

The Water Forums recognised that shorter interruptions are less disruptive than longer ones.



Ofwat has questioned the justification for the ratio between the ODI rewards for this new measure, when compared to those for the common interruptions to supply PC.

NWL included this element in its deliberative engagement events in February 2019, and asked customers to trade-off several shorter interruptions as opposed to a single longer interruption. They used the results of this exercise to justify the levels of ODI proposed.

We support this approach, and strongly support NWL's inclusion of this PC.

**Request for penalty for Unplanned Outage measure**

The Company is applying a penalty to this measure, as requested by Ofwat. There is no customer research for us to draw on to be able to comment on this matter.

**Aligning penalty and reward incentive rates with industry range**

The Water Forums broadly support alignment of penalty and reward rates across the industry. We note our support for the Company's proposals to align with Ofwat's proposal. We advocated for this approach as the PR19 methodology was being designed and would have preferred to see it adopted from the outset, rather than only at this stage. We support an approach in which benchmarks for incentive rates are published much earlier in the process, with scope for an element of modification to reflect 'local' customer needs and feedback.

It has been estimated that the net result of the adoption by NWL of the newly emerged standard rates is to decrease reward potential by £8m and to increase penalty exposure by £7m; a shift in risk in favour of the customer that we applaud the Company for accepting.

**Multipliers for enhanced rewards**

In our original report we said that we had challenged the NWL proposal to seek enhanced ODIs which would be 5x the 'plain' rate of ODIs for those areas of performance where these would apply. Notwithstanding this challenge, the Company proposed this level of enhancement in their submission (Challenge #87). We did not accept the arguments adduced to justify these very elevated levels of enhanced ODIs, which derived largely from an argument that this would incentivise companies with frontier levels of performance to go further, and thus to elevate the performance of other parts of the industry. Whilst this may be desirable, we were concerned that NWL's customers would pay for this to come about, whilst it would be other companies' customers who would benefit. The scale of the proposed enhancement arose from economic modelling that the Water Forums did not find to be convincing.

The Company has conducted further engagement with customers through deliberative events on these complicated questions. We observed these events, and agree that, with a full explanation, customers could understand the concept of enhanced ODIs. Whilst these were not events that were quantitative in nature, the results suggest informed support from customers for enhanced rewards at a multiplier of 2.78x and enhanced penalties at 5.36x. After further explanation as to the scale of bill impact those respondents that expressed a view were in support of the Company's proposed use of a 5x multiplier.

The Water Forums has also read Ofwat's Technical Appendix 1 to the IABP report in it is suggested that a cap on the multiplier to enhanced rewards should be set at 2x. On balance we commend this approach, which is consistent with our original representations to the Company.

**Caps and Collars**

NWL's original business plan submission had proposed limited use of caps and collars. The Water Forums were mindful of the results of customer engagement in which customers are concerned about the potential volatility of bills. We were also aware that some aspects of Company performance can be affected by external influences that can themselves be volatile. We suggested to the Company a number of areas of performance where the effects could be mitigated by judicious use of caps, collars and uncertainty mechanisms, for example the use of

moving averages.

However, the Company interpreted the extant guidance on PR19 as signalling that these mechanisms should be used sparingly, if at all, and this was reflected in their Business Plan submission.

The Company has now proposed in its resubmission an approach that is informed by Technical Appendix 1 to the IABP publications. It has set caps and collars in line with P10 and P90 modelled performance levels for those areas of performance where the potential scale of rewards and penalties are material.

In addition, in the unlikely circumstance of aggregate ODI rewards exceeding 2.04% of the Return on Regulatory Equity, they have proposed that allowed rewards above that level be subject to a 50:50 sharing mechanism with customers, operationalised by the Company limiting any claim of such rewards to 50% of their value. The value of 2.04% emerged from customer engagement during the development of the initial plan, as the lowest of a series of thresholds of acceptability for customers of this type of system of rewards.

As the new proposals will offer further protection for customers from the effects of volatility, whilst still incentivising the Company to strive for improved performance, the Water Forums support these changes.

## 6. Securing cost efficiency

In its Initial Assessment of NWL's Plan, Ofwat questioned the efficiency of the submitted proposals. On base costs, Ofwat regards the Company proposals as being approximately 5% more costly than its modelling would suggest is appropriate. Turning to enhancement proposals, Ofwat's initial assessment is that the costs are 38% higher than modelled costs. In part this is because some proposed enhancements have been judged, at this stage, to be unjustifiable. In other cases, Ofwat argue that the benefits of enhanced activity should be delivered through base expenditure.

The Water Forums acknowledge that it is for Ofwat to reach conclusions about these issues, following consideration of additional evidence, corrected data, and representations made by the Company in its resubmission. We have, however, scrutinised the approach that the Company is proposing to take to respond to these concerns. We have sought to understand the major reasons for the discrepancy. We have revisited relevant evidence from customer engagement conducted prior to the submission of the original plan. We have offered constructive challenge to the Company as it formulates its response. And we have sought to better understand the impact and profile of risk to the services received by customers, now and into the future, from any proposed changes to the originally submitted programme of enhancements.

In engaging in these considerations, the Water Forums have recognised that Ofwat will need to balance a number of factors. Improved efficiency is an imperative and is in customers' interests. Assessing that efficiency, in a way which accounts for the specific local challenges to delivering resilient services to customers, in different geographical settings, requires judgment as well as analysis. These judgments will include the need for immediate decisions to be placed in the context of the longer term and will be seen to signal strategic directions; for example, in the contribution of natural capital to challenging problems, rather than bricks and mortar solutions.

We were also very aware of the bigger picture; the plan which encompassed the enhancements that Company was seeking to resource, was one which entailed a very significant and enduring reduction in customer bills, and which had commanded strong customer support in a programme of unprecedented customer engagement. The factors driving these bill reductions lead to an opportunity to invest in securing resilient services; in the context of NWL this

particularly relates to customer protection from the risk of flooding, as water resource resilience is less of a challenge than for many other water companies.

None of this is to deny the great importance, from a customer perspective, of ensuring that any enhancements are needed, are made efficiently, and that customers do not “pay twice” if outcomes can be justifiably regarded as to be delivered from base income.

In the following section we comment on specific aspects of the revised approach taken by the Company, informed by the context that we have outlined above.

<p>Ofwat required NWL to address areas of cost inefficiency or lack of evidence for investment (enhancement) programmes, with an expectation that investment proposals would be withdrawn if the need was not compelling or if there was no need for a cost adjustment claim beyond the baseline costs. (ref: <a href="#">NES.CE.A1</a>).</p>
<p><b>Enhancement Opex</b></p>
<p>We note that in its IABP response, Ofwat has moved enhancement Opex to base costs – we are concerned that doing this will have a negative effect on large catchment/partnership schemes, which would deliver environmental, social and other benefits, and have been shown to be cost effective and sustainable. We are concerned that Ofwat’s stance appears to be counter-intuitive when reviewing it next to Government policy, as outlined in Michael Gove’s letter about the Defra 25-year plan; as well as appearing to be inconsistent with the greater emphasis on a Totex approach that has been advocated since PR14. We are concerned that the comparative simplicity of attribution, costing and customer protection of capital-led solutions should not outweigh the considerable benefits of Opex-led alternatives.</p> <p>Specifically, the Environment Agency’s (EA) position on the movement of Opex into base is that it should not compromise or influence the uptake of catchment solutions or other environmental enhancements as set out in WISER. It is not the role of the EA to comment on how Ofwat allocates funding across its cost models, as it does not have the expertise for this. However, the EA will work with NWL if it holds evidence that could help provide additional justification for investment.</p>
<p><b>Wastewater resilience – flood risk</b></p>
<p>Wastewater resilience is an area of significant importance to customers and, therefore, to us as the Water Forums. The Company’s proposed £86m enhancements to proactively reduce flood risk will see them leading the industry by innovating in this area, and we were really pleased to see that the schemes received very strong customer support of 71% in the business plan originally submitted.</p> <p>In response to Ofwat’s challenge, the Company initially considered a move away from this ambition, at least for this business plan resubmission, as it feels time is too short to gather further evidence. We challenged this move, as we believe it is too important not to do this work, and not making an investment now could increase the cost of resilience in the future.</p> <p>We are therefore pleased that the Company has decided to resubmit a revised business case to Ofwat for this area of performance which is based on gathering further climate data and evidence. We understand this business case will be resubmitted on 1 June 2019 as it will take time to re-evidence this business case properly. The Water Forums are fully supportive of NWL plans for proactive flood risk work, as flooding is such an important issue for customers.</p> <p>We believe that Ofwat recognises this issue, given that part of its previously stated strategy was to prevent future flooding by identifying properties at risk – their challenge does not fit with the direction of travel arising from the IABP, and we encourage them to review the methodology used. Our view is that the proposed enhancements were focused on reducing long-term risk of sewer flooding, rather than driving the shorter-term performance measure for 2020-25.</p>

In support of NWL's revised business case we would like to understand (from customers) whether the focus should be on reducing bills but maintaining the likelihood of a detriment and then getting compensated; or reducing the risk of a detriment in the first place. Whilst research has not been done into this specific question, there is a lot of evidence that customers do not like sewer flooding and think NWL should work to reduce it.

It is our intention to keep this important issue of risk to customers on the agenda.

The Environment Agency work in partnership with NWL on flood risk work and NWL play a full role in the Northumbria Integrated Drainage Partnership (NIDP), Strategic Flood Partnerships, NRFCC and the Catchment Partnerships. The NIDP is a joint EA-NWL partnership including the 12 Local Authorities across the North East. Its purpose is to identify and progress future flood schemes that manage multiple sources of flood risk and require integrated working. This partnership is viewed as nationally leading practice and it won the national Flood and Coast "partnership" award in 2018. Both the EA and CCWater, which has also supported the scheme since its inception, want to see this work continue. Indeed, the Water Forums asked NWL to share their learning with other companies and we were pleased that they responded to this challenge as part of their contribution to the 21st Century Drainage Board.

#### **Smart wastewater networks**

We are disappointed this enhancement removed (£25m to £0m) by Ofwat, as it received 80% customer support in the research done in May 2018. However, we note that the Company is proposing to take a different approach to this important area and we support it being part of the new network resilience package.

NWL has been proactive in trying to inform the Drainage and Wastewater Management Plan (DWMP) process, and we believe this alternative plan will be a positive step in supporting that.

The Water Forums are very supportive of Smart networks as these provide better understanding of the sewer network and how it can be better managed to reduce both sewer flooding and pollution incidents.

#### **The effect on customers**

Having presented Ofwat's cost assessment challenges to us, on both base costs and enhancements, we challenged the Company to help us understand the overall impact on customers and bills. The Company has modelled the likely bill impact if Ofwat accepted the changes the Company are proposing in their resubmission. At a constant price base (17-18 prices) customers in the Northern area served would see combined bills falling by £62 or 15.7 % by the end of the AMP; a further £10 annual reduction over the estimates from the original business plan. Essex and Suffolk Water (ESW) customers would see the water component of their bill fall by £34 (13.7%); a further £4 annual reduction over the original plan. These estimates assume a neutral impact of ODIs, for modelling purposes.

Customers will welcome reductions of this scale. From customer engagement, the Water Forums believes that this reduction in bills creates an exceptional opportunity to place in context the proposals from the Company to invest in resilient services, and customers supported this approach in the original PR19 business plan research. Water Forums' members are well aware that many customers struggle to pay, and we see bill reductions of this magnitude as a very significant contribution towards NWL's stated ambition to eradicate water poverty.

Ofwat required NWL to investigate the impact on its business plan of a metaldehyde ban and to propose a PC and ODI if it felt they were required due to any significant changes or uncertainty, to protect customers should expenditure not be required. (ref: [NES.CE.A3](#)).

NWL has amended its business plan by removing the funding included to pay for metaldehyde substitution products, as these will no longer be needed after the metaldehyde ban comes into force in spring 2020.

We support the Company's £2.97m investment in catchment management work in AMP7 to

protect drinking water from agriculture, including metaldehyde monitoring and targeted advice where elevated concentrations are found in rivers from which they abstract.

## 7. Targeted controls, markets & innovation

Ofwat required NWL to explain the steps that ESW are taking to engage with other companies in the south east around the development of strategic water resource options. It is intervening to disallow the water trading export incentive claim, where the net effect of the trade is to implement a reduction in the amount of water that could be imported from Thames Water rather than a net increase in exports. (ref: NES.CMI.A3).

Members of our environment sub-group considered this subject in the context of the 25-year predictions of water resource requirements in Essex, post the Abberton Reservoir engineering works. We would encourage, and be willing to participate in, further discussions about how to create a more resilient solution than ESW importing water from Thames. Although it may suffice for the next Price Control period, longer-term population growth in Thames' area means it will need its water to serve its own customers. We suggest that ESW needs to assess how much water it could export to, rather than import from, Thames Water – this via the proposed Ely Ouse transfer scheme, which will become essential in the next 20 years.

We encourage NWL to take a leading role in focusing on water resilience in this context, as some long-term planning to address the challenges of the future is clearly required. We would want to come back subject to this in our Water Forums' discussions with the Company.

Ofwat included a number of advised actions for the company (ref: NES.CMI.B1)] that cover subject areas that we as the Water Forums have regularly engaged with NWL during the entire course of the PR19 process, through both our sub-groups and main Water Forums' discussions, namely: bioresources, collaborating with other water companies and partnerships for sustainable drainage solutions.

We have therefore taken the opportunity to understand their response to these actions, and whether the response will have a beneficial impact on customers.

The company has provided the Water Forums with a wealth of evidence indicating that they are leading the way in many of the areas covered by Ofwat's Advised Actions. We support the company's proposals to develop long-term contracts and further trading opportunities as the market for bio resources evolves; to build on their current collaborations within and beyond the water sector – such as its Water Resource Groups, and the annual Innovation Festival; and to build on existing strong partnerships and work on establishing new ones. As covered earlier in this report, we fully support the leading role that NWL plays in the Northumbria Integrated Drainage Partnership (NIDP). This partnership is viewed as leading practice and it won the national Flood and Coast partnership award in 2018.

## 8. Securing confidence and assurance

The 'Our Finances Explained' customer engagement work that the Company undertook in 2017 demonstrates to us how transparent NWL is with its customers on financial matters, and how much importance it places on the principles of transparency, fairness and trust.

For the resubmission of NWL's business plan, we wanted to understand the Company's assurance process. The Company outlined that having undertaken a review of its assurance, key elements for the business plan resubmission were:

- To ensure some senior members of team read everything to ensure consistency across the plan; and some subject owners scrutinised all elements of their subject (e.g. wastewater) to avoid gaps and assure consistency
- To use external advisers to scrutinise the plans, as done for the original submission
- To review the confidence grades of its data and improve any that may have had a lower than desired confidence level.

**Gearing benefits:** In its original business plan submission, the Company forecasted gearing close to 70% over 2020-25 but did not commit to applying a sharing mechanism if gearing exceeds 70%. Ofwat therefore required that NWL should incorporate Ofwat's default sharing mechanism from 'Putting the sector in balance' position statement into its business plan, so that customers will receive bill reductions if gearing in any year is above the 70% threshold. (ref: [NES.CA.A3](#)). Our observations are included below.

Following the amended guidance during 2018, in which the threshold for a sharing mechanism for the benefits of high gearing was moved to 70%, we considered this issue during the preparation of the Company's initial business plan submission. The Water Forums accepted assurances that, on the basis of modelling, the Company gearing would not breach this threshold.

We are not clear as to whether modelling conducted by Ofwat has led to the conclusion that this threshold might be breached, or that all companies should propose a sharing mechanism should it be breached, irrespective of the likelihood of this happening.

Either way, we note two important facts in this matter:

- that the Company is not proposing to use altered Regulatory Capital Value run-off rates or PAYG to deliver favourable financeability ratios in the submitted plan
- the plan originally submitted contained significant projected bill reductions for customers, which were large enough that bills would be likely to be lower at the end of the AMP than in 2019/20, even after the effects of inflation

Nonetheless, the Company is accepting the gearing sharing mechanism proposed by Ofwat and we support this.