
Senedd Climate Change, Environment and Infrastructure Committee: water quality and sewage discharges

We welcome the opportunity to provide evidence to the Senedd Climate Change, Environment and Infrastructure Committee.

We have a strong focus on ensuring companies are delivering environmentally sustainable water and wastewater services which are in the long-term interests of customers, as set out in [our strategy](#).

In this response: we briefly set out who we are, how our regulatory framework facilitates environmental improvement, and how we support better water quality and a reduction of harm from storm overflow discharges in Wales.

Who we are and our ambitions for the sector in Wales

Ofwat is a non-ministerial government department. We regulate water and wastewater companies in Wales and England. In Wales our regulation principally applies to Dŵr Cymru Welsh Water and Hafren Dyfrdwy. Our work ensures that monopoly water companies deliver high quality, affordable, resilient, and environmentally sustainable services to their customers. Through setting clear and stretching objectives, we incentivise companies to provide the very best service for customers, protect and enhance the environment, and make the investments needed for the future. We have the power to take enforcement action, including imposing financial penalties, where companies fail to meet their obligations. We use all our regulatory tools to align the interests of customers, management, and owners, and to encourage companies to build strong relationships with their customers and other stakeholders. To summarise, our regulation, as set out in our strategy '[Time to act together](#)' aims to:

- transform companies' performance;
- drive companies to meet long-term challenges through increased collaboration and partnerships; and
- encourage water companies to provide greater public value, delivering more for customers, the society and the environment.

Welsh Government expects Ofwat to develop and implement a regulatory framework that is applicable to Wales, relevant in a Welsh context and that accounts for the specific circumstances of Wales. Our ability and commitment to operating effectively in this context is reflected by the steps we've taken over recent years to strengthen our presence in Wales, including our recent establishment of a Director Wales role to lead the regulatory process in Wales.

In line with our functions and duties we act in accordance with strategic priorities statements issued by both Welsh and UK Governments. We also take account, where appropriate, of current and future differences in both policy and law between the Welsh and UK governments including where new obligations on water companies in Wales emerge. For example, we regulate for a different approach to competition in Wales than in England.

Our approach in Wales aligns with the Wellbeing of Future Generations Act. Collaboration has been a key component of how we've worked with partners in the context of storm overflows and drives the way we work alongside our partner agencies Natural Resources Wales (NRW), the Consumer Council for Water (CCW) and the Drinking Water Inspectorate (DWI) to secure the best outcomes for customers and the environment. We lead a collaborative approach to price reviews that is distinct to Wales and that brings together water companies, partner regulators and the Welsh Government. We place planning for the long term, focusing on outcomes and responding to the climate and nature emergencies at the heart of everything that we do.

How we work towards achieving our goals, including on the environment

Currently, less than half of the rivers in Wales meet good ecological status. While recognising that the water sector is not the only contributor to water quality, we do believe that the sector, including Dŵr Cymru Welsh Water and Hafren Dyfrdwy, can do more to help achieve the goal of clean rivers in Wales.

While a cross-sector approach is needed, our regulatory framework is designed to provide a robust foundation for the water sector to deliver required improvements. Our framework is designed to ensure that companies are investing customers' money efficiently and effectively; promoting transparency; enabling and incentivising companies to provide the services that customers pay for and deserve; and holding companies to account for their delivery.

Investment

Ofwat's regulation of the water sector since 1989 has delivered transformative investment in customer service and environmental performance, with over £12 billion of capital expenditure investment¹ in Wales alone under strong regulatory oversight.

One of our key roles is to set the price and service packages that water companies must deliver over a five-year period, known as a price review. This includes financial and reputational penalties and incentives to drive performance. Our most recent price review, PR19, allows over £3 billion in Wales over the 2020–25 period to deliver day-to-day needs, as well as new and improved services. For example, we allowed Dŵr Cymru Welsh Water around £33 million to reduce wastewater discharges to the Loughor Estuary and £97 million to improve water quality through upgrades to its infrastructure.

In addition to this, PR19 includes almost £600 million for Dŵr Cymru Welsh Water and Hafren Dyfrdwy to invest in improvements to service, resilience and the environment, including £219 million of investment to deliver the work identified as necessary through the National Environment Programme (NEP) for Wales. The NEP is a key programme focused on delivering benefits to the natural environment, especially water quality, through investment, asset improvements, investigations, monitoring and catchment interventions. Through the NEP, NRW set out the measures that water companies must take to tackle some of the biggest challenges facing the water environment, such as pollution in Wales' rivers. Ofwat does not challenge the need for investment, which is set out as part of the NEP – our role is to scrutinise the cost efficiency of schemes. As part of the NEP, during the 2020–25 period, Welsh companies will invest £23.2 million to improve resilience in water and wastewater.

Innovation was one of the key themes for PR19. We see innovation as essential to empowering Welsh companies to deliver for customers, the environment and wider society. We were pleased to see Dŵr Cymru Welsh Water's RainScape strategy in central Llanelli, where 20% of the urban drainage area has been diverted to natural watercourses using green infrastructure.

Outside of our price review, we have funded environmental improvements through our Innovation Fund. We have made £200 million available through a series of competitions, for the 2020–25 period began, to spark innovation and encourage companies to address the big challenges facing the sector including improving the ecological status of our water.

¹ £12 billion capital expenditure investment is from 1989–90 to 2019–20 and is based on 2019–20 prices and calculated using RPI.

Our competition also encourages schemes which respond and adapt to climate change, address long term resilience, deliver wider public value and explore opportunities associated with open data and the need for further innovation. For our first two competitions 'Innovation in Water Challenge' and the 'Breakthrough Challenge' Dŵr Cymru Welsh Water and Hafren Dyfrdwy led winning projects with partners, including both the University of South Wales and Cardiff University.

To continue making environmental improvements and tackling the challenges facing the sector in Wales, further investment is needed. We have a strong direction from Welsh Government in our strategic policy statement to incentivise companies to continuously seek efficiency gains to deliver more value for money. Our role is to ensure that companies spend customers' money efficiently and we are very mindful of the affordability of bills in both the short and long-term.

When companies submit their business plans as part of our price review process, we check and challenge those plans to ensure that companies have the money they need to invest in improvements and to do so efficiently so that customers do not pay more than what is necessary.

Partly due to our scrutiny, customers in Wales saw a nine percent fall in bills before inflation. This was driven by our lower cost of capital and our efficiency challenge. Companies in Wales have also engaged their customers on benefits of social tariffs and we expect 137,000 customers in Wales to receive help through social tariff and WaterSure Wales by 2025.

We have also encouraged new approaches to dealing with problem debt. Hafren Dyfrdwy has stated it will offer 'payment matching' which sees the company forego debt for customers who make regular payments.

We remain attuned to the pressure on household finances, especially among low-income households and will continue to encourage water companies to be as efficient as possible.

Outcomes, incentives, penalties and scrutiny

As part of our price review process, we set performance commitments and associated incentives for companies to achieve outcomes, such as a reduction in pollution incidents..

At PR19, we set a range of ambitious and challenging environmental performance commitments which companies must meet and report on, and which carry strong financial or reputational incentives. For example, Welsh companies are committing to a 32% reduction in pollution incidents by 2024-25, as well as a 32% and 25% reduction of internal and external sewer flooding incidents, respectively.

Dŵr Cymru Welsh Water and Hafren Dyfrdwy have bespoke performance commitments that will further contribute to improving rivers and that are specified in a variety of ways, such as improving river water quality and improving catchments.

We monitor companies' progress on the delivering outcomes and their level of expenditure through their annual performance reports. This includes performance related to the health of their assets and infrastructure. Where companies do not meet their performance commitments, they incur financial penalties, which are reflected in reduced charges to customers. More information on Dŵr Cymru Welsh Water and Hafren Dyfrdwy's recent performance is in the appendix (page 9).

Where companies demonstrate failure in relation to their legal obligations within our remit, we investigate and this could lead us to take enforcement action, including imposing financial penalties.

Transparency

To monitor the delivery of companies' proposed outcomes, we require them to publish performance metrics, including on the environment, in their annual performance reports.

Each year, we use this information, along with other data sources, to understand the progress companies are making on their commitments to customers. We [publish our assessment of performance](#) and rank companies in areas such as pollution, water quality and sewer flooding. We also monitor water companies' financial resilience to ensure that they can attract investment to deliver essential services to customers. We publish our findings annually in our monitoring financial resilience (MFR) report.

This monitoring provides transparency for customers and wider stakeholders, as well as driving performance and ensuring that companies are accountable to us and their customers. Overall, Welsh companies have achieved most of their performance commitments but there is scope for improvement to deliver the high level of service and cost efficiency that customers deserve.

This data also informs the outcomes and commitments that may need to be incorporated into the next price review (PR24).

More recently, we have opened a discussion on the benefits of open data, where regulators, customers and stakeholders have freely available data to access and share. Some companies, including Dŵr Cymru Welsh Water, are already harnessing the use of artificial intelligence and open data but the industry needs to go further. We recognise the benefits of open data, particularly in tackling some of the environmental challenges in the sector, and its importance in encouraging companies to monitor and report on areas of performance, including pollution incidents and wastewater discharges.

Our approach to water quality and storm overflows in Wales

Improving water quality constitutes a complex and multi-faceted issue that requires strong intra-sector and cross-sector collaboration. It's a key component of Welsh Government's Programme of Government and, in line with that, we are fully committed to playing our part, working in partnership with NRW, Welsh Government, industry, wider stakeholders and the public to achieve our common goals.

We have been a core member of the Wales Better River Water Quality taskforce since its inception in June 2021. The taskforce was established by NRW, Welsh Government, Ofwat, Dŵr Cymru Welsh Water and Hafren Dyfrdwy to examine and evaluate the current approach to the management and regulation of Storm Overflows in Wales. Membership has recently been extended to include CCW and Afonydd Cymru, the umbrella body for a number of Welsh River trusts.

The taskforce has examined regulatory and planning challenges faced by the sector and looked at where improvements may be required including improvements over and above existing work programmes and regulatory actions. Through co-design, the taskforce has the overall ambition of achieving long-term and sustainable improvements to river quality in Wales.

In tandem and alongside other regulators, we have fully supported the development of drainage and wastewater management plans (DWMPs). This is an important step in addressing the harm from storm overflows as DWMPs will require water companies to carry out long-term and collaborative plans taking account of the capacity and resilience of their wastewater networks. Through this process, we will have a better understanding of the issues and actions companies need to take to address them. We can also ensure that companies are appropriately funded and incentivised to deliver on these plans.

While the taskforce and DWMPs consider a longer-term focus, we have been clear that companies must make the best use of the investment and resources available to them to make improvements in the short-term. Water companies will be delivering more green solutions in the next five years, and we were pleased to see catchment management becoming more of a mainstream activity. However, companies could go further to keep rain and ground water out of sewers.

Companies must also consider their approach to customer behaviour in reducing sewer blockages by plastics and non-biodegradable waste and have a much greater focus on effective operation and management of sewers to reduce blockages and overflows.

We are aware that to make the necessary environmental improvements, considerable change is needed. Companies must deliver the planned improvements to wastewater discharges during this period and reduce the harm from storm overflows. Looking ahead to PR24, we will work closely with NRW, companies and key partners to ensure that companies in Wales deliver the services that customers want and deserve.

Our current investigation

On 18 November 2022 we launched an investigation to establish whether companies are breaching the conditions of their environmental permits at wastewater treatment works. We do not have a role in monitoring or enforcing individual environmental permits, that is a matter for NRW. However, we may have a role if a water company is breaching the rules of its environmental permits so often, and in such a way, that it suggests that the water company might be breaking other legal requirements that a water company has, and that Ofwat is responsible for enforcing. These include requirements water companies have about how, overall, they operate, manage and report on their performance, including of their wastewater treatment works.

Our investigation is focused on company compliance with the flow to full treatment (FFT) conditions of wastewater treatment works permits. FFT is a measure of how much wastewater a treatment works must be able to treat at any time. Where the amount of wastewater going into the works exceeds the FFT level, for example during heavy rainfall, a company's environmental permit will usually allow extra flows to be diverted to storm tanks (where the works has them) until the storm passes. The contents of these storm tanks can then be returned to be treated by the works.

If the storm is prolonged or sustained, then the environmental permit will allow the water company to release the extra incoming rainwater and diluted wastewater into the environment, normally after partial treatment by settlement by storm tanks or through storm overflows into a river or sea.

New information that some water companies have shared with the Environment Agency suggests that water companies may not have been treating the amount of wastewater they should do before diverting it to storm tanks and/or discharging it to the environment. If this is the case companies will have broken the conditions of their environmental permits.

Ofwat assesses and agrees the amounts of money water companies can recover from their customers to ensure they can meet all their legal obligations, and we have an important role in setting out how we expect water companies to deliver for their customers, society and the environment. If companies are not meeting their legal obligations or our policy expectations, we want to understand why and how they are putting that right.

This investigation is a priority for Ofwat and we are working as quickly as we can to progress it. We are currently assessing information submitted by all water companies in Wales and England to understand what actions they have, or have not, taken. We hope to have completed this initial assessment by the end of February 2022 where we'll then be setting out next steps. We're also engaging closely with NRW and the Environment Agency as we conduct our assessment. As with investigations of this type, the timetable may change depending on what we uncover; whether we need to gather further information; and the next steps we decide to take.

Appendix A1: Dŵr Cymru Welsh Water and Hafren Dyfrdwy's performance

How are the companies performing against their performance commitments?

Dŵr Cymru Welsh Water and Hafren Dyfrdwy's 2020–21 performance across key performance commitments was assessed as 'average' in our [service delivery report](#), which compares the 17 largest water companies in England and Wales. Both companies were at or above some of their performance commitment targets – such as leakage, pollution incidents and wastewater treatment works' compliance.

However, they were both also below their performance commitment targets in some other key areas such as internal sewer flooding and water supply interruptions. A number of the performance commitments include financial payments to reflect whether each company out or underperforms their expected level of performance.

For 2020–21 Dŵr Cymru Welsh Water received a £4.524 million underperformance payment, which will return to customers in 2022–23 bills. This includes:

- The largest contributing underperformance payments relate to supply interruptions, water quality compliance and internal sewer flooding.
- The largest contributing overperformance payments were external sewer flooding and pollution incidents.
- The company ranked 4th of 17 on the customer satisfaction measure (CMeX), receiving a £2 million outperformance payment. The company ranked 12th for developer satisfaction measure (DMeX), receiving a £0.354 million underperformance payment.

For 2020–21 Hafren received a £0.750 million underperformance payment. This includes:

- The largest contributing underperformance payments relate to supply interruptions and internal sewer flooding
- The largest contributing overperformance payments were linked to the number of lead pipes replaced and its biodiversity commitment (hectares managed for biodiversity).
- The company ranked 11th of 17 on the customer satisfaction measure (CMeX), receiving a £0.035m underperformance payment. The company ranked 4th for developer satisfaction (DMeX), receiving a £0.035 million outperformance payment.