

IAP Response

Ref B2.WSH.PD.A5

Expenditure on the Loughor Estuary

1 April 2019

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B2.WSH.PD.A5 Expenditure on Loughor

Nature of Adjustment (Summarise how you have responded to this action)

Our inclusion of expenditure incurred between 2015-16 and 2018-19 as transition expenditure in 2019-20 was a deliberate decision on our part and was not an error. If we account for the £54 million of 2015-2019 expenditure in the year it is incurred, then this expenditure will be subject to the cost sharing mechanism and would not be recovered in full. This is because the data tables only allow for transition expenditure to be recorded for 2019-20.

We believe the unique circumstances of the Loughor Estuary warrant an exception to Ofwat's standard approach and that the expenditure between 2015-16 and 2018-19 should be allowed in full, as it was required to meet a new legal requirement to the required timescale and in the most efficient manner for customers. Delivery could not have been delayed until 2019 without very severe consequences for Welsh Government (significant risk of infraction fines) and for our customers. These unique circumstances are summarised below.

1.1. Political and Legal Context

In May 2017, the UK Government was found by the Court of Justice of the European Union (CJEU) to be in breach of the Urban Waste Water Treatment Directive (UWWTD) in respect of the Llanelli and Gowerton catchments (collectively referred to as the Loughor Estuary) among other catchments in the UK and Gibraltar. The Welsh Government, which has devolved powers in relation to environmental discharge regulations in Wales, worked with the UK Government on the response to the European Commission with the aim of avoiding large scale infraction fines.

Dŵr Cymru worked collaboratively with the Welsh Government and Natural Resources Wales (NRW) to develop a discharge improvement plan that would satisfy the European Commission requirements that the matter should be resolved by 31 December 2020 and that substantial progress in reducing the frequency of spills from the sewerage networks should be demonstrated over the intervening period, if the risk of infraction fines was to be avoided.

To avoid this risk, NRW have issued new discharge permits that come into force on the 31 December 2020 and periodic reports are made by Welsh Government to the European Commission on historical spill frequency and the projected reductions in future spill frequency up to 2020 that will be achieved, based on the ongoing investment programme. (The press release issued by the European Commission in the context of bringing the legal proceedings specifically welcomed the proposed sustainable approach being proposed by Welsh Water to address the Loughor Estuary case.)

In this context, it was not a politically or legally viable option for Welsh Water to delay the start of its investment programme until 2019-20, as this would have greatly increased the risk of very substantial infraction fines being levied on the UK Government. Under a Memorandum of Understanding between UK Government and the Welsh Government, these fines would have been met by Welsh Government. (We understand that the

Commission is considering a damages claim in respect of the London catchment, where the solution being implemented will not be delivered until the end of 2023.)

Such a set of circumstances in Wales was actually foreseen in the Social and Environment Guidance issued by Welsh Government to Ofwat in 2013, which stated:

1.16 There may be circumstances in complying with European Directives where water and sewerage undertakers will be required to undertake additional work to ensure that there is no risk of infraction outside of the set price review period. For these matters, we would expect Ofwat to give due regard to evidence based requests from water and sewerage undertakers, supported by Natural Resources Wales, to facilitate compliance with Directives.

Ofwat were regularly briefed by Dŵr Cymru during the period on the proposed approach and timescales of the investment required to avoid infraction fines. Dŵr Cymru explained at the time that it was not pursuing the option of seeking an Interim Determination of regulatory controls during the AMP6 period, as it was desirable to avoid an immediate increase in bills to customers, but would expect full funding of the programme at PR19.

1.2. Sustainability, innovation and cost efficiency

Welsh Water has brought forward £75 million of expenditure planned for AMP7 to AMP6 to meet the 31 December 2020 deadline. The initial engineering assessment carried out for Dŵr Cymru concluded that a conventional storage solution, involving underground storm water tanks would have entailed a cost of some £650 million, to serve a population of 120,000. Analysis of such a programme showed that it would have been technically infeasible, would clearly not have been cost effective for customers and would have had adverse environmental impacts (being highly carbon intensive).

As a consequence, we undertook a series of international innovation and best practice exercises, to find a more cost effective and environmentally positive solution.

This involved taking learnings from studies in Portland (USA) and Malmo (Sweden) of how to best apply sustainable urban drainage techniques (SUDs) on a scale which had never been attempted in the UK before. Indeed, retro-fitting such SUDs solutions into post-industrial communities, as opposed to new build developments, has elements of worldwide innovation which have been recognised in numerous awards and interest from municipalities in other countries. The European Investment Bank (EIB) part funded the projects as part of its commitment to promoting environmentally beneficial investment.

These SUDs methods have significant environmental, community and bio-diversity benefits for our customers and are far more sustainable than traditional engineering methods. However, such schemes involve numerous small interventions right in the heart of busy and congested communities, often requiring the closure of access roads and considerable traffic disruption to town centres and residential areas. As a consequence, this sustainable delivery method has a long lead-time, requiring an early start in order to phase the works at a pace which was acceptable to the local community and its political representatives.

In addition, we engaged with supply chain partners to carry out an international search for innovative peak flow treatment systems worldwide which might be able to cope with the very extreme rainfall perturbations exhibited in the Loughor Estuary. Ultimately, two

possible treatment methods were identified as being in use around the Great Lakes in the USA, neither of which had been deployed in Europe before. As a consequence, we have had to build trial plants at Gowerton in Swansea to test the effectiveness of these treatment methods, to choose a preferred option and to demonstrate to NRW and Welsh Government that this innovative treatment method would be able to secure compliance with the new discharge permits in time to meet the Commission’s December 2020 deadline. Clearly, this trial process had a significant lead time and could not have been delayed, if the process was going to be reliably up and running by the required deadline.

The forecast total cost of the innovative investment methods employed in the Loughor Estuary is some £114 million – saving our customers more than £530 million (over 80%) as compared to a traditional solution. Furthermore the SUDs methods used have substantial sustainability and biodiversity benefits for our customers. Finally this approach is more robust in the face of a changing climate and has already demonstrated the resilience it provides for customers when severe storms hit the area. The innovative solution was clearly the right thing to do for our customers, albeit with the consequence that investment had to commence early to ensure that the December 2020 deadline is met.

The innovative SUDs solution implemented in the Loughor Estuary also ensured compliance with the specific legal duty on Welsh Water under the Environment (Wales) Act 2016 to:

“seek to maintain and enhance biodiversity in the exercise of functions in relation to Wales, and in so doing promote the resilience of ecosystems, so far as consistent with the proper exercise of those functions.”

1.3. Conclusion

In the unique circumstances of the Loughor Estuary, we strongly believe that the full expenditure incurred during the period 2015-16 to 2018-19 needs to be allowed for in the PR19 Regulatory Determination. This has been our consistent view as explained to Ofwat over the last four years.

Any other treatment which does not allow for this expenditure in full would clearly be seen to have highly perverse regulatory consequences, in that it would penalise a company for taking the innovative and more beneficial approach, which ultimately will result in a much lower cost to our customers, a much better environmental and societal outcome, and which, in any case, was necessitated by the unique legal and political context.

As a consequence, we have continued to report all of the Loughor Estuary expenditure as AMP7 transition expenditure in our resubmitted data tables. However, we would welcome further dialogue with Ofwat on the appropriate presentation in the data tables, as long as that is consistent with full funding been allowed for this expenditure.