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3 June 2009

**SUSTAINABILITY COMMITTEE**  
**SHORT INQUIRY INTO FLOOD AND WATER MANAGEMENT BILL**

Thank you for your letter of 5 May 2009 inviting Dŵr Cymru Welsh Water to submit written evidence to inform the Committee's short inquiry into the Flood and Water Management Bill, particularly its implications for Wales.

Dŵr Cymru is a statutory water and sewerage undertaker that supplies over three million people living and working in Wales and some adjoining areas of England. We are owned by Glas Cymru, a single purpose not-for-profit company with no shareholders. All financial surpluses are retained within the business for the benefit of Dŵr Cymru's customers and we are the only water and sewerage company in the UK to pay a "customer dividend" by way of rebate on the customer bill. To date, "customer dividends" of £150 million have been paid to Dŵr Cymru's customers. Further background on Glas Cymru, which secured the ownership of Dŵr Cymru in 2001 and only then with the cross-party support of the National Assembly, and our business model is included in our February submission to the EFRA Committee and attached to this letter for reference.

**glas**  
Glas Cymru Cyfyngedig

We welcome correspondence in Welsh and English  
Rydym yn croesawu gohebiaeth yn y Gymraeg neu yn Saesneg

Welsh Water is owned by Glas Cymru - a "not-for-profit" company  
Mae Dŵr Cymru yn eiddo i Glas Cymru - cwmni nad yw'n gwneud elw

Dŵr Cymru Cyf, a limited company registered in  
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In preparing this response about the draft Bill we have concentrated on what we see as key issues for Wales and for our company. We will continue to consider the implications of the draft Bill before submitting our formal comments to the Welsh Assembly Government by the 24 July deadline: let us know if you would like to see those comments.

There is much in the draft Bill that Dŵr Cymru welcomes in general terms, particularly the package of measures designed to improve surface water management; the proposal to set mandatory build standards for new sewers; and the strengthening of ways to tackle misconnections. These measures will certainly improve the ability of Wales's infrastructure to cope with some of the predicted impacts of climate change.

The draft Bill rightly makes full provision for the different circumstances that may apply in Wales and the fact that many of the powers that will follow from the draft Bill will be the responsibility of the Welsh Assembly Government. In that light, we would draw to the Committee's attention a number of areas where, from a Dŵr Cymru or indeed Wales point of view, we judge that what is proposed could be improved upon and/or where we have particular concerns as to what is proposed because of the impact it would have on the water industry in Wales. I will be happy to flesh out these issues further when I appear before the Committee on 10 June.

### **SUDS (clauses 217-232)**

As well as reducing flood risk, properly designed sustainable drainage systems (SUDS) bring considerable environmental benefits by, for example, reducing diffuse pollution and helping to restore natural flows in the aquatic environment. They will undoubtedly be an important component of any credible plan to enable the water industry to adapt to climate change. From Dŵr Cymru's perspective, removing surface water (eg run off from roofs) from our foul sewerage systems lowers the risk of sewer flooding and/or pollution incidents because of over-loaded sewers and reduces the volumes that need to be pumped, so saving energy and greenhouse gas emissions. Indeed, the predicted impact of climate change for the water industry in Wales is as serious for our sewer network as for water supply in the sense that more frequent severe summer storms will have as much impact on the service we give our customers as more frequent summer droughts. Where we have known problems with sewerage capacity wherever possible

we are working to deliver solutions based on the removal of surface water from our sewer system, rather than, as has been the norm to date, increasing the size of the sewers and/or adding storage, and our AMP5 investment plan makes specific provision for further progress in this regard. Dŵr Cymru has led, and indeed continues to lead, the water industry in England and Wales in promoting SUDS.

We are therefore pleased that the Bill includes measures designed to encourage more SUDS schemes. We strongly endorse the establishment of national standards for SUDS and the commitment that the requirement that local authorities adopt and maintain new SUDS scheme. Where we retrofit a SUDS scheme to improve the capacity of the public sewer system in Wales we would be prepared to support local authorities by maintaining such schemes for a time.

### **Right to connect (clause 233)**

The draft Bill proposes that Dŵr Cymru becomes a statutory consultee for the purposes of approving a SUDS scheme where any residual flows will connect to the public sewer system. We would like the draft Bill go further and make Dŵr Cymru a statutory consultee in the planning process regarding any development which intends to connect to the public sewer network. As things stand, the planning authority will notify us of a proposed development to our sewer network and it will generally take note of our representations. However, S106 of the Water Industry Act provides for the right to connect to our sewer network which means that if the planning authority disregards our representation connections can take place which add to overloading of the sewer network and increase the risk of sewer flooding of properties and/or pollution due to discharges from the overloaded sewer. When this happens (and, to be fair, in most cases it doesn't and our representations are taken into account) the cost of fixing the resulting problems then falls on our customers rather than on those who have caused the problem.

### **Misconnections (clause 253)**

As part of the package of improvements to surface water management, we also very much welcome the proposal to enhance the powers of sewerage undertakers to tackle misconnections onto our sewerage (Clause 253).

### **Mandatory build standards (clause 252)**

The Minister for Environment, Sustainability and Housing, Jane Davidson, has previously announced that privately owned sewerage in our area will transfer to us. The legacy of un-adopted private sewers is largely because developers have not provided infrastructure of a standard (eg capacity) that sewerage undertakers, such as Dŵr Cymru, consider meet minimum standards. Our industry has for some years been calling for minimum statutory build standards to prevent the continuing proliferation of sub-standard sewerage. Clause 252 in the draft Bill is therefore very welcome and we hope that our industry will be closely involved in developing the statutory standards.

### **Major infrastructure (clauses 239-246)**

Our industry has three main regulators, the Drinking Water Inspectorate, the Water Services Regulation Authority (“Ofwat”) and the Environment Agency. Two have no permanent presence in Wales. Although the Agency does have a Wales Headquarters, it has limited policy development capacity here, and so Agency policy is usually formulated in England, without a full appreciation of the issues here. Perhaps it is inevitable that the regulation of our industry therefore tends to focus on major issues affecting large parts of England (for example in water resource planning) and reflects the more conventional for-profit corporate structure of our English counterparts.

This background is relevant to the matter of major new infrastructure, such as new reservoirs. Dŵr Cymru believes that there must be safeguards within the Bill to ensure that control over any large infrastructure projects of this kind in Wales should remain in Wales.

The predicted impacts of climate change may lead to a situation where, with all other options exhausted, new sources of large volumes of water will be required to supply those parts of the UK where water resource deficits already exist and are expected to worsen. For example, every time there is a severe drought affecting the South East of England the proposal to raise Craig Goch dam in the Elan Vally is resurrected. We accept that large projects intended to serve several water companies may require special regulatory arrangements. However, as currently drafted, the Bill will ensure that Welsh Ministers have control over large new infrastructure projects provided by, or for the use of, water or sewerage undertakers whose supply areas are “wholly or

mainly in Wales”. However, given the potential impact of such projects on the Welsh landscape and the sensitive history of some schemes, we believe that the people of Wales would expect that any large projects planned for Wales but promoted by predominantly English companies should also be subject to control by the Welsh Assembly Government and National Assembly for Wales. We also believe that the ownership of key Welsh water assets belongs in Wales as does the economic benefit that might and indeed should come to Wales as a result of meeting demand for water outside of Wales. The likely proposals to break-up the water industry in England and Wales following the Cave Review is also very relevant here (see below).

### **Modifying conditions of appointment (clause 234)**

Currently the Ofwat can only make changes to Dŵr Cymru’s conditions of appointment as a regulated and licenced water and sewerage undertaker by agreement and where Ofwat wants to make an industry-wide change it must get agreement from all companies. The draft Bill proposes that Ofwat will be able to make changes provided no more than a “specified minority” of companies object to the changes.

Dŵr Cymru is unique in the regulated water sector in England and Wales in a number of important respects. Policy is set by the Welsh Assembly Government not Defra, and alone in the water industry Dŵr Cymru is not-for-profit. In addition, the very nature of the water industry in Wales is different to much of the water industry in England (history, long coastline, topography, water resource position etc). All of this means that in a number of important areas we have, and are likely to have, a position which is distinct from the water companies owned by shareholders and based wholly or mainly in England. This would include, for example, our position with regard to the breaking-up of the industry into a number of competing for-profit companies following the Cave Review (see below). We therefore judge that there is considerable danger for the water industry in Wales as currently owned and governed by ceding to Ofwat the power to change Dŵr Cymru’s conditions of appointment without the agreement of either Dŵr Cymru or the Welsh Assembly Government.

### **Cave Review**

For reasons that are not entirely clear, the draft Bill does not include any provisions with regard to the conclusions reached by Professor Cave following his “Review of

Competition and Innovation in Water Markets". We understand that Defra will be consulting on what might be added to the final Bill before the summer recess and the Welsh Assembly Government may do likewise. What seems likely to be put forward in the final Bill following the Defra consultation would amount to a wholesale re-shaping of the water industry in England – to an extent that has not been attempted anywhere else in the world. Our strongly held view is that this should not happen in Wales by default and because we follow what happens in England, but rather as a result of a carefully considered assessment of the costs and benefits taking into account the particular and very different circumstances that apply in Wales.

For reference, attached to this letter is our position statement, which dates from September 2007 and still holds, plus my letters to Martin Cave of 22 August (ahead of his interim report) and 4 February (ahead of his final report) which together summarise our views on what we think is likely to be proposed by DEFRA and included, in one form or another, in the final Bill. Also attached is a short briefing produced for Oxera by Martin Cave plus three slides from a recent conference on the Cave Review's final report which show how the water industry in England and Wales might look in 2013 and then after 2015.

This is a crucially important matter and we would welcome the opportunity to discuss what it might mean for the water industry in Wales when we meet next week. Put bluntly, do we all want an integrated industry, owned on behalf of its customers, controlled in Wales, providing a public service and looking after the industry for future generations, operated and financed efficiently, with regionally averaged prices, with strong sanctions in place for any shortfalls? Or do we all want an industry which is broken up into lots of small for-profit monopolies (as with insets) or broken up horizontally across England and Wales with retail separated from networks which in turn are separated from treatment, where high-cost-of-serve customers pay more than low-cost-of-serve customers (as we see in energy), where responsibility for the quality and safety of tap water is split and where control (including Welsh Assembly Government jurisdiction) resides outside of Wales? These are big questions that have to date been debated largely (and at great length) inside the industry but with little or no interest from outside. That has to change if the final Bill is going to include provision for the break-up of the water industry in Wales.

It is easy for Ofwat and other proponents of “liberalisation” to dismiss concerns raised by Dŵr Cymru as being those of the incumbent seeking only to protect its monopoly position. I must stress that we are not against competition – the comparative competition regime operated by Ofwat has been and remains a major spur to performance and we competitively outsource currently around 85% of our operating and capital expenditure to ensure that our customers get the best available mix of quality and efficiency in the marketplace (see our EFRA submission attached).

What we do not yet have is an effective market for water rights. A properly functioning market would provide important price signals and as such lead to better allocation of what will become an increasingly scarce resource in parts of England in particular. As our 2007 position statement sets out and as emphasised in our letter to Martin Cave of 22 August 2008, we strongly endorse the development of a market for water rights.

Nor do we have customer choice in the regulated water industry – ie competition “at the tap” – and, as things stand, it seems likely that the final Bill will include provision for legal separation of water companies’ retail activities so that some (and ultimately all) customers can choose between different retailers, as is the case in energy. This change would be accompanied by a relaxation of merger rules to allow separated water retailers to combine and consolidate, again as we have seen in the energy market. The point we want to emphasise is that while few would argue that “choice and competition” is not a “good thing”, in the case of the water industry it will come at a significant cost to our customers.

As we have shown with Glas Cymru’s not-for-profit ownership of Dŵr Cymru, an integrated water company focused on providing a public service and looking after a long term industry can raise finance very efficiently – we are a “safe home” for long term investors. To date, ie in the 8 years since Glas Cymru secured ownership of Dŵr Cymru, we have made financing efficiency savings that have paid for “customer dividends” of £150 million and have grown “customer equity” to just over £1 billion. Every 1% increase in the cost of capital adds 5% to bills and the cost of capital for a “liberalised” water industry would be considerably higher than what Glas Cymru has achieved for the water industry in Wales. The cost of capital just on what has been invested since privatisation in 1989 now accounts about a third of everyone’s water and sewerage bill

whereas “retail” accounts for just 4% (we have outsourced our billing and income activities and so know the market cost of this activity). Our other concern is that as a public service employing assets with net value of £19 billion (or £15,000 per customer) there are many “good” cross subsidies that would inevitably be unwound by “liberalisation” – as we have seen in energy, high-cost-of-serve customer would pay more than low-cost-of-serve customers and we do not believe it is right that we end up in the situation we see in energy where pre-payment (ie poor) customers pay £150 more than direct debit (ie more well off) customers. This is not an outcome Dŵr Cymru could support. In our view, the “least worse” outcome – as a quid pro quo for “no choice” – is to make sure the water industry in Wales continues to be regarded as a safe home for long term investment so that its most important cost, the cost of capital, can be kept as low as possible, recognise and indeed endorse its public service remit and its role in protecting public health, and continue to reinforce the current comparative competition and “competition for the market” arrangements that have delivered to date. In our response to the upcoming consultations on the Cave Review we will point out, inter alia, that compared to the possible £2.5 billion of net present value that Martin Caves estimates that his wholesale changes would produce over 30 years for all of England and Wales, Glas Cymru has in just 8 years produced a net present value of some £1.2 billion for Wales alone.

All the evidence we have supports the view that customers in Wales like the idea that their water company is owned on their behalf and is not-for-profit. The scope for the Welsh Assembly Government to reflect this and take a different position to that followed in England in respect of the for-profit water companies may in practice be limited by the fact that Dŵr Cymru serves customers in Herefordshire and Deeside and Severn Trent serves customers in mid Wales. Current legislation deals with this by relying on the term “mainly or wholly based in Wales” and to date this construction has not caused any serious difficulty. But such is the extent of the structural change being envisaged for the regulated water industry that we can anticipate considerable pressure being placed on Wales to fall into line with England so as to avoid any complications or challenge as a result of the “wholly or mainly” construction. This probably means that we have to be very sure of what we want for the water industry in Wales in order to avoid the default position which is to adopt whatever is finally put in place for England.



I trust that this correspondence serves as useful evidence for the Committee and look forward to meeting you on 10 June.

Yours ever  
Nigel

Nigel Annett  
Managing Director

**Attachments:**

1. Submission to EFRA Committee's re Ofwat's Price Review (26 February 2009)
2. Dŵr Cymru position statement on market competition in water (September 2007)
3. Letter to Martin Cave ahead of his interim report (27 August 2008)
4. Letter to Martin Cave ahead of his final report (4 February 2009)
5. Martin Cave's Oxera briefing note (May 2009)
6. Selected slides (annotated) from conference on Cave (May 2009)