



Llywodraeth Cymru
Welsh Government

WG22-27

Strategic Priorities
and Objectives
Statement to Ofwat
issued under section
2B of the Water
Industry Act 1991

2022

Welsh Government Strategic Priorities and Objectives Statement

The Welsh Government's Programme for Government (2021 – 2026) sets out clear commitments for improving the lives of people in Wales. It presents a vision of a Wales where we work together to deliver the sustainable future we all want to see. The principles of economic, social and environmental justice are at the heart of this Government's work to deliver a stronger, greener and fairer Wales.

We need every citizen, community, group and business in Wales to take action to address the climate and nature emergencies.

Sustainable water and wastewater services for current and future generations are based on a healthy natural environment and a resilient asset base. We envisage a resilient water and wastewater sector in Wales that is customer and environment focussed, integrated, sustainable and resilient, while delivering value to customers and the environment. The work of the sector will empower vibrant communities and help to protect and enhance our treasured natural environment.

Set within the context of the unprecedented challenges and opportunities we face and the Welsh Government's Programme for Government, this replaces the statement issued in 2017¹.

The legislative framework

Under section 2B of the Water Industry Act 1991 (as amended by the Water Act 2014), the Welsh Ministers may from time to time publish a statement setting out strategic priorities and objectives for Ofwat to follow in carrying out its relevant functions relating to companies wholly or mainly in Wales.

Ofwat must carry out those functions in accordance with any statement published under section 2B. In doing so, we expect Ofwat to:

- Embed the objectives and priorities set out in the SPS throughout its regulation of companies operating wholly or mainly in Wales.
- Set out how the relevant activities in its forward work programme deliver against the government's expectations and strategic priorities.
- Set out how its major decisions consider the specific circumstances of Wales and are consistent with government's expectations and priorities, for example, when establishing the methodology for price reviews, publishing draft and final determinations or proposals for change to the regulatory framework.
- Have an effective framework to hold companies to account within its statutory remit.

¹ <https://gov.wales/programme-government>

Strategic objectives: how the Welsh Government expects Ofwat to carry out its functions

We expect Ofwat to develop the regulatory framework as applicable to Wales on the basis of sound evidence relevant in a Welsh context. Where appropriate, it should adopt a different approach for UK Government and Welsh Government regulated companies, proportionate to the size of investment, company and customer base. Ofwat should have regard to how it can enable or incentivise companies to contribute to the delivery of relevant government policy and strategies.

Ofwat should take due account of differences in both policy and law between the UK and Welsh Governments including where new obligations on water companies emerge. Ofwat should encourage and incentivise companies to contribute to the delivery of relevant Welsh Government policy and strategies in the short, medium and long term in the fulfilment of their functions. The Well-Being of Future Generations (Wales) Act 2015 is a central pillar of the policy landscape in Wales. We expect Ofwat to have regard to the goals and ways of working set out in the Act, and to recognise water companies' efforts to adhere to the Act².

Ofwat should engage transparently and proactively with Welsh Government, Natural Resources Wales (NRW), water companies, Welsh stakeholders and customers on the development of its price review methodology, regulatory framework, policies and priorities.

The Welsh Language (Wales) Measure 2011 establishes that, in Wales, the Welsh language should not be treated less favourably than the English language. We expect Ofwat and companies to observe this when carrying out their work. The Programme for Government commits to implementing the Welsh Language standards for water companies. Our ambition as Welsh Government is to see the number of people able to enjoy speaking and using Welsh reach a million by 2050³.

In delivering its relevant functions in Wales, Welsh Government expects Ofwat to fully take account of the following strategic objectives:

Plan and deliver for the long-term

Promote an appropriate focus on addressing long-term risks, safeguarding long-term resilience and performance, and seeking to ensure that the timing of investment results in intergenerational equity. We expect Ofwat to seek to address future social, economic and environmental risks, challenges and emerging threats over the long-term, including through adaptive planning principles and to consider proposals to address these issues on a multi-AMP basis, including no regrets investment.

² <https://gov.wales/well-being-future-generations-act-essentials-html>)

³ <https://www.welshlanguagecommissioner.wales/about-us/the-welsh-language-measure>

Deliver a cohesive and transparent regulatory framework

A framework that, taken as a whole, is proportionate, effective, transparent, and efficient allowing companies, investors, and customers to plan for the long-term.

Take a preventative approach

Pursue a preventative approach by encouraging companies to understand and consider how problems could be addressed at source.

Involve and engage customers and stakeholders

Ensure the regulatory framework encourages companies to meaningfully involve and engage with customers and stakeholders on long-term outcomes, priorities, and the pace of delivery, and take account of their views. Where appropriate companies should be encouraged to engage with customers to educate, understand and test their needs and priorities, co-create solutions and co-deliver outcomes, for example, where customer behaviour can help address operational challenges.

Collaboration

Welsh Government want to see effective collaboration to maximise the impact and effectiveness of regulation, to learn from collaborative approaches already in place and to encourage multi agency 'Team Wales' working between water companies and relevant third parties such as local authorities, catchment partnerships, wildlife trusts, private landowners, Public Health Wales and community groups.

Where appropriate third-party contributions should be leveraged particularly where others share responsibility.

We recognise that the principles of competition and markets can sometimes play a role in raising performance standards and driving efficiency; for example, comparative competition through benchmarking. However, the promotion of in-market competition in the water industry is not a priority for Welsh Government and the Welsh Government does not support the introduction of competition where the activity of new entrants would reduce companies' overall accountability for the delivery of excellent services to customers and the environment; nor where it would threaten the integrity and efficiency of the management of the water system; nor where it cannot clearly be evidenced that it would be beneficial to customers.

The Welsh Government does not support the fragmentation of the water industry in Wales and further promotion of competition is undesirable.

Focus on Outcomes

Ofwat should adopt an outcome focused approach to the delivery of water company activities, the relevant Welsh Government policies, and incentivise the sustainable, integrated, and efficient use of natural resources. The regulatory framework should encourage water companies to deliver appropriate and customer/stakeholder supported social and environmental value beyond their minimum statutory obligations whilst carrying out their functions. Delivery of core services contributes

towards achieving the well-being goals of all key organisations in the Welsh water sector to improve the well-being of the communities they serve and the environment they operate within. The regulatory process should therefore encourage action that achieves the maximum benefit for multiple drivers.

Best value for customers, communities and the environment

Ofwat should challenge companies to deliver value for money for customers, communities and the environment. Ofwat should challenge companies to demonstrate that their plans are acceptable, affordable, and best value, having regard to their existing and future customers. They should also challenge companies to provide sustainable and effective support to customers who are struggling to pay their water bill.

Ofwat should challenge companies to deliver for customers based on comparison across companies in Wales and England, and across other sectors where appropriate, while making appropriate allowances for differences in the operating and legal environments of companies in Wales and taking into account variations in the priorities of customers and other stakeholders.

Ofwat should challenge companies to deliver best value solutions through their regulatory framework. Ofwat should encourage investment that responds to multiple drivers (for example, tackling leakage, asset health, discolouration, and lead simultaneously) or has multiple benefits, and takes account of outcomes and the wider environmental and social value of solutions.

We expect Ofwat to assess company proposals as a package, incentivising companies to develop a package of investment to deliver best value for customers and the environment in the round, at an acceptable cost given the current and future challenges that need to be tackled.

Evidence based regulation

Ofwat should challenge companies to provide clear and compelling evidence to underpin their investment plans. Through sound evidence and research, we expect Ofwat to challenge companies to innovate and seek new, more efficient, ways of delivering services for customers and the environment. Evidence can involve collaborative collection, sharing and analysis of data to enhance understanding of challenges and suitability of solutions.

Innovation

Ofwat should challenge companies to seek new ways of delivering services for customers and the environment more efficiently, based on sound evidence, appropriate monitoring, open data and research. Welsh Government welcomes the Ofwat innovation fund as a route for funding of further research and development of innovative responses.

Taking all these objectives into account, Ofwat should ensure the regulatory framework delivers best value for customers, communities, and the environment.

When making decisions, Ofwat should consider social and environmental benefits and disbenefits and be clear on what alternatives have been considered and rejected. Welsh Government recognises there may be trade-offs. Levels of resilience, investment required, scale of ambition and customer affordability must all be taken into account.

Ofwat should encourage water companies in Wales to have regard to procurement principles and practices aligned with the Wales Procurement Policy Statement, reflecting the water industry's potential to play an important role in enabling green growth and supporting the foundational economy in Wales and its role as a major local employer, contractor and developer of workforce skills and expertise⁴.

Delivery for customers in Wales should be benchmarked across companies in Wales and England and across other sectors where appropriate. This baselining should appropriately reflect differences in the operating and legal environments of companies wholly or mainly in Wales and account for variations in customers and stakeholder priorities.

Strategic priorities for Ofwat

Climate & Nature Emergencies

The climate emergency is a global challenge requiring urgent action. The Intergovernmental Panel on Climate Change (IPCC) has concluded further temperature rises are inevitable. The more we do to reduce emissions now, the better our chance of limiting the devastating impacts we are already seeing both in Wales and around the world. In line with the advice from the Climate Change Committee (CCC), this must be a decade of action in Wales. We need to make more progress in the next ten years than we have in the last thirty⁵.

As set out in our Programme for Government, this Government is committed to fairness. We believe that by working together and taking collective action we can deliver a stronger, fairer and greener Wales for future generations.

In March 2021, the Senedd put the 2050 net zero target into legislation.

We welcome the commitments by the water companies. Dŵr Cymru Welsh Water has set a net zero carbon commitment for scope 1-3 emissions by 2040 and Hafren Dyfrdwy, as part of Severn Trent Group has committed to achieving net zero for scope 1-2 emissions by 2030.

We expect Ofwat to:

- Encourage companies to adopt practices and behaviour which act as an exemplar and positively enable change to achieve a net zero carbon society in Wales.

⁴ <https://gov.wales/sites/default/files/pdf-versions/2021/3/1/1615195510/procurement-policy-statement.pdf>

⁵ <https://gov.wales/climate-change-committee>

- Encourage companies to develop clear, robust plans for how they are proposing to address the impacts of climate change and achieve their net zero commitments, contributing to net zero Wales, recognising the need to respond to the climate emergency now, including how they will:
 - engage with the supply chain and customers to play their part;
 - deliver value for money for customers; and
 - achieve the step-change required for decarbonisation across both operational and embedded carbon emissions.
- Encourage companies to adopt circular economy principles when delivering their core activities, where waste is minimised, products and materials are reused, remanufactured or repaired, recycled materials replace raw materials where possible, and natural systems are enhanced with nutrients recycled.
- Encourage companies to ensure their activities in appointment areas wholly or mainly in Wales, even where the beneficiary is in England, contribute to Welsh Government's net zero commitment.

Nature is declining globally at rates unprecedented in human history and the rate of species extinctions is accelerating. Recent reports indicate biodiversity loss and natural capital/ecosystem services degradation in Wales continues, despite some of the positive interventions made in recent years. The inter-connectedness of the nature and climate emergencies has never been clearer: by limiting changes to the climate by reducing emissions we will support biodiversity and well-functioning ecosystems, which in turn provide natural solutions and build resilience to climate risk.

In June 2021 the Senedd declared a nature emergency, believing there should be parity between actions we take to tackle climate change and those taken to tackle biodiversity loss. This includes ensuring that nature and the climate are on the agenda of every public service and private sector business and integrating positive action for nature into more of our economic activity.

We expect Ofwat to:

- Challenge companies to demonstrate how biodiversity and ecosystem considerations are embedded across activities, including any policies, plans, programmes and projects.

Environment

The Environment (Wales) Act 2016 puts in place a delivery framework for the sustainable management of natural resources (SMNR). It introduces principles to focus on a more integrated approach to natural resource management, looking at the root cause of problems and working with stakeholders to find solutions, which improve Wales' environment and deliver multiple environmental benefits⁶.

⁶ <https://gov.wales/sites/default/files/publications/2019-05/environment-wales-act-2016-overview.pdf>

NRW State of Natural Resources Report 2020 is an assessment of how Wales is doing with sustainably managing its natural resources. Based on the latest available evidence, it sets out opportunities for achieving SMNR⁷.

The water industry sits alongside other stakeholders in contributing to environmental pollution. However, it is acknowledged that water companies are well-positioned to be conveners within catchments. Learnings from catchment management approaches and partnerships should be captured and acted upon by companies.

We expect water companies to meet the requirements of all environmental legislation. Water companies should, when supported by customers/stakeholders and where it represents good value for money, also exceed these legislative requirements and deliver wider environmental and social benefits while carrying out their functions.

We expect Ofwat to:

- Challenge companies to shift to a catchment based, outcomes-led approach with nature-based partnership (including customers) solutions that address problems at source. Where there is uncertainty around the ability of nature-based solutions to deliver the required outcome, the risks should be understood, and where possible mitigations put in place while retaining the intended benefits, ensuring proportionate protection is in place for customers and the environment. Ofwat should give precedence to these types of solutions, where appropriate. Companies should explain why the options selected are best value for customers and the environment and what alternatives have been considered and rejected.
- Encourage companies to consider emerging threats that may impact their core activities e.g. endocrine disruptors, pharmaceuticals, microplastics and so-called “forever chemicals” e.g. PFAS. Support collaboration with other stakeholders including academia to achieve this and encourage companies to share their data and understanding.
- Challenge companies to demonstrate how they will achieve continued improved environmental performance with particular attention to delivering the measures set out in the River Basin Management Plans, addressing Reasons for Not Achieving Good status, as well as failures in protected sites (e.g. phosphorus).
- Encourage companies to develop plans that take account of customer and stakeholder expectations around harm and impact.
- Encourage companies to explore and maximise collaboration and co-funding opportunities with other sectors and organisations as well as green finance opportunities to deliver best value for customers.

⁷ <https://naturalresources.wales/evidence-and-data/research-and-reports/state-of-natural-resources-report-sonarr-for-wales-2020/?lang=en>

- Encourage and incentivise the sustainable and efficient use of water resources, including by encouraging companies to reduce leakage and customer consumption. This may include setting challenging but achievable targets for reducing per capita household consumption and, leakage, and implementing strategies for increasing public awareness and encouraging customer behaviour change.

Resilience

Resilience is the ability to anticipate, cope with, and recover from, disruption. It requires companies to anticipate trends and variability to maintain services for people and protect the natural environment, now and in the future.

The current and future threats to the water sector are likely to increase in frequency, severity and complexity. These range from the impacts of the climate and nature emergency, demographic and societal change and, emerging contaminants to technological advances and disruption. Providing resilient, reliable and sustainable water and wastewater services in the face of these threats is essential for people, the economy, and the environment. Customers expect reliable water and wastewater services now and in the future. For example, around 80,000 citizens in Wales use a private water supply. Climate change increases the vulnerability of these citizens to water scarcity.

The legislative framework within Wales supports this government's ambition to be a resilient nation and to maintain and enhance the resilience of ecosystems and the benefits they provide.

Water companies, along with other risk management authorities, have statutory flood risk management roles and duties. These include managing the risks of flooding from their sewer systems caused by excess rainfall.

Cyber security is a core part of water company resilience. The exponential advances in technology and global expansion of cyberspace are changing the way we live, work and communicate and is transforming the critical systems we rely on. The scale and speed of these changes often outpace our social norms and laws, creating unprecedented complexity, instability and risk.

We expect Ofwat to:

- Challenge the companies to ensure current and future resilience of water and wastewater services is understood and managed through a robust, adaptive, and evidence-based plans. Company plans should be updated periodically to respond to best available evidence, emerging risks, company evidence and policies on distinct risks such as coal tip safety and vulnerability of private water supplies.
- Encourage collaboration between water companies, regulators and local authorities to determine the appropriate level of resilience for communities and the environment in Wales. Companies should collaborate with other infrastructure providers, for example the energy sector and chemical sector, to

understand their interdependencies and plan for cascading consequences of disruption. Companies should collaborate on the development of Water Resource Management Plans (WRMPs) and Drainage and Wastewater Management Plans (DWMPs) in line with Welsh Government guidance⁸.

- Encourage the use of catchment wide, nature-based solutions and sustainable drainage schemes, where appropriate.
- Encourage companies to understand the resilience of their workforce and supply chains in respect of current and future water and wastewater services.
- Encourage companies to engage with customers on the level of risk they are exposed to and empower customers to contribute to their own and to community resilience such as through behaviour change.
- Challenge companies to deliver greater flood resilience for their own infrastructure and services, and where appropriate provide wider benefits to their customers and wider community in doing so.
- Work with other parties, for example, through the Regulators' Alliance for Progressing Infrastructure Development (RAPID) to explore any changes to the regulatory framework to manage resilience risks.
- Encourage companies to consider the need for proactive investment in cyber security and undertake necessary upgrades for example under the Network and Information Systems (NIS) Regulations 2018. Working with the Drinking Water Inspectorate, companies should develop plans to enhance their cyber capabilities to be cyber secure and resilient, and better prepared for the rapidly evolving threats and risks of cyberspace.
- Require companies to consider the Welsh Government WRMP guiding principles and RAPID guidance that state new transfers from Wales should only be considered if the level of service in the Welsh resource zone (and any other zones in Wales affected by them) is equivalent or higher than the recipient resource zone. Consideration should be given to the resilience of the zone including economic, environmental and social impacts and opportunities.

Asset Health

Poor asset health is a chronic stress where assets deteriorate to a point where the risk of failures (impacting on service to customers, the environment and wider society) exceeds a company's risk tolerance. The good management of companies' assets is a crucial element of achieving resilience in the water and wastewater sector in Wales.

⁸ <https://gov.wales/water-resources-management-plan-guidance> & <https://gov.wales/guiding-principles-drainage-and-wastewater-management-plans-dwmps>

The impact of asset health on service for customers and the environment may only become apparent in the longer term.

In the period 2017 to 2019, compliance with the standard for iron was the poorest in Wales, with failures for manganese also being among the highest of all the parameters. Iron, which can be an indicator of asset health, is also responsible for high numbers of discolouration contacts and a number of drinking water quality events, with associated implications for customer confidence in their water supply.

We expect Ofwat to:

- Challenge companies to monitor their asset health and provide forward-looking plans to address any issues over the long-term. Companies should demonstrate a clear understanding of the health of their existing assets including interdependencies, trends in the long-term, and how this impacts levels of overall resilience.
- Encourage companies to plan for obsolescence of assets within their networks and necessary asset upgrades under the Security and Emergency Measures Direction 2022.
- Consider intergenerational inequity when evaluating capital maintenance investment and seek to protect the interest of future as well as current customers. This should include ensuring that expenditure allowances for capital maintenance are sufficient, considering available evidence that future requirements may differ from current and historical levels owing to, for example, impact of climate change on assets.

Customers and Communities

The water companies in Wales contribute to the foundational economy in Wales and deliver essential services that play a vital role in our everyday lives. As major employers they are vital for our local economy as they are key providers of skills training and employment, they also have the resources and expertise to play a leading role in working collaboratively with local authorities, landowners, businesses and communities to protect our health and environment.

We are in the midst of an unprecedented cost-of-living crisis, which is being driven by energy prices. As a government we are determined to do all we can to support those who find themselves vulnerable at this time and take the steps needed to build resilience in our communities. We are encouraging our stakeholders to do the same.

The Consumer Council for Water's independent review of water affordability considers that low-income households spending more than 5% of their income (after housing costs) can be considered to be facing water poverty and in need of help with their bill. Whilst there is financial and practical support available, there are often barriers to access – including awareness, health, trust, complexity, literacy and location. Supporting financially vulnerable customers efficiently and effectively could

remove barriers driven by bill affordability to investment in the delivery of environmental, social and resilience outcomes.

From a broader affordability perspective, between 1989 and 2010, water bills increased in real terms. However, since 2015, bills have fallen in real terms. In the future, there are a multitude of drivers with the potential to further impact on both water poverty and general bill affordability. These include achieving the priorities set out in this statement.

Businesses, charity or public sector organisations currently served by a water supplier based in Wales are only eligible to switch water retailers if they use more than 50 million litres of water a year. Welsh Government is committed to consulting on increasing the eligibility threshold.

We expect Ofwat to:

- Consider affordability for all customers and affordability for customers who are struggling to pay their water bill in the design of its regulatory framework.
- Facilitate price determinations that provide value for money for current and future customers. Customers should be engaged meaningfully on the affordability and acceptability of future bills.
- Encourage the provision of transparent and accessible and sustainable social tariffs for those who struggle to pay, reflecting the views of the generality of customers and encourage the proactive management of customer debt. Ofwat should engage with companies to ensure that social tariffs are sustainable in the long-term and resilient to economic shocks.
- Collaborate with companies, CCW and the Welsh Government to implement relevant recommendations of CCW's affordability review in a way that benefits customers of companies operating wholly or mainly in Wales.
- For business customers, work with companies, Market Operator Services Ltd (MOSL) and Welsh Government to ensure a smooth transition as we seek to increase the eligibility threshold for retail competition.
- Keep under review its approach to developer services to ensure it is fit for purpose to support economic development in Wales.

Appendix: Summary of Ofwat's duties

Sections 2 and 3 of the Water Industry Act 1991 (as amended) place a number of statutory duties on both the Welsh Ministers and Ofwat.

Ofwat's primary duties (as set out in Section 2) are to carry out its relevant functions in the way it considers best calculated to:

- further the consumer objective to protect the interests of consumers⁹, wherever appropriate by promoting effective competition;
- secure that the functions of each undertaker¹⁰ are properly carried out;
- secure that undertakers are able to finance the proper carrying out of their functions, in particular by securing reasonable returns on their capital;
- secure that licensees (companies with water supply or sewerage licences) properly carry out their licensed activities and functions; and
- further the resilience objective to secure the long-term resilience of undertakers' water supply and wastewater systems, and to secure they take steps to enable them, in the long term, to meet the need for water supplies and wastewater services.

Subject to these, Ofwat has secondary duties to:

- promote economy and efficiency by undertakers in their work;
- secure that no undue preference or discrimination is shown by undertakers in fixing charges; secure that no undue preference or discrimination is shown by undertakers in relation to the provision of services by themselves or other undertakers or by licensees;
- secure that consumers' interests are protected where undertakers sell land;
- ensure that consumers' interests are protected in relation to any unregulated activities of undertakers; and
- contribute to the achievement of sustainable development.

Ofwat may also have regard to the interests of consumers in relation to other utilities. In exercising any of its powers or duties in accordance with those duties outlined above, Ofwat shall have regard to the principles of best regulatory practice.

⁹ Consumers are defined at s2(5A) WIA 1991 as both existing and future consumers, and the "interests of consumers" are their interests in relation to the supply of water by means of a water undertaker's supply system [...] and the provision of sewerage services. For the purposes of this duty, s2(2C) WIA 1991 sets out a non-exhaustive list of particular groups to whose interests Ofwat shall have regard, which consists of: individuals who are disabled or chronically sick, individuals of pensionable age, individuals with low incomes, individuals residing in rural areas, and customers who are not eligible to switch suppliers.

¹⁰ That is, company holding an appointment as a water and/or sewerage undertaker.

Ofwat and the water companies also have general environmental and recreational duties in section 3 of the Water Industry Act 1991 (as amended). Subject to the duties in section 2, these are to:

- further the conservation and enhancement of natural beauty and the conservation of flora, fauna and geological or physiographical features of special interest and to further water conservation;
- have regard to the desirability of protecting and conserving buildings, sites and objects of archaeological, architectural or historic interest; and
- take into account any effect which the proposals would have on the beauty or amenity of any rural or urban area or on any such flora, fauna, features, buildings, sites or objects.

Subject to these, Ofwat has duties to:

- have regard to the desirability of preserving for the public any freedom of access to areas of woodland, mountains, moor, heath, down, cliff or foreshore and other places of natural beauty;
- have regard to the desirability of maintaining the availability to the public of any facility for visiting or inspecting any building, site or object of archaeological, architectural or historic interest; and
- take into account any effect which the proposals would have on any such freedom of access or on the availability of any such facility.