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1. Introduction

- 1.1 Water UK is the representative body and policy organisation for water and wastewater companies across the UK. Given the geographical scope of the consultation, we are responding on behalf of companies wholly or mainly in England.
- 1.2 The Strategic Policy Statement (SPS) is a hugely important part of the legal and regulatory framework of the water sector. It is one of the very few opportunities the Government has to set out policy goals for water, and a rare chance to set out expectations of the economic regulator. Getting these right is crucial; a poorly-constructed SPS will result in a failure to achieve the Government's aspirations for customers and the environment.
- 1.3 This new statement will be the third since the introduction of the SPS in 2013. Although the statements have evolved over time, our view is that they have never met their full potential of galvanising all parts of the sector – regulators, companies, and other stakeholders – to work together towards clear and unambiguous strategic goals. Each, in their way, has been a missed opportunity.
- 1.4 The water sector faces profound challenges in the coming years and decades. Maintaining resilient supplies of this essential public service is becoming harder in the face of the climate emergency and a growing population. Other challenges include the urgent need to decarbonise the sector as part of the Government's overall net zero targets for 2035 and 2050, and the clear need to catch-up with ever-rising consumer and citizen expectations of the role water companies should play in enhancing the environment.
- 1.5 These challenges are bigger than those we have faced before. Their scale means we cannot afford to again miss the opportunity to set a proper long-term direction with the SPS – nor miss the chance to ensure everyone is held to account for delivery. We have to do things differently.
- 1.6 The rest of this response is intended to offer some constructive suggestions about how best to do that.

2. A missed opportunity to provide clear and unambiguous direction

- 2.1 We are encouraged by the growing consensus that, given the long-term challenges facing the sector, a long-term approach is needed in its regulation, and we fully support the establishment by Government of long-term targets under the Environment Bill.
- 2.2 However, while the draft SPS broadly covers the right themes, our view is that it is a missed opportunity to provide a clear and specific direction for the latter part of this decade and confidence that the whole sector will act together to deliver shared goals. Our concern is that without more clarity on the specific goals the Government wants delivered, there is a high likelihood that vital investment will be deferred in favour of perceived short-term pressures. Waiting until the 2030s for that investment will be too late – as a country, we cannot afford to waste the 2020s, and the delay will also increase cost.
- 2.3 We recognise the importance that Defra attaches to maintaining the independence of economic regulation and strongly agree with that objective. We understand, therefore, the reluctance to be seen to ‘micromanage’ targets; after all, the independent economic regulation of private providers of public services has been fundamental to the sector’s transformation of the environment and services to customers over the last 30 years, made possible by over £160 billion of investment at no cost to taxpayers.
- 2.4 However, our view is that the current draft is much too cautious and deferential. It is negligent in failing to make proper use of the provisions made by Parliament for governments to set a strategic direction to the sector’s economic regulator.
- 2.5 As a result, the document as drafted will be ineffective in ensuring that the Government’s priorities are met in a timely – and environmentally sustainable – manner.
- 2.6 The Government has set, or is about to set, a series of long-term targets (for example on drought resilience, net zero and through the Environment Bill on issues like storm overflows) that it views as essential for protecting the public interest. The water industry – enabled by its economic regulator – is at the heart of delivering those public goods. The lack of concrete direction in the SPS to achieve those targets is therefore an incomprehensible gap, and contrasts sharply with the Government’s statements of determined action.
- 2.7 It is essential that the SPS sets an explicit expectation that regulatory decisions at each price review should demonstrably set the sector on a measurable trajectory to meet these long-term targets. This would retain the ability for the regulator to make different decisions across different companies – reflecting, for example, the quality of their evidence and plans – while ensuring broad progress against the things the Government has said it wants.
- 2.8 There is a clear precedent in the communications sector for government, through the mechanism of Strategic Policy Statements, to state timebound objectives that the regulator is tasked with achieving, within the bounds of their statutory duties, and to provide an explicit steer on the relative

priorities to be given to promoting investment and reducing customer bills. We note that the Statement of Strategic Priorities for telecommunications¹ states:

We want the nationwide deployment of gigabit-capable broadband networks at pace. We also want to be a world leader in the next generation of 5G mobile technology, with deployment to the majority of the country by 2027

and

The Government's aim is to promote investment and competition in world-class digital networks, to as many people and businesses as possible. Investment in new networks by BT and alternative providers is key to improving consumer outcomes, in terms of choice, service quality, and innovation. The Government's view is that promoting investment should be prioritised over interventions to further reduce retail prices in the near term.

- 2.9 Not providing equivalent clarity to the water sector run a serious risk that substantive progress towards meeting the Government's long-term targets will be deferred into future periods as a result of perceived short-term pressures. This would not only comprise delivery against the sector's long-term targets but would also be likely to increase overall costs to customers compared to more timely investment².
- 2.10 Providing this clearer and more specific direction regarding the Government's priorities and expectations would not compromise independent economic regulation. On the contrary, it would assist Ofwat by providing the opportunity to demonstrate clearly and unambiguously how its decisions were in accordance with the Government's priorities, strengthening the overall legitimacy of the regulatory framework and avoiding unnecessary and distracting disputes regarding the direction of the sector.

3. Strengthening accountability

- 3.1 However, even with clearer and more specific direction, the SPS risks being ineffective unless appropriate arrangements are in place to ensure that it is acted upon.
- 3.2 While the information provisions for Ofwat in paragraph 10 of the draft statement provide some limited degree of accountability, we suggest that accountability would be enhanced by Parliament taking a more active role. This could, for example, involve a relevant Parliamentary Committee (such as the Efra Select Committee or the Environmental Audit Committee) holding an annual hearing to enable Ofwat to explain, and be scrutinised on, how it is acting in accordance with the SPS.
- 3.3 In our responses to the consultation questions, below, we provide more specific suggestions on how the draft could be strengthened to give the Government greater confidence that its priorities and expectations will be delivered in practice without unintended consequences.

¹ <https://www.gov.uk/government/publications/statement-of-strategic-priorities>

² See, for example, NIC's analysis of the benefits of timely investment to improve drought resilience: <https://nic.org.uk/app/uploads/NIC-Preparing-for-a-Drier-Future-26-April-2018.pdf>

4. Consultation question 1: Has the government identified the most relevant strategic priorities for Ofwat? If not, please provide details of the priorities that should be included.

- 4.1 Broadly, we agree that the most relevant strategic priorities have been identified in the document, although there are two crucial areas which, as drafted, only receive minor references.
- 4.2 Firstly, in an infrastructure sector with an extensive and often long-lasting asset base, ensuring sufficient underpinning investment to maintain the health of the asset base for future generations is an essential foundation for achieving all other objectives. While asset health and how this impacts resilience is referred to in paragraph 26, we suggest that the statement should go further and set an expectation that Ofwat ensures that the regulatory framework takes a forward-looking view of future needs of investment to maintain asset health, rather than relying on assessments based on historic data and an implicit assumption that future will be in line with the past.
- 4.3 Secondly, we note that while the draft recognises that safe, clean drinking water is vital for public health and the wellbeing of our society (paragraph 25), there is little reference to the actions necessary to ensure that this fundamental objective for the sector continues to be met. Maintaining high standards of drinking water quality will require continued focus, both to progressively reduce known harms like lead and to address new or emerging threats in a timely manner, and it would be helpful to recognise this more explicitly in the final statement.
- 4.4 In addition, there two areas where we are concerned that the priorities as articulated would have unintended consequences:

Storm overflows

- 4.5 Water companies are passionate about protecting and enhancing our nation's rivers, and over the next five years will be investing £1.2bn in improving storm overflows as part of a £5bn environment programme. We have been working closely with Defra and other stakeholders on how to go further through the joint industry-government Storm Overflows Taskforce, and fully support the long-term goal set by the Taskforce, and announced by Defra in January 2021³, to 'eliminate harm from overflows'. Meeting this goal will require significant and sustained investment; the focus on eliminating the 4% of harm caused by storm overflows to English rivers would enable environmental benefits to be demonstrated to the customers whose bills will fund this investment.
- 4.6 We note, however, that in contrast with the previously announced goal, the expectation in the draft statement (paragraph 24) is 'to significantly reduce the frequency and volume of sewage discharges from storm overflows', irrespective of whether they are causing environmental harm. Given the scale of investment this would require, the consequence would inevitably be significant upward pressure on customer bills for little or no demonstrable environmental benefit, and the potential for 'crowding out' other investment areas which would provide greater benefits to customers and the environment. While this is a policy choice for the Government, we question whether customers

³ <https://www.gov.uk/government/news/taskforce-sets-goal-to-end-pollution-from-storm-overflows>

would regard this as representing value for money and urge the reinstatement of the goal of eliminating harm.

Managing water demand

- 4.7 We agree that as part of a twin-track approach, it is crucial to manage the demand for water, alongside increasing supply, and companies are committed to play their part in this. We are however concerned that the specific way in which the draft statement proposes to take forward this objective (a target for per capita household consumption, paragraph 30) is suboptimal and would have unintended consequences.
- 4.8 As set out in the 25-year Environment Plan, the overall desired outcome is to reduce abstraction, reducing pressure on the environment. The most effective and efficient way to do this is to incentivise the broadest possible range of actions to achieve this goal, which is why the Government is considering setting a target under the Environment Bill on the volume of water distributed (distribution input) to reflect all water consumption – both household and non-household – and leakage.
- 4.9 A narrow focus on just one component, as proposed in the draft statement, would be less effective and less efficient at achieving the desired outcome of less water being abstracted from the environment. We therefore urge Defra to replace the specific expectation in relation to reducing personal water consumption with an expectation of holding companies to account for their contribution to meeting the forthcoming Environment Bill target on the volume of water distributed.

5. Consultation question 2: Does the strategic policy statement effectively set out government's expectations of Ofwat in supporting delivery of our priorities? If not, please identify where these expectations could be made clearer.

- 5.1 As set out above, our overall concern with the draft statement is that it is not sufficiently clear or specific in its expectations, and as a result will not be effective in ensuring that the Government's strategic priorities are delivered in a timely manner.
- 5.2 This could be addressed by being clear that proportionate progress towards long term targets is expected to be made at each price review, such that the sector is demonstrably on a realistic and achievable trajectory to meet the long-term target. In particular, this should apply to:
- the delivery of targets set under the Environment Bill to meet the outcomes in the 25 Year Environment Plan (paragraph 18)
 - ensuring that the water industry makes a proportionate contribution to meeting both the Government's 2035 target to reduce greenhouse gas emissions by 78% and the Government's 2050 net zero target (paragraph 19)
 - progress towards meeting long-term water resources needs and the need for water companies to be resilient to a one in 500-year drought by 2040 (paragraph 29)

- 5.3 A further area where in our view the expectations should be clearer and more specific is in relation to nature and catchment-based solutions. The multiple benefits from these approaches are widely recognised, and we agree both that their use should be significantly increased and that to do so will need collaborative working between companies and regulators.
- 5.4 However, we believe that there should be greater collective ambition to make the next price review transformative, truly mainstreaming catchment and nature-based approaches. We suggest two amendments to the current text (paragraph 22) to aid in making this transformation a reality:
- that the default national presumption should be that catchment or nature-based solutions are used, with alternative solutions only used if they demonstrably provide better long-term value to customers and the environment or are required by legislative obligations
 - that Ofwat ensures that its regulatory approach supports, encourages and incentivises catchment based and nature-based solutions and removes any barriers to their wider adoption
- 5.5 Finally, in relation to bioresources, the draft statement rightly notes that the bioresources market can provide benefits to customers and the environment by improving affordability, supporting renewable energy and avoiding the need to incinerate waste products.
- 5.6 In light of the continued uncertainty relating to the application of the Farming Rules for Water and the Industrial Emissions Directive, and the consequent impact on the bioresources market, we suggest that the expectations of Ofwat are expanded to include working with the Environment Agency and Defra to ensure that decisions, regulations and regulatory strategy are aligned across organisations and provide best long-term value to customers and the environment.

6. Consultation question 3: Do you consider that this statement to Ofwat is clear and easy to understand? If not, please identify any areas that could be clarified.

- 6.1 In general, we find the statement to be easy to understand; we have though identified some areas that could be clarified.
- 6.2 We note the comments made in paragraph 23 on the industry's environmental performance. Despite the significant environmental improvements made over the last 30 years, which include a 70% reduction in discharged nutrients and a transformation to coastal bathing waters, we must also acknowledge that the public have ever-higher expectations about the environment that threaten to outpace the speed of change. In addition, new threats like climate change are adding to concerns about the lack of progress on increasing the ecological status of rivers. It is clear that the Government, regulators and the water industry need to change aspects of their approach – as will other sectors, responsible for three-quarters of the reasons for rivers not achieving good ecological status.

- 6.3 We have separately set out more detailed thinking on the reforms that will make the biggest difference to the water environment and the health of our rivers⁴. But it is vital that, if we are to make changes for the better, we also understand where progress is already being made. The draft statement does not do this. For example, the latest Environmental Performance Assessment shows a record five companies in England achieving the highest possible 4-star rating for their environmental performance, while serious pollution incidents have fallen to their lowest level ever. To be credible, and bring focus to the right things, the final statement will need to give a balanced assessment of the current situation, avoiding misleading statements about ‘stagnating’ performance, and instead lend its weight to reforms that will allow for a modern, outcome-based, better-monitored approach to the environment.
- 6.4 Paragraph 42 includes an expectation that Ofwat ensures that the impact of any increased investment remains ‘affordable’. To avoid confusion, it would be helpful to clarify that affordability should be assessed in relation to the impact specifically on financially vulnerable consumers, rather than consumers in general. This would avoid inadvertently over-constraining investment to the detriment of all consumers and the environment.
- 6.5 Paragraph 46 notes that water companies should proactively manage customer debt. In doing so, we agree that water companies should raise awareness of the support available to household customers; however, this paragraph also refers to support for non-household customers, who since the opening of the non-household retail market have been served by retail licensees. It would be helpful to clarify whether the reference to non-household customers in this paragraph was intentional – and it may be more appropriate for any expectations of retail licensees in relation to raising awareness of support available to non-household customers to be covered in paragraph 48 on protecting small business customers.

⁴ <https://www.water.org.uk/news-item/water-industry-calls-for-a-wave-of-bathing-rivers-as-part-of-a-new-national-plan-to-improve-the-health-of-english-rivers/>