Wildlife and Countryside LINK

Smarter regulation: Strengthening the economic regulation of the energy, water and telecoms sectors

Submission by e-mail to: economicregulation@businessandtrade.gov.uk

We write as chairs of Blueprint for Water[1], a unique coalition of environmental, water efficiency, fisheries and recreational organisations that come together to form a powerful joint voice across a range of water-based issues. We welcome this opportunity to respond to the consultation on smarter regulation on behalf of Blueprint members.

As our area of interest is water policy, the following reflections focus on Ofwat, taking the five areas covered by the consultation in turn. However, many of the principles we discuss should equally be considered in relation to the other regulators, where relevant.

1) Growth: A full & transparent assessment of the investment needed across the sector

The proposal for an assessment of the investment needed across the sector is a welcome one.

In Water Resources, the National Framework has gone some way to setting out a long-term environmental objective which water resources investment could secure, but the commitment to infrastructure and investment to meet that aspiration does not necessarily follow, being set out instead in various scenarios of varying ambition. A clearer direction to companies on the ambition that infrastructure investment needs to meet, with regards to customer and environmental requirements (rather than specifying the specific infrastructure proposals per se) would give companies and stakeholder the opportunity to identify the best means of meeting future needs, without the prescriptiveness of an 'infrastructure shopping list' which could constrain innovation and collaboration.

In wastewater, learnings can be drawn from the Storm Overflows experience around the folly, in public perception terms, of a lack of investment in both maintenance and development. Regulators must ensure a sufficient focus on management and maintenance, and not just on new investment. Similarly the Flow-to-Full-treatment (FFT) investigation is a lesson that the performance of 'grey' infrastructure can no longer be considered 'safe and reliable' whilst calls for nature-based solutions (NbS) are dismissed due to their performance being 'unreliable'; regulators must weigh up options based on the reality of past performance rather than idealized assumptions. Indeed, investment in NbS would increasingly look like the sensible choice from a societal point of view if the relative merits of one form of infrastructure over another were assessed less in purely economic terms and more by using a full multiple benefits approach.[2] For example, investment proposals for PR24, despite being based on 'best value' rather than a pure economic assessment, are still set to see huge bill increases and significant carbon costs due to their reliance upon built infrastructure. An approach that more fully explored the carbon, biodiversity, flood risk and other (particularly non-monetised) benefits of any delivery proposals would likely drive very

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[1] Blueprint for Water is part of Wildlife and Countryside Link, a coalition of 82 organisations working for the protection of nature. Together we have the support of over eight million people in the UK and directly protect over 750,000 hectares of land and 800 miles of coastline

[2] And indeed, a study published this week by the Consumer Council for Water found that despite cost-of-living pressures, consumers were willing to make some trade-offs to help pay for environmentally-friendly approaches as they recognised they could provide additional benefits.

different outcomes across the water sector, and should be fully implemented for PR29. This would also assist in identifying synergies, particularly in drainage & wastewater management and flood risk, that could enhance coordination across different funding regimes.

Furthermore, the assessment should consider how the sector should work collaboratively with other partners to deliver growth, alongside environmental outcomes. More-so than for either of the other regulated sectors, water utilities have a central role to play in securing better outcomes for the environment, and working holistically with partners from the public sector and civil society will be fundamental to achieving this. Catchments are the natural geography within which decisions relating to the water environment should be taken, and Catchment Partnerships provide an existing vehicle for collaborative decision-making and delivery at the local level; Defra are already reviewing the ways in which the existing catchment planning framework could be supported and outcomes enhanced, and this should form the building blocks of a systems-based approach where catchment partnerships could, with extra funding and mandate, enable more cost-effective investment decisions to be made by the sector. For example, partners in these partnerships are well placed to help companies identify opportunities to implement nature-based solutions, and work with them to implement them, capitalising upon partner expertise, stakeholder relationships and local knowledge. Such approaches – meaning both innovation and collaboration – will be fundamental to improving societal outcomes from company spend.

With regards investment needs, there is a tension between the encouragement of efficiency savings across the delivery period, and the need to ensure sufficient investment in both maintenance and new infrastructure. Pushing too hard on making savings risks seeing planned-for spend not made, and necessary infrastructure not delivered. As this is considered to be a risk across sectors, this is an area where regulators could usefully learn from each other; by sharing the mechanisms that most successfully deliver genuine cost savings as opposed to simply encouraging under-delivery. Our regulatory approach since privatisation has eschewed the case for meeting any but the most pressing and narrowly-defined needs and thereby saving on today's costs at the expense of future resilience. In the water sector, there is an irony with how lauded Victorian infrastructure is on the one hand, yet, on the other how little we take from its design principles, which saw hugely oversized assets accommodating unthought-of levels of growth and demonstrating 'efficiency' only in the distant future. Any needs assessment must revisit the short-termism of recent regulatory practice and the false economy of piecemeal and reactive upgrades. The background deterioration of the natural world and volatility caused by climate change will put huge strain on our water infrastructure in particular, and the bill for repeated emergency actions in the long term will exceed that of preventative actions now. Economic regulation in the English/Welsh water sector model is the perfect vehicle to address a typical market's likely failure to manage these risks and invest accordingly.

The needs assessment must include recognition of the water sector's fundamental dependence on the natural environment and should include an assessment of the future direction of travel for land-use in England, which will be a strong determinant of our future infrastructure needs. A consequence of this must also to be explicit consideration in the role of the regulated sector in *achieving* more favourable land-use outcomes. At present, water consumers pay for retrospective clean-up of raw water sources contaminated with pesticides or discoloured by degraded peatlands. The sector- and therefore consumers- are passive agents in a system of land-use that makes free use of their resources and assets. Water companies must be empowered and incentivised to take a more active role in shaping the landscapes their operations depend upon, thereby minimising the need for more expensive (often carbon intensive) infrastructure that consumers cannot avoid having to pay for. The assessment of need must therefore look holistically beyond traditional infrastructure.

The paper also asks about the effective facilitation of water transfers. In our view these ought all to be underpinned by universal metering as the most sustainable way of understanding and reducing water demand. This will help rationalise the need for major infrastructure development, given the associated costs and potential environmental harms. Just as the greenest energy is the energy we don't use, the same is true for water.

In addition, there is a risk that water transfers are viewed negatively by the public if not underpinned by action to first reduce leakage, and must also be planned with a clear view of abstraction reduction needs, to avoid the creation of stranded assets or the excessive costs of piecemeal solutions.

Any assessment of need must also embed a firm and long-term view of what 'good' looks like from the water sector. Our view is that a modern water sector must operate to strict environmental standards in terms of pollution control; its operations must be sensitively embedded into its environmental context, such that it can fulfil its duties with no overall loss to the environment; and that as the sector is a delivery body for specific water-related environmental targets, it must also play a transparent and directed role in achieving wider nature recovery ambitions, demonstrably supporting species and biodiversity objectives as well as net zero. The infrastructure needs assessment must therefore be made with reference to these and other relevant long-term outcomes, allowing the public to understand in some explicit sense what the water sector is for and what their bills pays for.

2) Competition: comparative performance targets

Blueprint for Water is significantly engaged in the PR24 process having published an environmental manifesto for the Price Review against which we will be looking at the outcomes for the environment that PR24 delivers. However experience from this and prior PRs tells us that despite Common Performance Commitment (CPC) metrics and standard Business Plan Tables completed by the companies, it is not straightforward to understand the performance of one company relative to another. For example, companies with the highest ambition on reducing Per Capita Consumption (PCC) may be those that failed to invest in prior PRs and therefore have the greatest scope to make reductions. As such, metrics that look over a longer period, or measure relative to a more distant baseline, may be more helpful for understanding improvements over the longer term.

In terms of Comparative Metrics specifically - where a company is rewarded or penalised depending upon its performance relative to its peers - we welcome these as a means of driving competition in a sector where the regional monopoly structure otherwise precludes this. (In our view, this form of competition is preferable to one which simply opens up retail markets as has been the case for Business Customers, because this breaks the place-based company-customer relationship and makes it more difficult to make the case for investment in environmental outcomes, which are inherently place-based.)

We recognise that the format of such metrics would need to be carefully devised to avoid unduly penalising those whose performance has already been sector-leading; such as in the PCC example above. An alternative could be metrics fostering collaboration, rather than competition - metrics that encourage companies to share and adopt best practice for the benefit of the customer base as a whole; one or more sector-wide Performance Commitments could be devised whereby all companies would benefit if the target were met.

This would be of most value in an area where sharing learning would facilitate the delivery of better outcomes, so for example around water efficiency, where companies trialling different approaches to engaging business and domestic customers around efficiency would share their success and failures across the sector, to enable faster progress compared to each company devising and trialling methods independently, in a process which can be inefficient and ineffective.

3) Consumers: A multi-sector priority services register

In order to ensure that necessary environmental investments are affordable across the customer base, support for vulnerable customers needs to be a key feature of PR24 and beyond. We welcome the proposal for a multi-sector priority services register, and for better communication of available support, but do not believe the proposals alone will deliver the protections needed.

Defra and the Welsh Government commissioned the Consumer Council for Water to review financial support for water customers in October 2020. The resulting affordability review highlighted the issue of unfairness in the current system and recommended the creation of a national single social tariff. Today, with recognition of the significant environmental challenges faced by the sector that urgently require investment, the need for such support is greater than ever.

We need such action if we are to ensure that this necessary investment in sustainable water management does not push people further into financial hardship. For example, CCW predict that just an extra £100 on water bills will plunge another 1.2m people into water poverty, and many bill increases for 2025 can be expected to be greater than this. Whilst companies have provisions in place to support those in hardship, their variability creates a postcode lottery for vulnerable customers. A single funding pot approach would enable expansion of support in areas where need is greatest – this is important because regions already facing the most significant poverty challenges are often those also requiring the largest environmental investments.

In March 2023, almost 50 organisations from the water, environmental and social sectors, including members of Blueprint for Water, wrote to then-minister Dr Thérèse Coffey MP setting out support for a single social tariff and urging the Government to undertake a promised consultation on a scheme. This ask has yet to be acted upon, and should form a key part of Government action to ensure that necessary investment in the water sector is affordable to society.

Given the role of the water sector in delivering statutory water quality and other objectives, Government needs to be much clearer with consumers about how these goals (and infrastructure) are paid for when targets are set.

4) Duties and functions: Govt departments to review their regulators' duties

We welcome the proposal for government departments to review their regulators' duties, but do not agree that the purpose of this activity should be to 'rationalise duties and enable regulators to focus more on economic duties and functions'.[3] Instead, the purpose of a

[3] Our wider thoughts on the topic of regulator duties are set out in Link's response to the consultation on the Growth Duty draft Statutory Guidance and Link's submission to the DBT Smarter Regulation call for evidence.

review should be to identify how economic regulators can better undertake their duties and functions to contribute to Government ambitions and societal needs. On both fronts, this will include delivering against environmental ambitions; a truth eloquently set out in the Dasgupta review. To ensure the ability of a regulator to consider the needs of the environment is to actively prevent the erosion of the bedrock upon which our economy is seated.

The review should instead look at the effectiveness of Strategic Policy Statements and consider the need to strengthen their effect. For example, for PR24, Government's SPS to Ofwat set 'Protecting and enhancing the environment 'as the foremost priority for Ofwat's oversight of the Price Review, yet it is not at all clear what companies' draft Business Plans, submitted to Ofwat for consideration, will ultimately deliver for the environment; whilst significant *spend* is planned, it is uncertain what this financial investment will translate to in terms of improvements to the ecology of our rivers and coasts, and the condition of our protected sites.

The review should also look at the effect of other Government interventions such as Ministerial Directions, legislation and guidance, in order to determine how a clear and early steer can most effectively be given to regulators, and therefore to the entities they regulate. Particularly with the long lead-in times associated with Price Reviews in the water sector, methods of giving 'advance notice' on priorities will be helpful to companies, who find it difficult to make changes to plans late in the process, or at best, risk doing so with limited opportunity for customer scrutiny.

To provide longer-term clarity, it may be necessary to add rather than remove duties from the list of regulators' functions. For example, a duty to contribute to the achievement of Environment Act targets would set a strategic 'envelope' within which regulatory decisions should be made.

5) Appeals Regime

We have no direct experience of the (non-price control) appeals processes discussed by proposal 11, however in principle we welcome all parts of the proposal. Enabling an appeal to be determined by a group of more than three members will increase the chance that some members will have a background and expertise in environmental or consumer topics, leading to a more 'well-rounded' consideration process. Indeed, there is a case to be made that these two areas should be explicitly represented via the skillsets of members, given the impact that appeals decisions could have upon the environment and customers. The ability to extend a deadline to ensure the fullest consideration of the issues in hand is likely to be welcomed by regulated companies; the very act of taking a regulator decision to appeal demonstrates that companies value getting a 'correct' decision over receiving an earlier but unsatisfactory settlement. The ability to enable consumer interests to be represented in the process by exploring cost recovery powers would be welcome; as cost is identified as a barrier to participation, the government should consider whether other legitimate interests (for example environmental concerns) are unrepresented in the process due to cost concerns, and should determine whether broadening out the proposed cost-recovery solution would be beneficial. Placing a (suitably low) limit on the costs that could be incurred by an intervener, rather than providing for all of their costs to be met by the losing party, may be a necessary way of guarding against spurious or vexatious interventions which could otherwise tie up significant resources and staff capacity, and prevent the consideration of other 'genuine' consumer views. However the government should also consider alternative means of enabling consumer and other representation in the process, such as though dedicated workshop sessions with customer panels – this could be a means of gaining valuable customer perspective without requiring their 'full' involvement in a process which may potentially be lengthy and complex.

With regards water sector price control appeals, we do not have a fully-formed view on the proposal to change Ofwat's price control appeal regime from a redetermination to an energy-style appeal regime, and would wish to contribute to any future consultation on this topic.

We can see the potential benefits of a process which looks at the decision on specific grounds rather than by making a full redetermination, but we also see the risk that a 'cherry-picking' of issues in isolation by the regulated company will result in the CMA unpicking regulator decisions that were made 'in the round'.

A mid-way regime which looked at the award across the relevant 'segment' of the Business Plan for each challenge brought, could represent an approach that is more pragmatic than full redetermination but sufficiently holistic compared to an individual item approach. This could, for example, be done by Price Control line (water network plus / wastewater network plus / Bioresources / etc.) With only 7 Price Control lines used in water company plans, even reviewing one would still be a significant undertaking - and challenges on a handful of items under different PCs could easily see the majority of the Business Plan being reassessed - but neither should the process be so low-risk or low effort for companies that they begin to routinely challenge decisions (- we note that in water, referrals to the CMA are rare, whilst in energy they are very common); so a mechanism based on re-assessment by Price Control could represent an appeals format which is reasonably accessible without being substantially less robust than the existing approach.

We would welcome the opportunity to discuss any of these points further.

Best regards,

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