

Regulation of the water industry inquiry

Written evidence for the Environment, Food and Rural Affairs Committee by the Blueprint for Water

Blueprint for Water is a unique coalition of environmental, water efficiency, fisheries and angling organisations, part of the wider environmental NGO coalition, Wildlife and Countryside Link. Blueprint members come together to form a powerful joint voice across a range of issues.

The following organisations support this response:

- Amphibian and Reptile Conservation Trust
- Angling Trust
- Arocha
- RSPB
- Salmon and Trout Conservation
- The Rivers Trust
- The Wildlife Trusts
- The Woodland Trust
- Waterwise
- Wildfowl & Wetlands Trust
- WWF-UK
- Zoological Society of London

Q1. Is regulation of the water industry improving outcomes for consumers and the environment?

Key points:

- We are concerned that the way in which the water sector is currently regulated may be inadequate after Brexit.
- Ofwat must do more as the economic regulator to take account of water companies' environmental outcomes.
- Corporate governance of the water sector needs strengthening to improve outcomes for customers and the environment.
- There is a mismatch between Integrated Water Management and the desire to create competition. We suggest an urgent review of the fitness for purpose of the new retail market.
- We are concerned that future delivery of significant environmental outcomes by the water sector will be limited by failure to adequately regulate and incentivise land management and agriculture, particularly around diffuse pollution.

1.1. Need for greater ambition on environmental outcomes

1.1.1. Ofwat's role as the economic regulator is central to water companies playing a greater role in improving the environment. We are pleased that Ofwat in PR19 has included

environmental outcomes in its common performance commitments for the sector; that it expects water companies to include bespoke environmental performance commitments, and that it has provided a strong steer to the sector to improve its performance on leakage.

- 1.1.2. In Ofwat's [Initial Assessment Methodology](#), its proposed approach to assessing and grading the water company's PR19 investment plans inadequately recognises or incorporates the environmental regulators' guidance to water companies (see their [WISER document](#)).

Recommendation 1: Ofwat should commit to properly involve the Environment Agency and Natural England in the assessment and grading of investment plans this Autumn and include tests that link to the environmental outcomes set out in WISER. They should publish the detailed results of the assessment.

Recommendation 2: Ofwat should not financially or reputationally reward water companies with 'exceptional' or 'fast-track' status unless they are aiming for top level environmental outcomes, e.g. zero pollution incidents, a reduction in water taken from the environment, a reduction in carbon emissions, and a step beyond environmental protection to environmental restoration.

1.2 Stronger corporate governance needed

- 1.2.1 Until recently, Ofwat has been too weak in terms of corporate governance in the water sector, which has had adverse outcomes for both customers and the environment.
- 1.2.2 Company ownership has often been [dominated by investors interested in short-term financial gain](#), resulting in deferred investment and profits taken before the investor moves on. This can result in a lack of investment in water supply resilience, [major pollution of our rivers](#), sewer flooding and [unacceptable levels of leakage](#)
- 1.2.3 There has also been a lack of transparency around who owns the private water companies, how they are organised, executive pay, offshoring and whether they are paying an appropriate amount in UK taxes, see [Michael Gove's speech](#). Ofwat has not been strong enough to date to redress this in the customers' interests.

Recommendation 3: We propose a published annual Corporate Governance Assessment from the economic regulator alongside the annual Environmental Performance Assessment from the environmental regulator. We would also like to see representatives of customer interests and of the environment on all water company boards.

1.3 Mismatch between Integrated Water Management and the desire to create competition

- 1.3.1 We are concerned that a desire for greater competition in the water sector, the Government and Ofwat are creating an increasingly fragmented and disjointed sector. This brings risks to the environment which relies on an integrated and joined up approach, as nature does not respect boundaries.
- 1.3.2 Government and Ofwat, in a drive to create competition, have separated the retail water market for business water users ([Open Water](#)) and developed separate price controls for water resources and sludge biosolids. The direction of travel is towards an increasingly fragmented water system overseen by an increasingly complex regulatory system.
- 1.3.3 The new retail market for business water is already having adverse consequences for customers and the environment. Reports from several water companies suggest a

breakdown in communication with retail companies since the market was created. Water scarcity issues and improving water efficiency needs concerted action not just from domestic users but also from business users. Whilst government, Ofwat and the environmental regulators have rightly been pushing the water company wholesalers to drive efficiency improvements on domestic use, we are not seeing parallel efforts, ambition or transparency from the retail business market. The recent freeze thaw event also tested this new system and [found it wanting](#) and we are concerned that the system will not work during a severe drought.

- 1.3.4** The water cycle is so defined because its component parts link together. How we manage water resources and our catchments has a direct effect on the ability of networks to convey water; of the company's treatment works to clean it; and of the sewerage network and sludge disposal system to safely discharge wastes without polluting the environment. Artificially fragmenting the water cycle restricts holistic and integrated thinking and risks a blinkered approach to delivery.

Recommendation 4: We propose an urgent review of whether the new retail market is fit for purpose in: (a) driving water efficiency amongst business users; (b) building resilience, and (c) coping during stress periods such drought or freeze thaw.

1.4 Brexit and regulation of the water industry

- 1.4.1** We are concerned that the way in which the water sector is currently regulated may be inadequate after Brexit.
- 1.4.2** The majority of environmental regulations, which have driven much of the investment in improved environmental outcomes by the water sector, have derived from the EU since privatisation. The EU has also provided a "watchdog" role in ensuring those regulations are properly implemented, penalising member states where they are not. How the UK and the devolved countries will maintain, develop and enforce environmental law post Brexit is highly relevant to the water sector in terms of both the level and focus of investment and compliance and indirectly through areas including Agricultural Policy.
- 1.4.3** Brexit will require UK government(s) and the environmental regulators to have a much more active approach to setting regulatory direction and standards, including for the water industry.

Recommendation 5: We would like the EFRA Committee to challenge both government and the water sector regulators regarding the level of preparedness post-Brexit concerning effective regulation of the water sector. Questions might include whether they have the resources and expertise across areas in which we have pooled resources and skills across Europe such as chemicals and invasive species).

1.5 Failure of parallel regulation in the land management sector

- 1.5.1** We are concerned that future delivery of significant environmental outcomes by the water sector will be limited by failure to adequately regulate and incentivise land management and agriculture, particularly around diffuse pollution.
- 1.5.2** Regulation of the water industry in England has driven significant improvements for the environment including cleaner bathing waters, healthier rivers and some of the best drinking water in the world. However, progress in delivering positive outcomes for the water

environment is increasingly limited by a failure of government and regulators to address diffuse pollution from land management including agriculture.

- 1.5.3** Water companies, recognising this failure and the adverse consequences of it on their services and customers, have increasingly intervened through investing in catchment management. However, Brexit provides an opportunity to increase alignment between water and land management regulation and policy.

Recommendation 6: Public payments for land management should be based on the delivery of public goods such as cleaner water and better biodiversity. They should be underpinned by effectively enforced regulation to prevent pollution, with any payments predicated on compliance.

Recommendation 7: The Water Framework Directive “no deterioration” principle (Article 4.1) must be effectively applied, providing a minimum standard on which to build if we are to leave the environment in a better state than when we found it and meet the aspirations of the 25 Year Environment Plan.

Recommendation 8: We would like the EFRA Committee to note the need for better alignment through regulation and policy between the water sector and the land management sector and for greater action to address diffuse pollution.

Q2. Is the water industry adequately delivering a “twin-track approach” of increasing water supplies and reducing water demand?

Key points:

- We do not believe that the water industry is adequately delivering a “twin-track approach” of increasing water supplies and reducing water demand.
- WRMPs fall short of demand management reduction plans.
- Few companies predict halving leakage by 2050 as recommended in the 2018 [NIC Report](#) into the resilience of water supply infrastructure.
- Universal metering should be considered beyond “seriously water stressed areas”.
- Building regulations and industry labelling could help to achieve more from the investment planned by water companies.
- Regional approaches need additional regulator support to ensure that regional solutions are more fully reflected in company WRMPs.

2.1 Water company draft water resource management plans (WRMPs), although better than previously, still fall short of ambitious plans to reduce demand management [1]. In our [Blueprint for PR19](#) we highlight the need to waste less water; reducing the need to abstract, and making our supply system more resilient to drought. Given that resilience is a priority for Ofwat and 23% of English catchments are at risk due to unsustainable abstraction there remains a need for improvement.

Recommendation 9: Although we support greater emphasis on reducing demand, we propose a two-tier approach where demand management is prioritised first followed by supply development.

2.2 We acknowledge the recent round of draft WRMPs showcased a great range of water efficiency work across the industry – whilst efforts vary from company to company, the amount of work was unimaginable just a few years ago. However, this is just the beginning of a long path. The water industry as a whole does not regard ‘soft’ solutions such as water efficiency with the same seriousness as ‘hard’ engineering solutions. The flow of effort and resources is an indicator of this culture.

2.2 Leakage

2.2.1 Reducing leakage is well supported by customers, and a failure to tackle leakage can alienate customers. Ofwat’s steer on a 15% reduction from 2020 to 2025 is clearly reflected in the draft plans, encouraging several companies to significantly increase investment in reducing leakage. The new methodology for the Sustainable Economic Level of Leakage (SELL) seems to have allowed most companies to increase their proposed investment in tackling leakage. However, we question how well the calculation accounts for the environmental benefit of reduced abstraction. Ensuring this benefit is adequately reflected could garner further investment.

2.2.2 Few companies predict halving leakage by 2050 as recommended in the 2018 [NIC Report](#) into the resilience of water supply infrastructure.

Recommendation 10: We suggest a similar steer from Ofwat to that of the 2018 NIC Report will be necessary in subsequent AMPs if we are to see the scale of reduction the NIC deem necessary.

2.3 Per capita consumption

2.3.1 The lack of a comparable steer from OFWAT on water use / efficiency has meant the ambition in draft plans is more limited. The lowest level of ambition being a less than 2% decrease in per capita consumption proposed by Affinity Water for the coming AMP, despite starting off with relatively high levels of customer consumption.

2.3.2 At the other end of the scale, Southern Water’s proposals are industry-leading, planning for a near-10% reduction in the coming AMP. This is underpinned by the company’s ability to implement Universal Metering, demonstrating that the ‘seriously water stressed’ designation not afforded to other companies such as neighbouring Portsmouth places significant limitations on their scope to deliver water efficiency work.

Recommendation 11: We recommend that as water becomes a more national resource universal metering should not be restricted to “seriously water stressed” areas and should at the very least reflect regional water stress.

2.4 Metering

2.4.1 Metering is a precursor to the development, trial and subsequent roll-out of tariffs. Smart meters allied to incentive schemes help to foster behaviour change which embeds water saving approaches. Companies appear resistant to tariff use, often citing a lack of support from customers. However, we question whether in polling, the distinction has been made between punitive tariffs and those which are reward-based, as the latter tend to be much better received. A stronger steer from the regulator will be necessary to further the use of tariffs in future.

Recommendation 12: Enabling water efficiency is not solely within the gift of the water industry. Embedding water efficiency requirements into the Building Regulations, and improving water efficiency labelling (an independent review into this is currently being undertaken by WaterWise) would both help to achieve more from the investment planned by water companies.

2.5 Regional working

2.5.1 We also suggest that regional approaches such as Water Resources East and Water Resources South East, whilst promising in terms of fostering collaboration between companies and with other sectors, need additional regulator support to ensure that regional solutions are more fully reflected in company WRMPs. Currently companies are not being pushed on demand management and leakage because they don't face shortfalls themselves, whilst neighbours are proposing large-scale investment in major infrastructure schemes such as desalination (which potentially come with significant environmental down-sides).

Recommendation 13: Regional solutions to water shortages and resilience challenges should be assessed and reflected in future AMPs, hopefully enabling greater collaboration across the sector, and better outcomes for the environment and for customers.

2.5.2 There remains a failure for water companies to look towards innovative solutions and break from 'business as usual' planning which will be necessary for significantly reducing demand management.

Q3 How can innovation be increased in the water industry?

3.1 Water companies are incentivised to look at developing solutions which assist towards strategic place-making and regional issues rather than company-based commitments. This will need increased contact and early dialogue to develop partnership opportunities with local authorities and catchment partnerships.

3.2 Long term resilience and planning must drive investment despite uncertainty – flexible solutions which can mitigate uncertainty must be encouraged. These tend to be 'soft' and 'green' approaches, rather than hard infrastructure, which remains the preferred water company option. Companies must become more comfortable with accommodating uncertainty and spending more time with partners developing appropriate solutions.

Recommendation 13: We propose that Ofwat deliver strong incentives and disincentives which propel the industry to devise creative solutions to environmental challenges.

Q4. Are penalties and enforcement mechanisms encouraging responsible behaviour?

Key points:

- Environmental permits are not an adequate indicator for meeting Water Framework Directive requirements for waste water.
- Consents relating to sewer overflows should be changed.
- The current system of enforcement of water company pollution incidents – particularly for sewer flows – is not fit for purpose.

Although the level of compliance by water companies with environmental permits is over 98%, water companies are responsible for [at least one serious pollution incident](#) per week. In 2016, the number of pollution incidents reported in England rose for the first time in five years. There was also an increase in the most serious pollution incidents and they were [all associated with sewage](#). In addition, the improvements seen in category 3 pollution incidents over recent years seems to be levelling off.

Recommendation 14: We propose that consents relating to every single sewer overflow should be changed to ensure:

1. The precautionary principle is adhered to – so the environment does not have to be damaged before action is taken. Regulators must deem all sewer overflows high risk unless evidence has shown otherwise.
2. A clear link between river flow and volume of discharge, so that when river flows are low, much tighter constraints are in place.
3. Controls are made on the duration of spills, as well as the frequency.

Many incidents could be prevented as key factors in sewage pollution incidents include shortcomings in monitoring, management and [risk assessments, operational practice and staff culture](#).

Many incidents are linked to sewer overflows. The UK has already been deemed in breach of the Urban Waste Water Treatment Directive by the European Court of Justice ([in relation to the Thames in 2012](#) and the [South Wales coast](#) in 2017) and was prosecuted in May 2017 for non-compliance at a [number of sites across the country](#).

The Environment Agency and Natural Resources Wales have a range of enforcement options at their disposal. These include warnings, prosecutions, fines and the revocation of environmental permits, depending on whether the purpose is to stop the action, restore the environment, bring into compliance or punish the polluter. However, the current system of enforcement of water company pollution incidents – particularly for sewer flows – is not fit for purpose. There are a number of contributing factors, including:

4.1 Reliance on self-reporting

4.1.1 Since 2012, the Environment Agency has reduced its frontline enforcement staff [by a third](#). As such the Agency is becoming increasingly reliant on water company self-reporting and members of the public to notify them of a pollution incident. It is therefore increasingly likely that incidents pass unnoticed or unreported.

4.1.2 It is largely up to individual companies to decide how they will effectively monitor sewer overflows, which is currently largely based on routine sampling that can be insufficient to detect intermittent pollution incidents. Whilst there is an ambitious Environment Agency programme to increase monitoring of overflows, a significant proportion of sewer overflows remain unmonitored and there is little information readily available about the duration and frequency of discharges.

Recommendation 15: We propose this programme is progressed as fast as possible covering all sewer overflows. Water companies should increase self-reporting to improve their performance and the information shared with regulators, their customers and communities. We would also like to see more water companies admitting to incidents rather than cases being taken to court.

4.2 Follow-up action to pollution incidents

- 4.2.1** In 2016, WWF-UK asked water companies what actions the Environment Agency had taken following pollution incidents occurring between 2015 and 2016. Responses from three water companies revealed that 93%, 81% and 57% of incidents did not result in any follow-up action¹.
- 4.2.2** Meanwhile, the number of Environment Agency prosecutions for all environmental offences dropped year-on-year from over [300 in 2007 to over 50 in 2015](#).

4.3 Size of penalties

- 4.3.1** In 2014, [revised sentencing guidelines](#) dictated, “the fine must reflect the seriousness of the offence and the court [is] to take into account the financial circumstances of the offender”. This was pivotal in increasing the size of fine companies have recently received relating to sewage pollution and is a key step forward in ensuring it is no longer cheaper for a company to pollute than invest to prevent pollution. In March 2017, Thames Water was [fined a record-breaking £20 million](#) for sewage pollution that occurred over 2012-2014.
- 4.3.2** As a result, companies are being more proactive. For example, Thames Water analysed previous pollution incidents and detected that energy use at a treatment works surges directly before key pollution incidents. Monitoring energy use can therefore help predict when an incident is likely to occur. Its new Wastewater Operational Centre monitors near-live data and advanced weather radar to detect potential problems and respond. This has resulted in [a significant reduction in pollution incidents](#) from their peak in 2013.
- 4.3.3** Although record breaking, the fine to Thames Water was equivalent to just ten days’ worth of the company’s operating profits. Further action is needed to ensure companies take pollution incidents seriously. The Environment Agency Chair, Emma Howard Boyd, called for water pollution penalties to be made tougher as the Agency published its “State of the Environment” report earlier this year. She said “financial penalties must force board members to seriously consider environment risk, and not see it as an operational expense.”

Q5. Are there any potential benefits for the environment that could be achieved though regulatory divergence post-Brexit?

Key points:

- It is vital that EU environmental regulation is not weakened post-Brexit through regulatory divergence.
- Our inability to meet some of the requirements set out in the Directives has often been down to poor implementation.
- Water companies can help improve implementation through a range of measures and deliver improvements in the water environment beyond regulation, e.g. innovation and investing in sustainable abstraction.
- EU regulation has driven investment particularly in waste water infrastructure.
- To ensure improvement and investment in a healthy water environment we must be able to hold Government to account for its own performance.

¹ WWF analysis based on responses to Environmental Information Regulations Request made to all 10 water and sewerage companies in October 2016

A healthy natural environment is at the heart of a resilient and successful water industry able to meet the needs of customers now and in the future.

5.1 Maintaining levels of protection

- 5.1.1** EU directives such as the Water Framework Directive, Bathing Water Directive and Urban Waste Water Treatment Directive have delivered significant environmental improvement, triggered investment in environmental safeguards and enhancement and provided a strong incentive to avoid deterioration.
- 5.1.2** If divergence from EU law weakened legal obligations on water companies, this would likely result in reduced spending and investment decisions by the water industry to the detriment of UK water quality. If the UK wants to be global leaders, environmental protection must be valued and invested in.
- 5.1.3** EU regulation has driven investment particularly in waste water infrastructure, without which there is no other current regulatory driver. For example:
- The Thames Tunnel is the proposed solution to the UK breaching the requirements of the Urban Waste Water Treatment Directive owing to the frequency of spills from Combined Sewer Overflows along the River Thames. This £4.2 billion investment to ensure capacity within the Thames sewer network to deal with current demand would not have occurred without the threat and implementation of [serious fines to the UK](#).
 - Welsh Water are investing £115M by 2020 to deliver sustainable drainage systems in and around Llanelli in order to try to meet Directive requirements.
 - The proposed Water Industry National Environment Program for PR19 potentially requires water companies to invest millions of pounds to ensure they meet statutory requirements under the EU Directives. Without such drivers water companies are unlikely to propose sufficiently ambitious levels of investment. These are required if the quality of our water is to be improved.
- 5.1.4** The water industry also benefits from regulation that limits pollutants entering the waste water system. This ultimately affects treatment costs.

Recommendation 17: It is vital that regulations which control the release of pollutants from industry such as the Integrated Pollution Prevention and Control Directive are also not weakened and we retain access to the Environmental Chemicals Agency and REACH (see [Link's response](#) to the EAC inquiry into the Future of Chemicals Regulation after the EU Referendum.)

5.2 Improving implementation

- 5.2.1** Our inability to meet some of the requirements set out in the Directives has often been down to poor implementation, such as a failure to review measures or impose costs on polluting sectors, rather than reflecting flaws in the regulations/directives themselves.
- 5.2.2** Water companies can help improve implementation through:
- Effective, transparent, accessible and adequately resourced monitoring and reporting.
 - Action on emerging chemicals – water companies currently monitor a range of emerging chemicals and this must result in action where a chemical is shown to significantly affect the environment. In addition research must keep up to date with new emerging chemicals post Brexit followed by relevant monitoring and action.

- Action to ensure that land management sectors make a much greater contribution to reducing the impact of their activities on the water environment.

5.2.3 The reluctance of governments across the UK to apply the measures needed to deliver the environmental requirements currently required by EU Directives does little to inspire confidence that our performance would be better without them. The benefits of EU environmental regulation and consequential risks of Brexit have been highlighted in many reports [1][2].

Recommendation 16: We suggest four areas the water industry could help deliver a healthy environment in addition to EU regulations:

- Help deliver 25 Year Environment Plan through habitat creation, catchment partnerships and integrating sustainable drainage systems
- Produce and enhance natural capital accounts
- Investment in sustainable abstraction – most investment by water companies to address issues arising from unsustainable abstraction is as a result of WFD
- Advancing innovation within agricultural policy (such as reverse auctions to drive down nutrient inputs)

5.3 Government accountability

5.3.1 To ensure improvement and investment in a healthy water environment we must be able to hold Government to account for its own performance.

Recommendation 18: We propose an independent Commission with the power and resources to undertake investigation and enforcement proceedings. In addition, environmental principles, such as the precautionary principle and the polluter pays principle, must be applied by the Government in its decision making.

5.4 Agricultural policy

5.4.1 As mentioned in Q1 agriculture has a significant impact on the water industry as such we refer you to [Wildlife and Countryside Link's response](#) to the Government Health and Harmony consultation which sets out important recommendations. We have made significant achievements over recent decades in improving river and bathing water quality but there is still much to do. We cannot risk reducing water company investment in improving the environment through weakening the regulatory framework that underpins it.