

Defra

The government's strategic priorities and objectives for Ofwat

Background to CIWEM

CIWEM is the leading independent Chartered professional body for water and environmental professionals, promoting excellence within the sector. The Institution provides independent comment on a wide range of issues related to water and environmental management, environmental resilience and sustainable development.

CIWEM welcomes the opportunity to respond to Defra's consultation on its Strategic Policy Statement (SPS) for Ofwat. This response has been formulated with the assistance of a number of our technical panels who have a wealth of experience in the sector.

Summary

CIWEM welcomes the focus of the statement on resilience, the environment, natural capital and delivering best value for customers in the long term. In general:

- ◆ We welcome the expectation for Ofwat to promote ambitious action to reduce leakage and per capita consumption.
- ◆ Resilience should be considered in the wider context of the water environment. Ofwat should be challenged to ensure value for customers whilst taking explicit account of the needs of other sectors that are also relevant to customers (i.e. the environment, energy and agriculture).
- ◆ Reducing carbon emissions in the water sector should also be made a priority.
- ◆ We welcome the expectation for Ofwat to challenge and incentivise companies to include promoting, adopting or maintaining sustainable drainage systems. We would like to see water companies becoming the default 'adopter' for sustainable drainage systems in new developments, should these be built in line with their adoption criteria.
- ◆ Whilst we welcome the identification of high risk sites from the national flood resilience review, we are still concerned that this did not address flooding from surface or groundwater sources. Further studies into flood resilience will be needed and adaptation measures put in place.
- ◆ The market for environmental services should be expressly based on the polluter pays principle.
- ◆ We are yet to be convinced that the requirement to promote retail competition can be compatible with the requirements to improve service resilience and protect vulnerable customers. We agree that the lessons learnt from the business retail market should be used to inform the decision as to whether retail competition should be extended to households. Building the evidence base further is key.

- ◆ More data is needed to establish the clear business case in the new markets for water resources (household competition) and bioresources. CIWEM considers there are still concerns over harmonisation of regulations and standards for co-digestion of sewage sludge and organic waste.
- ◆ Customer resilience (including preparedness) should also be included in the statement to recognise wider societal issues.

Whilst the SPS recognises that whilst the UK remains a member of the EU the rights and obligations of membership will remain in force, we are concerned that the document does not address some of the potential challenges from EU exit. For example the document references Defra's 25 year environment plan for England, yet this may not be released until the end of this parliament. There is also likely to be a delay to legislating abstraction reform.

There is other good practice among the devolved administrations that Defra should be considering in setting Ofwat's priorities. The SPS does not recognise that Wales has developed different legislation, such as the *Well-Being of Future Generations (Wales) Act 2015*, which is driving a different policy direction compared with England. As Ofwat covers Welsh Water too, its guidance needs to allow for this interface.

Response to consultation questions

7. Has the government identified the most relevant strategic priorities for Ofwat?

Overall yes, although please see our answer to question 8.

8. If not, please set out any strategic priorities you consider should feature

Paragraph 8 priority:

Ofwat should challenge the water sector to plan and invest to meet the needs of current and future customers, in a way which offers best value for money over the long term.

As well as mentioning the needs of current and future customers, the needs of the environment should also be mentioned in this priority as the two are interlinked. Especially as these are recognised in paragraphs 22-26, but not given their own priority.

We welcome the statement in paragraph 9 on the need for "*collaboration with other water companies, local authorities, and partners*". This is important in order to enable cost-effective large-scale water efficiency options. We suggest that this is made explicit in the guidance so that water companies can feel reassured when proposing collaborative schemes that these will be considered in the Ofwat framework, in terms of the benefits they provide as well as the costs to customers.

Paragraph 36 priority:

Ofwat should promote markets to drive innovation and unlock efficiencies, with the aim of furthering: (i) the long-term resilience of water and wastewater systems and services; and / or (ii) the protection of vulnerable customers.

CIWEM is yet to be convinced that the requirement to introduce markets along with the associated market operator in the water industry can be compatible with the requirements to improve service resilience and protect vulnerable customers. We question whether this will unlock efficiencies, drive innovation or help protect vulnerable customers. Any changes in this respect should fully account for all of the costs and benefits including the extra costs needed to administer these markets and the potential for customers to be more confused about who is providing their water and wastewater services. A key lesson from Scotland opening of retail market was the need to properly communicate the options available and make exercising choice simple.

We are not aware of any evidence that demonstrates promoting competition will further long term resilience. Is the government investing or preparing to invest in research to assess the contribution of market separation to water sector resilience (which includes the resilience of organisations, infrastructure and financial systems)?

Following a recent CIWEM workshop on the subject we consider that more data is needed to establish a clear business case in the new markets for bioresources. There is a lack of data as to the benefits with some water companies unaware of their own sludge treatment costs. To move forwards there will need to be a better understanding of the capex and opex in the water industry and of capacity nationally. There remain significant barriers including the need to harmonise regulations and standards for co-digestion of sewage sludge and organic waste. As noted in paragraph 41, building the evidence base further is key.

Upstream competition as outlined in paragraph 43, could also include demand management services, as was highlighted by the *Cave Review*. Defra could give guidance to Ofwat around demand management as part of strengthening upstream competition. For example where water companies are setting out the requirements based on supply-demand deficit (i.e. needing x MI/day), new providers of large-scale demand management services could be considered to meet this by reducing water use. Ofwat could consider how incentives from water companies could enable the supply chain to develop this way. Although this could happen under the current regulatory regime, CIWEM is unaware of any upstream competition bids based on demand management to date.

CIWEM considers mitigation to climate change should also be included as a priority. We would welcome a discussion around how carbon emissions should be considered as part of overall best value for money over the long term during optioneering, in order that carbon emissions are reduced for the sector in line with our commitments under the Paris Agreement.

9. Will the supporting objectives effectively underpin Ofwat's delivery of the strategic priorities?
Generally yes, but there is room for improvement, as noted in question 10.
10. If not, please identify any key objectives that could be strengthened or key objectives you consider to be missing.

Paragraph 11 Objective:

Ofwat should further a reduction in the long-term risk to water supply resilience from drought and other factors, including through new supply solutions, demand management and increased water trading.

CIWEM welcomes the priority to secure long term resilience in water supply through new supply solutions, demand management, water trading, and reducing infrastructure failure to the full range of hazards. However the language used could be clearer in referring to 'risk' and 'resilience'. Perhaps the use of 'threats to' resilience, rather than 'risks to' resilience (replace also in paragraph 19) as 'risk' has certain meanings. Additionally, approaches to examine risk are distinct from those used to examine resilience. Threats/ hazards are well established terms in this respect, which prevent confusion with risk.

Clarity could also be provided as to what 'other factors' Ofwat is expected to focus on, including the water supply system failure modes (rather than just threats such as drought) that could be considered. Mention of customer resilience (including preparedness) would also be worthwhile, as an alternative set of interventions to solutions such as new supplies, demand management and trading.

We support the expectation that Ofwat will recognise the need for significant investment using a 'twin track' approach and for the need for increased water trading to share existing capacity more effectively. However there will inevitably be competing priorities when attempting to reconcile these needs and further guidance may be needed from Ofwat as to how to prioritise competing demands when conflicts arise and how to measure 'best value' more objectively.

Certain assumptions are also made, for example, paragraph 14 suggests a 'twin track' approach will effectively promote system resilience without referring to supporting evidence. This is particularly pertinent given accelerating the process of providing development consent is mentioned in the same paragraph (and specifically in paragraph 27). We consider that the SPS should not 'green light' planning consent for large supply-side schemes without significant scaling up of demand management. There is an opportunity for the government to develop a more holistic approach across the sector through the National Policy Statement, working with Water Resource Management Plans (paragraph 14). This will also help to achieve Sustainable Development Goal 6 and its indicators on water use efficiency.

The SPS refers to the supply side issues and drought in paragraph 11 and references the Water UK Long Term Planning Framework Report. This report also outlines extended water efficiency practices (smart metering, tariffs, retrofitting 65% of properties, new home standards of 105 litres per head per day and reduced leakage through active leakage control and pressure management) as well as enhanced water efficiency (all new homes achieve 105 litres per head plus extensive retrofitting, large-scale mains replacement for leakage). The report also highlights significant policy and regulatory support to achieve cost effectiveness to deliver the 'extended' demand management strategy.

In paragraph 15 Defra asks Ofwat to "promote ambitious action to reduce leakage and per capita consumption, where this represents best value for money over the long term". CIWEM recognises that ambitious actions that deliver value for money will also need greater collaboration between water companies and changes to government policies. This could be facilitated by the Water UK sponsored Water Efficiency Strategy Steering Group, which

includes Defra. The final Water Efficiency Strategy for the UK is due to be published in spring 2017 and the SPS could also reference this for Ofwat and water companies to consider.

It is good to see water sharing and reuse schemes highlighted in paragraph 16, but again it should be highlighted that evidence is required to demonstrate where such interventions effectively enhance resilience. Additionally, does 'best value for money' include non-tangible benefits/ externalities? If not it may not represent the best measure of the long-term contribution to resilience of a solution.

Paragraph 17 objective:

Ofwat should challenge companies to improve planning and investment to meet the wastewater needs of current and future customers.

CIWEM agrees that companies are not planning and strategically investing in wastewater infrastructure in the same way as public water supply. The sewerage system's performance cannot be isolated from the performance and long term capacity of other types of drainage (both urban and rural). Planning should take account of local drainage infrastructure and planning/ development should have a much stronger duty to not just prevent deterioration, but seek to improve the current flooding risk where brownfield development or redevelopment is being planned.

Defra should consider introducing a resilience aspect to this objective, as this would help Ofwat enable water companies to enhance their consideration of the responsiveness within wastewater/ stormwater infrastructure. We welcome the expectation for Ofwat to challenge and incentivise companies to include promoting, adopting or maintaining sustainable drainage systems (SuDS). This should also be highlighted in the section for new housing for a growing population. CIWEM considers water companies are the optimal 'adopter' for SuDS in new developments, should these be built in line with water company adoption criteria.

Paragraph 19 Objective:

Ofwat should work with water companies to ensure that they assess the resilience of their system and infrastructure against the full range of potential hazards and threats and take proportionate steps to improve resilience where required.

This is well phrased, using recognised and understandable resilience-focused terms.

Paragraph 21

CIWEM supports paragraph 21 on additional resilience. Whilst we welcome the identification of high risk sites from the national flood resilience review, we are still concerned that this did not address flooding from surface or groundwater sources.

We consider resilience should be considered in the wider context of the water environment. Ofwat should be challenged to ensure best value for customers taking explicit account of the needs of other sectors that are relevant to the same customers, including the environment, energy and agriculture.

A high-risk site may already have high resilience to certain threats/ extreme events. Risk and resilience are measured in and responded to in different ways and this needs to be recognised across Defra, Ofwat, the water companies and a number of other parties. Assessment of both risk from, and resilience to, a range of threats needs to be encouraged.

Paragraph 31 Objective/ Paragraph 32

Ofwat should challenge companies to improve the availability, quality, promotion and uptake of support to low income and other vulnerable household customers.

This objective could also mention customer resilience and how that might also assist those less able to pay. This may also help with measures to reduce bad debt across the sector. This could also apply to small businesses mentioned in paragraph 34 objective.

In order for the sector to deliver its priorities and objectives, consideration is required regarding the value of water. Mitigating against increased water scarcity and flood risk as a result of climate change and population growth, increases the value of water and we would welcome consideration of this in the document.

11. Do you consider that this statement to Ofwat is clear and easy to understand?

Overall yes, as many areas are covered, though some terminology used is confusing as some terms are used interchangeably.

12. Please identify any areas that could be clarified.

The interlinked and interdependent nature of a lot of the elements covered is underrepresented in the statement and could be improved.

13. How should we measure Ofwat's success in securing the government's strategic priorities and objectives?

Success should be measured by the degree to which water companies and other undertakers have met their regulated and unregulated duties whilst achieving resilience within their organisation and contributed to the resilience of the sector as a whole. Value for money in the long term is a key component, recognising that funds are likely to be required in the shorter and medium term to fully address the issues and conflicting priorities. This long term component should be factored in to any measure of Ofwat's success, to prevent a short term focus on results and prices.

The SPS would benefit from how Ofwat is to evaluate value under conditions of long-term uncertainty. In particular it would be good to see Ofwat embrace decision making techniques such as robust decision making that are starting to be used by water companies.