

Environment, Food and Rural Affairs Committee

Oral evidence: Work of the Department and its arm's length-bodies, HC 415

Tuesday 26 November 2024

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[Watch the meeting](#)

Members present: Alistair Carmichael (Chair); Sarah Bool; Charlie Dewhurst; Helena Dollimore; Sarah Dyke; Jayne Kirkham; Josh Newbury; Andrew Pakes; Jenny Riddell-Carpenter; Henry Tufnell.

Questions 77 - 175

Witnesses

I: David Black, Chief Executive, Ofwat; Helen Campbell, Senior Director for Sector Performance, Ofwat; and Chris Walters, Senior Director for Price Review, Ofwat.

Written evidence from witnesses:

– [Ofwat](#)

Examination of witnesses

Witnesses: David Black, Helen Campbell and Chris Walters.

Q77 Chair: Good morning, and welcome to the Environment, Food and Rural Affairs Select Committee of the House of Commons. We are delighted to be joined this morning by colleagues from Ofwat. David, you are very welcome to the Committee. Can I invite you, for the benefit of the official record, to introduce yourself and your colleagues?

David Black: I am Chief Executive at Ofwat.

Helen Campbell: I am a Senior Director at Ofwat.

Chris Walters: Good morning. I am the Senior Director for PR24 at Ofwat.

Q78 Chair: Good morning. You are very welcome.

We want to start this morning with some questions about the economic regulation of the sector, something that has been the subject of some considerable political comment and controversy. David, we appreciate that Ofwat is a creature of statute, that you have your remit and your objectives set by the Government. However, looking at where it has brought us, regulation of the sector has failed, hasn't it?

David Black: No, I would not agree. I think it does show the need for strong regulation of the sector and it does show the need for the actions that we have taken as a regulator in recent years to turn around performance of the sector. It is clear that the sector needs to change and certainly issues around public anger over storm overflows, sewage discharges, and concerns about companies' corporate behaviours very clearly signal the need for change.

That said, it is important to keep in mind that since privatisation, the sector has raised over £240 billion of new investment. There have been significant reductions in leakage to the lowest ever levels, a 40% reduction over the last 30 years, and there is more to do. Areas that we are focused on are improving and playing a role in providing strategic leadership for the sector. We are going to back a record level of investments to turn around performance, and we are working to change the culture in the sector to one that owns responsibility and to drive up performance for customers and the environment.

Q79 Chair: Regulation has been so successful that we need to have all these changes?

David Black: We are very clear that there is a need for change, but it is our role as regulator to help drive that change and protect the interests of customers and the environment. Clearly, the issues that we see do require changes across the board and that is all about—

Q80 Chair: Can I just take you back to the objectives set out in the 1991 Act?



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Your objectives, as amended, are to protect the interests of consumers?

David Black: Yes.

Chair: Do you feel that that has been a success?

David Black: Take, for example, customer bills. They have increased since privatisation. However, we have saved customers billions of pounds at each price review by driving value for customers. We have also seen improvements in services. I have talked about leakages being reduced by over 40% since privatisation. That is on the back of around £240 billion of new investment. That has seen, for example, the replacement and relining of 40% of water mains over the last 30 years. So, while it is very clear that some things need to change, we can point to real successes in the model since privatisation.

Q81 **Chair:** "Ensuring that water companies are financially able to carry out their statutory functions and that these functions are properly carried out." Is that a fair description of, for example, Thames Water at the moment?

David Black: Thames Water very clearly has issues with its financial structures, and we have taken action to make sure that customers do not bear the consequences. At privatisation, it was always expected that we might see companies fail. That is why the special administration regime was created. Ofwat's role is not to stop companies going bust. It is our role to make sure that customers' interests are protected when companies are not able to meet their obligations, but the point is that the sector has raised finance. The sector has raised around £100 billion of finance since privatisation and has used that to finance around £240 billion of investment.

Q82 **Chair:** Then to, "Check that water companies abide by the terms of their licences". That may be a more direct process point. Then to, "Encourage the water industry to take steps to secure the long-term resilience of water supply and wastewater systems". Compared to where we were in 1991, success or failure?

David Black: The resilience duty is a new duty added to us since 2014. It has changed the way that we look at the sector and, in particular, the focus we have put on securing new water resources. In the last price review, in 2019, we set aside around £500 million of funding for companies to investigate and develop new water resources, and I am pleased to say that at this price review we have over 18 schemes worth over £25 billion coming forward. These are major new reservoirs, major new water recycling schemes, and major water transfer schemes.

These will require planning consent and that has been a challenge for the sector in the past. For example, a major reservoir in Oxfordshire was denied planning permission in 2012. However, we are confident that the sector does have a set of options now that does allow the challenges of climate change to be addressed.



Q83 Chair: We have seen this development in the models of ownership of water companies over the years. It has been an evolutionary process, but it has moved quite far. We have gone from low-risk, low-yield models to something that has returned rather more significantly higher yields. How do you think that has impacted the industry?

David Black: Companies at privatisation were listed and so we have seen a move for most companies to move into either private equity models or in Wales, we have a not-for-dividend company model.

We do see variations in performance. We think there are particular challenges with the private equity model, where there are consortiums of private equity owners, but it is not the case that all private equity firms have performed poorly by any means. We do think there are some benefits in the listed model, but we regulate to try to secure the best outcomes from each model.

One of the things that we have changed perhaps since we were established is to put much more weight on company performance for customers and the environment than into driving their returns. At privatisation there were relatively few incentives in place for companies to improve service. In this coming price review, we will have a much sharper focus on environmental performance. One of the things that Ofwat needed to change was to basically align the returns of investors with performance for customers and the environment, and those are the steps that we are taking now.

I do think there are certainly lessons to be learned from the levels of debt that some of the companies have taken on. At privatisation, we were not established to stop companies going bust, but we do think that more preventive action would improve outcomes, and we now have new powers to do just that.

Q84 Chair: Obviously it would have predated your tenure, but why did that preventive action not happen?

David Black: In the early to mid-2000s, there was the development of the use of high gearing structures in energy, water, and aviation, and all regulators took the approach of putting additional protections in place in terms of requirements for companies to obtain investment credit ratings, but they did not take more active steps than that. That model has not been successful. We should have had tighter controls and that is why we have changed the regimes since we received new powers to do so in 2020.

Q85 Chair: Some of these credit ratings are now through the floor, aren't they?

David Black: Yes. In a sense, the model does work but it takes a long time. I think rating agencies have been quite slow to downgrade companies and that comes back to the issue that that protection may



apply too late. Effectively, the regime stops investors taking money out once they lose a good—

Q86 **Chair:** As a regulator, what other performance indicators should you be looking at?

David Black: We think some of the basic ones around customer service, customer satisfaction, things like leakage, as well as on the environment side, pollution incidents. We now have good data from storm overflows and sewage discharges, so that should be part of it as well. Sewer flooding in homes is a really distressing issue for customers, so that is a key measure for us as well. Then obviously the compliance with regulatory obligations and terms—

Q87 **Chair:** What are these performance indicators telling you at the moment? Customer satisfaction?

David Black: Customer satisfaction is not good. When we compare the water sector with other utility sectors it looks quite similar, but all utilities tend to rate towards the bottom end of customer rankings. What concerns me most is that we do not have a water company that is in the top quartile of customer satisfaction. We have some better performance but, overall, we do not see enough good performers in the sector and the worst performers tend to be at the bottom of national league tables, along with other utilities and transport providers.

Q88 **Chair:** What powers do you effectively have to turn this round? Licences, price review process, what else do you have?

David Black: Our key tools are the price review and the company licences. That is the rules that we set around company compliance. Since 2021, we now have much stronger powers to change company licences. We went through a period of 30 years where we did not have good powers to change company licences. I think that was a key weakness in the regime that has now been remedied.

As for future questions, there are questions around investment planning. At the moment most of that sits with the Environment Agency in England and Natural Resources Wales in Wales. The question of whether we have the quantum of environmental investment right is clearly in sharp relief given the issues that we see in the sector, and we think that the planning process has not delivered the kinds of outcomes that have kept pace with climate change.

We are also looking at new powers in terms of board governance and oversight. The Government have the Water (Special Measures) Bill before the House. That would give us new powers in regard to executive pay. We also think that there are some powers that are perhaps more technical around enabling more competitive procurement of infrastructure.



You may be familiar with the Thames Tideway model, the £4.6 billion new super sewer going under London, which will reduce sewage discharge by up to 95% in the tidal Thames. That model is the first project of its kind, and we would like to see it used more frequently across the sector. It is possible to do so, but the legislation is constrained on that so we think that should change.

We also think that our enforcement powers, in terms of our powers to require companies to provide redress on issues, are quite limited and need to be modernised.

Q89 **Chair:** It is quite a crowded landscape in terms of regulation, isn't it?

David Black: Yes.

Q90 **Chair:** Is that helpful? Could it be streamlined?

David Black: There is a question for the Government about the different regulators and how the regulatory models work, but we think the most important thing is for us to make the most of the powers that we have. So, for example, we have established RAPID, which is our regulatory alliance with the Environment Agency and the DWI—Drinking Water Inspectorate—to bring forward major new projects and we have seen real success with that model. We are seeing 21 new projects coming forward.

Q91 **Chair:** You have this new growth duty, which gives you fairly broad priorities. What are you doing to make sure that this range of duties under your growth duties is achievable?

David Black: Yes. One of the key areas is around investment to support growth, particularly growth in new housing, growth in new business sites. We are looking at that as part of the 2024 price review. We will look at how we can take action to make sure that companies are investing to anticipate and meet growth demands.

It is also very clear that in places, wastewater infrastructure is a potential constraint to growth, so we need to make sure that that is addressed. Then there is a question about whether companies are complying with their duties, making sure that they are doing all that they can to address issues that might arise from growth and new development.

We have reviewed that new duty and how we can implement it. We will consult on that as well.

Q92 **Charlie Dewhirst:** I would like to explore that complex regulatory environment a little bit more. How would you assess the current effectiveness of your working relationship with those other regulators, such as the Environment Agency, Drinking Water Inspectorate, or Natural Resources Wales?

David Black: We work closely with them. I meet frequently with the chief executives of the Environment Agency and the Drinking Water Inspectorate. We have established RAPID, the bespoke operation on new



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water infrastructure. We think the area of wastewater is more complex, and that is where we have been working hard with the Environment Agency in England and Natural Resources Wales in Wales. For example, the key investment driver for the wastewater investment is the water industry national environment programme. We have been looking at how we can work with the Environment Agency to reform it so that we get the kind of outcomes that people expect from the water sector.

Q93 Charlie Dewhirst: If you had a blank piece of paper and you were to start this all over again, what would you change in terms of the regulators, the regulatory environment or the legislation under which you are working?

David Black: There are questions about the allocation of responsibilities between the Environment Agency and Ofwat. That must be clear. For example, the Environment Agency set permits on waste water treatment works. I think that it is absolutely right that they do that and that aligns with their duties elsewhere with industry and farmers. It is really important that the regime that we operate encourages companies to comply and to go well beyond what the Environment Agency does.

The challenge with any regulatory regime is to get the best out of the arrangements that exist. There is a question about how the Government want to allocate responsibilities, which no doubt we will investigate with the review by Sir Jon Cunliffe. There is a question for the Government in that space. However, in terms of working closely with the Environment Agency, we think about making sure there is effective information sharing between them and us, and then making sure that we are using our enforcement powers in a way that reinforces the activities of each other.

Q94 Charlie Dewhirst: It is a fascinating and interesting subject area and the Environment Agency's relationship with other agencies in this space is also something that I have no doubt we will be exploring in due course.

The structures of the water companies themselves are complex. Does that hinder your work as a regulator? Would there be a better way forward in terms of how those companies are set up?

David Black: We have what we call a regulated company structure. There is a licence that sets out the requirements for companies. We think it is very important that they are transparent and we have put quite a lot of weight in terms of making sure that the requirements that we have on companies to be transparent about their finances and explain them are in place. Companies have more to do in that space. We think that some of the corporate structures that companies have traditionally used were not helpful, things such as Cayman Island structures, which I think were developed for issuing bonds rather than for tax purposes but, none the less, have certainly not helped the sector. That is why we have been pleased to see companies take action to address those issues.



Helen Campbell: Can I just add something to that? I think it is right to look at structures for companies, but also Ofwat has done a lot of work on the governance of companies and making sure that there is good balance in boards so that it isn't solely represented by investor nets, for example. We have introduced standards and principles around good governance, and we are looking at refreshing them as well in light of the latest developments in good corporate governance.

Q95 **Charlie Dewhirst:** Thank you. Lastly for now on this, you say you want to make the water industry national environment programme more transparent. Can you go a little bit further into that? How do you intend to make that happen and what you want to see?

David Black: That programme is led by the Environment Agency. It is a huge environmental investment programme. The price review that we are talking about, which is over £20 billion of investment, will touch every community across England and Wales. We would like that to be fully transparent and there to be an open consultation process on that. We would like to see participation by environmental groups in the design and the delivery of that programme.

We will be encouraging companies to be very clear about the schemes within that programme—around 17,000 individual schemes—and to engage with their communities as they deliver on this programme over the next five years.

Q96 **Henry Tufnell:** Just following on from the point around it being a crowded space from a regulatory point of view, do you think there has been a democratic deficit and lack of accountability, particularly with Ofwat? We have had a huge amount of anger from the public. You are here today. What are your thoughts about that democratic deficit in that regulation space?

David Black: We think it is really important that, as a regulator, we engage as part of this price review and Chris can talk more about that. We have engaged. We have held public meetings on our draft determination decisions. Over 700 customers attended those meetings and shared a broad range of opinions. We had an independent chair to make sure that customer voices were heard.

We think it is a real challenge, but it is one of the opportunities that we actually have as a sector, curiously, as you have said, because the public is very much more engaged on these issues than they were, say, five years ago even and much more so than they were a decade ago. We do require companies to engage with customers as well. We think it is absolutely right that customers are at the centre of the decision-making for the sector.

There has been a big challenge to make sure that voices are heard in the environmental space and we look forward to working with the Environment Agency and Natural Resources Wales on that as well.



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Chris Walters: From a price review perspective, our job is to scrutinise proposals that are made to us to make sure that they are good value for money, and then to hold companies to account for those proposals, but we do not get to say what is in those proposals. That is the job of our sister regulators, the Environment Agency, Natural Resources Wales, the Drinking Water Inspectorate in the UK and Welsh Governments.

It is important to us to engage with people so that they can see what our process of scrutiny is delivering, but a lot of what we are talking about is in the gift of others.

Q97 **Chair:** Is that a system that you think works well?

Chris Walters: I think the system was set up to generate creative tension between its constituent parts. As you have already set out, views differ as to how well that creative tension has worked in the past but, to my mind, a system that has more collaboration built into it is more important for the future.

Q98 **Sarah Dyke:** There are 27 former Ofwat directors, managers and consultants who are now working in the water industry, creating a potential concern around conflict of interest. Do you do you share that?

David Black: No. We are very rigorous about how we manage our conflicts of interests. For any staff who leave Ofwat, we generally have a set of requirements around what they can do, what they cannot do. That applies for up to two years after they leave. A lot of these people you are talking about left Ofwat some years earlier and worked in other sectors, with other employers, and have then gone to work for water companies. It is not the case that people have left Ofwat and gone directly to water companies.

In many of the cases that have been referred to—we think it is really important and we ourselves access people from water companies—our decisions are made by our board and our senior executives. We are absolutely rigorous in how conflicts are managed. Most people who leave Ofwat go to work in other sectors or to other regulators or to other parts of government. About 40 to 50 people per year leave Ofwat each year. If one or two of them go to water companies, I do not think that stops us being an effective regulator.

Q99 **Sarah Dyke:** You mentioned that customer satisfaction is low and that there are enforcement issues around that. Why have the regulators failed to address weak performance?

David Black: We set financial incentives on companies to improve customer service and we have tried to strengthen those incentives. We have tried to make sure that we are capturing customer satisfaction accurately, bearing in mind that the main contact that many customers have with their water company is receiving a bill, paying a bill, rather than dealing with a service issue. However, where they do have an issue, it is usually really important for customers to have that issue addressed.



If that is an issue with water not being supplied or about sewage, it is very important to have that sorted out.

The regime on complaints has not been all that effective, so we have introduced a new licence condition—again under those new powers that we received in 2021. The first licence change we made was around financial resilience. The second was around introducing new standards for customer service. We will use that to make sure that, even if companies are addressing customer service satisfactorily in a general sense, if they fail to supply or address issues that customers raise, that gives us new powers to take enforcement action against companies that do not improve and we will use those powers.

Q100 Sarah Dyke: Moving on to pollution incidents being at an unacceptable level, do Ofwat and the Environment Agency need to work more closely together to ensure that companies take these incidents seriously enough to tackle them?

David Black: That is an area of poor performance. Let's be clear, in some areas companies have made substantial improvements since privatisation but on pollution incidents they did so up until about 10 years ago, but since then their record has been poor. It has either been stagnant or increasing in recent years. That must change. To drive that change, we are going to strengthen the incentives companies have. For instance, every time there is a pollution incident, there is an automatic penalty on them. We are introducing a new measure in the next price review on serious pollution incidents. These are the ones that cause harm to the environment, and so they will attract additional attention.

Coming back to the point that the Chair raised earlier about the operation of companies, perhaps I could ask Helen to talk a bit more about the work that we are doing across the board to drive company performance, which often is about the environmental performance.

Helen Campbell: I would say that, in addition to some of these hard measures in our licence and the fines and enforcement approach, one of our key tools is working with our fellow regulators—to your point about the EA—to monitor and oversee where companies are performing and to lean in much more and challenge companies where we see performance falling short.

We publish an annual performance report, the "Water Company Performance Report", which was published in the autumn. That report sets out where companies are performing against the 12 common performance commitments that they committed to in PR19. I accept that with pollution incidents the whole sector was in a poor state, but we hold the companies at the bottom of those categories against expectations to account. They come and meet Ofwat, we invite our fellow regulators and we ask those companies to set out commitments in service commitment plans that are transparent on websites for customers and stakeholders to



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see, to explain how they are getting performance back on track and we meet them quarterly to assess their progress.

Your point about working with other regulators is really important to us. There is real strength in having the quality regulators alongside Ofwat in this kind of forum.

Q101 Sarah Dyke: Do you think that the use of self-reporting by water companies undermines the robustness of the data that you are getting back in?

Helen Campbell: It is clear that having measurable, undeniable data is very important. There is now monitoring on all storm overflows across England and Wales, and that has been in place since 2021 and gives undeniable evidence of how storm overflows are operating that, as regulators, we can act on.

There are elements within all regulatory regimes where there is a degree of self-reporting, but that does need to be followed up with a checking regime, and certainly the Environment Agency, Natural Resources Wales and the Drinking Water Inspectorate have regimes checking with companies on the commitments that they have made.

David Black: We welcome the new regime of inspections that the Environment Agency is going to roll out, with the additional funding that it has secured from the Government.

Q102 Sarah Dyke: How are you looking to improve the transparency of the data that is provided by water companies, given that Thames Water has recently been fined £3.3 million after a deliberate attempt to mislead the Environment Agency?

David Black: Generally, we think that there is real power in open data, the ability to make transparent company performance across the piece. We have seen what a great force for change the making public of the data on sewage discharge and storm overflows has been. We think there is more data within companies that should be shared. That is why we are pursuing an agenda for open data with the sector.

We take misreporting, where companies deliberately misreport information, very seriously indeed and where we find instances of that we impose very large penalties. For example, we imposed penalties of around £127 million on Southern Water in 2019. From our perspective that was essentially a case of misreporting, and a very serious one in terms of its reporting on pollution incidents.

A more recent case with Dŵr Cymru Welsh Water was around misreporting on leakage. That was not a deliberate attempt to conceal its performance but none the less, the data was an error. We uncovered that through our robustness check on the data submitted by the company. The company has put that right. So we will take action. We are very clear



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to companies that we set high standards in this space. If they fail, there are severe consequences.

Q103 **Chair:** Just before I come to Henry, by which means did the misreporting at Thames and Southern come to light?

David Black: The misreporting of Southern Water was uncovered by the Environment Agency, I believe. I am not exactly sure about the Thames' instance you are referring to. I believe it was an environmental issue that you are referring to so that would have been the Environment Agency.

Q104 **Henry Tufnell:** You talked about greater oversight in terms of performance. I wonder about those investment cycles. I think you have a five-year investment cycle. Is there a case to be made for a longer term investment cycle that would enable a longer term view from the individual water companies?

David Black: I will pick that up. Yes, we want a long-term sector, and we have put a lot of focus on taking a long-term approach. At 2024 price review, we require all companies to prepare their business plans in the context of a 25-year, long-term delivery strategy.

We have looked at the length of the price review repeatedly since we were established as a regulator. We have not seen a strong case to extend it. We looked at Ofgem. Ofgem moved from a five-year to an eight-year price review. It has moved back to a five-year price review. I think the answer is not in the length of the price review. The answer is in making sure that each price review builds towards a longer term outcome.

The sector has lacked long-term goals. That is changing. The Government set a number of long-term goals. For example, we now have a goal to drive down leakage by 50% by 2050, having those goals in place, and then using the five-year price review as a check and challenge.

To come back to the disadvantages of a longer term price review, it does lock you in. For example in storm overflows, we are introducing a raft of new measures and new investments in 2025. If the price review period had been eight to 10 years, we would have been waiting another three to five years to do that.

In the last price review period, we have had Covid. We have had war in Ukraine. We have had high inflation. It is important that we do update the settings. There is a balance to be struck. The important thing is that other companies and other sectors do not have the luxury of a five-year forward look. We think it should be useful for companies, but it is no excuse for a company to only look ahead five years. It is a long-term sector. We need to be looking ahead 25 years, 50 years, and 80 years into the future, to anticipate the challenges that are going to come.

We are seeing a number of investments come forward at this latest price review, which will be started but not completed in the five-year period. I



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am confident that we have the regime that can run investments that span a longer period of time. The proof of that is in the investments that we are seeing coming forward in the 2024 price review.

Q105 Helena Dollimore: The Chair touched on some of the failings that have come out relating to Thames Water and Southern Water and how those have come to be exposed. It would be fair to say that a lot of the failings in the water industry have only been exposed because of the work of campaign groups and volunteers in our communities and constituencies who have gone out, tested water supplies and exposed what has been happening, groups such as Surfers Against Sewage, and in my own constituency the Clean Water Action Group. Many of them have paid out of their own pockets to test water supplies. How do you make sure that you are including the voice of those campaign groups in the work that you do?

David Black: First, I think they have done a great job in highlighting issues, and this is the point about open data that we think can at least help those groups to look at what companies are doing, look at the data that is available and then test and challenge if they think something different is happening.

We work quite hard to take account of their views. They obviously submit views to us as part of, say, the price review process. We engage with environmental groups. We meet with them and hear their views. They are a vital source of information and challenge.

Chris, do you want to talk a little bit more about that?

Chris Walters: I would add two things to that. Thanks, David. Thank you for the question.

The first would be Ofwat's Innovation Fund, which is a £200 million fund that has now doubled to £400 million. It funds a lot of joint working between the regulators, Government and environmental campaign groups, and, in particular, in one area around mainstreaming so-called nature-based solutions using green solutions instead of grey solutions. As an organisation, we sit on the board of that and regularly talk to the environmental campaign groups about it.

The other area would be the representations we have had back from environmental campaign groups in response to our draft determinations back in July. We received many hundreds of representations overall—of course, from companies and, of course, from investors and, of course, from customer groups, but also many from environmental NGOs. You will see those representations reflected in the changes that we are making for our final decisions, which we will publish on 19 December, which will have the biggest step change in environmental investment, first, and will also have new performance commitments for important environmental issues, such as improving biodiversity and reducing operational greenhouse gases.



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Q106 **Helena Dollimore:** As part of the process that you are undergoing at the moment around the price review, you obviously take submissions from those groups but how regularly do you meet with those environmental campaigners, David?

David Black: We meet regularly with them. Chris has met with them. We do meet regularly with them, yes.

Q107 **Helena Dollimore:** I want to turn to another section around interruptions to water supplies and water outages, which Ofwat regulates. For the public who may not understand the terminology here, that is when the taps stop working; the taps to your house run dry.

Of the 17 water companies that Ofwat regulate, how many are meeting their targets in that regard?

David Black: I do not want to put Helen on the spot. I think maybe three to four in the latest year. We have set a very challenging target in terms of bearing down on supply and disruptions, because we do appreciate that this is difficult for customers to face. There is an automatic penalty regime that runs when water is not supplied to customers for more than three hours. We record company performance against that and penalise companies.

We have seen this improve quite significantly since privatisation. The number of water supply interruptions has been reduced by a very significant margin. We do see that two or three companies in particular have performed very poorly in this space. We are targeting those companies to address and improve on these issues.

We have seen the rest of the sector actually improve its robustness. For example, I can go back to a freeze-thaw incident we had in 2017 when four companies performed poorly. The challenge in a freeze-thaw is when you have a rapid thaw, the pipes expand and the mains burst. The same incident happened two to three years later, and we saw that three out of four of those companies had significantly improved the way they handled those issues.

There are probably two or three dimensions. One is in terms of preventing these incidents from happening, by making sure systems are resilient. The other dimension is being able to react and respond when these incidents occur. One of our criticisms of companies in some of these incidents, which I think you may refer to, is that companies have not handled the incident itself—

Q108 **Helena Dollimore:** Yes. We will come on to that, but the answer is four. So, four out of 17 companies are actually meeting their basic target on water supply interruptions?

David Black: I would have to confirm that data.

Q109 **Helena Dollimore:** Interruptions have a huge impact on people in our



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communities. You can imagine the impact on going about your daily life—using the toilet, cooking food—and also the impact on businesses and communities when this happens. There have been two major incidents in my community, one in Rye and the surrounding area, which affected people for eight days in October 2023, and then one this year in Hastings and St Leonards that affected 30,000 people for five days. They had no water. It had a massive impact.

As you have touched upon, Southern Water completely failed to meet its basic obligations during that period. It promised bottled water deliveries to the vulnerable. That did not come. It promised water stations. There were not enough. We had traffic gridlock in the town. Businesses had to close, and it had a huge impact on them.

There are two parts that I want to ask you about. First, I want to ask you about the compensation when these incidents happen. This is something Ofwat regulates. You have the standards of service that dictate what should happen when you have a water interruption. It is very clear that when a customer's water supply is interrupted, they should be compensated.

In this incident, the most recent one in May 2024, Southern Water has said that the Ofwat standards of service do not apply and that my constituents will be given no compensation. More than that, Southern Water has said that we have to pay our water bill for the five days when we had no water. So, what is the point in having the Ofwat standards of service, if they are not actually upheld when you have no water for five days?

David Black: First, I should clarify that the guaranteed service standard is set by the Government, not Ofwat. The Government set the terms. The terms are being reformed at the moment by the Government. We fully support that. The difficult issue is that the way the standards are currently drafted, they do allow companies an exemption for extreme events. We think that companies use this to avoid responsibility. We think that is wrong. We think the rules should be changed but it is not our responsibility. Unfortunately, we are not given the power to change that, so that is—

Q110 **Helena Dollimore:** Who decides whether it is a once in a lifetime event or not?

David Black: If we get a complaint we can adjudicate on that complaint, but we have to follow the rules that are set by DEFRA. We had an incident earlier with South East Water where a complaint was referred to us. We had to find in favour of the company because that was consistent with the rules, but we would urge all companies to voluntarily compensate customers in instances like that.

Q111 **Helena Dollimore:** I am pleased to hear you can look at it where there is a complaint, because the leader of my council wrote to you in August



regarding this incident and the lack of compensation. We would be grateful if you could look into that incident. We have not yet had a reply on that matter. Residents have not been compensated, they have actually had to pay their bills for those days, and it has had a big impact on businesses.

David Black: The point I would make is that I think the regime needs to be changed to make sure that compensation is automatically provided. It is not at present, but if we get a complaint we can adjudicate on that. However, I do regret to say that I do not think the rules about company responsibility are sufficiently clear.

More generally, we would expect companies to compensate customers where they are off supply, regardless of whether or not there is an extreme weather incident or there is some other particular—

Q112 **Helena Dollimore:** Yes. Then looking at the wider system issues around water interruptions, how are you working to make sure that we do not have incidents like this happening again? If I take the most recent incident of which I have the most experience, that was due to a pipe that had been identified by Southern Water for repair in 2007. Southern Water had actually identified it needed replacing, sought the planning permission to do it but then never did it. Then we had the incident that we had. How is Ofwat actually acting if it has not done so for the last 17 years? What is changing now to make sure that those pipes are repaired and that we do not have incidents like this?

David Black: It is really important that companies improve the resilience of their networks. We have investigated that particular incident and we can talk more about the work we have done with the company in that space. Generally, we set automatic penalties on companies so that when they fail to supply customers, those penalties kick in and that impacts on companies financially. We will also look at enforcement powers. In another incident where South East Water has repeatedly interrupted customers, we have enlivened enforcement action against that company to assess whether it is complying with its duty to supply customers with water.

Thirdly, we are putting much sharper focus on the standards that we hold companies to in areas of asset management. We would expect companies to be putting investment proposals to us to improve the resilience of their water supplies. I think that Southern does have major investment proposals in front of us as part of part of our price review. It is part of the company's licence obligations to maintain the infrastructure, so if it does not do that adequately, we have the ability to take enforcement action.

Chris Walters: Could I just add to that? The current rate of replacement of water mains in the sector is about 0.1% a year, which means that you replace the entire network once every 1,000 years, which is self-evidently not fast enough. We think that a more sustainable rate of replacement of



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water mains would be somewhere around 0.8 to 1.1% a year, which reflects the average asset life of 100 to 125 years.

In the current price review we are providing funding to quadruple the rates of mains replacement from 0.1 percent a year to 0.4% a year in this five-year period. We will do the same in the next five-year period and Southern Water will benefit from that increase in investment.

Q113 Helena Dollimore: You are right to say that it is very important we prevent incidents like this because in that instance, for example, the Southern Water boss has said Southern came this close to calling in the military. We could have very serious incidents on our hands if we do not look at this more closely.

You are looking into South East Water in relation to interruptions. Why are you not looking into Southern Water?

David Black: We have not yet opened an enforcement action against Southern Water. We would have to take a view as to whether or not we think it is in breach of its legal obligations. That is something that we would have to assess.

Helena Dollimore: That is something people could refer to you?

David Black: Yes.

Q114 Jayne Kirkham: I have been in a similar position as Helena with South West Water. I represent Truro and Falmouth. We have had outages for days, in the hospital as well, where people have struggled to get water. Now people are trying to get compensation but they have been told there is limited compensation and they are struggling to get it. I would echo what Helena Dollimore has asked for, that these schemes can actually be changed and amended so people can get what they need to get.

I was going to move on a bit to water security and resilience. I read just now that 4 billion extra litres will be needed by 2050, which is an absolutely staggering amount and will put real pressure on a system that has already been struggling so much for so many years and has been under invested in. One of my questions would be about South West Water, which as well as the outages, has struggled with leakage, and the leakage data has been shown to be not correct. What checks is Ofwat doing to make sure that that leakage data is robust and will be more robust in the future?

David Black: Measuring leakage is a challenge in the sense that you are measuring something that, by definition, is not automatically triggered like the way a storm overflow monitor works. Every year companies submit their data to us. We have a number of inbuilt checks in that process to detect where we think companies are not accurately reporting that data.



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As discussed earlier, with incidents such as Welsh Water we were able to spot that the data raised some questions. We followed up with the company and that has uncovered issues. We are talking to South West Water about the data. If we do find evidence that it has not been reported accurately, we will take action, but we are not in that position at this point.

More generally, we are trying to drive leakage down. We are talking about a 50% reduction by 2050. Companies have made significant reductions in the past—

Q115 Jayne Kirkham: How far have we got? I understand there is quite a long way to go in the last year of the current five years—

David Black: Yes. Companies have been set a challenge to reduce leakage by around 16% in the current price review period. Some companies are on track to do that. Many of them are not. They will face challenges to get there. We will also set them challenging targets to reduce leakage in the next price review period.

Q116 Jayne Kirkham: I read earlier that there is still 30% of the way to go in the last year, so they do seem to be struggling to cope with that, don't they? They do not seem to be managing to keep up with this level of requirement, so how do you think they will cope in the future?

David Black: At each price review period, as part of the water resource management planning process, companies set out their proposed plans to reduce leakage and demand, as well as to build new infrastructure. As part of that, there is an agreement about the measures that they are going to take to reduce leakage. That gets built into the price review and funded as part of the company's business plan.

We do see reducing leakage as a challenge. We think there are quite a lot of opportunities there for companies, because we are going to roll out 10 million smart metres in water over the next five years. That will give much better data about what is going on across the network and would allow companies to target issues, to spot issues much earlier. In order to reduce leakage, you have to spot the leaks happening sooner and take action faster, both of which are vastly enabled by smart metering programmes. Also, as Chris said, we are stepping up the replacement of pipes. Between those two interventions, we do think there is significant scope for companies to drive much harder on leakage. The sector is very clear about some of its ambitions in the space. They know that they need to do better and we will continue to challenge companies to address those issues.

Q117 Jayne Kirkham: The other question, of course, is water demand, which is frustrating when you are getting leakage. It seems harsh to put the onus on consumers. I think all companies now also have targets for reducing consumption. Does the water sector have a general plan for this? Where I am in Southern Water there have been mandatory seasonal



tariffs, which have gone down quite badly with some consumers and they do seem to be impacting what they pay. Is that a good idea? Are there better ways of doing this?

David Black: Driving down demand is a huge challenge for the sector. It is one that we have set targets for in the current price review period, and generally the sector is not on track to meet them. Some of the reason for that was a Covid impact, but we think some of it does underline the scale of the challenge. We do not think the sector has worked sufficiently hard at this. We are establishing a new water efficiency fund in the next price review period—a £100-million fund to help drive behavioural change. We think smart metering is part of the solution as well. We are open to companies trialling tariff innovation, which is to try to link what customers pay to the water that they use. Whether these trials are successful remains to be seen. It is a challenging space.

Q118 **Jayne Kirkham:** Measures have been quite controversial, haven't they? People have been put on them—

David Black: Yes.

Jayne Kirkham: —and had their tariffs changed almost without their agreement. Are they mandatory? We have been told that the water companies have been told to make the changes; that they have to do them. Is that the case or is there leeway?

David Black: These are trials undertaken by water companies, so they are a choice made by an individual water company to trial a different type of tariff, usually in an area, to see whether or not it will work. We all hope that these trials will find a successful way to set deals for customers in a way that will drive demand down, but we do not know until the trials are complete.

Q119 **Jayne Kirkham:** One last question. I suppose, looking back at that 4 billion litre figure, which is huge, water security and resilience will be such a big thing in the future. How will the sector build to cope with that?

David Black: The 4 billion is driven by the need to reduce abstraction. Affinity Water, for example, one of the companies in the south-east, is going to reduce the water it extracts from chalk streams by one-third over the next 25 years. It is also driven by the need to cater for population growth, and it is driven by the need to build resilience to adapt to climate change.

One of the success stories in the sector is that we have established the RAPID group with the Environment Agency and the Drinking Water Inspectorate. We now have 18 major projects coming forward, which gives us the ability to address these challenges in the future. We have three very large reservoirs coming forward. We have major water transfer schemes. We have water recycling schemes. These things will have a big impact. They are also schemes that will attract controversy, so we think that there will be a challenge in getting them built but we think



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it is vital that new infrastructure is built to provide for the future. I completely agree that, even though we are adequately catering to broader demand and supply, at present, we need to take action because otherwise the sector will face very serious challenges in the years to come. Droughts will come. We will see more impacts of climate change. We need to change the way the water system works. We need it to be more interconnected. We need more resources, and we need networks that can deliver this resource to customers.

Jayne Kirkham: We pretty much had a permanent hose pipe ban last year. The sector is struggling at the moment, so the future—

David Black: I think the case going forward call does illustrate the importance of the need to get more water resources, so it is interesting that the company is in the process of trying to build a desalination plant to address that issue and has been blocked from doing so. That is one of the challenges that companies face.

Jayne Kirkham: Reservoirs or desalinisation plants. Sorry, I have finished now.

Chair: Desalination plants in the rest of England.

Q120 **Josh Newbury:** I would like to come back briefly to the point about support for vulnerable consumers, which Helena touched on. I had an incident recently in my constituency, less extreme than some of the other examples we have had, but several thousand customers were affected by a burst water main. One of the things that concerned me the most in that incident was reports I had from consumers who are on the priority services register but did not have any water delivered, despite that being promised by South Staffs Water. What are you doing to monitor companies' performance around supporting those vulnerable consumers? Are you seeing any worrying trends like that, that show that perhaps the support is not there when it ought to be?

David Black: Yes, we have. There have been a number of incidents and it is very important that companies act speedily to provide water to those who need it. As for the priority services register, I think that is an area where there has been some success. We are seeing a significant increase in the number of customers on priority service registers. Going back three or four years ago, there was not adequate data on priority service registers for them to work. We are getting to a place now where we are getting much higher levels of penetration.

Then there is a question of whether companies deliver in an incident. That is overseen both by the Drinking Water Inspectorate, and ourselves and DEFRA also has a role when there is an emergency to make sure that companies comply with their obligations. If we get complaints, we will investigate, and we can take action.

Q121 **Josh Newbury:** Sometimes, it is a matter of proactive communication as



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well. I am on the priority services register because we have a two month-old baby. I am also a Member of Parliament. I did not have any proactive contact from the water company in that instance. So, I think it is not just a case of acting on complaints; it is also trying to encourage and require water companies to be more proactive with that approach when things like this happen.

David Black: Yes. I agree. We do also work across sectors. We recently held an event with Ofgem on vulnerability. We got all of the chief executives of the water sector there, and particularly we worked through some of the issues of how the sector can do better to address the issues of vulnerable customers. Everyone depends on water. It is self-evident that there will be customers who really need service and inevitably there will be interruptions from time to time, so it is very important that companies are able to respond to that and we will do what we can to make sure companies deliver on that as they should.

Q122 **Helena Dollimore:** On that point, the way it has worked when we have had these situations is that there will be a few select water stations opened. Traffic descends on those causing massive gridlock—it happened in both incidents in my patch, and I know it has happened in other places—which then causes wider implications. Then vans go round delivering bottles of water to who they regard as the priority people.

Often that will lead to a situation where on a street you are delivering to 15 out of 20 houses. Those of us who go around delivering leaflets know that it is often more time efficient to just drop to every house than to pull out specific houses. So is that actually the most efficient and effective way of doing it? Are the water companies avoiding doing that to save money on the cost of bottled water in these emergency situations?

David Black: The companies' ability to respond to emergency situations, is where we are changing company licences or have changed company licences. We have given ourselves new powers to enforce against companies that fail to provide service in these incidents. Where companies do not deliver, we will have the power to impose fines. Obviously, the aim here is to get companies to best practice. We will also work with companies to try to make sure that they share lessons learned from these experiences, because I think it is also vital that we look at what has gone wrong.

It is often challenging for companies to roll out water distribution in an area, and so the question is about what we can learn from what has not worked and how we can change things for the future. We will work with companies on that, but equally we have new powers in this space and we will use them.

Q123 **Helena Dollimore:** You say you have powers, but you have not opened an investigation into Southern Water from two major incidents. I find that odd.



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David Black: It depends whether or not we think they have breached their obligations and whether we have received complaints.

Helena Dollimore: You have to receive a complaint?

David Black: No, we do not have to receive a complaint but, clearly, if we have received complaints that may add weight to the need to investigate.

Q124 **Chair:** Can I take you back, David, to your point about leaks? You kept talking there about inbuilt checks. What do you mean by that?

David Black: When companies submit data to us they do not just submit a total leakage number. They submit details about how they have calculated it, how the water balance has been calculated. That may reveal information to us that raises questions about how they have made that calculation. That might lead us to make inquiries and that is what we do. There is also an assurance process around that, which companies provide.

Q125 **Chair:** I will move questioning on in a second, but we have been exposed to quite a lot of real-life outcomes, all produced by a system of regulation that you say has not failed. How much worse are things going to get before we call it failure?

David Black: I think the question is about how we respond to the challenges that we see in terms of can we take action to drive improved outcomes and we have.

Chair: The question surely is outcomes.

David Black: Yes.

Q126 **Chair:** In terms of the lived experience of the people represented around this table, when can we expect to see better outcomes? It sounds to me that we are almost heading to that old territory of the saying, "The operation was a success, but the patient died".

David Black: I think you have to look at the total numbers here in terms of the data. I appreciate that people have very challenging experiences, but when we look across the data of water suppliers, we actually see significant improvements in the period since privatisation. Therefore, the question is whether there will still be incidents. Yes. Do we want companies to improve performance? Yes. Do we have companies that are not good enough in this space? Yes. Are we taking action to drive better outcomes? Yes.

And so, the question is what more could we do, what more should be done. I guess I am not very clear about what it is that you think would change that? We are imposing automatic penalties on companies when they fail to deliver. We are providing an innovation fund to drive better practice. We are working with other regulators to make sure that there is adequate investment.



Q127 **Chair:** The Committee will come eventually to what we think may need to change, but you defined the relationship between the customer and the company as being one that focuses on the payment of a bill. Does the point of contact between the company and the customer start when they turn on a tap?

David Black: It does, but customers do not see that. They turn on the tap, they flush the loo and that service is provided and that is great. I am talking about when customers rate their water company. They probably have a particular incident in mind and the great thing about water services is that they happen day in, day out without intervention. The question is whether when things go wrong, customers get the redress that they need.

Chair: Based on the experience we have heard around the table?

David Black: There are clearly incidents where companies have not done well and, ideally, that would not happen but the question is about what, as a regulator, Ofwat can do to drive performance to better levels.

Chair: Right. We will move on.

Q128 **Sarah Bool:** I want to look a little bit more at Ofwat's strategy and its powers and I think, as has just been addressed, this is clearly a very complicated position at the moment because financing for the water companies is clearly an issue. We have questions about how they are structured. On the other hand, we are also fining them for poor behaviour, but equally we need more innovation and more investment, and so it is all in the same circle. On that note, what more are you doing and what more could you do, to encourage investment and innovation in the sector for the actual companies? Do you think that increased regulation could actually stifle investment and innovation?

David Black: What we have done and what we are doing is trying to link companies' revenues and their profits to good outcomes for customers and the environment. We have automatic incentives that provide penalties but also rewards for companies if they exceed the standards that have been set. If they beat the level of improvements, for example on leakage, they can earn a reward for that. We are trying to drive innovation in the way that we regulate.

Chris has touched on the Innovation Fund, which I think has had some success so far, and so we are doubling the scale of that fund. That is designed to provide a pipeline of new ways of working across the sector—accessible by all companies—so we can drive change across all companies.

Sarah Bool: Do you think that is enough? Some of these companies are going to need even more external investment coming in. Do you think it is actually an attractive prospect at the moment for them? Because in this sort of environment, it does not feel like that. How do you counter that? I appreciate it is all very well having these rewards but is that



enough at this stage?

David Black: That is a question that we get at each price review. We have to set an allowed return on companies on investment, and so that is a challenging exercise, and we try to get that right. Companies have the right of appeal against our decisions as well.

When we look at listed companies, we can look at their share price. That tracks fairly well, showing that the sector remains an attractive prospect. Severn Trent Water raised £1 billion of new equity last year when it issued its business plan. We can point to evidence of companies that are able to tap into markets. They are raising debt, they are raising equity, and that does suggest the sector remains attractive to investors.

However, it is a challenge in terms of a lot of the criticism of the sector. That does unsettle investors. Investors are looking at the sector with a fresh eye and that does make it challenging for water companies but we think ultimately a regime that links returns to investors, to better services for customers and the environment, is one where, if customers benefit, the environment benefits and investors benefit, we can try to drive the right kinds of performance.

Chris Walters: Could I just add to that? As you know, we are getting very close to announcing our final decisions on the price review, which include the rate of return to investors that Dave has just highlighted. This is my first price review but I understand that it is not uncommon at this stage in a price review for the mood music to be that Ofwat needs to move. Therefore, what we are hearing collectively on PR24 has to be seen in that wider context.

Q129 **Sarah Bool:** How will you use the new powers that you will have under the Water (Special Measures) Bill to tackle poor performance? Do you have enough resources to be able to do it?

Helen Campbell: That is a good question. The Water (Special Measures) Bill gives Ofwat powers to set the rules for remuneration and governance. We do already have powers that we use today. We set out our principles on board leadership, transparency and governance and updated those in 2019. This year was the first year that we used powers that we had introduced in PR19 to stop customers paying for bonuses for executives where we felt that these were not justified in terms of performance for customers and the environment.

The new measures will allow Ofwat to ensure that bonuses would not be paid where companies do not meet the expectations that we set out. That stops bonuses completely. The measures will allow us to set expectations and to direct companies to involve customers on boards and it will introduce rules on fitness and propriety for executive members of boards. As this Bill passes through Parliament, we are consulting. We have just closed our consultation on that and we will be working, as that Bill gets passed, to establish the rules in 2025.



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Q130 **Andrew Pakes:** I have a couple of questions on that. First, Thames Water's boss took a £195,000 bonus for three months' work at the end of March. Do you understand why the public is angry?

Helen Campbell: Absolutely. I understand that it is important for companies, if they are going to pay bonuses, to explain why that bonus is justified. In the report that we have just published, we set out our view that that bonus was not justified and we are stopping Thames customers from paying for that bonus.

Q131 **Andrew Pakes:** You talked about some of the powers that the new Bill would give you. In what circumstances should water companies be able to pay large salaries and bonuses to its executives, and do you think that any companies are meeting those standards?

Helen Campbell: The rules for setting out how companies will pay bonuses and incentive plans are a matter for companies, but they have to comply with the expectations that we set out. We expect companies to explain how bonuses are justified against performance delivery. Through the extra measures that we will introduce, we will be very clear on circumstances where we feel that they are not justified. We are consulting, for example, on including rules around a criminal conviction, for example. If a company has received a criminal conviction, we would expect the company to explain extremely clearly why those bonuses are justified despite that, and in the round.

In the recent report that we published, we found that nine companies had not justified the bonuses based on the performance. Five of those companies had said that the customers would not pay and a further three we stopped bonuses, including Thames.

Q132 **Andrew Pakes:** Would it be better, given the recent history of playing off bonuses and others, just for directors to be paid a salary for the job that they do?

Helen Campbell: While I can understand that perspective, it is not for Ofwat to set exactly how companies should remunerate their executives. I recognise that where bonuses should be paid, clearly, they have to be linked to performance. If we see bonuses that we do not feel are justified, we would take action.

Q133 **Chair:** I am sorry, but you are telling us that it is not for Ofwat to tell companies how to remunerate, two minutes after you have told us that you will not allow—was it five or nine?—to pay bonuses. Talk me through that one.

Helen Campbell: Chair, what I meant was in response to the question on the balance between base salaries and bonuses, that it is a matter for company boards and remuneration committees to decide. However, where there is performance-related pay, where we use powers currently and we will have strengthened powers in the Water (Special Measures)



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Bill, we will require those companies to pay performance-related pay in accordance with the expectations that are set out.

Q134 **Chair:** Do you see a role for yourself in determining performance?

Helen Campbell: We would set out the guidance that we expect companies to comply with. That guidance will clearly state that bonuses should be paid and aligned to performance for customers and the environment.

Chair: I am sorry I interjected there.

Q135 **Andrew Pakes:** No, that was a very good line. In most other walks of life, having a criminal conviction would get you sacked, not just losing your bonus. Do you think that the public will accept the verdict that you are giving, that it is just about bonuses?

Helen Campbell: The criminal convictions that are applied to the water sector that I have referred to relate to the company. We still believe that it is for leadership, for companies, to explain what has gone wrong and what they have done as a result. It is not acceptable if they cannot explain that and are still rewarding their executive teams with bonuses.

Q136 **Andrew Pakes:** Do you think that it is acceptable, given that you measure performance and the expectations of companies, to say that some of those expectations should be about a bonus for having met them, whereas for most of us doing our job is the expectation?

Helen Campbell: I can understand that point of view. It is on that basis that we determined in our recent report that nine of those companies had not justified the performance-related pay.

Q137 **Helena Dollimore:** On that point about criminality, am I right in my understanding of the Water (Special Measures) Bill that is currently going through Parliament that it will include new powers not just to hold the company responsible for criminal activity but the individual water bosses themselves where necessary?

Helen Campbell: I believe that powers are being introduced that where there is obstruction of investigations that the EA want to undertake, there is potential for powers to be introduced that align to criminal accountability for companies and executive directors, yes.

Q138 **Chair:** Before we move on to the next section, I want to tease out a bit more about this question of criminal convictions. Bonuses are paid on the performance in a year. The act that will lead eventually to a criminal conviction, from the commission of the act to the conviction and possibly the conclusion of any appeals, how long is that taking at the moment?

Helen Campbell: It could take, we have seen, between three to five years between an act and the criminal conviction.

Q139 **Chair:** As a meaningful sanction, then, how is that working?



Helen Campbell: The way that we are proposing these rules apply and the way that we have applied our performance-related pay recovery mechanism is that the year in which a criminal conviction was secured is the year that the executive is held accountable. I appreciate that the executive team that is in place may not be the one that was in place at the time. However, it is important that companies explain what it is that they have done and how the executive team has addressed it if they are paying bonuses in that year.

Q140 **Chair:** Does this come back to the point earlier about who owns and operates water companies? These are people—bankers, financial institutions, and everyone else—who live in this world of bonuses. That is why they expect these sort of remuneration packages. Are these the right people to be providing a public service such as water?

Helen Campbell: It is important to think about the balance of leadership not just on the board but on the executive team. We explained earlier that we had introduced rules around governance that required companies to demonstrate that they have a balance of independent, non-executive directors as well as—

Q141 **Chair:** Have you considered the position of the banks prior to 2008 when you look at the performance of your own sector?

David Black: Can I clarify, Chair?

Chair: It seems to me as an outsider that effectively you are back in exactly the same position. You have complex governance structures, complex ownership models, people getting significant bonuses as part of their base package, and I wonder about the extent to which the non-execs in this sector, who should be the meaningful brake in this, are performing any useful function.

David Black: Thanks for clarifying. We think that that is a key contention and that is why we have strengthened our requirements on board leadership and governance. We introduced requirements for the first time in 2013, I believe, and we updated those in 2019. We think that more effective governance of water companies would help drive better outcomes. There are limits to what regulators can achieve and we need to see better decisions being made in the boardroom. That depends on having the right people on boards, as you have correctly observed. There needs to be a balance of engineering and operational talent as well as other backgrounds. One of the measures that the new Bill will give us is the ability to look at that balance of skills. We also think that there are questions about the decisions being taken by boards and how effective they are, and the role of owners in companies. That is an area that we are doing further work on.

Q142 **Jayne Kirkham:** I was going to ask a bit more about the balance on the board but it seems that there will be movement there anyway. It seems that you are looking at a private company structure that may be moving



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towards almost a regulated control structure. How far will that go, what will those boards be in the future, who will they comprise, how will they be picked, how far can you go with that, how much difference can you make and how can you control the limit of decisions that they can make?

David Black: Where we started from was trying to make the boards work more like boards of listed companies. There is a set of requirements on stock exchange listings around boards, which we think make a good starting point. Therefore, our initial focus was making boards of private equity firms operate consistent with requirements of listed companies. The UK Corporate Governance Code is another helpful building block.

Helen, do you want to talk more about the reform programme?

Helen Campbell: It is very important that boards act effectively and can effectively challenge leadership teams. To be able to do that, you do need a range of skills on boards. We hold pre-appointment meetings with new proposed NEDs before they are confirmed in. That is an opportunity for us to understand what skills that individual brings to the company, what understanding they have of the water sector, of Ofwat and how they will exercise that duty of oversight. Therefore, it is important. It is part of the need for companies to demonstrate how they are making decisions, how they are making decisions in the interests of customers and the environment. Part of the work that we will be doing through the Water (Special Measures) Bill looks at the composition of boards and how we can make them more effective.

Chair: We have 40 minutes remaining and I promise that I will bite my tongue, but we still have some significant areas we want to cover. Josh, you agreed to lead on the price review so far.

Q143 **Josh Newbury:** David, you mentioned at the top of the session that across several price reviews since privatisation, that process has saved consumers money, but we know that at this point, we cannot continue with below-inflation price increases. We can see from the draft determinations that all of our constituents are likely to face some quite significant increases on their bills in the coming five years. The underlying question with all of this is will this price review tackle the long-standing issues of under-investment and under-performance in the sector.

David Black: I will turn to Chris but there are a couple points to make usefully in advance. One is that a key driver of bill levels is the level of investment. The level of investment will increase very significantly at this price review. In the draft determination, that was a 300% increase from previous price reviews and it is likely to go up at final determination.

The other key component of bills is companies' allowed returns. That is returns that go back to investors to make the sector attractive for investors to invest in and for the sector to raise new finance. Those rates fell, if you like, across consecutive price reviews, which helped keep bills down up until the current period. Those rates returns, in line with interest



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rates elsewhere, are going up and that is another upward pressure on bills.

We think that this level of investment will be game-changing. This will produce a dramatic increase in investment to reduce particularly sewage discharges but also to upgrade wastewater treatment works and, as Chris said, upgrade water-treatment works as well.

Then there is a question for us about whether the sector can deliver against this challenge. We are talking about a massive increase in work for the supply chain and how we make sure that the sector is well-placed to deliver that.

Chris Walters: Thanks, David, and thank you for the question, and for the congratulations on becoming a father. Being a dad is the best thing that ever happened to me.

Let me set out what our price review is, the goals we want to achieve with PR24 and what that means for our decisions on 19 December. The price review is one of our main tools for overseeing the sector. It is something that we do once every five years and it has three core components. The first core component is the costs that we allow companies to run themselves day-to-day to maintain their water and wastewater networks. In return for those allowances, companies commit to levels of performance on things that matter to customers and the environment. There are about two dozen of those performance commitments and we have talked about some of them today. Around those performance commitments there is a regime of rewards and penalties. If companies outperform their performance commitments and customers benefit, they are entitled to charge their customers. Conversely, if they underperform, they are penalised and that money is automatically returned to customers. The third component of the price review is what David has touched on; it is financial. It is the fair rate of return that we allow investors and it is about the level and profile of bills over time.

For PR24 we want to achieve four things with our final decisions in December. The first is to link this next five-year investment cycle more closely to some of those long-term goals. David has set those out in terms of the resilience of our water supplies and environmental improvements. The second goal is to link investment more closely to the needs and the wants of customers and their communities so that the investment that is taking place is what resonates with customers and communities and what they need. The third is for there to be a step-change in the environmental and social value of investment so that we have much more green investment than we did before, we have performance commitments linked to improving biodiversity, reducing operational greenhouse gases and reducing pollution incidents. The final thing is the thing that we always do in the price review, which is to drive investment through innovation and efficiency.



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What do I think that means for the decisions that we will announce on 19 December? I think that we will see record levels of investment to safeguard the health of our rivers, our seas and our waterways. I think that we will see record levels of investment to improve the resilience of our water supplies. I think that we will see incentives for committees to really raise their game on performance that matters to customers and the environment, and we will seek all that at a level of bills that I think is fair for customers and a rate of return that is fair for investors.

Q144 Josh Newbury: A couple of follow-ups on that. It sounds like a great picture going forward, but if we are saying that the rate of investment is going up massively and the rates of return will reduce or keep track with inflation, does that not suggest that over past price reviews the level of investment has been way too low and the rate of return has been too high, therefore? Also you mentioned tripling the investment in new infrastructure. We know that a lot of our existing infrastructure is in a really bad condition. How much of that investment will be put into remedial works for what we already have?

Chris Walters: I would push back against the characterisation that our price reviews have meant that there has not been enough innovation. As I set out earlier, the price review's job is to scrutinise proposals that are made to us, to ensure that they are good value for money and then to hold companies to account for those proposals. It is not our job to say what goes in those proposals; that is the job of water companies. That is in large part determined by the demands of our sister regulators—the Environment Agency and its Welsh equivalent, Natural Resources Wales, the Drinking Water Inspectorate, even Natural England and the UK and Welsh Governments. If the criticism is that the price review did not scrutinise things that it was never asked to scrutinise, I do not think that that is fair.

David Black: It is an interesting point in terms of the investment planning process. We do think that that there is a question of if the investment planning process produced a 300% to 400% increase in investment at this price review, why that did not come through in previous price reviews. That is something that will be explored in the work that the Government Commission is doing.

Q145 Josh Newbury: The Consumer Council for Water suggested that around 40% of consumers will struggle to afford the proposed increases. How do you balance the need for that vital investment with the need to protect the consumers at the same time?

Chris Walters: It is true that bills will rise to finance investment. In our draft determinations, there was an average annual bill increase of 22%, which works out to £19 a year. We are concerned about the evidence that we have gathered with the Consumer Council for Water on affordability. We are doing a number of things in the price review to mitigate that.



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The first is that our process of scrutiny of companies' proposals will ensure that customers do not pay a penny more than they have to for this vital investment. In particular, they will not pay twice for things that they have already paid water companies to do but that the water companies have not done. We are also ringfencing, in our final determinations, customer money for investment. That money will only be used for investment. It will not leak out into dividends or leak out into executive bonuses. If it is not used for investment, it will automatically be clawed back and returned to customers in the form of lower bills.

Our final determinations will also see a doubling in financial support, social tariffs, to customers in need of a helping hand, from 4% to 8% of customers. You will know better than I that the Department finished a consultation on extending the social tariffs from companies to national, and that will be a decision for Parliament and for the Government. Finally, David has already mentioned improvements to the priority services register and some of the changes to the Government-guaranteed standards scheme for returning customers' money when performance is not as it could be. Together those things will ensure that bill increases for customers are fair and fund the much-needed investment.

Q146 Josh Newbury: Given that those ringfences are about to be put in to protect money for investment, do you think that consumers in the past have been offered good value for money by water companies?

Chris Walters: I think that customer bills have been low because the drivers for investment have not made sufficient investment for bills to be higher. I know that our role as the regulator has been to keep bills as low as possible but no lower, and levels of support have been where they were in the sector. That has been largely a matter for the companies. The key thing now is that we have seen a tripling in investment expenditure at draft determinations and we will see a bigger increase at final determinations. The protections that I have described to you put in place will ensure that customers do not pay a penny more than they need to for that vital investment.

Q147 Josh Newbury: Lastly, as we often do see, some commentators in the sector say that the draft determinations will limit the ability of companies to improve infrastructure and secure investment. How do you respond to that?

Chris Walters: It is not uncommon at this stage in a price review process for commentators to say that Ofwat will have to move from its draft determination position. The process normally goes as follows—companies submit proposals on those three core components that I described earlier to us. We scrutinise those proposals and we pare them back. We did that for our draft determinations in July. Companies and others then push back against our draft determinations. There is some toing and froing and final determinations end up somewhere in the middle.



What is different this time is that the first two parts of that process went as they normally do. We received proposals on those three core components and we pared them back. However, companies in their representations to us doubled down and more. They asked for an extra £7 billion on top of what was requested in their original requests. That was driven in very large part by the requirements of our sister organisations. However, we will still be in a position to have scrutinised that to ensure that customers only pay what they need to pay for this vital investment when we announce our final decisions on 19 December.

Q148 Josh Newbury: Clearly leveraging private investment, as you said earlier, will be key to keeping bills down but also maximising investment. Sarah touched earlier on the 3.72% return on investment. Are there other ways other than the pure return on investment that we can make the sector an attractive investment prospect? I am thinking maybe things like consumer satisfaction. You mentioned some best practice that is going on in the industry that perhaps we could share more widely and other wider things that we can do to make it more of an attractive investment prospect so that we can keep bills down.

Chris Walters: Yes. I cannot tell you what the base rate of return for final determinations will be but I can say that financial markets have moved since the information that we used in September. We are not blind and deaf to that fact. However, the base return is augmented by money that companies can make from outperforming the performance commitments that we described. As Helen set out earlier, we have gone from having a dozen common ones there to 24 so that we as the regulator have an even tighter grip. If companies deliver for their customers, they could earn a rate of return greater than that base return. That ought to be enough to attract investment into the sector. I am confident that the final determinations that we announce on 19 December will provide a bedrock for the sector and an investable proposition.

David Black: To build on that, it is about the balance of risk as well. One of the key things from an investor perspective is not just the return, it is about the risk. What we thought very carefully about—given companies that are facing this significant challenge to deliver major infrastructure—is how can we make sure that we are getting the balance of risk and return right, we are not proposing unnecessary risks that drive up the cost of capital, but equally holding companies to account. One of the ways that we have done that, for example, is with major projects. We are taking those outside the price review and dealing with those by a competitive procurement process. It is these projects that are often the most difficult for companies to deliver, so that will go through a competitive market route and firms will bid to supply. That will take care of risk and return.

We are also thinking very carefully about risk-sharing rates on new infrastructure and investment and we are doing a range of measures to try to calibrate that balance of risk correctly, because often investors are



represented to us as not so much about the level of returns, it is about the balance of risk. If we can strike that balance, that will enable us to drive the right outcomes for customers and the environment without driving up the cost of capital unnecessarily.

Q149 Henry Tufnell: My question is about supply chain; you mentioned the supply chain. What is Ofwat's role in the supply chain? Often water companies are very keen to hide behind supply chain—if there is an issue that has been happening with sewage discharge, they say, "There's a delay on the supply chain so the sewage has to keep going into the waterways".

David Black: We do not think that that is an acceptable excuse. Water companies have a licence and they have an obligation to deliver against their obligations. Nonetheless, the way the sector works with the supply chain will be vital. If I could characterise the last six price reviews, there has been a roughly constant level of investment—investment has grown slightly over time—so that is a relatively stable market for companies to operate in. Clearly they have to step up and deliver this huge increase and that will test and challenge the supply chain. We have tried to help that by signalling early about the level of investment.

We have also allowed companies to bring forward investment from 2025 into the current year and into the most previous year. Some companies have made an early start on this investment, which obviously allows the supply chain to start bidding against these contracts. We are also trying to work in the longer term, to signal again that this will not just be an investment for a brief period of time, this will carry on beyond the five-year period, so in terms of the supply chain coming into the sector we are sending very positive signals as well.

Q150 Andrew Pakes: I have a few questions about Thames Water, and I presume you may have expected that there would be some. I represent a city in the Anglian Water area and it strikes me that something has reached significance when in community and other meetings people in my patch recognise the national significance of what is happening at Thames Water for all of us. Thames Water is facing significant financial and operational challenges. How do you think that it reached this point and, given the scale of the challenges, do you think that Ofwat has the skills and expertise to be able to manage those challenges?

David Black: Thank you for your question. Two clear things have gone wrong at Thames. One is operational performance. The company has struggled to deliver against the performance requirements that we expect of it, more so than most other companies. The benefit is that we as a regulator can benchmark companies and their performance and what we see at Thames is that they have struggled to deliver the same kinds of performance that other companies have in different parts of the country.

That, with our regime that we have talked about, which has applied increasing penalties on companies, meaning that their investors are



bearing the consequences for this poor performance, has then fed into the second issue, which is the lack of adequate financial resilience. That is the buffer or the headroom that they have to withstand shocks and challenges that they meet. Thames's level of debt was higher than other companies, not just in absolute terms but as a ratio in terms of its assets. Therefore, it had less headroom going into this set of operational challenges. It has tried unsuccessfully to turn itself around in recent years. It has reached the point that has led the current owners to refuse to invest further in the business. That has precipitated the current crisis. There are lessons there in terms of how we regulate company finances and that we should do more earlier to stop companies getting into this position. However, nonetheless, the regime of privatisation always anticipated that a company could fail. Perhaps you might say that after 30 years we have not yet reached that point, but that is clearly the challenge in front of us.

It is an extremely challenging situation and it is complex. There are billions of pounds of debt; there are lots of different interest groups. In terms of how we are managing this process, first we are applying lots more scrutiny to this company. We have made sure that we have the special advisers and we are working closely with the Government in this space as well. Where the company is at with the process is its current equity holders have refused to invest further. It is therefore engaging in a process with both its debtholders and potential new investors. Its aim is obviously to secure new investment coming into the company and it is working with its creditors to assess whether or not that needs to include a financial restructuring, that is a restructuring of debt to the business.

If that process happens, that is what we refer to as a market resolution of these outcomes and the outcome would be that a new investor comes into the company, the company is de-gearred and that new investor will also need to take responsibility for securing the turnaround of the operational performance of the business, because ultimately the outcome that we want to get to is a business that is recapitalised and its performance is turned around.

As a regulator we are trying to ensure that customers do not bear the consequences of the previous financing decisions of the company or of its poor operational performance. That is the test of the regime—can we work through this process, can we make sure that customers' interests are protected, that even though the company may fail, customers still get service and ultimately there will be a new or turnaround company that steps into the situation. It is a challenging situation but it is one that we are confident that we can address and manage the issues that are in front of us.

Q151 Andrew Pakes: You have described some of the catastrophic failures of privatisation around the Thames Water model. Do you recognise that some people will also say that it is not just a failure of Thames Water, it is a failure of Ofwat to have allowed it to get to this point?



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David Black: Yes, I can see that, and we certainly speak to people who hold those views. At privatisation, the focus on the Government was not to say, "Don't stop companies going bust", the focus was to have a regime so that if it works through, we can protect customers' interests. It has to be said that the level of debt at Thames is the same as Heathrow Airport. Other companies—BT, for example—gears at the same level as water companies do. Therefore, when you say that the regulator should have stopped this, this is a problem that is not just in the water sector or a choice of financing arrangements. Debt is a low-cost source of financing; it is important for the water sector. It was very clear at privatisation that debt was going to be part of the solution. Some companies, such as Thames, have taken it too far but the question is does this come back on customers or does the problem sit with investors. That is the test of the regime.

Q152 **Andrew Pakes:** Do you think that debt loading by Thames Water and maybe some other companies has enabled some of them to get out of some of the responsibilities that they have?

David Black: It should not do and I do not think that it has done, but that is the challenge that we face as the regulator, that the companies will say that it is the regulator's problem and not theirs. That is why we are very insistent that the company addresses these financing issues.

Q153 **Andrew Pakes:** Are you comfortable with the level of debt loading?

David Black: No. I have said that if we were to run this again, I think that Ofwat should intervene earlier to stop companies reaching such high debt levels. That would not necessarily have stopped Thames facing the issues but it may have helped. It would have given it more headroom when it reached these financial problems. However, I do not think that we should try to prevent companies getting into trouble, but we could have forced and taken action, if we had the powers to do so, to stop companies entering into such high gearing structures. That would be a better approach.

We have tried to do that as a regulator. We put new measures into our price review at the last period. They were thrown out on appeal by the CMA. We only have only got licence change powers since 2021 and the first use of our powers was to introduce financial resilience requirements. In a sense, the question here is did we have the powers as a regulator when we were set up to do this, and the answer is no and that is an important lesson.

Q154 **Andrew Pakes:** Thank you. One of the frustrations that may be coming through some of our questions is that we seem to have a lot of discussion on how things could be done differently when looking in the rearview mirror but very little about a sense of urgency about what we are driving towards. That may be a sense of frustration. If the restructuring of debt fails for Thames Water, what would a special admin procedure involve?



David Black: The special administrator is appointed by the Secretary of State on advice from Ofwat. The role of the special administrator would be to take control of the business to ensure that service is provided to customers and then to set about restructuring the business and finding a new owner for the business ultimately. Then it would transition back into private ownership.

Q155 **Andrew Pakes:** Therefore, what we could see is a phoenix from the ashes. Could we see a new Thames Water come through a special admin process, being launched for investment?

David Black: We could. That would be a potential outcome. The challenge with special administration is making sure that there is no adverse impact on customers during this process. Obviously, there will be a cost to running the process as well. Therefore, there are effectively two options to get to these outcomes. One is a market resolution; one is a special administration. Special administration applies in the case of insolvency; the company is not insolvent at present. It is also performance-based criteria and that is something that we keep under consideration.

I want to touch on your other point about looking forward, because a lot of the questions have been looking back. We certainly think, learning the lessons from the past, that that is why we are introducing new controls and gearing. In terms of the issues about water suppliers in the future and why we think climate change is important and why we are working as a regulator to help drive change is to make sure that we have the resilience that the sector needs in the future. We are very clear that change is needed and I do not want to leave the Committee with the view that this is all about looking backwards. In fact, I think that the challenges show that the sector has not adapted to change fast enough. Customer expectations have changed, society has changed, the sector has not moved with those changes and we as a regulator need to be part of that as well.

Q156 **Helena Dollimore:** Andrew has talked about the issue with Thames Water. Much of that has been attributed to Macquarie, which has invested heavily in Thames Water and is an Australian investment bank. There are two parts to my question. Do you think that it is appropriate that an Australian investment bank has such a large stake in one of our most basic utilities and what are you doing at Ofwat to make sure that the same does not now happen with Southern Water, with Macquarie now investing heavily in Southern Water? How will you stop what happened to Thames Water happening to Southern Water?

David Black: The simple answer to that is that the rules have changed and we are very clear in terms of the controls that we have introduced on dividend payments. The questions at Thames Water was that during Macquarie's tenure large amounts of dividends were paid. We have changed the rules around that to be very clear that dividends need to be linked to performance. In particular at Southern Water it is now in what is



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called cash lockup, so it is prohibited by its licence from paying dividends out. Macquarie has invested so far £1.6 billion into Southern Water, so the money is going the other way. It is going into Southern Water.

Southern Water faces a very clear set of challenges. We are very clear with our understanding of the regime, and we communicated that to Macquarie. There are letters on our website and it is all in the public domain in terms of setting expectations to make sure that it understood what its responsibilities were as investors in this sector. In its view it has changed its model. It is a question for it but we are very clear, as the regulator, that it needs to invest to turn around this business and that we will hold it to account in terms of making sure that dividends do not flow out of that company until it is delivering the performance that customers would expect.

Q157 Helena Dollimore: Do you have any sense of nervousness about an Australian investment bank investing so heavily in our utilities?

David Black: I do not have anything particular against Australians, despite being from New Zealand myself. The sector needs to raise investment and does so from a broad range of international sources. We have Canadian pension funds, we have UK pension funds, we have investors from around the world. It is a capital-intensive business and it needs to raise capital. The best way to do that at the lowest cost is to go to international markets. Therefore, there is not a problem with that as such.

I have more concern about consortium-owned companies because I think that they raise more problems about consortiums not agreeing. We saw that at Thames in terms of putting in new funding. However, it is about the regime and making sure that investors understand that they are focused on the long term. We are very clear about the performance that will be expected in order for the company to earn returns. At the moment Southern Water is incurring penalties year after year because of its performance failures. That goes to the detriment of Macquarie.

We do not have powers at the moment to vet owners in the sector. That is a question for the Government, but I guess that my cautionary note is that if we start limiting investors, we have more limited pools of capital and the sector does have to raise money.

Q158 Helena Dollimore: Moving swiftly on, the boss of Southern Water received a bonus for the last financial year of £183,000, the chief financial officer, £128,000. Given the incidents that we have heard about from colleagues today—massive sewage pollution under its watch, incidences of flooding in many communities caused by Southern Water, major water outages—do you understand why our constituents feel shocked that such failure is rewarded with that kind of bonus? And, mindful of time, I know that the new powers that are going through Parliament, the Water (Special Measures) Bill, will give you the power in the future to stop bonuses such as that, and that you did not have those



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powers when the bonuses were paid. Had you had those powers, would you have banned these two bonuses?

David Black: Do you want to take that question?

Helen Campbell: Yes. The powers that we used are the powers that we introduced in the price control to stop customers for paying for bonuses where we feel that they are not justified. We looked at Southern Water's bonuses and felt that they were not justified, based on the performance for customers and the environment. We would have applied those rules to prevent bonuses being paid, but Southern Water had already not charged customers for those bonuses.

Q159 **Helena Dollimore:** However, now you will have powers in the new legislate to totally ban them, not just to ban them from being paid from the customers' pockets. Would you have used those powers to ban these bonuses completely?

Helen Campbell: Yes, we felt that the bonuses for Southern Water bosses were not justified by performance.

David Black: And we understand the public anger about this. It has brought the sector into disrepute, coming back to the questions at the start. It is not just performance of companies that has led the sector to face its troubles, it is the perception that company bosses and investors have done well while some services have not been provided.

Helena Dollimore: It is the lived experience of people in our communities as well.

Q160 **Henry Tufnell:** On the relaunch of the IPO with Thames Water, will those costs be recoverable under the Water (Special Measures) Bill?

David Black: If the company goes into special administration?

Henry Tufnell: You talked about relaunching Thames Water under an IPO. Will the costs of that be recoverable under the Water (Special Measures) Bill?

David Black: There are two things here that may be confused. I am not sure that I understand your question. The Government have given the power—if they put the company into special administration and it incurs losses from doing so—to recover that from customers, and that is one potential issue. If the company restructures itself and launches on the lists, that is a question for the company and the costs of doing that will be a question for the company. It could choose to list without anything to do with—

Q161 **Henry Tufnell:** You will still be impacted by those costs, right? If it is relaunching under an IPO, there would still be an impact on—

David Black: The company would incur those costs, that is right, but we as the regulator set costs on a benchmark basis. It is not driven



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specifically by the cost that Thames would incur. However, we would seek to encourage companies to list on the stock market and we are considering in the price review whether we reflect the costs. If a company that is not listed does list and there are costs associated with the listing, should those be recoverable from customers? We think that there is a case for doing that.

Q162 Henry Tufnell: Does the Water (Special Measures) Bill allow you to get those costs back? Are they recoverable?

David Black: I do not think that it does. I do not think that that is covered by the Water (Special Measures) Bill, but I might be not understanding your question correctly.

Helen Campbell: The Water (Special Measures) Bill gives Ofwat the powers to set remuneration and governance for executive members of the water companies, so it is not relating to—

David Black: The Government have given themselves powers to recover the cost of a company in special administration from other water customers. There would be two triggers for that. First, the company would have to be in special administration and secondly is that Government would be left out of pocket. We think that the most likely scenario is that the business has £20 billion of assets, the business would be sold and the Government would not ultimately be out of pocket. However, if it is, the Water (Special Measures) Bill gives the Government the option to recover that from customers. That is not a question for us.

Q163 Chair: Before we move on from the question of Southern Water—because this is very much forward-looking rather than a rearview-mirror point and it is therefore very important—Southern is currently attracting additional finance at rates above the market average and that is above your own suggested rate for new debt. This looks suspiciously like what happened in Thames. What impact do you think that this would have on Southern and what will you do about it? What powers do you have?

David Black: The way that we set the cost of debt, as you observed, is based on the sector average. When we have a company like Southern that has financing issues, those costs fall back on its investors, in this case Macquarie, as you have referred to. That is a question for the company and its own finances. The difference between Thames and Southern Water is that Macquarie, or its investment funds, has invested over £1.6 billion. A similar scale in Thames would probably be an amount of about £4 billion. That gives the owners of Southern Water a much stronger interest in ensuring that it can finance itself. What it has said is that it does plan to inject more equity into Southern, which is what we and rating agencies think needs to happen. It will do that following the final determination that we set out in December. We will continue to engage with it and to press that that investment comes forward. Until it does so, it will face the consequences of facing higher costs in the bond



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market and where it raises money. We are very clear that customers do not pay for that, that is a question for its investors.

Chris Walters: If I could add to that, the costs that will be reimbursed in the final determinations will be the average cost of debt issued in the market across the sector. Southern will receive that but its debt issuance cost will be higher and it will face that.

Q164 **Chair:** Average cost. Is that the best metric?

Chris Walters: There is a benchmark in the market for the issuance of debt for companies like that. We then look at whether debt has been issued below, at or above that benchmark. In the current period debt has tended to be issued above that benchmark including Southern's debt and one or two others. Therefore, that issuance will be reflected in the day-to-day costs of running the companies, which I described earlier, in our final determinations in December.

Chair: We might return to that some day. You will be pleased to hear that we are coming to the final round of questions. It will take us a bit beyond 12 noon. I am sorry for the inconvenience but this is important material that we do need to cover.

Q165 **Jenny Riddell-Carpenter:** Finally, we are going to cover off environmental performance and enforcement. Over the last couple of years we have seen £300 million in fines and penalties, yet at the same time we have not seen an increase in performance, an improvement in performance. Instead, we have seen an increase in sewage and spillage incidents. Why are these penalties not an effective deterrent?

David Black: There are probably three key elements to improving companies' performance. First is a question about companies' compliance with their current legal requirements. We have live enforcement action against wastewater companies, we have announced draft decisions to impose fines of £164 million on three companies. Therefore, there is a set of questions about their compliance with the law. We do not just fine companies; we also issue requirements for companies to bring themselves back into compliance with the law. That will help but compliance is not good enough. We need to see companies improve their performance. We think that financial incentives have a role in that process. This is setting penalties on each pollution incident.

However, you are absolutely right that that in itself helps, that helps give investors the incentives to drive company management to improve. However, coming back to the Chair's challenge about how we are changing our role as regulator, if you had spoken to us five years ago, we would have said we have set the incentives and expect that to do the job. As Helen talked about earlier, we now sit down and engage with the company. We talk to it about its plans, what it is doing to improve, in particular to identify what is driving the pollution incidents. When you talk to a company it is not usually just one cause. It may have a problem with



a particular part of the infrastructure. It is getting to that understanding of what is driving that incident and how can it change the operational practices, how can it change its maintenance, how it can change its investment plans to address those issues. It may also require differences in approach and innovation, and that comes back to the role of the innovation fund that was set out.

Q166 Jenny Riddell-Carpenter: You talked about sitting down with the water companies and understanding what drives them. What, in your experience, is the most common reason for those spillage or sewage incidents?

Helen Campbell: Often in conversations that I have with the water companies, they explain that there are failures, often power failures, at the wastewater treatment works. Therefore, building power resilience and backup power is important to companies. Parts of their assets may fail, either because they have not been used in the ways that they should have been or they should have been replaced or maintained. Part of it is about response. When something starts to spill, they need to understand it, get out there, look at it and solve the problem before it becomes a breach of permits.

David Black: Building on that, one of the challenges that we face with companies is that often they are not quick enough to get to the root causes of what is driving the problem, understanding not just at that particular sewage treatment works what happens but understanding the lessons for all their sewage treatment works. When we talk to companies, the better companies have a clear line of sight between the actions that they are taking and the outcomes that they are getting. When we talk to companies that are struggling with their performance, we find they often have a much poorer grasp on what is going wrong—or what is causing what is going wrong, should I say—in order to correct it.

Q167 Jenny Riddell-Carpenter: Which are the better companies?

David Black: The better performers that we have seen in the current period are companies like Wessex Water, Severn Trent, United Utilities in some of its performance.

Chris Walters: United Utilities is proactively using AI-enabled tools to target maintenance in advance of something going wrong. We think that that is a model that could be exported to the rest of the utilities.

Jenny Riddell-Carpenter: Spills and leaks?

Chris Walters: Yes.

Q168 Jenny Riddell-Carpenter: One thing that comes up with me and I am sure with my fellow Committee members a lot whenever we talk to constituents about sewage in particular is the question of whether we will ever get to a point where we are sewage-spill free. I appreciate that our infrastructure is incredibly old and complex and has some of the issues



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you set out a moment ago and the most frequent reasons for the sewage spills that we experience are incredible complex and hard to manage. Will this country ever get to a point where our rivers, our canals, our waterways and our seas are sewage free?

David Black: Getting to zero serious pollution incidents is the expectation of Government targets, that is pollution incidents that cause serious harm. At the other end of the scale in terms of sewage discharges, the Government goal and plan for the sector is to have all sewage discharge points operate at no more than 10 times per year by 2025. The target is not to get to zero. The reason for that is one of practicality.

The problem is not so much age and infrastructure. I have seen some wonderful examples of very old assets operating very well and seen some examples of some younger assets failing quite early in life. It is about the integration of surface-water drainage and wastewater systems. I think that we are about to uncover a lot of good ways of driving down sewage discharges. I have been on sites where we have seen local government assets on surface-water drainage directly connected into sewers, leading to sewage spills. We need to get a much better grip on what is driving the problem and taking action to prevent it. This is about stopping rainwater getting into sewers, and building storage and smart technology on networks so it will better manage the excesses when they happen.

Finally at the other end, in terms of the treatment, for example some companies have been trialling reed-bed treatments on sewage discharges so that if you do have a sewage discharge that is operating, treat it and make sure that the discharges coming out of it are fine. At the moment that is not permitted by the Environment Agency as a resolution but it is a direction of better. Therefore, we can do much better but the current aspiration is not to get down to zero sewage spills. I appreciate that that will be frustrating for people. We think that the sector needs to take action to drive down sewage spills quite dramatically over the next five years but we will not get to the point of getting to zero sewage spills.

Q169 **Jenny Riddell-Carpenter:** Understood. You talked, David, earlier about the current investigation that has been going on since 2021. You mentioned that £168 million in fines have been issued to Thames, Yorkshire and Northumbrian Water. Why is it taking so long and when can we expect this investigation to conclude?

David Black: I share your appetite. I would like to see these matters resolved as soon as possible. We have increased the level of our resources and our enforcement function. Since I have become chief executive, we have trebled the scale. That has helped us to cope with this workload, but each of these investigations is complex and serious. We have also faced legal action from companies to slow us down. Thames Water took a judicial review against Ofwat at an early stage. That put our work on hold for several months. However, we are making good progress and we issued a draft decision for it. Obviously I am not prejudging



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outcomes of any of these investigations but we will reach a resolution, whether that is to decide not to take action further or whether to progress to final on those three companies. We are making good progress with the other three companies that we started on in 2021. More recently we have opened investigations against four further companies and we will endeavour to close those as soon as we can as well.

Q170 Sarah Dyke: I have a specifically Somerset question. In May 2023, Natural England changed the condition status of the Somerset Levels' SSSIs to unfavourable and declining due to poor water quality from a combination of domestic, agricultural and sewage waste in rivers. That was on top of the letter that we received in August 2020, which was on the phosphates issues, the knock-on effect being a moratorium on house building. Why, despite large fines to water companies, does this still take place to the extent that it does, and what additional powers of improvements are needed to clean up the mess?

Chair: Hold that thought.

Q171 Helena Dollimore: There has been a lot of discussion about the monitors on pipes to monitor sewage discharges and obviously a lot of work going on to increase the number of them to make sure that all the pipes are monitored as part of the Water (Special Measures) Bill. Previously, the discharges have only been measured by length of time, duration, but we have the technology to measure the volume of sewage discharged. Do you think that that should change and do you as Ofwat have the powers to implement that change?

Q172 Jayne Kirkham: My question is a quick one. Who paid the fees for the judicial review that you mentioned against Ofwat?

David Black: On Somerset Levels, I am not familiar in detail with what is driving the issues in that catchment. You are probable right that it is probably a mixture of wastewater, agriculture, maybe urban runoff if there is any. Generally, we would like to see catchment-based approaches in that space. At the moment this is about whether we can work more on a catchment basis, can we align what water companies are doing to get better outcomes with those and work with farmers and other sources of the issues. Therefore, it is coming up with a catchment plan, identifying what needs to be done. Some of the solution will be around investment.

We are observing that we are running hard up against the technically achievable limits. The Government, as part of the recent legislation, required water companies in these areas to not just build wastewater treatment works to their economically beneficial level but to go all the way to what is technically achievable. If they do that, there is perhaps nothing more that can be done in that particular wastewater treatment works. Then it is a question of how we work in the catchment to make sure that we are taking out the phosphorus in the most sensible way.



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There probably are better ways but I would have to come back to the specifics on that.

I do not think that it is within our powers to specify duration. That is an Environmental Agency measure but I would have to check exactly on that. At the moment the plan is to measure the event, the time and the duration. We think that that gives us a good sense of what is going on and we can incentivise companies to take action to reduce sewage discharges and that is what we will be doing in the next price review period.

The judicial review would have been part of Thames' cost base. We set costs on a benchmark basis so we can protect customers from paying for those costs, so effectively that will come back on Thames' investors.

Q173 **Helena Dollimore:** Can I just clarify, David, on that point it sits with the EA so it is something that we need to ask the EA?

David Black: I will check on that and come back to you.

Chris Walters: There are government regulations called MC regs that prescribe how event-duration monitors are to work, but they are given effect by the directives of the EA.

Q174 **Chair:** Just before you go, the *Mirror* reports that Southwest Water's owners paid out more than £1.5 billion to shareholders. Last week Southwest Water pled guilty to fresh charges of dumping raw sewage, after it was fined £2 million in a separate prosecution in 2023. Can dividends be blocked due to environmental performance?

David Black: We have introduced new requirements requiring companies to demonstrate that dividends are linked to performance for customers and the environment. That is a judgment made in the round. We are conscious that dividends are important from an investability perspective of the sector. We will assess whether companies have complied with those requirements. We have live enforcement action against Thames Water for the payment of a dividend. We will take action against other companies where we think that is justified. However, that said, we would look at the performance of Southwest Water in the round.

Q175 **Chair:** Does it begin to look as if taxpayers are pouring water into a sink with no plug in it?

David Black: The *Mirror* article is not—the question is whether it is accurately characterising the way that the Government subsidy works. The level of dividends that Southwest Water is paying are from the returns that are allowed for in the price review. Whether or not the Government subsidy occurred would not, as far as I can see, have affected the level of dividend payment.

Chair: I shall leave you to raise your concerns directly with the *Mirror*, and wish you as much joy with it as we doubtless have from time to time.



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David, Helen, Chris, thank you very much for your attendance. We have covered a lot of ground today. I hope that you found it helpful and that in terms of producing better outcomes for all our constituents that this is something that will help, because ultimately that has to be where the focus is.

Thank you for your attendance today. It is the start of a process rather than an event in itself, but we do appreciate your time, your attention and your candour.