

Public Accounts Committee

Oral evidence: Water sector regulation, HC 824

Monday 9 June 2025

Ordered by the House of Commons to be published on 9 June 2025.

[Watch the meeting](#)

Members present: Sir Geoffrey Clifton-Brown (Chair); Mr Clive Betts; Mr Luke Charters; Anna Dixon; Peter Fortune; Rachel Gilmour; Sarah Green; Sarah Hall; Lloyd Hatton; Chris Kane; Sarah Olney.

Max Tse, Executive Director, National Audit Office, and Edward Pinney, Alternate Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1-113

Witnesses

[I](#): David Henderson, Chief Executive Officer of Water UK; Dr Mike Keil, Chief Executive, the Consumer Council for Water; and John Earwaker, Director, First Economics.

[II](#): Dame Tamara Finkelstein DCB, Permanent Secretary, Department for Environment, Food and Rural Affairs; David Hill, Director General for Strategy and Water, DEFRA; Philip Duffy, Chief Executive, Environment Agency; and David Black, Chief Executive, Ofwat.

Written evidence from witnesses:

– [Add names of witnesses and hyperlink to submissions]

Report by the Comptroller and Auditor General
Regulating for investment and outcomes in the water sector
(HC 853)

Examination of witnesses

Witnesses: David Henderson, Dr Mike Keil and John Earwaker.

Chair: Welcome to the Public Accounts Committee on Monday 9 June 2025. The supply of clean water is essential to human health, the environment and the economy. However, the water sector currently faces significant supply and environmental challenges, with England facing a shortfall of 5 billion litres of water every day by 2050 if no action is taken in the meantime.

Ahead of our questioning of the Government officials later, we are fortunate to have with us a panel of witnesses with a huge wealth of knowledge and experience in the field of water regulation. We hope to hear from this panel what they think are the biggest challenges facing the water regulators and companies, and what can be done overall to improve the water regulatory system to ensure that customers get the best value for money for their bills.

With us to help us with all the complexity is David Henderson, the chief executive of Water UK. Thank you, David. Water UK is the trade body for the water industry, and David joined as the CEO in February '23—I think that is right.

David Henderson: Yes.

Chair: Dr Mike Keil is the chief executive of the Consumer Council for Water, which is the independent voice for water consumers in England and Wales. Mike became its chief executive in October '23. Welcome to you both. Last, but by no means least, John Earwaker is the director of First Economics, which is an economic consultancy that advises companies, regulators and Government on regulatory issues in the utility and transport sectors. John is one of the founders and has worked there since 2004. I think you will be able to answer from both sides of the fence.

John Earwaker: I hope so.

Chair: You are all extremely welcome. We will start off with Lloyd Hatton.

Q1 **Lloyd Hatton:** I have a very simple question. When we, as parliamentarians, look at the water sector in this country, the number of deeply rooted challenges is often quite overwhelming. In a nutshell, what is the single biggest challenge facing the water industry over the next 25 years? Are we in a fit state to even begin to address that challenge, given

where the Government, regulators and industry are?

David Henderson: It is a pleasure to be here. This is a critical issue. Water is about one of the most essential services of all, if not the most essential. In terms of challenges for the future, climate change in particular presents the biggest challenge to our network. The changes that we are seeing to the weather almost every day are putting untold pressure on a system that was not designed to cope with it.

On top of that, we have a growing population and changing needs for water from businesses, and particularly data centres, which need a lot of water to keep themselves cool. The Government rightly want to build 500 over the next five years to harness the potential of technology. That is going to require a lot of water, in a way that we have not needed to supply it before. So the challenge is enormous.

Your second question was about whether we have a regulatory and legislative system and companies that are in the right place to deliver that. At the moment, the answer is no, we do not. That is why we are particularly pleased to see the National Audit Office Report and, last week, the interim report of Sir Jon Cunliffe's Independent Water Commission. They shine a very useful spotlight on many of the reasons why we do not have what we need and set out some useful ideas on what would make a big difference in putting that in the right place.

First of all, we need a clear, Government-set objective for the whole water sector. At the moment, we have overlapping objectives, inconsistent and incoherent regulation, and duties among regulators that overlap or create gaps. That has caused a system that is too expensive, too complicated and far too slow to give us the infrastructure we need to withstand the pressures of climate change and deliver the economic growth we need.

Chair: There is a lot in that answer, David, which no doubt we will want to unpack. Thank you.

Dr Mike Keil: I will keep my answer shorter. I agree with David that climate change is a key issue. It is too much water and too little water, sometimes simultaneously, and that can be quite a baffling concept to get your head around. The sector is at the forefront of adapting to climate change. That is a huge challenge.

Public trust clearly needs to be rebuilt, and that is a huge challenge in itself. We track and measure trust each year in a big survey. It was at an all-time low last year, and this year it exceeded that—another all-time low. There is a lot of work to do to rebuild public trust.

Q2 **Chair:** On the latter point, does that survey break down, on a more granular level, the elements that are causing a lack of public trust?

Dr Mike Keil: The tracker survey tracks lots of different factors, so you can see what is driving the dissatisfaction. On what is causing this dissatisfaction, the clear winner—to put it that way—is environmental performance.

Chair: Thank you.

John Earwaker: To come in on the back of that, the big challenge for the next five, 10 or 25 years is that companies have to deliver the investment that they have promised consumers and the Government will be forthcoming over the next few regulatory periods. They have been permitted to increase bills by an average of 36%; in exchange, they will have to do what they said they would do and achieve what they said they would achieve with the money they have been given.

May I also answer your question from a regulatory perspective?

Chair: Please.

John Earwaker: The big challenge for policymakers and regulators is for the regulation of the sector to become unremarkable and ordinary again. There has been quite a lot of noise around regulation; we just need regulation to settle down. In practice, that means that if companies fall short, we expect the regulators to step in a proportionate and predictable way.

What we need more generally, though, is we need a consensus, coming off the back of the work that the independent commission is doing, about the structure of regulation and about regulatory methods, and we need a consensus to be forged quickly, so that the new normal makes regulation less of a talking point for consumers, investors and all other stakeholders.

Q3 **Chair:** You will know better than many the financial health of the 16 water companies. How confident are you that they will cough up the £106 billion they have committed to the Government to spend on water improvements?

John Earwaker: It is different when you look at different companies; it is not the same with all 14 privately owned companies in England and Wales. The National Audit Office identified that there has been a weakening of financial resilience, on the back of underfunding, performance penalties and less stable regulation.

The really important point to make here is that in order to deliver the £100 billion-plus expenditure, all companies are going to have to access very significant sums of new capital. Therefore, financial resilience depends on having confidence that the financial markets are going to supply water companies with both new borrowing and new equity. I think on both sides there have been questions on both sides recently, which makes it not an inevitability that the companies will be able to finance the programme in the cheapest way possible.

Q4 **Lloyd Hatton:** Those were very helpful answers. Obviously, I agree that the demand for water, climate change and public trust are big issues. To build on the Chair's point, is financial resilience not also jointly a serious concern? What explanation can you give the Committee to reassure us that the financial resilience of all the water companies in this country is sound? There is a mountain of evidence to the contrary.



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One of the great concerns facing the Committee is the reality that if the industry somehow topples over, the taxpayer will have to step in. We will then be having a very different conversation as a Committee about how the taxpayer can possibly step in to a water industry that has failed and, in some cases, financially gone under. It would be useful to get a brief answer from each of you.

David Henderson: I do not think it is quite accurate to describe the entire industry's resilience as being on the brink of falling over. It is true that the regulatory system in totality has had its creditworthiness downgraded. Moody's downgraded it in 2019 and again in 2024; part of the reason it cited for taking those decisions was an increase in the unpredictability and complexity of the regulations for the industry. That is having a direct impact on the resilience of every company in that regulatory system and, ultimately, that has increased the cost of capital. We estimate that £27 has been added to each and every household bill as a direct consequence of those two downgrades of the whole regulatory system.

Resilience can be looked at in multiple different ways. Companies have taken efforts to improve their resilience, and their average borrowing has fallen. For some companies it is clearly higher than for others, and they are taking additional steps, and additional regulatory interventions have also been taken to help to improve resilience. But I would not want to suggest that the entire industry's resilience is in doubt, because I do not think that would be accurate.

If you ask why there is any question about resilience, I think it is for multiple reasons. Partly, it is the issues identified in the National Audit Office Report. We have not had sufficient investment going into companies. Their balance sheets have not been strengthened, we do not think, to the extent that they should have been. Average returns—return on regulated equity, which is the standard measure used by all regulators across regulated sectors in this country—are running at 2.78%. That is very low. One company has not paid a dividend in eight years; many companies have not in six years. Many companies made a loss last year—in fact, eight companies made a loss last year.

This is not, then, an industry that is awash in cash, and we think that is because of a fundamental decision taken quite a long time ago to suppress investment. I am not saying that every company has behaved perfectly—far from it; we have been very open and honest about that and apologised for our shortcomings—but the NAO has identified that, in addition to that, there are fundamental issues with the nature of the regulatory system in itself.

Lloyd Hatton: To be clear—

Chair: Sorry, but we are under real time pressure.

Q5 **Peter Fortune:** I want to pick up on something that David said about data centres—I am on the shadow DSIT team. Dr Keil, what preparation



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has been done for the huge uplift in requirements for water to cool data centres? Is anybody talking to anybody to get ready for how that will be dealt with in terms of cost, regulation and perception?

Dr Mike Keil: I will make a quick point about the previous question, because I have an important perspective that is different from that of the others. Ofwat flagged in its financial resilience report that 10 companies are a cause for concern, which means that only six were not a cause for concern in terms of their financial resilience. When you look at how they got there, it is really important to make the point that Ofwat gave companies freedom to deviate from the notional company structure in terms of their level of gearing. Ofwat gave companies that freedom, but the second thing had to happen as well: companies then chose to deviate from the notional company structure. That happened over a long time, over successive price review periods. That has led to companies having exceptionally high gearing, which leads to an increase in risk that has led to, in the extreme case, what we see with Thames Water. It is important to recognise that those two things had to happen: Ofcom had to give companies the freedom to deviate, and some companies then chose to deviate.

I will now answer the question. The balance of supply and demand is crucial, and meeting that balance into the future is critical. The regulators have taken some really positive steps in the past 5 or so years, with the establishment of something called RAPID—the regulators' alliance for progressing infrastructure development—which is looking at large supply-and-demand projects.

Chair: I think we have got the gist. I am sorry to cut Members and witnesses short, but we have an awful lot to get through in a very short space of time. We will have one question per person, please.

Q6 **Mr Betts:** We have talked about the problems the industry has faced. We now have the price review and a new settlement. Can the companies deliver everything that is required of them as a result of that review, and are they able to borrow the amount of money they need to fulfil all their objectives?

John Earwaker: To start with the second part of your question, borrowing is only part of the story. When companies are financing these investment programmes, they need both new borrowing but, critically, in most cases they are going to need new equity capital as well. Wherever the limit is on their borrowing, the big question at the moment is whether there are a sufficient number of global investors who are going to positively choose to put money into our English water companies when it is very easy to make return elsewhere.

At the moment, there are six companies that are asking that question of the Competition and Markets Authority on the back of PR24, which will provide a bit more clarity on how these companies become investable and financeable. I think that story will run until the end of this year.

David is probably better able to speak about deliverability than I am.



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David Henderson: We are confident that we can deliver the £104 billion of investment over the next five years, but it is not without challenge. We need to hire 30,000 new people. The average age in the workforce is already quite high, so we need to replace the people who are about to retire as well as add a net total of 30,000 people up and down England and Wales. That is not easy. Of course, this is in a climate in which it is not just investors who have choices about whether they park their money into this sector or another sector; employees also have choices, so we want to make sure that they feel excited and enthusiastic about joining an industry that provides literally lifesaving products to people every single day, without which we would be in a great deal of trouble.

Q7 **Mr Betts:** Are we going to be back in five years' time bemoaning the fact that, once again, the companies' objectives and requirements are not being met?

David Henderson: The great thing about this investment programme is that a money-back guarantee is built in, so if we do not deliver anything that we have promised, customers will have that refunded. Customers will not be paying twice for any piece of infrastructure that has been authorised by Ofwat.

Q8 **Mr Charters:** Dr Keil, on the corporate debt side, there is arguably a risk of a death spiral for some companies; is there also a risk of a consumer trust death spiral? The £123 bill increase happened at the same time as pipes were effectively blowing up across my constituency. Is consumer trust recoverable, or could we risk a consumer trust death spiral?

Dr Mike Keil: I think it is recoverable. It is going to take a lot of hard work, focus and attention from the sector more widely, including regulators, companies and consumer bodies. I say that because in the tracker survey that I referred to earlier, the majority of companies actually had an increase, albeit small, in their trust scores, which shows that the dial can be moved. If the plan is delivered and people notice improvements, it is logical that their opinion of the water sector will change. That is why the water companies have to double down to deliver all the improvements that are promised and explain to people what they are getting for their money, because at the moment people feel that water bills are not fair. That has to change.

Q9 **Mr Betts:** John Earwaker, does the whole business of the price review work, or are we in a situation where, in the end, the regulator comes to a view about what is just enough to keep the water companies going ahead, but not too much to really upset the customers, so it is a middle way and does not really address any of the issues?

John Earwaker: In general terms, the five-year price review process that Ofwat runs is one of the great strengths of the water industry. It provides a focal point. It provides discipline. It allows for conversations to be had about what is the right investment programme and the right level of customer bills to support that investment programme. In general terms, because we have that process, we were a lot better off than other

industries that do not have five-year funding envelopes and those five-year discussions about investment priorities and performance.

If I then answer your question thinking about PR19 and PR24, the phrasing of the National Audit Office was quite interesting when it looked back at PR19. It said that DEFRA and the water sector regulators have not encouraged water companies to spend what they need to deliver the performance expected. That is the National Audit Office saying, perhaps with the benefit of hindsight, that PR19 was a lost opportunity. There was a chance to do a bit more in germs of investment to push performance in certain areas a bit further forward. There was a collective failure, not just on the part of the regulators but on the part of the companies, Government, and maybe even consumer representatives, to really use that five-year period to its maximum possible potential. And then on PR24, I think there is cause for optimism. The decision that Ofwat published at the end of last year is capable of providing a platform for what many of us want from the companies over the next five years.

Q10 Mr Betts: Mike Keil, do you tend to disagree with that?

Dr Mike Keil: No, I agree with chunks of what John is saying there. You need to have a framework to set prices. Obviously, this is a monopoly industry; we cannot just leave them to set their own prices. You have to have a framework in place. The price review has delivered benefits for customers, but there has been a collective failure when it comes to environmental performance. The drive to keep bills low was the mood music that everyone bought into. We got to where we are; we need to look carefully now at how to improve it. I think Jon Cunliffe's diagnosis of a lot of the factors, in terms of regulation over-complexity and duplication of responsibilities between the different regulators, was spot on. Also, how do you get a sector that is boring? You want a water sector that is boring, with a low-risk, low-return environment for investors.

David Henderson: We clearly need price reviews. The question is, how can we do them better? The current price review, in our view, was far too costly, slow and complicated. We spent £250 million as an industry, filling 55,000 pages' worth of documentation, and it took nearly 18 months to tell us what I think we probably already knew from the outset, which is that we need new reservoirs. We need leakage to fall further and a higher standard of environmental performance, which is going to take a degree of investment we have not seen before. All the time, money and effort spent on this price review could have been far better applied, and if we had done that, we would be in a better place.

There is very wide scope for reforming the price review. The National Audit Office has indicated some ways in which that would happen, as has Sir Jon Cunliffe. Instead of such reliance on abstract econometric models, which take very little account of idiosyncratic features of individual companies, moving towards a more company-by-company assessment of the costs being borne by that company would be far better. The fact that Ofwat has not had a chief engineer since 2005 is a strong suggestion that the emphasis has been too much on economics, and not enough on actual

engineering and physical assessments of what is required across our country.

Chair: Thank you for your answers. Anna Dixon is next.

- Q11 **Anna Dixon:** When I sat down with Yorkshire Water's CFO Paul Inman and my own customer bill, I asked why 12% of my bill was for making improvements and 24% was for borrowing return to investors. It seemed I was paying double for the Kelda holding companies' investors than I was for actually making improvements. Perhaps I can ask John Earwaker first: what do the regulators need to do to ensure that the investment in infrastructure that is needed can be delivered at the lowest cost and with the best value for bill payers so that more of the money from my bill goes on improvements and less on borrowing returns?

John Earwaker: You are right to identify that. When you think of the bill there are basically three things that the bill pays for. There is the day-to-day operating cost that the company has; there's payment towards the capital investments that have happened historically and are happening now; and there's the cost of the finance that the company has taken. Collectively, companies have taken £100 billion of investor capital because they have invested on our behalf, but we have not yet paid them for that investment. It clearly is the case that if they can finance that £100 billion at a lower cost, then we pay less through our bills.

The independent commission's report from last week is very interesting because it identifies that, if you want low financing costs, it is also quite difficult to have very high-powered penalty and reward regimes around cost efficiency and performance for the environment and customers. The independent commission has suggested that one way of bringing bills down would be to just de-power the incentive regime somewhat and make utility returns again more stable, low risk and boring. That would help to bring down the component part of the bills that you have referred to, which are at the moment based around just the financing costs for the industry.

- Q12 **Anna Dixon:** But that was only in the past. The regulators looked at the entity that was delivering the service. In the case of Yorkshire Water, there are nine other companies, all of whose purpose is nothing other than to leverage debt and then leverage costs against that. That is surely not good value for money for bill payers.

John Earwaker: Some of those corporate structures, in the views of some companies, have been unnecessary in the past, and some companies have tried to simplify that. But actually Ofwat does not pay attention to those structures when it sizes the bills. It identifies what a fair return is, based on a hypothetically efficiently financed company, and it benchmarks returns against what investors can make for their money elsewhere in the world from safe infrastructure industries. The returns that we pay through our bills are not actually influenced by that financial engineering; they are influenced by the bottom-line minimum return that we have to cover as customers if we want private sector financing to pay for investments.

- Q13 Anna Dixon:** Sorry—I may be ignorant—but figure 12 in the NAO Report shows that the vast majority has come through debt and not equity being raised. At some point, as customers we are paying for that debt.

John Earwaker: You are. Of the £100 billion of capital that I mentioned, roughly £70 billion is in the form of debt and roughly £30 billion is in the form of equity. In a price review, Ofwat works out an efficient cost for the whole £100 billion of financing. Because we as customers do not pay for investment in full at the point when investments are made, those financing costs ultimately come on to our bills, but I think Ofwat does quite a good job of making sure that that cost is minimised to the greatest extent possible. The cost will never go away. We will always be in a position where we look to companies to finance investments so that we can pay that investment in instalments over the life of the asset, rather than all in one go at the point when the investment is made.

Anna Dixon: I am sure we will come back to this in the main session, but I am really keen to make sure we ask intelligent questions. Getting to the bottom of the scope of regulation and whether you agree that the scope of the financial regulation of Ofwat has been drawn too narrow is really what I am trying to get from you as a regulatory expert.

- Q14 Chair:** Before you answer, can I ask whether it is satisfactory that Ofwat only covers the regulated company, not all the parent companies and associated companies? It is often the parent companies that actually incur the debt.

John Earwaker: It is helpful to separate two things. One is the cost of that £100 billion of capital. That £100 billion of capital is there; we cannot wish it away. That has to be covered through our bills. That is one conversation that you might want to have.

The second conversation is about whether there is a fragility to the finances of these companies because of the way in which they choose to structure their borrowing, the way in which they structure their holding companies and the way in which they choose to arrange their finances. It is a legitimate question to ask whether, in the past, Ofwat has policed those decisions in the optimal way, or whether that complexity at holding company level has ultimately led to some pressure on customer bills, through the kind of situation we see at Thames Water.

- Q15 Rachel Gilmour:** Mr Earwaker, I notice from your CV that your company is an economic consultancy that advises companies, regulators and Governments. Presumably, you earn your money by being an adviser to the water companies and regulators that you are currently talking about.

John Earwaker: Across all my work, I split my time roughly evenly between work for regulators and work with regulated businesses in the water sector. It is the case that in recent years I have spent a bit more time with water companies than with Ofwat. However, in coming to the Committee today, I am trying to look across all that I do in regulated industries.



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Rachel Gilmour: I just wanted to drill down a bit into where you were coming from.

John Earwaker: Sure.

Q16 **Rachel Gilmour:** Thank you. I'm afraid to say that my question is going to be rather tongue in cheek. I represent Tiverton and Minehead; Minehead is on the west coast of Somerset. Sewage outflows across the whole of the west country have gone up 10 times, almost on a year-on-year basis. As a former head of strategy at the Environment Agency, what parts of the regulatory system do you—any of you—think are working well?

David Henderson: The Drinking Water Inspectorate is working very well. Our water is regularly independently tested by the World Health Organisation and many other globally renowned scientists, and we have the safest and cleanest drinking water on the planet jointly with three other countries, so I think that part of the industry and the sector more broadly is working very well. There is a reason why, when you go down the supermarkets in this country, you do not see aisles and aisles full of bottled water. It is because people trust the wholesomeness of the drinking water that comes out of our taps.

That is not to say there are not problems; of course there are. There are very large problems that need addressing, and I think that the National Audit Office Report will go a long way to help address them, but I think that there are elements of the system that work well and one of them is drinking water.

Rachel Gilmour: So our water in the south-west is better than the water is in Mali. That is a pretty low bar.

David Henderson: As I say, drinking water is regularly tested by the World Health Organisation and other institutions around the world, and found to be the joint highest standard in the world.

Chair: Rachel, are you done?

Rachel Gilmour: Oh yes.

Q17 **Chair:** We have not covered water resilience. We have not built a reservoir for 30 years. Dr Keil, when the Report talks about a shortfall of 5 billion litres in the next 50 years, how parlous a state are we in with water supply in this country?

Dr Mike Keil: This narrative that we have not built a reservoir in 30 years is an interesting one, because it is absolutely true, but we have to ask why. Back in the early 1990s, leakage was out of control—it was 50% higher than it is now—so if you wanted more water resources, the most effective way to do that was to tackle leakage. That was an important point. The second point is that water demand over the last 30 years has declined as well, so you have those two factors.



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The third thing that means we need new reservoirs now is that our resilience standards have changed, so we are now building to a much greater protection. Absolutely, we need reservoirs now, but it is not true to say that because we have not built one in 30 years, we needed one in 1992. When we talk about this issue, we just have to be clear that we understand the facts around it.

In fact, back in 2022 Water UK was defending not building reservoirs—in fact, you were defending closing reservoirs—by saying that reservoirs are only one way of supplying water to the general public. We need to be careful about how we deploy the “We’ve not built a reservoir in 30 years” line, because you need to understand what sits behind it to really get to the truth about it. We absolutely need to build new reservoirs now and we see that happening. That is encouraging.

David Henderson: We have needed to build reservoirs for some time. I mean, the fact that a cancer hospital had its development delayed in Cambridge for no other reason than a lack of water should concern everybody in this room and far beyond. If we had had a reservoir in that area many years ago, we would not have had that predicament. We are seeing businesses unable to expand in parts of Essex, Surrey, London and Oxfordshire for no other reason than a lack of water.

We want to get leakage, which is currently at its lowest level, down and we also need more supplies. It would have been a hell of a lot cheaper if we had been building them when interest rates were near zero. If Water UK needs to apologise for anything that it said about reservoirs in the past, I am very happy to do that, but in 2014 the Consumer Council for Water objected to the building of a reservoir in Bristol—in Cheddar—which was denied by Ofwat at the time.

There is blame all round. As an industry, we have been very up front about the role that we played in the past, and I am very happy to apologise for that again, but no one can say that we should have only started building the nine new reservoirs that were authorised by Ofwat in December last year back then. We should have had more reservoirs built a long time ago and we should have been focusing on leakage a long time ago. We should have also had more water transfer schemes, and we are now having to play catch-up.

Sadly, it is going to cost us an awful lot more money than it would have if we had been building when we had interest rates near zero, as they were for a very long time, a decade ago.

Q18 **Chair:** To add to that, we were very close to using standpipes in London during the Olympics, and that was 12 years ago. We have had time to do something about this.

David Henderson: Yes. In 2012, the Secretary of State for Environment, Food and Rural Affairs denied Thames Water’s application to build a reservoir in Abingdon because, in her words, there was “no immediate need”. I mean, talk about a short-term decision.

Chair: Thank you very much for that very honest and frank answer.

Q19 Lloyd Hatton: To return to the exchanges at the top of the session, I found it quite striking, David, that given the challenges you set out as facing the water regulators and industry, you felt the industry's financial resilience was not of severe concern. Could you go into a bit more detail? Do you not share the concerns of many parliamentarians and water campaigners that the financial health of the water industry is in a pretty sorry state?

David Henderson: The industry is made up of lots of different companies—

Lloyd Hatton: Some of which are hugely debt laden.

David Henderson: Yes. I was objecting to the idea that the entire industry's resilience should be questioned. I do not think it should. Many companies enjoy very high creditworthiness ratings from Moody's, Standard and Poor's, and Fitch, and for good reason, because they are resilient companies.

Q20 Lloyd Hatton: Do you accept that many water companies, including the largest water company in the country, are in a very difficult financial position and that that could be a significant concern for the industry in the next five to 25 years, and indeed also for the taxpayer, should they have to step in to help those ailing companies?

David Henderson: We need a stronger system. The National Audit Office has identified many things that would help to make it much stronger, as has Sir Jon Cunliffe.

Anna Dixon: On a point of order, Chair. We did not invite the panellists to declare any of their conflicts of interest—for example, how their organisations are funded. Rachel asked that question of John, but do either of the other witnesses needed to be clear about that?

Q21 Chair: I am advised by the Clerk that they do not have to but, for example, it would be helpful if we knew how the CCW is funded.

Dr Mike Keil: The CCW is funded through a small levy on water bills.

Q22 Chair: Right. How is your organisation funded David?

David Henderson: Water UK comprises its members, which are every single water company in the United Kingdom from state-owned and run Northern Ireland Water and Scottish Water, which is owned by the state, to Welsh Water, which is a mutual, to the private companies in England. They are all the legal owners of Water UK, and they provide its full income.

Anna Dixon: Thank you. It is useful to put their comments in context.

Q23 Chair: David, you were very critical about the complexity of the regulation, and John, you have been critical about the financial bits of it. As a last question, I would be interested to hear from all three of you as to



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how you think regulation could be improved. Is it complete heresy to say that the Environment Agency and Ofwat ought to be merged so that we do not have those boundary issues? Starting with you, David.

David Henderson: As an industry we are more concerned about what goes in the building of a regulator, rather than what the regulator is called and what is above the door plate. Whether or not the regulators are merged is less important than what regulators do. At the moment, there is inconsistency and contradiction in their statutory duties. The Water Industry Act sets around 13 duties on the economic regulator, Ofwat, and then the Secretary of State for Environment, Food and Rural Affairs sets out 59 expectations on Ofwat in the strategic policy statement.

That is a very bad way to set out what that regulator should be doing. We need far fewer, clearer and simpler objectives. That would make it much easier and should be centred around what the Government want in terms of the standards of the environment, drinking water and customer service they desire. Then the economic regulator should be tasked with ensuring that happens as efficiently as possible, in a way that attracts sufficient investment—no more, no less.

At the moment, we have all sorts of competing objectives placed on the various regulators, which is a recipe for confusion, complexity and cost.

Dr Mike Keil: I agree with much of what David said. I also think that, in order to build customer trust, we need greater transparency. In this price review, Ofwat did not explain how customers' views were taken into account in its final decisions. Given that a hell of a lot of customer research was done to inform that process, that is not great in the eyes of consumers.

Similarly, with the Environment Agency, there is the national environment programme, or the WINEP. A lot of additions were made to that programme at the very end of the process that allowed no scrutiny or discussion with consumers about whether they liked the shape of the package and the price tag associated with it. You could say, "Well, that is a statutory programme, so why should you ask people?" Look at the state of the sector; are you really arguing for less transparency? That process needs to be transparent. People need to understand what they are getting for their money, if we have any hope of rebuilding that trust.

Chair: That is really helpful.

John Earwaker: It is really important that we ask who we want to be our regulators. My area of focus is economic regulation, and throughout the conversation we have referred in shorthand to Ofwat as being the economic regulator. Formally, the economic regulator is actually an organisation or authority called the Water Services Regulation Authority, which is a group of 10 men and women appointed by the Secretary of State. We have perhaps not thought as much as we should have in the past about the expertise that we want in that body of individuals.



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I do not think that we have thought enough about how many hours in the month we want them to work. I personally find it absurd that we ask our regulators to work three days a month and expect them to exercise all their statutory functions and make decisions that have impacts running into billions of pounds. This really comes to the fore with the independent commission's recommendations, where it is maybe suggesting a change in Ofwat's role or governance. For me, the No. 1 thing that the Department has to think about is how it assembles a body of experts, who would ideally be working full time, and regulates the sector through consensus among experts.

Finally, to come to your question about merging Ofwat and the Environment Agency, on the back of what I have said, I would like to understand how you would have a body of experts capable of doing both the economic regulation and environmental regulation. From my experience, they are actually quite different things, with different skillsets required.

Chair: That is very helpful.

Q24 Anna Dixon: You talked at the beginning about some of the challenges. When we were previously taking evidence from the chief medical officer, Chris Whitty, he was obviously very concerned about public health. If we think back in history, one of the great successes in public health was water sanitation. Mr Henderson, you said that we have some of the best-quality drinking water, but do you think we have taken our eye off the ball and probably now have some of the most polluted rivers? In a way, do you think that we need to get back to recognising the importance of public health objectives for water companies?

David Henderson: It is certainly true to say that we have had more emphasis on drinking water than wastewater. Any visit to water companies will show that that is where the relative investment has been allowed to go, compared with wastewater. I would argue that our rivers have actually had a noticeable improvement in the last 30 years—phosphorus and nitrates are well down from where they were. They are not in the state that they should be, but they are in a better state than they have been.

If we want them to be in an even better state, we need to have much more investment. The good news is that Ofwat has authorised a tripling of investment, such that we can halve the activation of combined sewer overflows. We are going to further improve final treated effluent, so that it contains even less phosphorus and nitrates that are going into our waterways.

However, we are only one contributor to the health of our rivers, and there are also many other actors. For example, run-off from highways causes a lot of issues, and some agricultural properties do too, as well as some housing developments. There are lots of contributors to rivers. It is true to say that, as a nation, we have not prioritised their health as much as we

should have. Some of the investment that will help that is flowing as of last month, but this will be a multifaceted approach.

One of things we were so happy to see in Sir Jon Cunliffe's interim report last week was the idea that we should have a more regional, almost catchment-based, approach to the way we manage the environment. We would look at all the actors inputting to the state of the environment, and then we would look at who should be bearing the cost.

Fundamentally, we would much prefer to see a "polluter pays" model, so that the people who actually make the products bear the full costs of the environmental damage they are causing. We have, for example, called for a ban of PFAS—forever chemicals—and we think that the manufacturers of those chemicals should be bearing the costs of cleaning them up in our environment, and over time those costs will be quite high.

Q25 Anna Dixon: Dr Keil, on your point about consumer confidence, people feel really angry about issues such as raw sewage dumping, don't they? They have been paying for a service that they thought they were getting—the processing of sewage—only to find that even in low rainfall it was being dumped, effectively illegally, and that the companies to which they had been paying money had not been doing the job. Do you not think that is a key part of the problem with consumer confidence?

Dr Mike Keil: Absolutely. People are rightly angry at the frequency with which storm overflows are being discharged. It is interesting that you asked about public health. Another public health impact that I am concerned about is that people are cutting back on their water use because of the cost. We have had a significant increase in bills. A new survey, out at the weekend, said that a third of households have cut back on their water use. That is fine if it is non-discretionary, but if you are cutting back on essential water use, that is a public health issue, too. That is why water affordability is such a key issue. We have not touched on it, but currently one in five households cannot afford their water bill and consumers tell us that, with the predicted rises that are going to hit over the next five years, that will rise to 40% of households. That is a big issue, and that is why we need to address water affordability as a priority.

Chair: Thank you for raising that, Dr Keil. We will raise that with the next panel. Anna Dixon is probably the person to do that. I thank our witnesses very much indeed. We have gained a lot from the three of you, who obviously have a lot of knowledge. We will take a break, and return for the next panel at 20 past. Thank you again to our witnesses.

Examination of witnesses

Witnesses: Dame Tamara Finkelstein, David Hill, Philip Duffy and David Black.

Chair: Welcome back to the Public Accounts Committee on Monday 9 June 2025. We now move on to our main session.

We have just heard from an excellent panel of witnesses about the challenges currently facing the water sector. It is estimated that the sector needs to spend almost £290 billion on improvements to water infrastructure over the next 25 years. Unfortunately, consumer trust has reached an all-time low since monitoring began in 2011, with issues like water pollution and the financial mismanagement of water companies being at the forefront of consumers' minds, as we have just heard. This also comes at a time when water bills are rising for customers across the nation.

Today we will be examining how DEFRA and the regulators will ensure that the sector meets long-term supply needs and manages long-term resilience. We will also be challenging DEFRA and the regulators on the gaps in the regulatory framework, as well as on how they will support the sector in driving improvement for consumers.

To help us with all that, we are pleased to welcome the permanent secretary, Dame Tamara Finkelstein, a regular attendant at the Committee. You have been permanent secretary since 2019. You have announced that you will be standing down in the summer, after six years of dedicated service leading the Department. Thank you for all you have done for the Committee—you have always been very helpful and courteous—and thank you for all you have done for the Department. You will be missed.

Dame Tamara Finkelstein: Thank you, Chair.

Chair: David Hill was appointed director general for strategy and water at DEFRA in June 2024, having been director general for the environment from October 2020. I believe it has been announced that you will be interim permanent secretary when Tamara leaves. Is that correct?

David Hill: That is correct, Chair, for the interim period.

Chair: Well done; congratulations on that. Everything will fall on your shoulders.

David Hill: Thank you.

Chair: Philip Duffy was appointed chief executive of the Environment Agency in July 2023, having previously worked at the Treasury. Welcome to you, Philip. We also have David Black from Ofwat. David was appointed chief executive in April 2022 after serving as interim chief executive from April 2021, having joined Ofwat in 2012—so you know the organisation pretty well by now, I should think.

Thank you all very much. I think you have been warned about one or two of the top-of-the-session questions. First, I will bring in Sarah Olney to talk about the Teddington direct river abstraction.

Q26 **Sarah Olney:** Good afternoon, panel. The Teddington direct river abstraction is one of the 30 projects referred to in the Report, and it directly impacts my constituency. We know that Thames Water is just



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about to undergo its statutory public consultation. However, it is obliged to publish a statement of community consultation for the proposed development, and we have not seen that yet.

Action groups, residents, council groups and RAPID are raising concerns that Thames Water is not sharing information in enough detail. First, Mr Duffy, can you confirm what steps regulators can take to ensure that Thames Water is not evading its statutory responsibilities and is being as transparent as possible with residents and stakeholders?

Philip Duffy: We are working very hard with Thames Water. It is the scheme promoter. It is for them to meet their obligations, but as you will know from when I visited the site with you to discuss some of the local impacts, we do have concerns about issues such as pH, water temperature, local environmental disturbances and access to the river for leisure. We are trying to balance that assessment against the very real need to provide drinking water for Greater London. We will no doubt come to the significant gap we have in water resources between now and 2050; that is one option to help to close that gap.

At the minute, we are still analysing the scheme. It will have to go through a formal development consent order process under the national strategic infrastructure system. It will ultimately go to the Environment Secretary for a decision, and we are working through that very carefully. I think all of us at the EA understand very well the concerns locally. We talked about not only the long-term concerns, but the short-term concerns, too, such as the traffic noise and the construction enclave around the site. All of those points are well made and will be covered both in the EIA and in the planning process.

Q27 **Sarah Olney:** Mr Black, are you confident that Thames Water is fulfilling its statutory obligations with regard to planning applications of this type?

David Black: I do not have anything to add to Philip's response. The Environment Agency are overseeing that process, so we will leave it to them.

Q28 **Mr Charters:** David Black, my constituents in York Outer are fed up with Yorkshire Water—soaring bills, sewage, pollution and burst pipes—and they welcomed the block on the chief executive's bonus last week, which came at roughly the same time that Yorkshire Water was in York magistrates court for a £350,000 fine. Do we not need to go further when it comes to clawing back executive bonuses from previous financial years?

David Black: We will use the full extent of the powers we have under the new Water (Special Measures) Act. That does allow us to go to this most recent year but does not go back further than that.

Q29 **Mr Charters:** That is really regrettable, because ideally we would be clawing back from previous financial years where sewage dumping has led to regulatory fines. I draw your attention to the forthcoming fit-and-proper test. In my book, when you have a chief executive who has been landed with a £350,000 regular fine, it does not seem—to be blunt in my Yorkshire way of speaking—like that chief executive is fit for purpose.



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When will you be applying the fit-and-proper test to the Yorkshire Water directors?

David Black: We will be consulting on our approach to applying the fit-and-proper test over the next two to three months, and that will set out both the criteria that we will look at and how that test will be applied to posts such as the chief executive of Yorkshire Water.

Q30 **Mr Charters:** Do you think a magistrates court fine would be a proper threshold to deem a director not fit and proper?

David Black: We are looking at the question of criminal convictions as part of the process. There is a question, of course, as to whether they are in post when the conviction was made, and there are questions about the extent to which other factors might be taken into account.

Mr Charters: I welcome the fact that you are looking at those historic cases when thinking about what is fit and proper.

Q31 **Chair:** My constituents are Thames Water customers, along with 15 million others, and they are all deeply concerned about what is going to happen to their water supplier and how much they are going to have to pay in the event that it goes into special measures. David Black, could you give us an update on where we are with Thames Water?

David Black: Thames Water is in the process of seeking new investors into the company. At the moment, it is considering a bid from creditor interests in that company. You will be aware of the rather late withdrawal of a firm called KKR. It has withdrawn from the process, so it is up to the Thames Water board to consider whether it needs to go further and look at other investors to raise equity funding or whether it continues to pursue the bid from its creditor interest group.

Dame Tamara Finkelstein: I think it is fair to say that this should not affect the water supply or bills of your constituents. The process that we have and the way in which Ofwat operates is to ensure that, so it is not something that will be impacted by the financial issues of Thames Water.

Q32 **Chair:** Presumably, if Thames Water does go into special administration, that is going to cost—however you call it—a certain amount of money. That money has to come from somewhere. Either it comes from the Government or it comes from my constituents and the other 15 million customers, so surely they have a right to be concerned about this whole matter.

Dame Tamara Finkelstein: The right to be concerned about the financial resilience of the water industry, and Thames as an example, is obviously right for all of us. That is something that Ofwat very much works with the industry on. Clearly, there are costs if one institutes a special administration regime, and one looks to retrieve that at the point at which something comes out of the special administration regime. I was just saying that the customers of a water company should not be impacted in that way.



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Q33 Chair: I had a letter from a senior executive in Thames Water this week. It said that they have enough cash flow till 2026, but if further investors—as David Black has just made clear—do not come forward, they are going to run out of money. What is the Government's view on special administration? Is that something that you are actively preparing for?

Dame Tamara Finkelstein: We are monitoring the situation at Thames Water, but we always stand ready to intervene to ensure the provision of vital services, of which water is one. So we are always in that position of readiness and assuring ourselves to be in that way—

Q34 Chair: I do not know whether you were listening to the previous panel, but I asked them whether the regulator should be involved in not just the regulated water company but all their parent and associated companies, because it is the associated company—Kemble Finance—where the debt has been incurred in Thames; that is where the mischief has occurred. Should the regulator's remit be widened?

David Black: You are absolutely right: we need to protect customers' interests against potential holding company structures. That is why we have a very tight ringfence around what we call the regulated business. That means that we can protect customers against, say, payments out to parent company shareholders or to associated companies. That is the first and foremost way we work—through that protection. We have also made it very clear that companies need to be transparent about their financing and about payments and structures. But in a sense, you can have holding companies upon holding companies upon holding companies, so the strongest and best protection is to make sure we are protecting customer money at source, and that is when it goes into the regulated business. That is why we have brought in new provisions such as the restrictions on dividend payments; it is why Thames at the moment are in a position where they are not permitted to pay dividends out to shareholders; and it is why we have just fined them for breaking the rules in regard to this last year.

Q35 Chair: Thames Water is £19 billion in debt. Why has the regulator for so long allowed all this equity to be withdrawn from Thames Water?

David Black: That is an excellent question, and it is one where I have said that I think Ofwat got this wrong. If you go back to the early 2000s, which was when effectively the policy decisions were made in this space, Ofwat, like all other regulators, took the view that they would protect customers by making sure that they set the costs on the basis of the most efficient, well-financed companies, and they would leave risk with the investors. What we can see now is that there are clearly costs in terms of companies that, even if they are not insolvent, are quite close to insolvency, which is why we have introduced a set of protections over the last five years. We have brought in, as I said, the new controls around dividend payments, and we have talked about incentives for companies to reduce gearing—we have talked about the potential to set limits on gearing levels. All those things are valid considerations, but in a sense, we think policy needs to move on. I have to say this was not just a water

sector issue. It is the same policy in airports and in energy networks as well.

- Q36 **Chair:** We must move on from Thames Water—otherwise we could spend the entire hearing on it—but I don't rule out the Committee coming back to it. It just so happens that I have the first programmed question, if you like, for you, Dame Tamara. Again, I do not know whether you were in for the previous part of the hearing, but I asked a question about why we have not built a reservoir in the last 30 years. The NAO makes it quite clear that if we do not something in the next 25 years, we will be short 5 billion litres of water per day by 2050. We know that at least one major planning application, for a lot of investment by a big firm, was turned down in East Anglia because there was not enough water. We are in a fairly parlous state on water resilience in this country, are we not?

Dame Tamara Finkelstein: Clearly, water is incredibly important for infrastructure. A lot of what we are doing is ensuring that the PR24 will have £104 billion of investment. We are doing a lot to ensure, both through Ofwat and through a water infrastructure taskforce ministerially from the Department, that that infrastructure is built. We are looking at areas of major infrastructure and big development to unblock things, to ensure that the infrastructure can be built quickly.

You talked about the challenge around supply. That is brought out in the NAO Report, which we welcome. The plans that we have in place are to tackle both supply—infrastructure is a very important part of that—and demand, including reducing leakage and various ways to bring down consumer demand in order to have adequate water supply to meet the gap that is projected to 2050.

Reservoirs and all sorts of other infrastructure are needed—desalination plants and infrastructure to do inter-area transfers and so on. That is now in place as part of PR24. I do not think that we would say anything other than that there has been an under-investment in the sector. That is one of the reasons that the Government have asked Sir Jon Cunliffe to do his review. A lot of the things that we will seek to do will come out of that review.

Chair: That is very helpful; thank you.

- Q37 **Anna Dixon:** Good afternoon. I declare a conflict of interest as I know Tamara—it is good to see you in your seat. You talked a lot about the investment that is needed, particularly into new infrastructure. We have been talking a lot about reservoirs this week, but obviously there is huge existing infrastructure—reservoirs, sewage treatment works and pipes—much of it dating from the Victorian era. Back in 2023, the National Infrastructure Commission called on Ofwat to take a lead on an asset health to look at the health of all the infrastructure assets and to come forward with a consistent way of measuring that. David Black, are those standards in place? What progress have you made?

David Black: That is something that we are working on. When we set the last price review in 2024, we sought information from companies on the



condition of assets and sought to use that in the setting of the price review process. Companies had good information on some of the assets, such as water mains, but they had less useful information on other assets. We have a work programme with the sector, which started back in 2021. We required all companies to go through an asset management maturity assessment. We now have a forward plan for working with the sector intensively over the next two to three years, to get them to a place where we have the right information for them to either make the case for further funding or not over the rest of the review period and future periods.

It is a complex issue. Lots of assets in the sector are underground water pipes. You can measure the asset health indirectly, or you can dig them out of the ground—it is obviously not very desirable to do that. It is about recognising the challenges in the sector. We are taking a different approach, which is consistent with the recommendations that you talked about.

Q38 Anna Dixon: Perhaps you can help me, because over the last number of price reviews there has been quite a significant amount of money for investment. Without knowing the asset health—the baseline—and then measuring whether that investment has resulted in an upgrade to asset health, how on earth have you been doing your job?

David Black: We have had in place a set of asset performance measures—things like mains bursts, leakage rates and blocked sewers. Those have formed the basis for measuring asset health. Ofwat's approach has been looking at outcomes, if you like—the impacts on systems and services.

The second thing we have done is to look very carefully at the information that companies have provided as part of their business plans and use that to reach views about what customers are paying for and whether improvements are being made. That is why we have made changes at this price review, by introducing additional measures to get greater clarity about the companies' systems and processes in terms of their approach to asset management, rather than just looking at the outputs.

Q39 Anna Dixon: Would you agree that your previous set of incentives was inadequate and led to short-term measures such as fixing leaky pipes rather than the long-term investments we needed in things like reservoirs and upgrading our Victorian sewerage systems to meet rising housing demand?

David Black: No, I would not characterise it like that. I do not think it would have helped with the reservoir question. It does relate more comprehensively to whether companies understand their assets, know their quality and are making the right operational decisions about investment and upgrade. Issues like reservoirs are a function of the water resource management planning process led by my colleagues at the Environment Agency. That is what drives whether or not we build new reservoirs.

Q40 Anna Dixon: Philip Duffy, the NAO Report says that at the current rate of

replacement for water mains, the entire network would end up being replaced just once every 700 years. Clearly, the industry has fallen quite a long way short of what you hoped for in PR19. You have again set expectations for PR24. How are you going to get to a more sustainable level of replacement? Sorry, is that a matter for Ofwat?

David Black: Yes; new reservoirs is for the EA, but on water main replacement rates, that is exactly right. Since privatisation, as the NAO documents, the replacement rate of water mains is about 0.83%. That seems roughly right for water mains, which have a life of about 120 years. But in the most recent period, we observed that we had allowed companies funding to replace assets at a rate of about 0.4% and the companies had replaced the assets at a rate of about 0.1%. That is clearly unsatisfactory and very concerning. We have revised the approach in the next period, both to increase the allowances and to put in a direct clawback to make sure that, if companies do not replace pipes at that rate, the money will be returned to customers.

Q41 **Anna Dixon:** So did you not claw back money when they failed to deliver last time?

David Black: No. The regime was designed to provide them an allowance, and then they were to make decisions about how they maintained assets. There are a number of different ways that companies can choose to maintain assets. For example, in reducing mains bursts, pressure management may be just as smart an option as replacing pipes. Even having set a mains replacement rate, you still have to make sure that companies are replacing the right mains—those that are in a poor condition and will cause problems to customers. Even looking at the aggregate level we do not think is enough.

This butts up against another issue, which we talked about in your last session: regulatory complexity. The reason we moved away from that approach was based on a review back in 2011, which said that Ofwat should get out of the detail of companies' businesses, step back and move to a more outcomes-based approach. We did that, but companies have not stepped up into the space and taken the ownership that the review thought that they would. That is why we are now stepping in to regulate the companies much more intensively.

Q42 **Anna Dixon:** It will not be much reassurance for constituents whose homes or businesses have been damaged by burst water mains that the companies were given money to do a job, they failed to do it, and it sounds like up till now there has been little consequence. I am glad that you are changing your approach.

My final question is about the regulatory gap—it is there in the Cunliffe review—between the EA and Ofwat as to exactly whose responsibility it is to know what the asset health of the infrastructure is and to make sure that the right long-term investments are made to maintain those assets and ensure that they are fit for the future; we talked earlier about developments in industrial growth sectors, which may cause water demands to change, as may house building. How are you—the EA and



Owat—fixing that gap? Or is that one for Tamara in the context of the Cunliffe review?

Dame Tamara Finkelstein: In the broader sense, there are issues of overlap and gaps in the regulatory system, and that is one of the things we have asked Jon Cunliffe to look at. He has said that that is a problem and, in particular, that there should be an aligned resilience framework, which speaks to what you are raising. That is clearly something that we will need to take action on, to assure that. I do not know, Philip, if you want to add something about how you have managed the gaps a bit up to now.

Philip Duffy: At the minute, the Environment Agency is seeing a lot of these asset failures causing serious pollution. The case that Mr Charters was discussing in York, at Foss Dyke, is a great example of that—a pumping station that failed. We need to move away from running around after the event to prevention. That requires a real focus on the condition of the assets. It requires the companies to take action. In our prosecution policy at the minute, we are being very tough on companies and taking them to court for prosecution where they should have known that was going to fail and they did not take action in a timely way. We have seen a number of cases of that causing very severe environmental damage in the last year, which is really problematic. You can tell that they have an ageing asset base, because there is often no particular pattern to where the assets are failing. They are failing here, there and across the system, which tells me that you have an overall problem with the asset condition.

I just want to say one thing before I close. In the price review this time, the EA's focus has been making sure that the water framework directive goals for 2027 have been met. We were very much focusing on things like phosphorus removal, the performance on storm overflows and reducing the volume of sewage going directly into water courses. That has been our focus. That does not mean it is unimportant to think about the sewer network and the other asset base as well, but we have been arguing in the price review for rapid action to meet those statutory deadlines we have in 2027. We are quite pleased at the way that that has found its way into the final determination from our colleagues at Owat.

Q43 **Anna Dixon:** Do you think that if, as the EA, you had exercised your powers a bit sooner and harder to tackle illegal raw sewage dumping, these companies might have taken action sooner to upgrade their ageing assets?

Philip Duffy: I have looked at this in detail. The EA was making the case for significant upgrades, particularly in nitrogen and phosphorous removal, at the last price review and the price review before that. You will be familiar with the way the law works in the main, which is that you have a 2015 deadline under the water framework directive, but if the cost is very high, it is allowed to be delayed. As a system, it has been delayed all the way until now, and now we have to do it. That explains why, in this price review, you have this very long list of things in the EA that need to be done. They are overwhelmingly statutory obligations to meet either the



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water framework directive or action on storm overflows in the Environment Act. That is why we have run out of delay time. We have to now do those works.

- Q44 **Anna Dixon:** So you are saying that over the last decade, as regulators, you have prioritised cost over environment?

Philip Duffy: The system as a whole has, yes.

- Q45 **Chair:** Listening to the two of you regulators, you prosecute and water companies get fined either for doing something like a pollution incident, or for not doing something, but the money goes straight back to the Treasury. Our constituents who have to suffer these incidents really would prefer that the money went back into the water system to improve their own environment.

Philip Duffy: That is a very good point, and one we are addressing. We would like to see more enforcement undertakings. That is a process we have in the legislation whereby, if a company promises it will take action to stop a repetition and offers us a credible sum of money that matches what it would have received in court in a fine, it can make a contribution to, for example, a local rivers trust, and we would resolve that case. It is a great idea, but in practice only about 12% of our cases get an offer of an enforcement undertaking.

We cannot force the company to make that offer; they have to agree to it, and we find that they are only agreeing to it literally on the steps of the court, in the week before we go to court. To get that kind of outcome, we are going to have to see a behaviour change in companies. They talk a lot about having a long tail of cases hanging over them; they could resolve those cases by coming forward with enforcement undertakings, and we have been very clear on that basis to all the companies we are working with.

- Q46 **Chair:** So what we need, Mr Duffy, is something like a guilty plea. They get less if they settle with you, and a lot more if they go to court.

Philip Duffy: The Government have addressed that, because the Water (Special Measures) Act gives us the ability to raise a civil penalty, rather like our colleagues at Ofwat can. I suspect that might focus minds in water companies about whether they want to resolve a case faster via an enforcement undertaking. That should be, in theory, a really positive thing about getting money to rivers trusts and local community groups that could help resolve those issues. To set a rider on that, we will not accept that if we think the behaviour is extremely reckless. We have had cases where we think the behaviour was so reckless—ignoring warnings of failure, repeated failures in a certain area—that prosecution is the only appropriate disposition.

Dame Tamara Finkelstein: Through the water restoration fund, we have channelled £11 million of water company fines to local water projects, and we are looking at ways of doing that going forward. It is very much on the agenda.

Chair: That is quite a small amount, compared with the fines.

Dame Tamara Finkelstein: That is what we had at that point; obviously, there have been higher and more fines since then.

Q47 **Chair:** Mr Black, do you wish to comment?

David Black: Yes. Of the three outcomes of major cases on our wastewater investigations, two have been resolved with undertakings with the companies, so £55 million will be returned back into improving environmental outcomes; in the remaining case, the company did not make a satisfactory undertaking offer, so we were forced to fine them.

Q48 **Mr Betts:** Looking ahead, there are some big challenges. Major investment is needed and therefore quite a lot of planning is needed to integrate all this. Looking at responsibilities, we do not often feel sympathy for the water companies, but apparently they have to navigate 12 different plans as part of the planning frameworks under the 2024 planning review, and they have to ensure they can deliver long-term plans set out in the water industry national environment programme. The Environment Agency is responsible for overseeing seven frameworks, covering flood risk, water supply, wastewater management and drainage management, and the DWI oversees three on drinking water quality. That is an awful lot of plans and strategies that need fitting together. Whose job is it?

Dame Tamara Finkelstein: I will start and then my colleagues will give their views. The regulatory system structure for planning has built up over time, and has got to a point where there are overlaps and obvious complexity. We have heard that clearly from the water sector. How we can simplify very much forms the terms of reference for Jon Cunliffe, who has identified other elements such as how we do our strategic planning, what the legislative framework looks like, and how we might reform regulation. All of those elements will form parts of his work. That will probably lead to our needing some legislation, but we will not wait for that; we will go in the direction of travel of the recommendations that we accept during the transition period. We fully accept the contents of the NAO Report and Jon's interim report. There are big changes to make and a big reset ahead.

Philip Duffy: Spare a thought for those of us who are trying to write these plans; it is difficult for us as well. We agree that it is very complicated. I do not think this work is unimportant. The thoroughness of the hydrology and the ecology and what is happening with flood risk is very important. We believe you have to expose the big trade-offs, and in a democracy the Government have an important role in that, too. We have just been talking about reservoirs, and at the last price reviews we discussed the trade-off between bills and environmental protection. We need some clarity, so we know what problems we are fixing, which is the most important, and how to prioritise the work. The water resource management plans we issued last July, ahead of the price review, moved on our understanding of the hydrology and the risks a lot, and I think that is a good example of how this can be made to work, with the right trade-



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offs and process. Hopefully, Sir Jon Cunliffe's review will help us to find a way through.

- Q49 **Mr Betts:** Is the complication you have alluded to responsible for the fact that it almost seems as if the industry is saying, "Oh dear, we might need some more reservoirs, and we haven't built any for some time!", as if it has just dawned on everyone. If we needed reservoirs, why has the planning not been done already to set that work in train?

Dame Tamara Finkelstein: Some of the planning has been done, but in the recent period, there has been deep under-investment. There is complexity, but the system and the price review did not set the level of investment that we clearly need. We therefore have a very big jump up in investment for this price review. What everyone is saying—certainly where Jon is coming out—is that that jump up and uncertainty need to be smoothed out. It needs to be predictable and have long-term planning. The different elements that he will ask us to do, including a clear strategic statement from Government about trade-offs, will be an important part of that.

- Q50 **Mr Betts:** The Government have a clear policy to build 1.5 million homes during this Parliament. It seems the importance of water, its supply and everything that goes with it, has not been thought about as part of that overall target. I was talking earlier with my colleague, Alice Macdonald, the MP for Norwich North. She says that homes in her constituency, which could be built now, are being held up because Anglian Water has a wastewater recycling centre that is at capacity, and that is stopping house building. Apparently, the Environment Agency is taking an awfully long time to issue a licence for a treatment plant following an application from Severn Trent Water. Those are major potential house building programmes which are held up in different ways because of water. Whose responsibility is it?

Dame Tamara Finkelstein: The importance of water to those big investment and development opportunities is really clear. One of the things that we are doing is the ministerially led water delivery taskforce to ensure, major project by major project, that where we can we remove the blockers that are preventing that. Mr Duffy is part of that. That is something that we are doing at the moment.

Philip Duffy: We have a statutory obligation to support sustainable development. That was the basis on which the Environment Agency was created in 1995. Clearly providing housing for the nation is part of sustainable development and it is something that we take very seriously. We are working incredibly hard right across the country to unblock housing, but unblocking does not mean that we allow houses that have no sewage treatment works. That would be unacceptable to us and illegal. We are insisting that the infrastructure for those homes is provided, so that we do not see deterioration in watercourses, including most recently at Oxford, where we had quite an innovative deal with Oxford city council. In Cambridge, on the Oxford-Cambridge arc, we have had to do a lot of work with the local authorities and the water companies to do things such as



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water trading and think about more water-efficient building and construction, and whether we could surrender water permits in certain areas.

The case you talked about in Norwich is again really about wastewater provision and making sure that we are not putting too much wastewater through infrastructure that cannot cope, which would lead to more sewage spills. We do not need to apologise for that. We are working very well with the local partners to deliver those homes. There is clearly a planning problem in that you should not be seeing homes stuck in that process without enough wastewater provision. We should be able to combine and integrate the higher housing numbers that the Government have set out with the infrastructure delivery in the water system. That is something we need to achieve better and faster.

Q51 **Mr Betts:** Whose responsibility is it?

Dame Tamara Finkelstein: In DEFRA we have responsibility with our arm's length bodies to ensure that we are enabling those growth and development opportunities.

Mr Betts: So it is DEFRA's responsibility that those homes are not being built?

Dame Tamara Finkelstein: You were asking about ensuring that we are unblocking the water issues where we can, and we are playing a role to ensure that that is the case. We are not responsible for developing the homes. It is very clear what we have responsibility for, which is removing those blockages where we can within the law.

Philip Duffy: Perhaps I can help. If we look at the east of England, given that that is the case you raised, we now have a compliant water resource management plan for the Anglia area. That is based on the 50,000 homes the Government say it wants to see built in and around Cambridge by 2040. To make that plan credible took several iterations on things such as water trading, industrial use, agricultural use and the construction of key infrastructure, notably the Chatteris reservoir that is in that plan. It took a lot of work, across lots of different parties, but we now have a proposal, which we put to the Secretary of State, and he agreed with it. That process seems to me to be working fairly well. It's not great if you see sudden changes in housing ambition, so we have to be careful and realistic about those areas, but we are capable of accommodating these changes from the Government, and we have done that, I think, quite successfully in key locations that are under significant water stress.

David Black: The Environment Agency leads on water resource management planning, so it is the agency that signs off on water resource management plans, to ensure adequacy. That feeds into the price review process; we take account of it in setting out our price review decisions. As a regulator, we were concerned that we were not seeing companies come forward with enough options, because the Environment Agency process depends on water companies coming forward with options to increase



supply. In 2019, therefore, we provided around £450 million of funding to companies to develop options. These options have now borne fruit in the sense that we now have 30 projects, totalling around £50 billion, and they will be going ahead over the next 15 years. So we have a role to play in this, but the planning process is led by colleagues at the Environment Agency.

Q52 Mr Betts: Do we know, Dame Tamara, how many homes are currently stuck in the planning system—homes that could be built but are not being built because either a water supply cannot be got to them or wastewater cannot be taken away safely and properly?

Dame Tamara Finkelstein: I do not have a number on that. What I am saying—

Mr Betts: Does anyone?

Dame Tamara Finkelstein: It is inevitable, when you are doing a big development, that all sorts of people have accountability for all sorts of things. What I am saying is that in order to tackle that fact, we are ensuring that we are looking project by project for the big, major projects, bringing around the table the people who can unblock things and, around that table, ministerially holding people to account to find the best way forward. Mr Duffy talked through some of the solutions that we have come up with for Oxford and for Cambridge, and that is the way to do this—when there are multiple accountabilities across Government, which there are, take some responsibility, which we have done, to find the ways in which to bring people together to unblock things. So we will do that in order to enable 1.5 million houses to be built.

Q53 Chair: Mr Duffy, can I challenge your agency's role in all of the planning system? Clearly, the Government want more houses built, but that should not be at the expense of the environment. I have seen houses in my constituency where there have been, before the houses are built, significant storm and even non-storm overflows polluting our precious limestone rivers in the Cotswolds, and where we have asked you to intervene and you haven't. You are a statutory consultee in the planning system. Thames Water is not. Thames Water almost never refuses to perform its duty to connect, even if it is going to cost it a significant amount of money. So while I do not think you should be a blocker to future development, it does seem that the present system is not working particularly well.

Philip Duffy: When we decided to object in Oxford—there were 7,000 homes we objected to in Oxford—that was a very big act by us, because we knew the severity of demand for housing in that area, but we felt that it would not be appropriate for our organisation to allow those houses to go forward without improvements in the Oxford wastewater treatment works. We got feedback from different sides on that decision, but it triggered a piece of work that was very intense between us, colleagues across Government—in just the way Dame Tamara said—and the county council to find a resolution to upgrade the sewage treatment works so that

the Upper Thames is not facing deterioration under the water framework directive.

That, I think, is a good model—a good, constructive model. I don't think I characterise it as blocking, because we are not blocking forever; we are saying, "Let's find some solutions." I am not familiar with what happened previously. Maybe we have not done that in the past, but it is something that my colleagues across the country take very seriously, both on the wastewater and on the water supply. We want to find, with planning authorities, constructive solutions that can deliver those outcomes. Actually, compared with other forms of infrastructure and particularly transport, water is relatively low cost; and, if it is planned correctly, we should be able to accommodate that housing growth. That said, to Mr Betts's question, there are one or two places around the country where we have very great difficulty with water—the so-called water neutrality zones. There are some of those areas, and we are looking with the Government for solutions for those locations. But generally speaking, that is our mindset as a regulator, and I hope it is a constructive mindset to proceed with.

- Q54 Chair:** My constituency has the source of the Thames. If you get pollution there, you will get it down into Oxford and you will get it into the Thames, so you should be enforcing just as much in Gloucestershire as you are in Oxfordshire.

Philip Duffy: Point taken.

Chair: I will leave it there.

- Q55 Rachel Gilmour:** I should declare an interest: until 2014, I was employed as head of strategy at the Environment Agency. I have to say, Mr Duffy, that I hope it is a happier place to work now than it was when Paul Leinster was the chief executive. My not-so-fond memories of those days are that it seemed that the optimum solution to any key performance indicator was to require every member of staff to score an amber. I have to say that I am not convinced, by what you have said today, that that has changed. Will you encourage your staff to aim toward a green, by stopping putting hindrances in the way when companies want to do their business planning?

Philip Duffy: I am sorry that you had a difficult time at the EA. I do not know what it was about, but I am sorry to hear that. I hope we are a happier place to work now. We are aiming to get as many of our key performance indicators green as possible. I have been accused of target chasing in that, but I think it is legitimate in a public body to make sure we meet the requirements that Ministers have set for the organisation. A little under two thirds of our indicators are now green, compared with about a quarter when I took on the role. I am very pleased with and proud of the work that has been done right across the organisation to do that.

That rests upon being clear about what you are doing and what you are not doing. Although we have seen an uplift in resources for environmental protection, we are still having to strive to be more efficient with every



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pound we use. We cannot do everything we would like to do. We are trying to make sure that everyone right across the country knows what their targets are, and that they are credible and resourced. We have published a business plan that contains where the money goes and the targets right down to area level, and we are discussing with our teams how they can deliver that and whether there are trade-offs.

There are often trade-offs. This year, for example, we may have drought. If we have drought, we will have to make some trade-offs. I am very pleased with how the agency responded to that initiative last year, on things like the 4,000 farm inspections and the 4,000—soon to be 10,000—water inspections. That activity is making a difference. You can see that our presence on the ground is changing people's behaviour both in the water companies and other sectors when it comes down to water quality.

Q56 Rachel Gilmour: I am glad to hear that the inspections are going better. I suppose it depends on which questions you ask farmers and how much you know about farming before you actually go there, which is feedback I have had from farmers in my constituency. My final comment is that I think it is very healthy for an organisation to have a churn of its employees. One of the great concerns I still have about the Environment Agency is that there are people who are still there after 20 or 25 years who are being endlessly promoted with no identification of ability whatsoever.

Philip Duffy: On your first point, on farming, we have set up dedicated farm teams and we are working very closely with the farming community to make sure we understand their pressures—their economic pressures. We understand issues like slurry management, cover crop management and soil quality. We are sending people who are farming literate to do these inspections. It is a technical area. We also have parallel teams who are learning deeply how a wastewater treatment plant works. They understand what is going on at the plant and can see the problems. That is a better way of doing it than having generalist teams. It is very hard to do farming and oil refineries in your working day.

In terms of senior people and recruitment, you are right that we had a very insular senior team. I and a lot of people from the senior part of the EA have come in from outside. I generally think you want a 50:50 mix between internal and external promotions—a healthy mix and churn. We have done a lot of work with Dame Tamara to connect the EA back into the wider civil service, to the same training programmes. We have access into the Government skills campus. That is giving a healthy level of churn. We have just brought in a new head of IT from the CAA. We have brought in a new communications deputy director from the Body Shop.

We are taking people from a wide range of areas, which is very healthy for us. We have some brilliant new people joining as area directors, often from other public services in those areas. There is a positive sign there in terms of leadership.

Q57 Rachel Gilmour: I would love to have a meeting with you to discuss the

issues.

Philip Duffy: I would love that—let's do it.

Rachel Gilmour: Thank you very much. I will get a date in my diary.

- Q58 **Sarah Olney:** Mr Black, Ofwat estimates that the average bill increase each year for the next five years will be £31. I have heard from a lot of constituents who are experiencing bill increases considerably more than that. I have had one constituent whose charges have tripled, somebody whose charges have gone up 158%, and another one by 164%. In each case, they have contacted Thames Water and they are getting very little information on why their bills are going up by quite so much. First, can you explain why you think people are seeing bill rises this year that are so much larger than that £31 you announced?

David Black: First, we really appreciate that people are facing a tough time with bill increases. Our research shows that around 20% plus of people are struggling to afford their water bill. Obviously, this increase adds to that. The first point I would make is that the £31 increase that we described was before inflation, which will add a small amount to that level of increase. The more general point is that we set an allowed revenue for the companies to recover. It is then up to the companies how they charge that individually from customers, and they must go no further than the allowed revenue that we set with them. They need to comply with a set of charging rules that DEFRA applies to Ofwat, and Ofwat then sets for our water companies.

Let me turn to some of the key differences. Some customers are on unmetered bills, so they are given allocated costs, and other customers are on metered charges. Metered charges obviously vary with the amount of water used, and unmetered charges are generally set to try to incentivise people to switch to metered charges.

- Q59 **Sarah Olney:** Let me press you on that. I was going to ask about water meters, because my constituents who have them are still seeing these enormous increases. Is it your expectation that people who are on meters will not see quite such a large increase?

David Black: Their bills will still be going up.

Sarah Olney: Understood.

David Black: But the companies are splitting that cost between unmetered and metered customers. Obviously I cannot comment on the specifics—I would have to look at them—but we get complaints from customers, and we respond to them and raise them with Thames Water. Obviously, CCW is the body that leads on water complaints in the first instance.

- Q60 **Sarah Olney:** How confident are you in your estimates of future bill rises? You have said that it is £31 each year for the next five years. Are you confident that in future years it will still be an average of £31, post-inflation?



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David Black: Yes. The other thing I should have talked about is the profile of bills over that period. The £31 is assuming an equal instalment—£157 over five years. In many cases, companies have front-loaded that bill increase, so it is going up by a greater proportion. If I remember correctly, something like £80 of that increase is coming in year one, which may explain why bills have been higher than people expected. We have a process whereby companies report audited accounts and revenues, in terms of what they have collected from customers, and are able to assess whether they are complying with the price controls.

Q61 **Sarah Olney:** Finally, does Ofwat have standards around transparency when it comes to billing? A lot of my constituents complain that they see these huge bill increases and are not getting much information from Thames Water about why their bills have gone up so much. Obviously, that £31 is part of it, but some of my constituents are seeing much greater increases than that and they are not getting much information from Thames Water about why it has gone up so much. What standards are you imposing on water companies for communicating with customers?

David Black: We have general principles about what they should be doing for their customers. Yes, I have seen unsatisfactory communications from companies. Some have just said, "Ofwat has let us put up bills," rather than explaining what those bills are going towards. We would expect companies to be pleased to explain that they are spending that money to improve services for customers, given that they spend a lot of time justifying those bill increases to Ofwat. They have the information, and they ought to be able to supply it to customers. Making that simple, accessible and consistent is a challenge, but it is certainly something that we are happy to look at if improvements can be made in that area.

Sarah Olney: Thank you very much.

Chair: It is quite warm in here. If any of our witnesses, any of my colleagues or anyone in the audience wish to take their jackets off, they are more than welcome.

Q62 **Mr Betts:** Obviously, my constituents—everyone's constituents and customers—are talking about the rise in their bills. It is something they can do little about. They can try to use less water, but there are public health concerns if people actually need to use it. Two customers in particular raised this with me. One said, "Look, I'm in my mid-80s now. I'm being asked to pay this big increase in my bill for things that somebody is going to benefit from in 10 years' time." Is that fair?

David Black: Fairness in bills is a challenging issue. Bills are going up, and we project that they will continue to increase following this price review if the level of investment that has been talked about in the NAO Report comes to pass. That will lead to much higher bills well out into the future. There is a question about how those costs are recovered from customers. There are choices to be made about how companies set tariffs. Some companies are trialling different ways of setting tariffs at present.



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The second point is about the provision of social tariffs to help customers in need of support. I am pleased to say that the level of social tariff support is going to increase from about 4% at present to 9% over the course of this price review period, so about 9% of customers will benefit from cheaper tariffs supplied by water companies. If those customers are eligible for assistance, I suggest that, in the first instance, they contact the water company to ask what help it can provide them to pay their bills.

Q63 Mr Betts: How proactive are the water companies at going out and making people know about those abilities to have lower tariffs?

David Black: That is something that we have worked with and encouraged companies on, particularly the use of third-party agencies such as charities, customer support groups and CCW. Companies have a responsibility to put information on customer bills, but not all customers look closely at their bills. That is a challenge. We find that too many customers still do not know about this assistance, so we think companies ought to be doing more in that space. It is really about how they partner with third parties to make sure that customers who need the support can get access to it.

Q64 Mr Betts: And eligibility?

David Black: I think this is a question about whether there should be a national social tariff or not. At the moment, every company sets its social tariff on its own basis. More standardisation would improve clarity. Nationwide charities could then communicate that to customers. That is a question that the Government are considering.

David Hill: To add to what David said, we are intending to consult shortly on reforms to the WaterSure scheme. That is a statutory scheme that caps bills for lower-income customers who might have higher usage, for example because of medical needs or because of large households. We intend to bring forward consultation on reforming that scheme and the eligibility for that scheme. That should be some additional help and support for more vulnerable customers.

In addition, looking to the future, we do think there is quite a lot of scope through water efficiency measures to save people money on their bills, so we do intend to bring forward legislation around mandatory labelling of products that use a lot of water. We estimate that that could save people up to around £45 million in aggregate on water bills. It could also save around £56 million on energy bills because often the real cost of water-intensive products, such as washing machines and so on, comes in the energy that they use as well. It is intended that those two things together will provide some additional help for customers.

Q65 Mr Betts: The comment I get most from constituents is: "They put my bill up, but I've already paid this. In the past, they have had the money, and they have used it for other things. They have paid massive dividends to their shareholders. They paid enormous salaries to their executives—and bonuses as well—and they have not actually put in the investment they were supposed to. They are coming back now for more money to do the

investment they should have done before.” How do you answer that?

David Black: We keep a careful record of the money that companies have received and what they have spent it on. Generally, in the last price review period, most companies have spent more than they have been allowed from customers; they have overspent against their cost allowances. That was due to a mixture of things such as inflation and higher energy prices. If we look back over the past 30 years since privatisation at the money they have been allowed on operating and capital costs in total, broadly, companies have spent in line with those allowances. There was one price review period back in 2000 to 2005 when they significantly underspent. The pattern varies across companies, but as a sector, companies have spent broadly in line with the cost allowances.

Q66 Mr Betts: If they overspend, that is simply clawed back in the next period.

David Black: The overspend is shared between customers and companies. In the current period, rates of cost sharing with customers vary from about 25% to 50%, so company shareholders bear a substantial proportion of that. Customers also bear some amount of that.

Q67 Mr Betts: But it is a very low-risk investment. Shareholders have done extremely well in terms of dividends, haven't they?

David Black: Yes, I would agree. The Cunliffe review—the Independent Water Commission—has set out the history of dividends in the sector, which shows that there were a number of years in which we saw double-digit levels of dividends. That has led to the concerns.

In terms of what we have done as a regulator, I think there are two things to keep in mind. One is the level of return that we set on companies. That has been coming down over recent periods. It is now starting to move up again in line with the rising costs of international finance, but we have tried to strike the balance there to make sure that it is enough to attract investment to the sector—you have been talking about those issues as well—but not so much that investors are getting excess rewards. Then there is the question of the level of dividends that are paid out of those returns. When we look at the sources of those dividends, in fact, a lot of that is from performance on financing. That is an area that that your Committee looked at in 2016, and we acted on those recommendations to tighten up returns in those areas.

We are now seeing dividends at much lower levels. You will have seen that, as the Report shows, since 2016, dividends are operating at much lower levels. It is important that the system is financially healthy, and we would expect a company that is performing well to be paying a dividend out to investors. That is part of the cost of financing. Equally, we are clear that companies need to demonstrate that those dividends are linked to performance for customers and the environment, and to demonstrate that they have adequate financial resilience.

Q68 Mr Betts: I think you will struggle to convince members of the public that



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extra money for shareholders is linked to any environmental performance that may have occurred.

David Black: Yes, I agree, and that is the challenge. A company needs to demonstrate that the rising bills that customers are receiving are going into more investment. Indeed, that is what the price review allows, and if companies do not make an investment, that money will be clawed back and returned to customers.

Dame Tamara Finkelstein: The Environment Act gave Ofwat further powers to consider dividends and take action if it relates to financial resilience—a number of companies are locked down on dividends for that reason—and services for customers and the environment, which were part of the recent Thames fine. Those powers have been increased. There have been a number of measures, and the Water (Special Measures) Act built on that, to try to give that confidence back to the public that customers and citizens are an important part of this process—to build that in in a whole range of ways, because there is an issue with trust.

Q69 **Chair:** You have a number of companies that you have put under controlled financial measures to pay out dividends, and that is presumably in recognition of precisely what Mr Betts is complaining about on behalf of his and all of our constituents. Is that not a recognition of what he is saying, and what our constituents are thinking—that this has been wrong in the past?

David Black: Just to be clear, high dividends have resulted in weak financial resilience in companies, but it has not been at the expense of customers. In terms of the way we set bills, we set an allowed return based on best-in-class financial resilience of a water company. That decision can be appealed to the Competition and Markets Authority. That sets the allowed returns for companies. The actual returns that companies will earn will depend on their operational performance and their financial performance, which depends on the cost of debt they raise against the cost of debt that we allow. That is the source of dividends.

With the companies that we have concerns about, which are on dividend lockup, it is because they have insufficient financial resilience, which is to say that they have too little equity and too much debt. That is why we have acted, and there are three companies that are unable to pay dividends. We have a requirement on all companies to demonstrate that any dividend payments that they make are linked to performance for customers and the environment. Companies ought to be demonstrating that when they are making returns to shareholders. Generally, investors that I speak to are quite comfortable with this. They get the view that the operational performance of these companies ought to be reflected in returns to them.

Q70 **Chair:** You may not have seen all the evidence that we have got, but I have evidence from Stanley Root, who tells us that in the last 20 years or so, the water companies have paid out £36.6 billion of dividends net of all capital contributions. That seems to me an awful lot of money.



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David Black: Yes, it is. Total dividends paid, according to Ofwat records, are around £52 billion. That is over 30 years, so about £1.5 billion a year. If you go back earlier in time, returns were much higher. It was much more expensive to raise capital in the early phase of privatisation, so returns were set higher and dividends were higher. Then there was a period where returns started to drift downwards and companies, in some cases, continued to pay high levels of dividends.

As I say, the position now is that we have set allowed returns. The allowed return for the next price review period is 4% in total for investors. Investors would argue that that may be too low, but we think that strikes the right balance. A 4% return—that is what we are asking customers to pay. They are not paying any more if the companies pay a higher level of dividend at all.

Q71 **Chair:** You can justify it, but the graph that I have in front of me shows a steady increase in dividends to that £36 billion over the last 20 years. There are no ups or downs; there is a steady increase.

David Black: If you look at the Independent Water Commission report, you can see a profile of dividends that does show a marked fall since 2018.

Q72 **Lloyd Hatton:** To start with a simple question, which one of you, as it stands, is actually responsible for ensuring that water companies deliver what they have agreed to do, particularly in relation to their infrastructure? When they make a commitment to invest x amount of money in x amount of infrastructure, how do we make sure that actually gets delivered, and who is responsible?

David Black: In terms of Ofwat, we are monitoring the companies' delivery of their 2024 price review plans. We work closely with colleagues in the Environment Agency and the Drinking Water Inspectorate. Clearly, the Environment Agency needs to sign off on certain aspects of environmental investments that have been directed by the Environment Agency, but the overall company programme review is something that we are looking at. We are very conscious that this price review will be extremely challenging for companies to deliver. That is something that we put a lot of thought into when setting the PR '24 determinations.

When we looked at company business plans, we challenged them to demonstrate to us that they could deliver those plans in practice over the next five years. Two companies flagged that they would struggle to do that, so we took account of that in the settlements that we set for those organisations. But generally, companies demonstrated to us, and they had third-party assurance, that they were confident they could deliver this ambitious programme of investment.

Q73 **Lloyd Hatton:** To be clear, I believe you just stated that you monitor what the big water companies do in relation to investing in their infrastructure. But you are not the inspectorate, so you do not have any formal powers to actually say, "You said you were going to invest this amount of money in this infrastructure by this time, and that hasn't



happened.” You are therefore unable to enforce any reprisals if that is something that they fail to do.

David Black: If the company fails to deliver on the capital investment, and if we have had third-party assurance against that with a duty of care to Ofwat—if we have independent reporting of company performance against the delivery that was put in place as part of our 2024 price review, which is what we call a price control deliverable—we claw that money back and return it to customers. We have built those powers into this price review.

Q74 **Lloyd Hatton:** Do you feel that Ofwat has the necessary powers to hold those big water companies to account, in terms of them actually investing in the infrastructure that they own when they say they are going to do so?

David Black: In terms of that narrow question, yes. We are confident that we have the instruments in place with this price review. But we are clear that this is a very challenging delivery programme, and therefore we will be scrutinising companies carefully over this time period. We are also working with the Department. We have a ministerial water delivery taskforce for particular large and high-profile projects, which will be linked to the Government’s growth agenda.

Q75 **Lloyd Hatton:** Take Wessex Water in my constituency. In its latest business plan, it says it has committed £3.65 billion—a lot of which will go on investment to upgrade its infrastructure. Who is actually on the ground making sure that Wessex Water does what it has committed to doing? Again, you are monitoring the situation and I appreciate there is the third-party element, but who is actually inspecting the assets? Who is inspecting the infrastructure to make sure that what companies say is going to happen actually happens?

David Black: The way we hold companies to account is that we use third-party assurance to sign off that they have delivered on those work programmes. Both the Drinking Water Inspectorate and the Environment Agency have inspectors, but they work on the particular aspects that they are focused on. So if it is an environmental investment, that may well be something that the Environment Agency looks at.

Philip Duffy: Maybe I can help. We were not in the business of doing significant inspections. We got out of that business in the period after 2010, but we have gone back into it in quite a big way. We have hired and redeployed 500 staff on to water. We did 5,600 compliance visits last year. To give a sense of scale, there are 5,500 sewage treatment works, 31,000 pumps, 14,000 storm overflows and 7,000 emergency overflows. From next year, we will be doing 10,000 inspections a year. We will get round that estate every couple of years.

I think the results speak for themselves. Of the 4,600 inspections we undertook, we found 1,653 breaches of permits. In more than a quarter of the visits we made, we found breaches in performance. A lot of those were minor. They were things like people not clearing trash screens—not clearing the screens that do the flow into the plant. If things were



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overgrown, you couldn't get to the water to do a sample, which tells us that perhaps the water company was not doing a sample either. But we did find 92 really serious breaches and six category 1 breaches, which would normally lead to prosecution.

It is very important that when we do the next 10,000, we are clear that we will be going back to those that were non-compliant and that we expect to see those problems resolved. We are sympathetic to the argument from the industry that they want more money to upgrade their resources, but at the same time, a lot of the problems we are talking about here are not very high-cost capital interventions; they are about clearing greenery from your estate or cleaning and maintaining the screens as the sewage comes into the plant. They are not things that require huge bill increases. In any other domain of regulation, if we went to an estate and found that a quarter of the sites we went to were non-compliant, we would be alarmed. We really want to see the industry step up next year. I do not expect to come back next year and tell you that we still have a quarter of these sites not viable.

One more rider on that is that we are going to publish these reports. Starting from April, we have published all our inspection reports—so nearly 500 so far. It is very important that communities can see what we are seeing, because those photographs and that evidence is a very important part of people's environmental information. That will hopefully have a gearing effect and put some pressure on these companies to go into their wastewater treatment estates and fix these problems, which I think can be fixed with good management and grip.

Q76 Lloyd Hatton: That transparency is certainly welcome. If you are now going around the entire estate every couple of years, can the Environment Agency realistically start to work more pre-emptively and take a far more preventive approach, where it looks at ageing, crumbling infrastructure belonging to these companies and says, "This is clearly an accident waiting to happen"? It certainly feels like, for the last couple of decades at the very least, the work of the EA is a swoop-in when things have already gone very wrong.

Philip Duffy: You make a very good point there, in two respects. First, it is clearly unacceptable when the Environment Agency tells a water company that an asset is ageing and looks like it could fail, and nothing happens. We have seen, certainly in my tenure at the job, a number of cases where we have warned a company repeatedly that a rising main may fail, and it then fails and covers a beach in sewage. That is very serious offending for us, which is a real problem. We need to make sure that the companies listen to that.

Secondly—this is something that the Government have really addressed—there is a bit of a justice gap here. We clearly cannot prosecute all these offences; there are too many of them. We will need the measures in the Water (Special Measures) Act to bring in a faster civil penalty regime that can say, "If you're not maintaining your sewage treatment plant properly,



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there will be a financial consequence.” We have to tip the scales towards action in these companies.

Q77 Lloyd Hatton: So you are confident that the Water (Special Measures) Act will enable you to go into these—

Philip Duffy: It is absolutely vital, and we are working hand in glove with DEFRA on getting that right, to give us those opportunities and unlock the change we want to see.

Lloyd Hatton: And you are confident that where you do persistently say to a water company, “This is ageing infrastructure; you need to repair it,” again and again, and they fail to act, the new powers in the Act will enable you to come down on them quite robustly for their failure to address crumbling infrastructure?

Philip Duffy: If it is that extreme, our policy would be to prosecute, because it is important that criminal law is there if you have a company that is recklessly not following advice. For the other broad tailored offences, where it is poor management, poor maintenance or non-compliance with basic regulations, the Water (Special Measures) Act will give us a much faster way of penalising these firms. That is a really important initiative.

Dame Tamara Finkelstein: The Act helps us to fund the level of enforcement that we need to see, by introducing charging that we can channel towards enforcement. There is a whole raft of measures in the Act to do that.

Q78 Chair: David Black, I am sorry to come back, but on this Committee we believe in having accurate figures. If I could take you to figure 7 on page 24 of the NAO Report, the graph shows us that in the last 34 years, two companies took out more than 100% of the equity of the company in dividends in one year. Can we agree that that is completely unacceptable?

David Black: Yes. Sorry, but without looking at the data—

Chair: It is there. It is quite straightforward. Look at the blue dots—it is very straightforward.

David Black: Those dots probably relate to what we would call inter-company loans, which was a policy—a policy that I do not agree was a sensible approach—whereby companies took loans from the regulated company back to the holding companies, and then discharged those loans by paying a dividend at some point in time.

Q79 Chair: They just compounded the errors, basically. In that chart, it shows nine companies at more than 60% in the last 34 years. To be fair to you as the regulator, it also shows that the situation has got better in the last six or seven years.

David Black: Yes. That reflects both lower returns, but also the introduction of the new licence conditions in terms of dividends, which Dame Tamara has referred to. In 2021, the Government gave us licence



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change powers, which we had not had before. Frankly, they were long overdue, but we have now got those powers and use them. The first use has been to introduce new controls on financial resilience, and the second was to introduce a customer protection licence condition.

Chair: Thank you for that answer. I am going to need shorter questions and shorter answers; otherwise, we are going to be here till well into supper time. To give the par exemplar of that, Luke Charters.

Q80 Mr Charters: Paragraph 2.4 of the NAO Report talks about regulatory gaps. Mr Duffy, while you are turning to page 27, is the EA looking at the aggregate impact of all your requests on water companies on net zero?

Philip Duffy: No, not comprehensively. That is not how the law works. The way that the law we have to work within works is to stipulate various environmental outcomes, both in the environmental improvement plan and in European law. One of them, for example, is a reduction in phosphorus to meet the water framework directive reductions. It is not that we have not done any of that; we have done quite a lot of carbon assessment on things such as water resource management plans. It is what has informed the balance of water efficiency versus new water resource construction in those plans, but the way our current environmental law works is very focused on delivering those outcomes.

Q81 Mr Charters: I understand the law, and we all want to see phosphates and so on come down, but the cost of implementing the measures must have a net zero consequence for some of the infrastructure, and so on. Do you recognise that there is a trade-off?

Philip Duffy: I recognise that, particularly in the domain of storm overflows, because you are putting a lot of investment into the lower part of the estuary. The issue of phosphorus removal has been a bone of contention between the Environment Agency and the water sector during the price review. We believe that phosphorus, because of its prevalence and durability within the ecological cycle, causes significant eutrophication. We are delighted that the price review provides for phosphorus stripping at 800 further wastewater treatment plants. That means that 95% of people whose homes are connected to discharges to freshwater will have the phosphorus stripped. That makes a very significant difference to the water environment. Overall wastewater is 1.2% of the UK's emissions. There is a focus on that in the agency to get those emissions down. About a third of that is fugitive methane. We are doing a lot of work on the industrial emissions directive to get fugitive methane reduced.

Q82 Mr Charters: You have almost pre-empted my next question, which is: how can we understand the impact of the sector on net zero when we are not doing proper inspections on wastewater facilities?

Philip Duffy: We are doing a lot. We are improving the inventory, which is actually held by DESNZ with support from DEFRA. On wastewater, which is about 1.2% of emissions, we are looking at the energy sources, gas recycling and fugitive emissions, particularly those from methane, which is



a very powerful greenhouse gas. There is a lot we can do to tighten those things and reduce those emission levels.

It is possible—perhaps the report from Sir Jon Cunliffe will get us there—that you could do an integrated view of the carbon trade-offs in those areas. At the EA we have to be a science-led organisation. The truth is that sustainably removing phosphorus from large urban areas is an energy-intensive process. If you want that as a social outcome, we are going to have to invest in it.

Q83 Mr Charters: I have a final question for Mr Black about the cyber-security of the water companies: who is looking at that? The Committee had a separate inquiry into cyber and we all read the news about the increasing threat of cyber-attacks on the British state. Who is regulating to make sure that the water companies are up to scratch, and not just the DWI, because we know that that is part of the infrastructure?

David Hill: I will respond on that, as the DWI has the lead responsibility for cyber-security and resilience within the sector—it regulates that under the network and information systems regulations. In broad terms, around 90% of water companies have met their sectoral resilience targets set by the Cabinet Office. We have the cyber security and resilience Bill coming forward. That is an opportunity to look afresh at the framework for cyber resilience in the sector. That is something that we are looking at actively in terms of that forthcoming piece of legislation.

Mr Charters: The DWI I understand, but who is doing that for wastewater?

David Hill: That is one of the areas that Sir Jon Cunliffe has identified in his report as one of the reasons why we need a more comprehensive and integrated approach to a whole range of aspects of resilience. I think we would agree with you that, for wastewater, we do not have as robust a framework as we have currently for water supply infrastructure assets, so that is an area that we are actively looking at, and the forthcoming legislation that I mentioned is an opportunity to look at that.

Q84 Sarah Olney: Dame Tamara, the Environment Agency and Ofwat have different types of obligations towards consumers. For example, the Environment Agency's statutory duties do not include an explicit duty to protect the interests of consumers, but Ofwat's do, and the Environment Agency has no obligation to balance environmental outcomes with affordability for consumers or, as my colleague just said, with net zero. Between DEFRA and the regulators, whose responsibility is it to balance those environmental needs with affordability?

Dame Tamara Finkelstein: We would say that there is too piecemeal a picture, with overlapping responsibilities and gaps in responsibilities, and that we need to address that. One of the major ways in which we set out what we expect of the regulators through the price review system is through the strategic policy statement. But what we see, and what Jon's work shows, is that this is not adequate for comprehensive planning and saying what the trade-offs are and what we expect. We have a range of

ways in which we set some of these things out, but what you describe is a problem in the system that we are seeking to solve.

Q85 Sarah Olney: I talked about the affordability of bills earlier. At the moment, for example, there is really no guarantee for consumers that when they pay higher water bill charges, that will necessarily lead to improvements in the environmental picture, because the two are not linked in that way.

Dame Tamara Finkelstein: The process we go through in the price review sets bills in a way that enables the companies to invest to deliver both the environmental targets and supply targets, and so on. It does come together through the price review, and we set an overall policy statement on that, and Ofwat has responsibility around bill setting as part of that process.

David Black: We have set a range of performance commitments and requirements on the companies to deliver in this period, such as getting to zero serious pollution incidents and reducing pollution incidents, and there is an obligation to improve biodiversity. We have worked with our colleagues at the Environment Agency to make sure that the improvements they will require are built in, in terms of the expected levels of improvements we are seeing.

I think the point Dame Tamara was making, in terms of the guiding mind, as you say, is really about the trade-off between reducing discharges from storm overflows and bill increases. At the moment, there is no formal basis for making that decision, nor was there in previous price reviews. We look back and say, "Not enough was done in the past," but actually there was no single body making that decision as a whole, which is what the Cunliffe report recognises and what needs to change.

David Hill: The point about a single guiding mind, and a more balanced approach to the economic and environmental trade-offs and choices, is certainly at the heart of Sir Jon's interim report, and we would expect to see him say more about that in the final report.

On your question about how customers can hold companies to account, some important steps have been taken, including in the Water (Special Measures) Act, which legislates to establish new customer panels so that for the first time there is more power for customers to hold board members directly to account, and summon board members and executives to account for their actions in water companies. There are also more transparency measures in that Act, including annual pollution incident reduction plans, and more requirements on companies to produce more accessible financial summaries. While that is only part of the story, those are important changes to increase direct accountability to customers.

Although this is not under the Act, it is worth noting—you obviously had David Henderson here earlier—that all water companies, bar one, have agreed to update their articles of association to make the interests of



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customers and the environment a primary objective. That was not previously the case, and all companies, bar one, have agreed to do that.

Q86 Mr Charters: Which is the one?

David Hill: Thames Water.

Chair: Thank you very much for that, David; none of us is very surprised.

Q87 Sarah Green: David Black and Philip Duffy, we have ended up in a situation where the performance of every wastewater company is so poor that both Ofwat and the Environment Agency have taken enforcement action against them. How have we got to that place, and is our wastewater system fit for purpose?

Philip Duffy: It is clearly problematic that more than a quarter of inspections from the EA are coming up with non-compliances; you have got a problem there that is hard to deny.

If you take the view since privatisation, you can see significant improvements in things like ammonia pollution, which is down 85% since 1990, and phosphorous pollution in the lower estuaries is down 83%, and about 70% of that is about improving performance in sewage treatment plants, so there definitely was an improvement in the post-1990 era that is worth noting. Also, if you look on a like-for-like basis at the EA's assessment of the wastewater sector—the EPA—it has gone from a 10-star performance to a 25-star performance now.

All that said, the performance has sort of plateaued at the minute. We have seen very little improvement in some things and really none at all in things like spill volumes. We now have the data and can see the spills. We are not seeing further reductions in phosphorus, and we will have to get the investment from these areas, so it is a bit of a balance.

One of the things the NAO says that I think is right is that one of the problems with the current performance management system is that it is very “after the event”. We are not saying, “Are you on top of your asset management? Have you got things that are going to fail in advance?” It is also quite narrow on certain factors, so naturally the executive teams focus on those factors. However, there may be other things that are not being done properly. For example, I mentioned fugitive emissions of methane and compliance with the industrial emissions directive. Currently, that is not something we are monitoring. There are more things we could do to put pressure on the sector to understand those areas.

After a long time where the EA was not present in wastewater treatment plants—it was not going to those places—that has now changed. Both we and the public are going to have an unprecedented level of visibility, mapped to every local area, about what is going on in this environment. That should give us some confidence that we can put pressure on the companies to turn the situation around and make the next leap. They cannot argue that they are not being given the money they need because they are, through the price review. Now, we need to see the delivery and the management action that should follow.

Q88 Sarah Green: Do you have the powers to do that? Do you have the powers you need to keep on top of them?

Philip Duffy: As I said earlier, we have a justice gap. We can and do take criminal prosecutions for the most serious offences, but a complex criminal prosecution against a plc is not a light undertaking. It can be the thick end of £1 million in cost and can take two years to come to court. These are difficult cases to bring.

It would be infinitely better if companies volunteered to come forward with enforcement undertakings—the Water (Special Measures) Act will give us the threat of an imposed penalty, which might accelerate the process and clear things faster—so I think there is a problem there. Otherwise, we have the powers—we have power of entry and power of working; we are okay.

David Black: To build on what Phil set out, the two points that I would make are about that forward look, as Phil was saying, because if you look at something like storm overflows, £1.5 billion of investment was approved at PR19 to address storm overflows. There was nothing in the strategic policy statement from the Government in 2017 on that issue; it was not a high-profile issue. At PR24, about £12 billion is going into that area.

Looking back, clearly that was the wrong approach; there was insufficient investment at the earlier price review. But in a sense, companies need to be much better at anticipating what is going to happen and proposing expenditure in that space, or the framework that we have needs to be more dynamic.

My second point, to build on what was said, was about the companies' approach to compliance. When we have taken our enforcement actions, and we have now finalised three cases against companies, what we are seeing across the board is relatively poor levels of oversight from boards and governance.

In the first instance, companies should know—they should be identifying—these issues around compliance and issues that Phil has touched on. While you would expect that that would not necessarily be a perfect mitigant, you would expect to see companies to be much more proactive and understanding where they have got risks and what steps they are taking to mitigate those risks. That needs to change. We need to see companies not waiting for the Environment Agency to inspect and spot a problem. They should be proactive. They should be identifying those issues. Yes, they won't spot every problem, but they should be doing much better than they are now.

Q89 Sarah Green: Can I ask a question about where the money from penalties goes? The NAO Report details that, between 2019 and 2024, "water companies paid over £430 million in penalties as a result of enforcement action" by both agencies and that, of the fines imposed by the Environment Agency, 84% went to the Treasury and, when it came to



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the Ofwat fines, only “32% went towards fixing the issue.” Are we getting that balance right? Do you have a perspective on that?

David Black: Where we can, we prefer to get undertakings from companies, and that is about targeting and fixing the issue or returning money to customers. In cases where companies resist or will not offer us undertakings, we will fine them. We will also fine companies, on some occasions, where we think the offence is sufficiently serious that a fine is warranted. But we would like to see the money go back to address those issues. We would like to have the power to impose the redress on companies, so that is a legal gap.

Q90 **Sarah Green:** Do you not have that power at the moment?

David Black: No. That is why we have to go through a process of taking enforcement action and getting the company to agree to the undertaking. If they do not agree, we are left with fining them.

Dame Tamara Finkelstein: We have had some money go back, as I said, through the water restoration fund. That was the start of a conversation—agreeing with the Treasury for some of that to go on water projects—and we are continuing that conversation.

Sarah Green: Only 9% went to the water restoration fund.

Dame Tamara Finkelstein: That was a recent conversation, and £11 million went, but it is an ongoing conversation.

Q91 **Chair:** I would like to follow up Sarah Green’s point with you, Mr Duffy. I think we must be careful about calling them storm water overflows. They are wastewater discharges, and some of the time it is from normal conditions, not storm water. In 2023, for the first time, all these discharge points were required to be measured. First, are they measured on a time and day, so that we can see whether they are genuinely storm water overflows? Secondly, are you monitoring them for quality, so that you really know whether national nitrate and phosphate levels are being reduced overall?

Philip Duffy: On the first question, operational instruction 16_02 sets out the interval and timeliness of the so-called polling for when you have to monitor whether the storm overflow is functioning. That will be changed by the Water (Special Measures) Act from 1 January 2026, so if we find what we call a dry day spill—where there is a spill without very heavy rain—we will record that as an incident. This is quite a controversial change but, I think, an important one. Companies can make a case to us that it was not a dry day. They can say that it had rained very heavily the previous day, and we are open to that. But we need to make sure that they are held to account for those dry day spills.

On the question of monitoring, no, we do not have water quality monitoring on all those sites. There are things we can do, through the permitting system, to put in various sondes to look at the level of pollution in the watercourse. We will look at that. Our water monitoring is under some pressure because it is very expensive to do, so I am not able to



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commit to monitoring the content of every CSO. They should be operating only in exceptional circumstances. The consequence of the minor failures I have discussed in this evidence session is that they could be operating too often, because water that could have been processed under the flow to full level in the wastewater treatment plant was diverted and that sewage was sent straight to the storm overflow. That is an unacceptable state of affairs.

Q92 Chair: When you are able to monitor whether they are being discharged on dry days and you find that they are consistently being discharged on dry days, will your agency take action?

Philip Duffy: You will have to wait a little longer for the DEFRA consultation on the Water (Special Measures) Act, which will cover this, but we will get powers to take action on dry day spills faster than we currently can.

Chair: Great. Thank you very much.

Q93 Lloyd Hatton: One thing that is quite striking in the NAO Report is that whether we are looking at broken or burst pipes, at pollution and sewage spills or at leaks and the amount of water being wasted in that way, there has not been a significant improvement in performance over the last decade or so. As a starting point, why do you think we are at a flatlining point where all the big water companies are not improving their performance?

David Black: I want to challenge the evidence base slightly, because when we look at leakage reduction—as part of the last price review, we challenged companies to reduce leakage by 15%. They are not delivering on that, but they have reduced leakage. I think it was suggested last year that the reduction was around 8%, so leakage is coming down, but it is not coming down fast enough.

Q94 Lloyd Hatton: Figure 6 in the Report says that there was a 10.6% reduction over the last six years, which is not a huge change, to be honest. That is from an incredibly high point, as well. Many MPs here will have had endless emails from constituents about leaks.

David Black: We understand that it is deeply—

Lloyd Hatton: It is a small reduction from a very bad starting point.

David Black: When we look at leakage rates and benchmark against other companies around the world, they look in line, but we are not yet at global best practice. We are seeing some of the leading companies in the sector that are going to drive leakage down towards those levels.

We think this is where investment in smart metering will help, so we are going to roll out 10 million smart meters as a sector over the next five years, as well as smart networks. One of the challenges that companies face is spotting leaks faster. If you want to drive down leakage, you have to spot the leaks and fix them faster than you are now, and that has been a huge focus for the sector.



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We also need new technologies to spot and fix leaks, and we are seeing innovation funding proposals come through on that. That is an area where the sector has not done enough historically. If we look at the data from 2000 to 2017, there was no reduction in leakage. We have taken action in the last few years to make sure companies are focused on reducing leakage. There has been a significant target—

Q95 Lloyd Hatton: Looking across the board, can you reassure the Committee that Ofwat is in a position to deal with repeated problems, whether leaks, burst pipes or pollution and sewage?

I will be brief, but there is one particularly worrying example in my constituency, where for 10 years inadequate sewerage capacity has meant that a road has been regularly flooded with diluted raw sewage, which goes on to the road, down past people's front gardens and into the River Wey. Local residents filed 12 formal complaints with Wessex Water in 2023, and a further 16 formal complaints in 2024, detailing such events. I have seen the photographs. It is disgusting—raw sewage literally going past people's front doors and into a river.

They are doing everything they can as billpayers, and for people living on Watery Lane in my constituency, this problem has been going on for a decade. What more can Ofwat do to make sure that companies start driving up performance and invest in infrastructure? Surely incidents like that are why the NAO Report shows that there has been no significant improvement in performance for the last 10 years.

David Black: That sounds like a horrific incident. The point I am making is that there have been more improvements on the water side than on the wastewater side. I think you heard Mr Duffy say in evidence that the performance on pollution and so on has stagnated. That needs to change. We hope that the new investment set out in the most recent price review will help with that, but the Environment Agency's inspection regime will help to address specific issues and companies breaching their permits.

Dame Tamara Finkelstein: I do not think that anyone on this panel is seeking to defend this level of performance. Lots of action is being taken, including the greater monitoring of sewage, the storm overflow discharge plan, and the actions that started with the Environment Act, built on by the Water (Special Measures) Act. We asked Sir Jon to do this review because the industry needs a complete reset. He has said that it needs a reset in its strategic planning, legislative framework, regulatory framework, water company structures, governance, assets and resilience. We have talked through some of those things, but the NAO Report shows exactly the things that require that reset. We have been putting in place some of the pieces to do that over the last few years, and PR24 is a very big part of that, but it needs a much more fundamental reset. That is what needs to happen, so we would not defend the performance.

Q96 Lloyd Hatton: Are you confident that Ofwat can do that in the majority of circumstances? At the moment, it feels like there are only a few success stories, if you like, where the Environment Agency and Ofwat are able to leap into action and demand improvements. An example where there has

not been any such action is the one in my constituency.

Dame Tamara Finkelstein: Both Ofwat and the Environment Agency have more powers to do that, but it will need a different approach on regulation, legislation and planning. There is more to do to be confident in the way that you are describing.

Q97 **Mr Charters:** I am absolutely fuming. My constituents are fed up because we have a burst pipes Armageddon in York; we really have a disaster because of Yorkshire Water. Can you take targeted action on that particular case, relating to the lack of investment in a particular geography? We want action.

David Black: I would have to understand what the complaints are about, but that is certainly a company that we have in our performance improvement regime, so we have identified it as a lagging performer across a range of indicators. It has put in place a service commitment plan, which is all about it getting to the root causes of its problems and then demonstrating to us that it has effective measures in place to address those causes. It is a company that has recognised that its performance is not good enough, and that is why Yorkshire Water describes itself as being in a turnaround process, but we have yet to see the evidence that it will succeed in turning itself around.

Chair: I suspect that, by raising the problem, you have brought it well to their attention. Well done, Luke.

Q98 **Sarah Olney:** The sector's funding is calculated "using benchmarking techniques...based on the company"—among the water companies—"who carries out their work at the third or fourth lowest cost," with an enhancement expenditure "often set based on the companies who spend the average amount." To me, it feels as if the funding is benchmarked towards low-spending companies, as opposed to those that might offer the best quality, or that are the most productive. How do you account for differences in quality if you benchmark based on spending?

David Black: That is something we look at very carefully to make sure that the benchmarks that we apply are against companies that are performing well and that have no issues with their asset health or asset management. That is examined at every price review. But equally, and somewhat offsetting that, we are not talking about a theoretical efficiency improvement; we are looking at companies that are already doing it, so there is a real question as to why a company cannot match that. We look at the evidence that companies provide. At the most recent price review, we adjusted allowances from the benchmarking models by around £3.9 billion to make sure that companies were getting the right funding to address their specific issues.

Q99 **Sarah Olney:** Does that include those differences that the report highlights: "soil type, wages and regional costs of construction"?

David Black: Yes, those are all things that companies advance arguments to us about. Companies will say that they have additional costs because their region is too hilly, others say it is because their region is too flat,



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others say it is because of a particular soil type. Those are all things that we consider. Companies are obviously also able to make appeals against our decisions to the Competition and Markets Authority, and they do on some occasions. The last time the CMA examined this matter, it generally gave a good, clean bill of health to the modelling that we were using but we recognise, none the less, that models are imperfect—they are just the first step. We need to make judgments about whether a company has an adequate cost allowance. That is something that we consider very carefully, and our board was very much engaged on that during the current price review.

David Hill: It is fair to acknowledge that Sir Jon, in his interim report, makes the point that there is a case for looking at how one could further augment that benchmarking model with more supervisory approaches to regulation to build a deeper contextual understanding of the particular circumstances and challenges facing a company. Given that Sir Jon has prefigured that finding in his interim report, we would expect him to bring forward some recommendations in July about what that could look like, which would add to the benchmarking model that you have described.

Rachel Gilmour: I am not going to ask my question, but I will make a final observation before I go. To say that I am fuming is putting it mildly. I think that most of us on the Committee are fuming. With the exception of Dame Tamara, who seems to be on it, I have never come across such an incompetent, complacent, obtuse reaction to the questions that we have asked.

I will tell you what happens in my constituency. Tiverton and Minehead relies a lot on tourism. Children are made sick by the water quality in our rivers. Floating sewage in tourist hotspots because of outflows has become the norm rather than the exception. My farmers are driven to despair because of the Environment Agency's lack of understanding and knowledge when it comes on to their land, with or without prior notice. There are brown-flag beaches that, when tested appropriately and adequately, turn out not to be brown-flag beaches. I would like to think of you as amber, but you have a long way to go.

Q100 **Chair:** Okay, Rachel—everybody has heard that. I am going to ask your question, and I will direct it to David Black. If you keep hammering companies like Thames Water for poor performance, is there not a danger that you will end up in a doom loop? The return for their investors will become so low—in fact, we are already seeing that, as it is why KKR pulled out—that they are never able to get out of this mire of poor performance because they will not be able to encourage investment. Even if they do, it will be more expensive. How do we get out of this sort of situation?

David Black: That is an argument from companies that we have considered, and it is why we have put in place a turnaround oversight regime for Thames Water.

We have set a number of new provisions in this price review to make sure that risk is shared between investors and customers. If investors are not

bearing those costs, will it come back on to customers? It is very important that customers are not paying twice.

What we have seen—this is where investors have a responsibility—is that a number of companies facing challenges are accessing financial markets to raise investment. Even in the case of Thames Water, which as you say has a particularly challenging set of circumstances, we have seen a number of investors come forward—some publicly, and some less so—who are interested in investing in the firm.

We are aware of the issue, but we have built in automatic stabilisers. There are limits, for example, to the level of risk that companies are carrying in the latest price review determination that we have set, which effectively limits much of the risk they face to the level of profits they earn.

The question is: should they have a guaranteed level of profit, or should that profit be at risk? That is something we carefully consider as a regulator. There is a balance to getting that risk and return right. We want the risks to be large enough to drive investor behaviour to be interested in long-term outcomes for customers.

Q101 Chair: If Thames Water came up with a good investor and was able to offer you a better plan, would you open the last price review, or is that now completely finalised?

David Black: The price review itself is finalised. The company has the option to go to the CMA to appeal that decision, although so far it has chosen not to do so. We have built into that price review what we think are sufficient flexibilities to be able to engage with investors' particular requests. However, they may well have requests that go beyond the scope of the regulation we have set.

Chair: That would be your decision.

Q102 Anna Dixon: I want to get into issues around finances—particularly the case of Yorkshire Water. You have mentioned it as a company that is looking to improve its performance, having recently been slapped with a fine. We are now using our new powers, which the Government have introduced, to make sure that the CEO is not taking a bonus.

Yorkshire Water, as a company, may not always have issued shareholder dividends, but it has produced a massive return for the so-called investors in the holding company. If you look back, basically since 1993, the owners of Yorkshire Water have extracted some £10 billion in dividends. During that time, they have built up around £6 billion in debt. Effectively, they have invested less than £2 billion of their own money.

Over that same period—since privatisation—£17.5 billion has been spent on capex. That amount could have been covered by customer bills. If you look at it historically, you could argue that private ownership has added no benefit for the customer. There are nine other companies, collectively known as the Kelda Group. Again, a variety of them are declaring different amounts of profit and, in some cases, paying very little or no tax. How is it



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possible that we have got ourselves into a situation where we have not been able to prevent large sums of money from being taken out of what are effectively monopoly companies?

David Black: I understand the concerns, and that is why we have changed the regime. We have introduced new provisions with the new powers that we got in 2021 to tighten controls around company dividend payments. The other feature we saw with Yorkshire Water was the use of what was called inter-company loans, which was a loan made from the regulated company to the parent entity. We took enforcement action against the company when we uncovered that it had not adhered to the terms of that loan. Based on a settlement in that case, that company is injecting £940 million back into Yorkshire Water and also investing £100 million of that to reduce sewage discharges.

We have touched on the recent enforcement case. It was actually the first company to settle and to agree undertakings to remedy its current and previous environmental breaches. With the company itself, there is clearly a lot of work to do, which is why we have set stretching performance targets for its next price review to prove against, and there will be a regime of penalties and incentives for them to deliver against those targets.

Q103 **Anna Dixon:** If you were kind, you would say it is “opaque”; if you were perhaps being more honest, you might say it is a bit “murky”, like most of our rivers. It feels like action is being taken now when these very complex financial schemes have been in place for a long time. Why are we only taking action now?

David Black: We did not have powers to make changes to company licences, which are our primary tool for controlling those measures. In PR19 we tried to use the price review to address those tools, but that decision was rejected by the Competition and Markets Authority. As a regulator, we have been striving since 2018. We introduced a “back in balance” package to try to address these issues, with very strong resistance from investors.

It is a challenging space, but we have new powers now and there are new transparency requirements as well. When we have set customer bills, we have based that on an efficient notional company. Customers have not paid more if dividends have been higher in a particular company. The customer bill level has not changed. What has changed is the level of debt that company has, and that is the situation that now needs to be addressed.

Q104 **Anna Dixon:** Are you saying that you now have the regulatory tools? Have you got the capacity in skills? One of the problems with these monopoly companies is that they will beat the regulator every time—we see it in other sectors. Are we not looking at regulatory failure?

David Black: It is a challenge to give them resources. To give you an example, at the last price review several companies appealed our decisions. They spent £23 million on those appeals and we spent £2.5



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million. We face well-resourced companies seeking to find ways around the system. The Government have agreed to increase our level of resources, so we have certainly expanded both our physical engineering capacities and our corporate financial expertise, but that is something the Cunliffe review will point to us needing more of. We will continue to make investments in that space if we can get support from the Government to do so. We are also hopeful, following our latest comprehensive spending review settlement, that we will be getting the resources in to make sure that the companies are held to account.

Anna Dixon: It sounds like we are spending an awful lot of money trying to keep these companies honest—I just make that observation.

Chair: Anna, are you finished?

Anna Dixon: I am, in the interests of time, but I would love to carry on.

Q105 **Mr Betts:** On stormwater overflows, or perhaps sewage overflows, which is essentially what they are, Yorkshire Water wrote to me saying, "Isn't it wonderful that we have all this money to spend?" I have written back to say, "Could you tell me how many of these overflows will not be fixed during the five-year period?" Does anyone know?

Philip Duffy: The answer is that the reduction in storm spills will be 44%, so 2,880 storm flows will be remediated under the price review. As Mr Black has said, that costs another £12 billion—it is a very expensive thing to do.

Mr Betts: So about 3,500 will not be fixed.

Philip Duffy: Roughly, yes.

Dame Tamara Finkelstein: We have got the plan through to 2050. We talk about this five-year period, but we have a storm overflow reduction plan that goes through to 2050 to fix all this. But it is long and expensive, no question.

Mr Betts: Having a plan for a few years' time does not help people when the sewage comes into their homes.

Dame Tamara Finkelstein: I totally understand that.

Q106 **Mr Betts:** We were talking before about fines and where they go to, and the idea that maybe local communities would benefit rather than the Treasury. I had a really bad experience with a constituent a few years ago. They had a storm overflow into their garden and into their house. They were a single parent with young children and a low income. Yorkshire Water's attitude was, "It's their responsibility. We cannot help the rain. It's just excess rain. It's their problem, not ours. Oh, and by the way, we will offer £150 towards the massive cost of clean-up." Should we not be looking at those situations? I wrote to Yorkshire Water and said, "You've got all these fines. How about paying a bit now to constituents who are left with the clean-up mess from the sewage coming into their homes?"



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Should we not ensure that people in that situation get some financial benefit for their experience?

David Black: In terms of hearing how the companies handled that situation, that is extremely poor. We have put some focus on that as a regulator. Sewage in homes is one of the worst disasters a customer can face from a water company. We have strong incentives in terms of companies driving down that happening at all. We would like to eliminate that issue as far as possible from a customer perspective.

The second angle is about companies taking the right action when it occurs. The complacency you mentioned from that company is unacceptable. This is why, using our new powers, we have brought in a new licence requirement on companies to treat customers well. If we identify issues where they do not, we will use those licence powers to take action against the company itself.

I have also convened a roundtable of chief executives to talk through issues that are of pressing concern to customers, and about taking action with much better responsiveness. Sewage discharges in homes is one of those issues. There will hopefully be a cross-industry position in terms of how companies respond to those issues.

David Hill: In December last year the Government announced new guaranteed service standards, which are compulsory payments that water companies should make in the event of various service outages. They will take full legal force shortly, but a number of companies are already operating as though they were in force. The minimum payment for, for example, internal flooding from sewers should rise to £2,000 or more. In very egregious cases companies can always choose to do more, but that will more than double the guaranteed minimum that customers should get in the event of a service outage or some other disruption.

Mr Betts: I met the Yorkshire Water chief executive a few weeks ago and all I got back was the standard response: "It is not our responsibility."

David Hill: They will be required to make a payment of £2,000 or more for a case of internal flooding from sewers.

Dame Tamara Finkelstein: You may wish to write and say that.

Chair: It seems as though Yorkshire Water is well and truly in the firing line this afternoon.

Q107 **Lloyd Hatton:** To draw together many of the points that have been covered this afternoon, can you offer us further reassurance that the water sector and the big water companies are even remotely aware of the work that needs to be done to win back the trust of the billpayer?

Dame Tamara Finkelstein: Some of the action was taken last July, and we have talked about the agreement that almost all water companies reached on changing their articles of association to give some more consumer power. We have been able to have conversations about some of

the actions the water companies can take. PR24 provided the investment possibility, so that is in place. We took some of those actions in the Water (Special Measures) Act, and now we have the Cunliffe review, which will enable that reset. I think we have the right things in place.

If it needs such a big reset—and the Cunliffe review will talk about very big, fundamental changes that will require legislation—the big challenge for all of us will be how we shape the transition. Some of these things cannot wait that long because they are too important and too pressing. We will need to build on some of the things we have talked about here, and we will need to look at what Sir Jon recommends to see what we can bring forward to make some of those shifts earlier. The sense of urgency is there, some of the legislation is in place, and the commitment to further legislation is in place, so I think those things can be done, but it will require all of us, working with the water industry, to achieve that.

Q108 Lloyd Hatton: On that point about working with the water industry, I am looking at it from the position of my constituents. They will say, “Nineteen per cent of the bills I pay just goes on servicing debt. Every hour that sewage is dumped by Wessex Water, £188 is given to shareholders.” That gives an idea of what Wessex Water are doing financially while you look at their sorry environmental track record. That is the kind of anger and frustration that billpayers feel. They are also really worried that if one of the water companies were to go into an even more perilous financial position, they would end up having to pay for it as taxpayers.

You say you are going to work with the water industry; do you think the current relationship that Ofwat, the EA or indeed the Department has with the industry is particularly sustainable? That is the stark reality we face when it comes to both the financial and environmental track record of the big water companies.

Dame Tamara Finkelstein: You have heard about some of the actions that have been taken, and some of the things in the Water (Special Measures) Act reset the balance. The Environment Act gave Ofwat a lot more power on licence conditions and the Environment Agency more power on storm overflows. Some of these things have been put in place to put requirements on the industry.

As has been mentioned, the 2011 review took us down the road of just looking at outcomes and dialling back on direct regulation and inspections. It has taken a long time to get back to saying that is not the relationship we should have. The Water (Special Measures) Act has done that sort of reset, but we see that it needs to be a much more fundamental reset. We will see what Sir Jon says and put those things in place.

You said something about paying for the cost of capital, and one needs to be a bit careful. Obviously, that is what you would expect bills to be paying for, because that is part of how you pay back for the borrowing that a company will rightly do to invest in infrastructure. Some of that is hard to understand, but it is right.

Q109 Lloyd Hatton: I appreciate that, but there is a fairly wide understanding



that, actually, the levels of debt in water companies are not purely down to good capital borrowing to invest in crumbling infrastructure. A lot of those high debt levels are because of poor, poor financial management.

Dame Tamara Finkelstein: And that impacts on the resilience of those companies more than on people's bills—David might want to say more about that. You have repeated what was said at the beginning of this hearing, which is the concern that individual billpayers might have about what might happen if their water company does not stay solvent. The idea of having the back-up of a special administration regime is to ensure that we protect the service that people receive, and to ensure that bills are set. Although there are clearly costs of taking over a water company, you would also look at the exit from any sort of SAR in order to get that back. We need to be a little careful about that sort of concern, and we should seek to make people more confident about the impact on individual billpayers.

Q110 Chair: I have two or three questions to mop up before we finish. First, David, paragraph 3.4 of the Report says that historically—up to the 2000s—the gearing of the sector has been 70% and it is now 80%, whereas in your price review '19 you set 60% and in your price review '24 you set 55%. Paragraph 3.34 says: "two companies have credit ratings that are three levels above Ofwat's minimum expected grade. Ofwat increased its expected minimum grade from 1 April 2025." Have you got enough financial advice within your organisation to overcome the clever accountants and financial advisers whom the water companies no doubt employ or take advice from? Are you able to counter that with real skills within your organisation?

David Black: Yes, because what we need to look at is, as you say, the company's financial position, and we need to make sure we have the right rules to ensure that is transparent and disclosed. There is then a question about having the tools to challenge the companies on their financial structure. Up until 2021 we had very limited powers. We now have powers to stop money leaving companies, and Sir Jon Cunliffe's report is looking at whether we need more powers to address those issues where companies are in a position of poor financial resilience.

That said, I can offer some comfort. Over the last five years, companies have raised £5 billion of equity. Since 1 April this year, even some of the companies that we have identified in our reports as facing the greatest difficulties have raised close to £2 billion of new equity. That is all in a very challenging landscape. We are seeing companies recognise the need to raise equity and succeed in doing so. We are seeing investors back these companies, even where they have disputes with Ofwat about the prices.

Q111 Chair: Okay. We need some shorter answers. This is a question for regulators. Your regulatory regime for the water companies is byzantine. On figure 10 on page 37, I made note at the top, saying: "Even the best novelist could not devise a more complex plan." You both do much of the same thing. One does environment and one does finance, but you do a lot

of the same things, such as prosecutions, and there are boundaries. What would be the advantages and disadvantages of merging the two regulators into one?

David Black: Your question is about planning processes, and we think there is huge scope to streamline them. That is what we have advocated to the commission. The question about mergers is one for the Government. We have a job to do and we are getting on with doing it. If the Government choose to make institutional changes, that is a question for the Government, and we will obviously support them in that process.

Chair: But there must be more on which you could co-operate, such as prosecutions. Even if the Government or Sir Jon Cunliffe decide not to recommend merging you, there must be areas where you could both co-operate more.

David Black: To reassure you, we have active co-operation going on at the moment. I will give you two examples. On performance, our staff regularly sit down in the same room and look at the performance of companies—particularly ones that are in trouble, but across the whole sector. That is to bring intelligence together. We think there is huge scope to do more in that space, but that is happening.

In terms of the enforcement cases we have been taking, our enforcement teams work very closely together. We acknowledge that we have had the support of the Environment Agency in taking the three enforcement cases against companies with wastewater issues to date.

Another example of co-operation is what we call RAPID, an entity that we set up back in 2020 to help to bring forward major water resource projects. We are now seeing 50 projects coming forward. That is designed to make sure that we work effectively with the Drinking Water Inspectorate to ensure that no regulatory barriers to water resources come forward. I agree that there is a real need for active co-operation, and we are doing that.

Q112 **Chair:** Could your organisation be more streamlined? Do the two of you absolutely share all the information and data?

Philip Duffy: Interestingly, we do not actually do the same work with the same skillset. The hydrologists, ecologists, flood modellers and geomorphologists are on the EA side, and the criminal prosecutors, economists, econometricians and financial advisers are on the Ofwat side, so there is not a lot of overlap in terms of the skillset of the people working with us. But we can absolutely do more to join up. I was surprised, coming into this role, that there was not the level of deep exchange of information and intelligence that we need to have.

Q113 **Chair:** Do you both exchange all information? Is all the information that you both have available to each other?

Philip Duffy: Historically, no, but we are now doing so. We are building a platform for sharing all our material. The inspections we do in the field will go to Ofwat. We will share intelligence priorities, tasking and what we



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need to do. There is a great deal more that we can do to align our operations.

Chair: We have had a long, hot session this afternoon, in every respect. I thank our witnesses very much for attending the Committee today. We ask probing questions, but we learn from them, so we do thank you. An uncorrected transcript of this hearing will be published on the Committee's website in the coming days. The Committee will consider the evidence that you have provided and will produce a report with recommendations in due course. I thank you all again—particularly Dame Tamara Finkelstein; I wish you well with whatever you are going on to do.