



Department for Environment Food & Rural Affairs

The Rt Hon Thérèse Coffey MP
Secretary of State Environment, Food & Rural Affairs

2 Marsham Street
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Lord Hollick
Industry and Regulators Committee
House of Lords
London
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Dear Lord Hollick,

Thank you for your letter of 2 December which asks me to respond to questions ahead of my giving oral evidence to your inquiry. I note the topic and scope of your inquiry. I suggest many of your questions go beyond the scope of your inquiry and I have answered the questions that are in scope.

1. Is the Government satisfied with the performance of Ofwat and the Environment Agency? Do they work effectively together, and are they too passive in responding to water pollution?

While Ofwat is focused on economic regulation of the water industry, they are responsible for assessing the business plans and required investment into environmental improvement and water quality. From what I have seen, there is good collaboration as has been most recently evidenced by the launch of civil and criminal investigations into water companies regarding sewage discharges.

In November 2022, Ofwat announced financial penalties of almost £135m as a result of water company performance against their 21/22 performance commitments, including pollution incidents. Money from these penalties will be returned to future customers through reduced water bills in the next financial year.

2. What is the Government's estimate of the level of infrastructure investment needed to eliminate sewage spillages? And why has the Government failed to require the regulators and water companies to agree and implement binding investment plans of sufficient scale to eliminate unacceptable levels of sewage spillages

We have not failed in this regard.

The costs of eliminating sewage spillages through different types of intervention are set out in full in the Storm Overflows Elimination Report, which shows that achieving complete elimination on a national level was unfeasible, due to the financial cost and the impact on customer bills. The report found that achieving complete elimination through separation of all

combined sewer pipes into separate sewer and surface water pipes could cost up to £600bn and increase annual water bills by up to £817 by 2049. Achieving complete elimination using a combination of increasing network storage and using Sustainable Drainage Systems could cost up to £200bn.

The Government's Storm Overflows Reduction Plan requires the largest infrastructure programme in water company history. With its set of strict targets, this is the toughest ever crack down on sewage spills. Between 2020 and 2025, water companies are investing £3.1bn to improve storm overflows, including £1.9bn of investment to reduce sewage discharges by building the Thames Tideway Tunnel 'super sewer'.

This Government has been very clear in our expectations of both regulators and water companies. We have set out, through our Strategic Policy Statement, that water companies are to prioritise appropriate action to improve water quality and deliver a resilient and sustainable water supply. This includes expectations on water companies to significantly reduce the frequency and volume of sewage discharges from storm overflows. The Government expects Ofwat to enable appropriate investment for companies to meet the targets in the Storm Overflows Discharge Reduction Plan, with the ultimate responsibility for delivering against our priorities sitting with the companies.

If it is possible to go farther and faster while balancing the cost to consumers, we will do so and intend to review the targets in 2027.

3. What level of return on capital invested in water companies does the Government regard as acceptable? What level of gearing in water companies is acceptable to the Government?

Investor returns are a matter for the independent economic regulator, Ofwat, and setting a cost of capital allowances is a key feature of Ofwat's price control. We are supportive of Ofwat's proposed changes to water company licences, that would require companies to explain how their dividend policies reflect their performance for customers and the environment.

Ofwat is consulting on measures to further strengthen financial resilience across the sector.

4. Should Ofwat require water companies to surrender their licence to operate if they persistently fail to invest at the required level?

Ofwat does have the power, with consent of my office, to remove a companies' licence to operate through a special administration order. This can be brought into force either on insolvency grounds, when the company may be unable to pay its debts, or enforcement grounds, where water companies are in serious breach of their core statutory obligations or licence enforcement orders.

Special administration is the ultimate enforcement tool in Ofwat's regulatory toolkit. As per the principles of best regulatory practice, Ofwat will pursue regulatory action independently from government.

5. Does the Department for Environment, Food and Rural Affairs have the determination, resources, skills and information to hold regulators and water companies to account for spillages, agree binding financial targets to achieve the necessary levels of investment and penalise companies and executives if profits and returns are excessive?

Yes, as is clear from our Strategic Policy Statement for Ofwat.

Yours sincerely,

Therese Coffey