

Government Response to the House of Lords Industry and Regulators Committee Report: The affluent and the effluent: cleaning up failures in water and sewage regulation.

Government response to the Committee's recommendations

The House of Lords Industry and Regulators Committee published its report '*The affluent and the effluent: cleaning up failures in water and sewage regulation*' on 22 March 2023.

Following the Secretary of State for Department for Environment, Food and Rural Affairs' attendance at the committee on 25 January 2023, Defra has published its 'Environmental Improvement Plan'¹ and its 'Plan for Water: our integrated plan for delivering clean and plentiful water'². Both plans address a number of the Committee's recommendations, in particular our Plan for Water sets out actions that government will take to transform the management of the water system, clean up the water environment and create a sustainable supply of water for people, businesses and nature. It brings together the significant action already taken by the Government and regulators, along with more investment, stronger regulation and tougher enforcement on those who pollute.

The Government has responded to each recommendation in turn.

Recommendation 1: Ofwat, the Environment Agency and the Drinking Water Inspectorate should set up RAPID-style structures, including joint working and close partnership with industry, in areas of high priority, including improving water quality, upgrading the wastewater network and reducing water demand (paragraph 41).

The Regulators' Alliance for Progressing Infrastructure Development (RAPID) was established by Ofwat in 2016 to accelerate the planning and delivery of new water infrastructure projects in England and Wales. The Government recognises the positive impact that RAPID is having on infrastructure planning. By working together more closely, water companies and their regulators can identify and address issues earlier in the planning process, reducing delays and costs and enabling projects to be delivered more quickly.

The Government already supports and oversees existing systems for joint-working and partnership between regulators and the water industry across a range of high priority areas, including the National Drought Group and Senior Stakeholder Group of the National Water Resources Framework. Additionally, the Storm Overflows Taskforce, a joint group established in August 2020 to significantly reduce the frequency, impact and harm caused by storm overflows, included representatives from Defra, Ofwat, the Environment Agency, the Rivers Trust, Consumer Council for Water, and water industry, to support the design of the Storm Overflows Discharge Reduction Plan.

The Government has made clear in its recently published Plan for Water (Chapter 1.3 on Smarter Regulation) that it supports the joint Ofwat and Environment Agency commitment to update their

¹Environmental Improvement Plan 2023 - <https://www.gov.uk/government/publications/environmental-improvement-plan>

²Plan for Water: our integrated plan for delivering clean and plentiful water - <https://www.gov.uk/government/publications/plan-for-water-our-integrated-plan-for-delivering-clean-and-plentiful-water>

existing memorandum of understanding to achieve even further enhanced joint oversight of water companies.

Recommendation 2: It is crucial that Ofwat and the Environment Agency share relevant information effectively and efficiently on matters of joint interest. Ofwat and the Environment Agency should formalise and publish how they plan to share information on water company performance (paragraph 42).

Ofwat and the Environment Agency already have information-sharing arrangements in place, and these have successfully supported enforcement cases.

Building on the collaborative working arrangements established with StreamLine, a new joint service launched by Ofwat, the Environment Agency and the Drinking Water Inspectorate in May 2022 to improve advice and reduce response times for water innovators, the group have secured further funding from the Regulators Pioneer Fund for a project commencing in September 2023 to collaboratively explore whether and how the data they each collect and hold can be proactively shared and potentially made publicly available. Data sharing and open data has the potential to help provide a more joined-up, efficient and effective service to water companies, businesses, local authorities and landowners they regulate, support and advise and help stimulate innovation in the water sector.

Recommendation 3: The Government should facilitate a co-ordinated approach to water pollution by publishing a National Water Strategy that approaches water policies in a holistic way. The Strategy should set clear expectations in relation to the quality of the water environment and the resilience of water supplies, giving regulators clear benchmarks to work towards. The Strategy should also set out clearly how the Government intends to oversee the regulators' delivery of these expectations (paragraph 50).

While this inquiry was established regarding Ofwat, the Government published the Environmental Improvement Plan on 31 January 2023, and on 4 April 2023, the Government published its Plan for Water, which brings together the significant steps the Government has already taken within the Environmental Improvement Plan with new action. The Plan for Water will transform our management of the water system, deliver a cleaner water environment, and secure a plentiful water supply.

Recommendation 4: The Government should update the SPS to strengthen the language contained within it to ensure that Ofwat requires companies to meet SPS priorities. It should also provide a clear steer to Ofwat on how to balance its priorities, particularly in relation to the need to ensure higher levels of infrastructure investment, and these lessons should be taken on board in future Statements (paragraph 82).

The Strategic Policy Statement (SPS), published in March 2022, sets out clearly the Government's priorities to Ofwat and the water industry to enhance water quality and deliver a resilient and sustainable water supply. The Government recognises that a system that works for consumers does not simply mean lower prices in the short-term at the expense of future generations.

The Government does not intend to update the SPS, recognising Ofwat's ongoing 2024 Price Review process (PR24). Water Companies are separately expected to fulfil statutory duties and Ofwat is expected to allow funding to fulfil them.

Recommendation 5: The Government should consider legislating to remove the scale and complexity test from the Water Industry Act 1991 and the Specified Infrastructure Project Regulations, ensuring that special purpose vehicles can be used much more frequently to build large water infrastructure projects (paragraph 122).

There are two existing competitive delivery models already in the sector: a licensed model (under Part 2A of the Water Industry Act 1991 and the Specified Infrastructure Project (English Undertakers) Regulations 2013), and a contracting model called Direct Procurement for Customers (or DPC).

In January 2022, the Government asked Ofwat to undertake a competition stocktake for the water sector. Ofwat's response set out proposals on how competition could be increased for high-value infrastructure projects by amending legislation. The Government is working with Ofwat to explore its recommendations further.

The Government has already set out in our Plan for Water that Defra will improve value for money of large projects by supporting the use of innovative financing arrangements, as was used for the Thames Tideway Tunnel, and encouraging water companies to use more competitive tendering, such as direct procurement for customers.

Recommendation 6: The Government should designate the final National Policy Statement for Water Resources Infrastructure to ensure strategically significant water infrastructure projects are designated as nationally significant infrastructure projects and can progress through the planning process in a timely manner. The definition of nationally significant infrastructure projects should be amended to ensure strategic water resources schemes are not excluded, particularly those delivered through competitively appointed providers (paragraph 123).

The National Policy Statement for water resources infrastructure was announced in the Plan for Water and laid in Parliament³ on 17 April 2023. This will bring further clarity to the planning process and be a key enabler for water supply options and an important step to accelerating water supply infrastructure development.

Recommendations 7 and 8:

The Government should legislate for a single social tariff in the next Price Review. This should provide a baseline of support for customers regardless of who supplies their water. As this would require some customers to subsidise other customers, the Government should take decisions on the level of support having consulted with regulators, companies and consumer groups (paragraph 138).

The single social tariff should include a no-detriment clause to ensure that no customer is worse off as a result of the introduction of the new arrangements. Water companies should continue to offer additional support where customers are struggling to pay their bills even with the single social tariff in place (paragraph 139).

³National Policy Statement for water resources infrastructure - <https://www.gov.uk/government/publications/national-policy-statement-for-water-resources-infrastructure>

This is not a matter for Ofwat, which is the subject of the inquiry. Defra's SPS encourages water companies to implement the recommendations of the Consumer Council for Water's (CCW) Affordability Review to improve awareness of access to existing support measures in the industry. There are no plans to introduce a single social tariff.

Recommendations 9 and 10:

The Government, Ofwat and the Environment Agency should ensure that the next iteration of the Water Industry National Environment Programme has a greater focus on the outcomes to be achieved. This will give responsible companies more leeway to use nature-based and catchment-based solutions (paragraph 152).

To the extent that prescriptive regulatory requirements are the result of retained EU law, the Government should examine whether the relevant provisions can be amended to enable an outcomes-based framework in time for the next Price Review (paragraph 153).

In 2020 Defra, the Environment Agency and Ofwat led a review of the water industry national environment programme (WINEP) to ensure the next round of WINEP actions achieve greater environmental benefits by using a more outcomes-based approach. The review resulted in the WINEP methodology, published in May 2022, introducing a 3-tiered approach to develop the WINEP for 2025-2030 which outlines that a list of tier 1 outcomes will be linked to improving river water quality, biodiversity net gain and surface water management to help secure wider benefit for the environment and for society.

Ofwat, in its Final Determination PR24 Methodology published December 2022, has taken an outcomes-focussed approach to increase companies' focus on long-term and adaptive planning to deliver the best long-term environmental outcomes.

Recommendation 11: We recommend the Government considers banning the sale of wet wipes that are not rapidly biodegradable (paragraph 175).

The Government has already announced⁴ that it will change the law to ban the sale of wet wipes containing plastic, subject to public consultation.

Recommendation 12: We recommend nature-based solutions and catchment approaches form a larger part of the next iteration of the Price Review and the Water Industry National Environment Programme (WINEP) (paragraph 183).

Defra's SPS has set out that water companies should increase their use of nature-based solutions to complement other schemes to improve the water environment.

Ofwat, in its Final Determination PR24 Methodology, made it clear that they want companies to make a step change increase in the use of nature-based solutions over the PR24 period (2025-2030) and has introduced a suite of changes to its methodology to support this. Ofwat is clear that they will not support funding of enhancements for companies that have not fully considered the use of nature-based solutions in a fair, consistent and transparent way. For this Price Review, Defra has worked with the Environment Agency and Ofwat to create a WINEP methodology that details how water

⁴Far-reaching ban on single-use plastics in England - <https://www.gov.uk/government/news/far-reaching-ban-on-single-use-plastics-in-england>

companies should develop their investment programmes that focusses on wider environmental outcomes.

Recommendations 13 and 14:

The Government should set out how it envisages the investment needed to prevent pollution will be funded through a National Water Strategy. Water companies should take the lead in meeting the majority of costs (paragraph 199).

A National Water Strategy should include consideration of how funding should be balanced across causes of water pollution, to maximise environmental protection and minimise costs (paragraph 204).

While this inquiry was established regarding Ofwat, the Government refers the Committee to the Plan for Water.

Recommendation 15: We recommend the Government ensures adequate funding is available to the Environment Agency to inspect and enforce environmental offences by water companies (paragraph 222).

While this inquiry was established regarding Ofwat, the Government notes the recommendation.

Recommendation 16: The Government, Ofwat, and the Environment Agency should publicly outline their plans to ensure open data on environmental performance is provided by companies as a matter of priority (paragraph 230).

Using powers in the landmark Environment Act 2021, the Government will significantly improve transparency by requiring companies to make storm overflow discharge data available in near real time to the public as well as monitor water quality upstream and downstream of their assets.

Recommendation 17: We recommend that the Government's commitment to a mandatory review of the Storm Overflows Discharge Reduction Plan in 2027 is used as an opportunity to set stretching targets to reduce storm overflow overuse. We would welcome Defra's research budget being used to examine how these more stretching targets could be met. In the meantime, Ofwat must ensure that significant incentives are in place to encourage companies to meet the targets in the Plan ahead of prescribed dates. We also recommend that a National Water Strategy should include a co-ordinated approach to reducing and preventing water pollution (paragraph 241).

The Government has set ambitious targets for water companies through the Storm Overflows Discharge Reduction Plan. The Government recently announced that its target to reduce storm overflows will be enshrined in law under the Environment Act 2021, to ensure there is no local adverse ecological impact from storm overflows by 2050. The Government has committed to review the plan in 2027, so that water companies remain as ambitious as possible, while balancing the impact on bills. As with all policy development, the Government will seek additional research, where appropriate.

Government and regulators are taking further steps to drive improvements in water company performance across the whole industry. This means more co-ordinated action across the regulators of the water industry when necessary.

Recommendation 18: The Government should deliver on its proposals to increase the limit on Variable Monetary Penalties (VMPs) for serious offences committed by water companies. The Government should ensure the Environment Agency has adequate funding to use its new powers effectively and prosecute criminal behaviour in the sector (paragraph 255).

While this inquiry was established regarding Ofwat, the Government has launched a public consultation to change the law to increase the maximum amount the Environment Agency can penalise water companies for damaging the environment. The proposed changes will also expand penalties to include a wider range of environmental breaches. Variable monetary penalties provide an alternative to criminal prosecutions which require considerable time and resources to progress and are reserved for the most serious breaches.

Recommendation 19: There is a need for greater individual accountability for executives and directors of companies that are responsible for serious and deliberate pollution incidents, including criminal prosecution where appropriate. The Government should give Ofwat powers to prevent directors of companies that are responsible for serious pollution incidents from continuing to work in the sector (paragraph 256).

Ofwat's direct enforcement powers or sanctions are primarily focused on the regulated business rather than to individual officers within those companies.

However, Ofwat is able to make applications to the High Court for a director disqualification order if (i) the individual is a director of a company that has breached competition law and (ii) the court considers that their conduct as a director makes them unfit to be concerned in the management of a company (Company Directors Disqualification Act 1986). There are other grounds on which directors can be disqualified in the Act, however, Ofwat is only able to make an application on the breach of competition law ground.

While Ofwat has only certain powers to disqualify directors they use their enforcement and other regulatory tools to incentivise the link between performance and the role of individual company staff to deter non-compliance. For example, Ofwat recently strengthened the existing dividend licence condition so that it can take enforcement action against water companies that do not make an explicit link between dividend payments and their performance for customers and the environment. These measures were made possible by new licence modification powers that this Government gave to Ofwat via the Environment Act 2021.

Recommendation 20: Ofwat should consider whether to be more proactive in using these powers to change the management of continued poor performers in the sector (paragraph 267).

Ofwat and the Secretary of State (who provides final consent), have the power to request the court to place a company in special administration so that its business can be transferred as a going concern to new owners. This can be applied for 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 principal statutory duties or an enforcement order.

Special administration is the ultimate enforcement tool in Ofwat and the Secretary of State's regulatory toolkit. It is available only where the statutory grounds are made out and where other means are inadequate, and should only be utilised where appropriate.

Recommendation 21: We support Ofwat's increased interest in executive pay, including its expectation that companies set out their proposed policies for performance-related executive pay during the next Price Review period. These proposals should ensure performance-related pay is much more closely linked to performance, particularly in relation to the environment. Ofwat should set out further provisions to ban bonuses at companies who have been found to have caused serious pollution incidents as part of the conditions of water company licences (paragraph 289).

Ofwat introduced a new measure on executive pay awards, setting out that shareholders, and not customers, will fund pay awards where companies do not demonstrate their decisions on pay awards reflect overall performance for customers and the environment.

Recommendation 22: Ofwat should ensure that water companies are subject to the same level of transparency as publicly listed companies, in order to improve transparency through the regular reporting cycle (paragraph 297).

There is a high level of transparency in the reporting cycle. All water companies publish their annual reports on their websites. The publicly available reports include financial and governance information. In addition to annual reports, all water companies publish an annual performance report (APR). The APRs are accessible to all stakeholders and set out how companies are delivering for their customers, environment and wider society.

On 20 March 2023 Ofwat announced⁵ new changes to company licences that will improve the performance and financial health of water companies and provide greater transparency with customers and stakeholders.

Recommendation 23: The Government should set out plans to accelerate the planning process for reservoirs, including by designating, and if necessary amending, its National Policy Statement for Water Resources Infrastructure as a matter of priority (paragraph 315).

While this inquiry was established regarding Ofwat, the Government has published the National Policy Statement for water resources infrastructure was announced in the Plan for Water and laid in Parliament on 17 April 2023. This will bring further clarity to the planning process and be a key enabler for accelerating water supply infrastructure, such as reservoirs and strategic water transfers.

Recommendation 24 and 25:

The Government should set out in a National Water Strategy how it envisions meeting its targets for reducing water demand. This should involve setting out new policies and setting clear expectations for regulators and companies (paragraph 328).

⁵Ofwat announces new powers on water company dividends - <https://www.ofwat.gov.uk/ofwat-announces-new-regulatory-controls-on-water-company-dividends/>

Ofwat, the Environment Agency and water companies should work closely together, as they do with RAPID, in order to set out schemes and proposals to reduce water demand (paragraph 329).

The Plan for Water sets out the Government's policies and plan to improve water efficiency and reduce leakage. Through these enabling policies, and working with closely water companies, we will achieve our statutory water demand target under the Environment Act 2021.

The Government has encouraged innovation in water efficiency through Ofwat's £100 million water efficiency fund to support the development of a range of new approaches to water efficiency between 2025 and 2030. The Government has also asked Water UK to develop a water efficiency route map and has encouraged them to consider regional and national solutions to water demand.

The Plan for Water delivery programme governance includes working with regulators, and the actions on water demand will be prioritised through this process.

Recommendation 26: The Government should make water metering compulsory for all households and businesses where it is possible to do so. In introducing compulsory metering, the sector should clearly communicate the benefits of metering to customers. Given the low levels of trust in water companies, the Government should proactively set out its view that the public should reduce its water consumption, both in the national interest and in order to reduce consumer bills (paragraph 345).

While this is an inquiry on Ofwat, the Government addressed this in the Plan for Water.

Recommendation 27: Ofwat must continue to set stretching targets on reducing leakage and incentivise companies to exceed these targets. Ofwat should ensure the necessary investment to reduce leakage is provided for through the Price Review process (paragraph 346).

The 2022 SPS set out that we expect Ofwat to challenge water companies to halve leakage across the industry by 2050. Water companies have committed to delivering a 50% reduction in leakage from 2017 to 2018 levels by 2050. We expect Ofwat to monitor progress towards this target. Ofwat's final methodology for PR24 includes performance commitments for leakage reduction, reducing household per capita consumption and reducing non-household water use to support meeting the statutory water demand target.

The Government is also supporting innovation through Ofwat's innovation fund which includes projects on the 'National Leakage Research Test Centre', 'Leak Detection using Dark Fibre', and using artificial intelligence and drones to find leaks.