Submission on the Economic Growth (Regulatory Functions) (Amendment) Order 2024

The Economic Growth (Regulatory Functions) (Amendment) Order 2024

Questions from Wildlife & Countryside Link

The Order extends the Growth Duty, a requirement on regulators to have regard to the desirability of promoting economic growth established by the Deregulation Act 2015, to Ofgem, Ofwat and Ofcom.[1] The Order has been published alongside refreshed statutory guidance which sets out how the Growth Duty would apply to these three regulators.[2]

Link has concerns about the extension of the Growth Duty to Ofwat.[3] It contrasts sharply with a growing public, parliamentary and civil society consensus, following new data on the scale of water company pollution, that Ofwat's regulatory focus is already overly economic and that greater environmental direction is required to tackle freshwater pollution caused by water companies.[4] Far from providing this greater environmental direction, the Order could reduce Ofwat's already limited ability to take enforcement action against polluting water companies.

The use of 2015 powers to tack away from environmental drivers in water regulation would also appear to overlook recent legislative and parliamentary developments, including the Government's adoption of the Environmental Principles Policy Statement under section 17(4) of the Environment Act 2021. The impact assessment for the Order fails to mention the Environmental Principles; it is far from certain that the Department properly considered the Principles before making the decision to apply the Growth Duty to Ofwat and laying the Order.

We expect this Order to be of interest to the House, especially given the public policy prominence of enforcement issues around freshwater pollution, the changed circumstances (both in terms of new data and the new Environmental Principles Duty) since the parent Act passed in 2015 and the inadequacy of the explanatory material, and apparent decision-making processes, around the Order.

We would be grateful if the Secondary Legislation Scrutiny Committee could consider putting the following questions to the Department for Business and Trade, to help inform consideration of the Order:

- The Environmental Audit Committee's 2022 'Water quality in rivers' report recommended that Ofwat be given clearer guidance to regulate for environmental objectives[5], stating: *''the value of biodiversity in rivers in England does not appear to have been priced adequately into the economic decisions made by companies and by regulatory agencies. If it is to meet the Environment Act's legally binding target to halt the decline in the abundance of species in England by 2030, the Government must make it clear, in strategic guidance to Ofwat and to National Highways, that from now on natural capital needs to be taken into account in all economic*

[1] https://www.gov.uk/government/publications/the-economic-growth-regulatory-functions-amendment-order-2024

[2] https://assets.publishing.service.gov.uk/media/65d611f2188d77001603883b/government-response-to-smarter-regulation-regulating-for-growth-consultation.pdf p34-70

[3] See full policy briefing: https://www.wcl.org.uk/docs/Growth_Duty_Ofwat_freshwater_pollution_impacts.pdf

[4] https://lordslibrary.parliament.uk/river-pollution-and-the-regulation-of-private-water-companies/

[5] https://committees.parliament.uk/publications/8460/documents/88412/default/

decision making.'' The Government's response to the report agreed with this recommendation, stating: *''We accept that Ofwat should take natural capital into account in economic decision making…Defra along with Ofwat, the Environment Agency and Natural England will continue to work towards this approach.''*[6] Natural capital is not mentioned in the Order, and receives only a fleeting, solitary reference in the accompanying refreshed guidance with no requirement to actively consider it in decision making.[7]
Question: How does the new legal duty on Ofwat to have regard to the desirability of economic growth, without a clear requirement to consider natural capital, align with the earlier Government promise that Ofwat will take natural capital into account in all economic decision making?

- The polluter pays principle is one of five environmental principles set out in the Environmental Principles Policy Statement adopted under the Environment Act 2021. The policy statement on the principles states that *''the costs of pollution should be borne by those causing it, rather than the person who suffers the effects of the resulting environmental damage, or the wider community''*.[8] It also states that *''the amount the polluter pays should be proportionate to the environmental damage caused and the wider costs and benefits to society of the activity in question''*. The refreshed guidance to apply the Growth Duty to Ofwat states that, before taking enforcement action, the regulator should first consider the *''likely impact of the proposed intervention on the business, and the wider business community both in terms of remedying and deterring the noncompliance and in terms of economic costs and benefits to businesses.''*
Question: How does the Growth Duty requirement to give extra weight to the likely economic impacts of enforcement before deciding whether to take action relate to the polluter pays principle which advises policy makers to match the scale of enforcement to the environmental and social damage caused?

- In February 2024, the Department for the Environment, Food and Rural Affairs announced plans to allow Ofwat to prevent polluting water companies from paying bonuses to executives.[9] A ban on bonuses is a financial sanction. The guidance accompanying the Order requires regulators to consider exercising restraint on financial sanctions, as they can be *''particularly damaging''* to growth. By allowing water companies to argue that the exercise of these powers would damage growth, the Growth Duty imposed on Ofwat by the Department for Business and Trade would appear to limit the application of the new bonus banning powers conferred by the Department for the Environment, Food and Rural Affairs. It is also unclear how the Growth Duty imposed by the Department for Business and Trade can be aligned with the 2022 Strategic Policy Statement imposed by the Department for the Environment, Foor and Rural

[6] https://committees.parliament.uk/publications/22190/documents/164546/default/
[7] https://assets.publishing.service.gov.uk/media/65df50cef1cab3863afc47a0/government-response-to-smarter-regulation-regulating-for-growth-consultation.pdf p54 & 55 (see the omission of natural capital from the list of indicators)
[8] https://www.gov.uk/government/publications/environmental-principles-policy-statement/environmental-principles-policy-statement
[9] https://www.gov.uk/government/news/government-cracks-down-on-bonuses-for-water-company-bosses

Affairs which says that "*protect and enhance the environment*" should be the top strategic priority for Ofwat.[10]

Question: Has the Department for Business and Trade considered how the application of the Growth Duty could allow water companies to challenge any future bonus restrictions as damaging to growth?

Question: What detailed engagement has taken place between the Department for Business and Trade and the Department for the Environment, Food and Rural Affairs concerning the Order and refreshed guidance?

- The Department for Business and Trade has produced an impact assessment for the Order, described as a *''full economic assessment''*. The economic factors it considers includes assessment of the benefits for businesses of a *''reduced business burden when engaging with regulators''* and the capping of a compliance costs *''at the minimal level''*. The assessment goes onto consider how such reduced costs for water companies could reduce *''the unit cost of water supply''*. The impact assessment makes brief reference to also considering the impact of the Order against the *''Environmental Duty (under the Environmental Act 2021)''*.[11] We assume this phrase refers to the Environmental Principles Duty under the Environment Act 2021.[12] This environmental aspect is dealt with in a few paragraphs under a wider 'consultation risks' section in the impact assessment. This is in contrast to assessment against other duties, such as the Public Sector Equality Duty, which receives its own dedicated section. The environmental paragraphs fail to mention the environmental principles that the Environmental Principles Duty requires new policies to be assessed against, including the highly relevant polluter pays principle.

  Question: Why is the focus of the assessment overwhelmingly economic?

  Question: Why does the impact assessment give such cursory attention to the legal requirement on policy makers to have due regard to the environmental principles policy statement?

  Question: Has the Secretary of State for Business and Trade considered the environmental impact of the order, following the approach set out in the Environmental Principles Policy Statement?

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[10] https://www.gov.uk/government/publications/strategic-policy-statement-to-ofwat-incorporating-social-and-environmental-guidance/february-2022-the-governments-strategic-priorities-for-ofwat
[11] https://www.legislation.gov.uk/ukdsi/2024/9780348258745/impacts (see pages 4, 9, 12, 18 & 19)
[12] https://www.gov.uk/government/news/environmental-principles-duty-comes-into-force

Response from the Department for Business and Trade

Overview

We would like to thank the WCL for raising these important points, and are happy to provide further detail to their questions below:

The draft statutory guidance provides clarification for regulators within scope of the Growth Duty, setting out ways regulators may exercise regulatory functions so as to promote economic growth.

The Growth Duty does not create a hierarchy of duties. As set out in the draft guidance, regulators, as independent and experienced bodies, are best placed to decide how to balance their own duties. Ofcom, Ofgem and Ofwat have a number of existing duties, and we believe that extending the Growth Duty to these regulators will enable them to consider the desirability of growth alongside these other duties.

Specific Questions:

Question: *How does the new legal duty on Ofwat to have regard to the desirability of economic growth, without a clear requirement to consider natural capital, align with the earlier Government promise that Ofwat will take natural capital into account in all economic decision making?*

- The purpose of the Growth Duty is to ensure that specified regulators give appropriate consideration to the potential impact of their activities and their decisions on economic growth, alongside their consideration of their other statutory duties.
- The draft Growth Duty guidance recognises the importance of the environment, with environmental sustainability identified as one of the seven drivers of economic growth.
- The Government has set out within the draft guidance that natural capital and the ecosystems in which we live are fundamental to economic growth, and therefore need to be safeguarded for economic growth to be sustained. We are clear that a resilient and prosperous society depends on the availability of natural resources and a healthy environment.
- The Government also considers that the existence of environmental legislation (including the Environmental Principles Duty, section 40 of the Natural Environment and Rural Communities Act 2006, and as well as other specific environmental duties applied to individual regulators), together with Net Zero Duties will prevent the possibility of environmental impacts caused by the extension of the Growth Duty to these regulators.
- Whilst extending the Growth Duty to Ofwat will mean it (Ofwat) will need to consider the Growth Duty when exercising specified regulatory functions, this will not take precedence over other duties, and does not prevent enforcement against illegal activities.
- We would draw the Committee's attention to the draft statutory guidance on page 4 which states:
  - "The Growth Duty does not legitimise non-compliance with other duties or objectives, and its purpose is not to achieve or pursue economic growth at the expense of necessary protections. Non-compliant activity or behaviour that undermines protections to the detriment of consumers, employees and the environment needs to be appropriately dealt with by regulators. It also harms the interests of legitimate businesses that are working to comply with regulatory requirements, disrupting competition and acting as a disincentive to invest in compliance."

***Question:** How does the Growth Duty requirement to give extra weight to the likely economic impacts of enforcement before deciding whether to take action relate to the polluter pays principle which advises policy makers to match the scale of enforcement to the environmental and social damage caused?*

- The potential environmental impacts of the proposed extension were a central consideration at consultation and when drafting the refreshed statutory guidance for the Growth Duty and the extension of the Growth Duty to Ofcom, Ofgem and Ofwat.
- The draft statutory guidance sets out that regulators should ensure that enforcement action is always proportionate and considers the needs of businesses. However, the guidance does not in any way set restrictions on regulators as to how their enforcement can and should operate. Regulators operate independently from Government and should be free to make enforcement decisions based on the evidence presented to them.
- As mentioned above, the Government considered that the existence of environmental legislation (which includes the Environmental Principles Duty, section 40 Natural Environment and Rural Communities Act 2006, and specific environmental duties applied to individual regulators), as well as Net Zero Duties were sufficient to prevent any environmental impacts caused by the extension of the Growth Duty to cover these regulators.
- Further, as discussed above, the draft statutory guidance is explicit that the Growth Duty does not take precedence or legitimise any failures to adhere to existing legal duties and protections including environmental protections.
- The Growth Duty means regulators will need to consider the Growth Duty when exercising regulatory functions. However, the Growth Duty does not take precedence over other duties and does not prevent enforcement against illegal activities.

***Question:** Has the Department for Business and Trade considered how the application of the Growth Duty could allow water companies to challenge any future bonus restrictions as damaging to growth?*

- The updated guidance sets out that an effective regulator will set a strategy that strikes the right balance between their various pressures or duties, informed by an understanding of what approach might best foster growth.
- The policy on bonus restrictions is subject to consultation and we would encourage all interested parties to respond to any future consultations on bonus restrictions.
- It is important to note we have established in the draft statutory guidance that the Growth Duty will not take precedence over other duties, and it will not prevent enforcement against illegal activities.

Question*: What detailed engagement has taken place between the Department for Business and Trade and the Department for the Environment, Food and Rural Affairs concerning the Order and refreshed guidance?*

- All consultations and government responses have completed the collective agreement process prior to launch or publication. DEFRA were engaged on this policy as part of the Write Round process for the extension consultation, for the regulating for growth consultation, and the government responses to both consultations. DEFRA were also engaged as part of the extension SI process before the SI was laid in parliament.

Question: *Why is the focus of the assessment overwhelmingly economic?*

Question: *Why does the impact assessment give such cursory attention to the legal requirement on policy makers to have due regard to the environmental principles policy statement?*

Question: *The impact assessment for the Order fails to mention the Environmental Principles; it is far from certain that the Department properly considered the Principles before making the decision to apply the Growth Duty to Ofwat and laying the Order.*

Question: *Has the Secretary of State for Business and Trade considered the environmental impact of the order, following the approach set out in the Environmental Principles Policy Statement?*

- The impact assessment is designed to primarily assess the economic impact of the policy.
- In accordance with their duty under section 19 of the Environment Act 2021 to have due regard to Defra's Environmental Principles Policy Statement ("EPPS"), Ministers considered the EPPS and the environmental principles in the assessment of the extension of the Growth Duty and the drafting of the refreshed Growth Duty Statutory Guidance.
- No adverse effects on the environment were identified from the EPPS assessment of the guidance and extension of the Growth Duty. In particular, the statutory guidance underlines that the Growth Duty does not equate to pursuing economic growth at the expense of environmental protections.