

Ofwat's evidence for the Sustainability Committee Inquiry into the draft Flood and Water Management Bill

Background

Ofwat (the Water Services Regulation Authority) is the economic regulator of the water and sewerage sectors in England and Wales. The sectors comprise:

- 21 regional and local monopoly companies;
- 4 newly-appointed water or sewerage companies; and
- 6 water supply licensees.

Ofwat has been in existence since 1989. It became a corporate body with a Board structure on 1 April 2006.

Our main duties are to:

- protect the interests of consumers, wherever appropriate by promoting effective competition; and
- enable efficient water and sewerage companies to carry out and finance their functions.

The price limits we set every five years allow well-managed and efficient companies to finance the services they deliver. They allow the companies to meet the needs of their customers and of the environment while continuing to deliver a safe and reliable service.

We congratulate Defra on producing a substantial body of work in a relatively short space of time. We have worked closely with Defra, Welsh Assembly Government and other stakeholders on the development of the Bill.

We have also worked closely with the Cave review team and the Walker review team on their reports on competition and innovation and household charges and metering, respectively.

Introduction

How the Bill can help address the future challenges the sectors face

We welcome the publication of the draft Flood and Water Management Bill for consultation. We believe this is a significant opportunity for the water and sewerage sectors and we are grateful for the opportunity to contribute to the Sustainability Committee's inquiry.

The water and sewerage sectors face many challenges, including:

- Meeting rising consumer expectations. We live in a modern, fast-moving, 21st century globalised society. All sectors, including water and sewerage, need to respond to these changing needs.
- Increasing demand from a growing population. The UK population is projected to increase to 71 million by 2031. By the same date, the population in Wales is expected to rise by 11%. An increasing number of single-person households, which use more water per person, are also creating pressures.
- World wide water scarcity. We currently export 60-70% of our water demand by importing water intensive goods from elsewhere. This has a significant environmental impact in water-scarce environments. Water resources in more than half of river drainage areas in Wales are classified as 'scarce' by the Environment Agency.
- Adapting to climate change. Rainfall in Wales will become more variable and could fall by 7-14% in summer and rise by 7-24% in winter by 2050.
- Mitigating the effects of climate change. We will need new technologies, processes and approaches to help the UK economy become low-carbon.
- Complying with stringent environmental standards. On the basis of current technology, meeting the standards of the Water Framework Directive (WFD) could result in a four-fold increase in greenhouse gas emissions by 2030. Eight per cent of catchments in Wales are over-abstracted, placing pressures on the ability to meet the 2015 WFD target. This suggests that demand will increase, but water supplies may not. Resources will become increasingly stretched, variable and difficult to manage.

All the parties involved have developed long-term strategies to meet these challenges. These include:

- the Welsh Assembly Government's environment strategy for Wales and the strategic position statement on water;
- our own strategy; and
- Dŵr Cymru's and Dee Valley's 25-year strategic direction statements.

The Bill provides an ideal opportunity to create the legislative framework to deliver all of our strategic priorities.

We believe that the Bill is an important opportunity to address many of the future challenges that the sectors face. It will also address legislative needs identified by:

- the Welsh Assembly Government's environment strategy and strategic position statement on water;
- the UK Government's strategies - 'Future water' and 'Making space for water';
- Sir Michael Pitt's review of the summer 2007 floods; and
- the independent reviews by Professor Cave into competition and innovation and Anna Walker into metering and charging.

This paper responds to the Committee's inquiry into the draft Flood and Water Management Bill. In this paper, we aim to give a strategic overview to the Committee on the implications for the draft Bill on the water and sewerage sectors in Wales.

Overview of proposals not covered by the draft Bill

Cave review of competition and innovation in the water markets

The issues facing the water and sewerage sectors are significant and putting in place measures to manage those issues is crucial. The Welsh Assembly Government's strategic position statement on water identifies some of these challenges, such as climate change and the current economic situation. Population growth, changing demographics and rising consumer expectations will also contribute to these pressures.

Ensuring a sustainable service for consumers in the long term in the face of these challenges is a core part of our strategy and we believe that we will need a flexible, adaptable regulatory framework to achieve this. Part of that flexibility includes the ability to use market mechanisms to help drive the type of innovative development the sectors need to be sustainable in the long term.

Introducing effective competition to benefit consumers is an important theme of the UK Government's water strategy. It is also a key element of our own strategy. The Bill is an opportunity to introduce enabling provisions to allow this to be realised.

Professor Martin Cave's review of competition and innovation in the sectors has highlighted the potential benefits that effective competition can bring in a range of water and sewerage services. He believes that effective competition can drive innovation, increase efficiency and engender greater responsiveness to consumer needs, better enabling the sectors to meet the challenges of the future. At the heart of his vision, is the creation of an effective retail market for water and sewerage services for non-household customers, similar to that which is already operating in Scotland, where Scottish Water has separated its retail functions to form 'Business Stream', which now competes with other new market entrants for non-household customers. This retail market and retail separation in Scotland has already helped to save £13 million of operating costs and 25% of the non-household customers served by Business Stream now receive a lower bill than they would have done otherwise.

The situation in Wales is different. Dŵr Cymru has a unique business model and has been under price cap regulation for longer, so some of these efficiencies may already have been realised. However, given the scale of the benefits delivered in Scotland, we think it would be unreasonable to assume that there are not substantial advantages which could be gained from introducing retail competition in England and Wales. Implementing Cave's vision would not stop Dŵr Cymru from continuing to adopt its current not-for-profit business model as this could be accommodated comfortably within the existing system.

Competition has also delivered substantial benefits in other utility sectors, leading to lower costs, improved service, and more choice for customers. Regulation can then be withdrawn when markets are sufficiently competitive to protect consumers, meeting the better regulation principles.

While many of the challenges will have a slow and gradual impact, taken together the impact is likely to be more substantial and immediate. We (and the Cave review) believe that successfully and efficiently addressing these challenges demands a more flexible approach to regulation than we have had in the past. The existing regulatory tools may not be enough. Greater use of market mechanisms in combination with better regulation will enable us to meet these challenges effectively.

It is paramount that we begin to put the tools in place to meet these challenges now and seize the legislative opportunity that the Bill represents. Primary legislation for the water and sewerage sectors was last introduced four years ago. It would curtail significantly our ability to meet these challenges with the appropriate tools if we have to wait another four years for the next legislative opportunity and even longer to implement the legislation and resulting changes.

We believe that there is strong evidence from Professor Cave's independent review, the experience of Scotland and other utility sectors that introducing Cave's suggested reforms will help the Welsh Assembly Government deliver its water strategy, including sustainable and secure water supplies and an improved and protected water environment. There is a strong case for adding to the Bill clauses relating to the Cave review at the earliest opportunity, given the challenges that the sectors face.

The Walker review of household charges and metering

It is becoming increasingly important for companies to address the risks and uncertainties, such as:

- evolving customer choice;

- increasing levels of metering
- making sure bills represent value for money; and
- protecting vulnerable customers.

We believe that companies' future charges and charging mechanisms will become increasingly important in addressing these challenges.

This is why we are working with Defra and the Walker review team. This would enable the development of innovative tariffs, promote metering and enhance the companies' ability to manage customer debt to the benefit of the overall customer base. It will also facilitate the development and implementation of key policies highlighted in the strategic position statement, including adapting to climate change by encouraging water efficiency, controlling leakage and addressing any social policy in relation to vulnerable customers.

The interim report of the Government's independent review of water charges and metering, led by Anna Walker will be published shortly. It will address issues such as the structure and fairness of the current charging framework, and the future of metering for household customers. It is also expected to look at the issues of affordability and debt. We look forward to receiving the Walker report. We will consider its recommendations carefully and respond to the review in due course. We will share our response with the Committee.

Overview of the proposals covered by the draft Bill

Flood risk management and drainage proposals

Flooding has a significant impact on Wales. It causes about £70 million of damage and there are around 170,000 properties in Wales at risk of flooding. The summer 2007 floods demonstrates the need for the Bill to take an integrated approach to drainage and surface water management, consistent with the Government's water strategy on surface water drainage. We recognise that the sectors will need to contribute to that.

The Bill is an important part of the UK Government's response to Sir Michael Pitt's report on the summer 2007 floods. The Government accepted the recommendations and committed to taking action. The Bill addresses a number of the key recommendations. The Bill will also give effect to the flood risk management elements of the Welsh Assembly Government's environment strategy.

We support the Bill's aims to address the issue of responsibility for managing surface water management plans (SWMP) and SUDS. This includes having greater clarity on the roles and responsibility of the parties involved in surface water management. We also see keeping surface water out of the sewers and more sustainable ways of managing surface water as a key priority.

We support the Bill's overarching aim to consolidate the mechanisms necessary to address flooding and develop clear accountability for flood risk management. The Bill contains much that we agree with, in particular:

- the aim of achieving more use of SUDS;
- limiting the volume of surface water carried by sewers; and
- more holistic arrangements for managing flooding from surface water.

We believe, however, that the current clauses potentially expose water customers to unquantified costs for uncertain benefits. We also consider that the new powers for local authorities may circumvent and conflict with the framework for economic regulation of sewerage services, which safeguards the wider interests of all customers.

We are concerned about the Bill's potential impact on the:

- the duties and powers of the water and sewerage companies;
- our role as the economic regulator for sewerage services; and
- our aspirations to improve the water and sewerage companies' accountability in delivering cost-beneficial and efficient sewerage services to customers.

We are working with Defra, the Environment Agency and other stakeholders to resolve our concerns and to make sure that we all have a clear understanding of the way in which the bill proposals will operate in practice.

Water proposals in the draft Bill

The Bill includes proposals to update several areas of existing water legislation and reflect the vision in the Welsh Assembly Government's strategic policy statement.

We have developed proposals in consultation with stakeholders that have been included in the Bill and which we believe will benefit consumers in Wales:

Securing compliance

Enforcing compliance in a reasonable and transparent way is a key strand of Ofwat's strategy and is vital to protecting consumers.

Lessons learned from using our enforcement powers so far indicate that there are a number of technical limitations to our powers that the Bill could address quite simply. These changes would bring our powers in line with other regulators where appropriate. In considering additional legislation to deal with other issues - such as the development of competition - we also need to consider what checks and balances are in place and ensure that we have sufficient powers in place to take action where there are failures in compliance.

In light of our experience of using our enforcement powers, we have developed proposals to enhance our existing powers to better protect consumers' interests. We have worked with stakeholders and reviewed the approach and powers of other regulators to develop our proposals.

Large infrastructure projects

We have developed a new regulatory approach for delivering large projects. This is to facilitate the Government's decision on the Thames Tideway to avoid the risk of infraction and reduce potential costs to customers. Our objective is to ensure that customers, who will pay for large projects, get the best possible value for money.

Our aim for the Bill is to put in place the most efficient financing framework for large projects. This will allow Welsh Ministers to decide how these powers will apply in Wales.

Complaint handling

We propose changes to Ofwat's complaint handling powers to introduce new provisions for the most appropriate organisation to deal with complaints against water and sewerage companies. This will mean that customers in Wales will now be able to have their complaints dealt with effectively and efficiently.

Next steps

We will respond to the Bill consultation and will continue to work with Defra and other stakeholders on the development of the Bill.

Ofwat

June 2009