Northumbrian Water Group response to the Independent Commission on the Water Sector Regulatory System

Response to questions in the Call for Evidence

23 April 2025

Note: this response refers to six short papers that Northumbrian Water has submitted alongside the responses to these questions. These will also be made available on our website. These are:

- Regulating for the long-term: Asset Health;
- Regulating for the long-term: Catchment Management;
- Regulating for the long-term: Financial Resilience and Investability;
- Regulating for the long-term: Long-term Planning;
- Regulating for the long-term: Mitigating and Adapting to Climate Change, and
- Regulating for the long-term: Regulator Accountability.

Section 1: About You

Introduction

Questions 1-9 cover information that will be used for data management and processing. For further information about how personal and identifiable information will be used as part of this call for evidence, please see the programme privacy notice.

Confidentiality

The Independent Water Commission may publish the content of your response to this Call for Evidence in its interim and final reports. These reports will be publicly available, but your name and private contact details (e.g. email address) will not be included.

If there is any part of your response that you do not want to be published, please select 'Yes' below and specify which information should remain confidential along with your reasons.

Questions

Q1. Would you like your response to be confidential? (required)

No

Q2. If you answered yes, which information would you like to keep confidential and why? (optional)

N/A

Q3. Do you consent to being contacted by the Independent Water Commission about your response? (required)

Yes

Q4. If you consented above, please provide your full name. (optional)

Q5. If you consented above, please provide your email address. (optional)

regulation.postbox@nwl.co.uk

Q6. In what capacity are you completing this consultation? (required)

As a representative of a water company

Q7. What is the name of the organisation or interested group that you are responding on behalf of? (optional)

Northumbrian Water Limited

Q8. Where do you live? (required)

N/A

Q9. Where does your business or organisation operate? (required)

England

Section 2: Questions on Chapter 2 - Overarching Framework for the Management of Water

Introduction

We have one water system that is facing many pressures, competing demands and low levels of public trust. It requires integrated planning and coordination between different groups, and clear strategic direction from government on priorities and trade-offs.

The following questions seek views across the following five areas:

- Whether there is a need for further strategic direction to improve water planning, funding and implementation.
- Whether the geographical scales for planning and delivery in the water system are appropriate and provide sufficient accountability, including through democratic structures.
- Whether there should be an integrated water management framework to improve the management of the water system across sectors and outcomes.
- Whether the current environmental objectives and planning frameworks reflect the right outcomes and incentivise the action needed to deliver them.
- Whether the current water industry planning frameworks are effectively producing the desired outcomes, or whether changes could enable better planning in aid of delivery, at both a water industry, regulator and government level.

Water system outcomes

Understanding what society wants from the water system will help to inform the objectives that are pursued in future. As there are limited resources available across the water system, it is also important to understand how these objectives should be prioritised, and how trade-offs should be made between them.

Q10a. Thinking ahead to what you would like the water system to look like in the future (e.g. in 25 years' time), what outcomes from the water system are most important to you? (Please select your first priority here)

We have not included the core objectives of the water industry to provide a reliable supply of clean drinking water, and provide management and removal of sewage and wastewater, as we have assumed these are important. We would like your views on what further outcomes are most important to you.

*Please choose your **highest priority** (in addition to reliable supply of clean drinking water and management and removal of sewerage and wastewater) from the list below.*

☐Improved water environment (e.g. healthy habitats for aquatic plants and animals)

☐Resilient and reliable supply of water for businesses

☐Water bodies being safe for swimming and other recreational uses (e.g. kayaking, paddleboarding)

☐Wider public health outcomes (e.g. limiting anti-microbial resistance)

☐A water system which contributes to net zero

☐Resilience to climate change

☐Reduced flood risk

☐Limiting increases to water bills

☐Aesthetic qualities of water bodies (e.g. no litter or visible sewage residues)

☐Recreational access to 'blue' (water body) spaces

☐None

☐Don't know

☒Other (please specify)

If you selected other, please specify below

As a water company providing both water and wastewater services, our priority is to deliver against all of our legal obligations. It is therefore imperative for us that the government, EA, Ofwat, DWI, Natural England, ourselves and other stakeholders work together to ensure both that our legal obligations reflect the expectations of our customers and society and the needs of the environment. And these decisions must not be made in isolation, but in the context of ensuring that we are provided with sufficient funding to deliver against the broad range of objectives while ensuring bills are affordable for current and future customers.

We have set Our Purpose in this context, informed by active engagement with our customers and stakeholders. Our purpose is:

> Caring for the essential needs of our communities and environment, now and for generations to come. We do this by providing reliable and affordable water and wastewater services for our customers. We make a positive difference by operating efficiently and investing prudently, to maintain a sustainable and resilient business.

As part of our ongoing engagement and bespoke engagement to inform our business plan development, we seek views on the priorities of our customers and will continue to reflect these into our future plans.

Q11a. To what extent do you believe the overall water framework already delivers the outcome you chose as your highest priority?

☐To a great extent
☒To some extent
☐Very little
☐Not at all
☐Don't know

Q10b. Thinking ahead to what you would like the water system to look like in the future (e.g., in 25 years time), what outcomes from the water system are most important to you? (Please select your second priority here)

*Please choose your **second highest priority** (in addition to reliable supply of clean drinking water and management and removal of sewerage and wastewater) from the list below.*

☐Improved water environment (e.g. healthy habitats for aquatic plants and animals)

☐Resilient and reliable supply of water for businesses

☐Water bodies being safe for swimming and other recreational uses (e.g. kayaking, paddleboarding)

☐Wider public health outcomes (e.g. limiting anti-microbial resistance)

☐A water system which contributes to net zero

☐Resilience to climate change

☐Reduced flood risk

☐Limiting increases to water bills

☐Aesthetic qualities of water bodies (e.g. no litter or visible sewage residues)

☐Recreational access to 'blue' (water body) spaces

☐None

☐Don't know

☒Other (please specify)

If you selected other, please specify below

See response to 10a.

Q11b. To what extent do you believe the overall water framework already delivers the outcome you chose as your second highest priority?

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don’t know

Q10c. Thinking ahead to what you would like the water system to look like in the future (e.g., in 25 years time), what outcomes from the water system are most important to you? (Please select your third priority here)

*Please choose your **third highest priority** (in addition to reliable supply of clean drinking water and management and removal of sewerage and wastewater) from the list below.*

☐Improved water environment (e.g. healthy habitats for aquatic plants and animals)

☐Resilient and reliable supply of water for businesses

☐Water bodies being safe for swimming and other recreational uses (e.g. kayaking, paddleboarding)

☐Wider public health outcomes (e.g. limiting anti-microbial resistance)

☐A water system which contributes to net zero

☐Resilience to climate change

☐Reduced flood risk

☐Limiting increases to water bills

☐Aesthetic qualities of water bodies (e.g. no litter or visible sewage residues)

☐Recreational access to ‘blue’ (water body) spaces

☐None

☐Don’t know

☒Other (please specify)

If you selected other, please specify below

See response to 10a.

Q11b. To what extent do you believe the overall water framework already delivers the outcome you chose as your third highest priority?

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don’t know

Management of water

The Commission has heard while there have been efforts by the UK and Welsh governments to create plans and strategies with a long-term, holistic view of water planning and management, these appear to have limitations. These plans and strategies do not appear to communicate a holistic view of the outcomes society wants and expects from the water system. The Commission is interested to know what is and isn't working well in the strategic management of the water system, and how it could be improved.

The range of sectors that depend and impact on the water system, like local and regional governments, transport organisations, landowners, farmers, businesses, water companies, regulators, and others, do not seem to be consistently coming together to make decisions. While water planning and decision-making occurs at local, regional, and national levels, the Commission has heard that there is a lack of coordination, funding, and accountability at local and regional levels which makes it difficult to realise objectives. The Commission is considering where responsibilities for managing the water system should sit, and which authorities should lead on this management.

Q12. Who do you believe should be responsible for making decisions about what outcomes to prioritise from the water system?

When thinking about who should be responsible, you may want to consider the UK Government (in England) and Welsh Government (in Wales), local authorities, mayors, independent regulators (including the existing regulators, and/or new ones), water companies, and others.

This is not intended to be an exhaustive list. Apart from the above, please think about other bodies you consider to be relevant.

Responsibility for decision making should sit in different places for different outcomes. For example, resilience standards – and therefore the outcomes that should be delivered in relation to resilience – should be developed and implemented at a national level. The overall objectives for national or global environmental issues, such as addressing anti-microbial resistance and delivery of Net Zero should also be set at a national level, although the approach to delivery of these objectives could be set at a regional or local level. See 'Regulating for the long-term: Mitigating and Adapting to Climate Change' and 'Regulating for the long-term: Long-term Planning' for further information.

Under the current system where customer bills depend on the company that serves them, the service level that customers receive should be informed by the preferences of the customers of each company. It must be the case that the customers have a voice in setting the service levels they receive and the bills that they will pay.

We consider that some decision-making authority on local environmental outcomes should be delegated to local stakeholders. This could be achieved through the creation of a funding pot within the WINEP for local environmental projects, the spending of which is directed by local groups, as discussed further in 'Regulating for the long-term: Catchment Management'.

Q13. Do you believe there should be changes to roles and responsibilities for water management across local, regional and national levels?

When thinking about roles and responsibilities for water management, you may want to consider setting targets, engagement with customers and the public, planning, decisions on funding, delivery, monitoring, enforcement and managing trade-offs with other sectors.

☐No changes are needed

☒Changes are needed

☐Don't know

If you selected changes are needed, please explain below. Consider how you believe roles and responsibilities should be better organised across local, regional, and national levels, including who you believe should be the lead authority at each level and why.

A number of different models could be implemented that would create a greater role for local decision makers. The model that is needed is likely to depend on the capacity and capability of local stakeholders to engage and so a 'one size fits all' approach is unlikely to be successful. For example, in our Northumbrian region, we have long-running partnerships with local authorities and other decision makers through the Northumbria Integrated Drainage Partnership (NIDP) to support co-delivery of drainage schemes.

We also have a separate Thriving Catchments scheme to coordinate catchment level schemes to for example improve rover water quality.

And we work with local stakeholders to deliver our Bluespaces program to improve amenity and access to the water environment. Each of these arrangements serves a different function and it is likely that different arrangements will be needed in different parts of the country to reflect different needs.

Q14. Do you believe changes are needed to help reduce the siloed approach to water management across different sectors? If so, what changes do you believe would be beneficial? *(Please select up to 5 options)*

☐No changes are needed

☐Government providing clearer national strategic direction and targets on water

☐A national scale systems planning authority*

☐A regional or catchment scale systems planning authority*

☒Streamlining or aligning existing water plans and planning processes across the water system

☒Increasing the status of water plans to influence other sectors (e.g. farmers, businesses, planning and development)

☒Streamlining or aligning water management planning and other plans such as flood risk plans, local nature recovery strategies, and local plans for development

☐Aligning water management with democratic structures**

☒Pooling together existing funding streams at a spatial level***

☒Changes to how regulators regulate sectors involved in the water system (e.g. through monitoring, advice, enforcement, etc.)

☐Don't know

☐Other (please specify)

* Where options refer to a '**systems planning authority**', this refers to an authority which could act as a central planning authority, deciding on the best actions for the water system.

****'Aligning water management with democratic structures'** would involve providing local or regional governments with responsibility for managing the water system in their area of responsibility.

*****'Pooling funding at a spatial level'** would involve bringing together sources of funding from different sectors at that spatial level. This could include funding from the water industry, agricultural and transport sectors, local or regional governments and others. This could allow funding to be targeted towards areas in which it would have the greatest overall impact on the water system, irrespective of which sector it came from.

If you selected other, please specify below

Q15. Do you believe there are barriers to money being spent more effectively and efficiently across different sectors to deliver the best outcomes for the water system? If so, what do you believe are the key barriers? *(Please select up to 3 options)*

When responding, please think about how money is spent in the water system now (e.g. money spent separately by different sectors, possible reliance on water industry investment etc.), and if and how it could be spent more efficiently in future.

☐There are no key barriers

☐Limitations of evidence on costs and benefits (including co-benefits, such as wider environmental or ecological outcomes)

☐Unclear targets and objectives

☒Limitations of understanding of the full set of pressures (e.g. which sector is responsible for a pollution source)

☒Limitations of alignment of existing funding pots (e.g. water company investment, agri-environment schemes, government funding for Catchment Partnerships)

☒The scale at which actions are developed (e.g. actions are developed at too large or too small a scale, lack of spatially targeted actions)

☒Planning timelines (e.g. timelines misaligned, too long, or too short)

☐The monitoring and classification system (e.g. how the quality of water bodies is assessed)

☐Barriers to partnership schemes (e.g. joint maintenance agreements, collaboration across sectors)

☐Don't know

☒Other

If you selected other, please specify below

The only sector with committed long-term funding for improvements to the water environment is the water industry. Organisations responsible for urban drainage have no long-term funding committed to improve drainage functions to remove the impact of urban drainage. The agriculture sector similarly does not have a committed programme of improvements at a specific catchment scale, despite there being significant public spending in the sector through for example the ELMS. Businesses have no committed programme of improvements for upgrading EPR permits.

The EA's focus is solely on regulating the water industry, despite the agricultural sector causing the largest impacts to WFD status across waterbodies. We consider that the regulatory system should aim to address environmental issues arising from all sectors that stop water bodies from achieving good ecological status.

Q16. In your opinion, is it more important that regional water system governance aligns with hydrological or local government boundaries?

The Water Environment (Water Framework Directive) (England & Wales) Regulations 2017 (referred to as the WFD Regulations) provide a framework for managing the water environment in England and Wales.

Planning under the WFD Regulations currently aligns with hydrological boundaries, such as river basins or catchments. This reflects the natural flow of water bodies and their

environment but means that there is no existing democratic structure aligned to these plans to support and enforce their implementation.

Local government structures (such as district councils, unitary or combined authorities, and mayoral authorities) have democratic accountability and are linked into broader planning structures (such as town and country planning).

The final option, 'Welsh government boundaries', is available to those who live in Wales or have a business of organisation that operate in Wales.

☒Hydrological boundaries (e.g. water catchments, river basin districts)

☒Local government boundaries (e.g. strategic authority, district councils, combined authorities, and mayoral authorities)

☐Don't know

☐[For Wales Only]: Welsh government boundaries

Management of the water environment

In England and in Wales, the Water Framework Directive Regulations (WFD) currently provide the overarching statutory framework for the water environment. Other regulatory frameworks, such as the Urban Waste Water Treatment Regulations 1994 and the Bathing Waters Regulations 2013, also drive action in the water environment. However, the WFD provides the overarching target condition for the water environment and the framework for achieving it.

Under the WFD Regulations, a River Basin Management Plan must be prepared for each river basin district. The plan includes environmental objectives and a summary of the programmes of measures required to achieve those objectives. The current River Basin Management Plans were published in December 2022.

The WFD requires governments to 'aim to achieve' Good Ecological Status (GES) for all surface water bodies by 2027. There is no published plan in place for these objectives beyond 2027. While the regulations implementing the WFD will not stop applying after 2027, they do not provide for a scenario beyond 2027. The UK and Welsh governments will need to decide what, if anything, should follow this objective after 2027.

Q17. Do you believe changes are needed to the WFD Regulations, including for 2027 onwards? If so, which areas would benefit the most from change? *(Please select all that apply)*

This could include, for example, strengthening, streamlining or clarifying the Regulations.

☒No changes are needed

☒The targets and objectives (e.g. 'Good Ecological Status' water body objectives, the designation of Artificial and Heavily Modified Water Bodies, the deadlines for achieving environmental objectives, the scale at which objectives are set and applied)

☒River Basin Management Plans (e.g. spatial coverage, scope, the length of the planning cycle, the programmes of measures)

☒The classification system (e.g. chemicals, ecological, groundwaters)

☒The way economic evidence is considered (e.g. cost benefit appraisals of actions, use of economic analysis to justify exemptions)

☒The monitoring system (e.g. the evidence base, the use of technology, data sharing for monitoring, reporting)

☒Governance and accountability (e.g. the duties of governments and organisations)

☒Public participation and engagement (e.g. through consultations, delivery and investment planning)

☐Don’t know

☒Other

Q18. If you feel the WFD Regulations would benefit from change, please expand on where you feel changes are necessary and the reasons why.

We do not consider the WFD needs to change in terms of legislation and policy, however it does need to be enacted effectively, including by giving other authorities responsibility through planning requirements to ensure objectives are met for each waterbody, including input into setting the objectives, and timescales. For example, there is no statutory requirement for Local Authorities and Combined authorities to assess the impact of growth in planning applications on the delivery of the WFD.

We consider that water bodies would be better protected if there were bespoke measures for other sectors.

Further monitoring of water bodies for classification and investigative purposes would also provide better data to inform WFD interventions.

Measuring and assessing the water environment

The WFD Regulations currently drive water body monitoring in England and Wales. A range of chemical, biological and physical elements of water bodies are measured, and these measures are combined to classify water bodies. Their ecological status is classified as high, good, moderate, poor or bad. This classification is an indication of water body health, which is often used to report on the state of the water environment. Classification is produced at a water body scale.

We are interested in your views on whether this measurement framework provides the right data for informed decision-making on the water environment and how this data can be collected and collated in a more cost-effective way.

Q19. Do you believe changes are needed to improve how we monitor and report on the health of the water environment? If so, what changes do you believe could lead to improvements? *(Please select all that apply)*

☐No changes are needed

☐Using statistical modelling for state of environment reports (reducing monitoring inputs)

☐Reporting on wider outcomes than ecological status (e.g. public health)

☐Use of citizen science

☐Data sharing platforms for government and third-party evidence/data

☐Expanding out from the water body level to report on a whole catchment

☐Full or partial integration with wider environmental/water monitoring

☐Don’t know

☒Other (please specify)

If you selected other, please specify below

Your statement for the question is incorrect (not accurate). Monitoring in the UK is not based on WFD; this changed in 2021 to a new methodology which requires at least 10 years' worth of data to detect changes and draw conclusions of pressures in the water environment. The EA has significantly reduced any monitoring done under WFD since 2016.

Other data sources could be used to assist with classification, and more importantly investigative sampling to identify pollution sources by 3rd parties could be more effective. However, this does need to be designed and overseen by a central body, either the EA, or if this was not considered viable for political reasons, a new body. Whichever body was chosen to fulfil this role would also need to carry out the monitoring role currently done by the EA for consistency purposes.

We also consider it would be valuable to report on improvements to water bodies within classifications. Currently there is limited transparency about the amount of improvement that has occurred as if a water body fails any criteria for a particular status, it cannot be classes as improved. While there are sensible reasons for doing this, the unintended consequence is that any one failure will result in no change in classification, meaning that headline statistics on the number of water bodies achieving good status have stagnated despite significant improvements across a number of metrics.

The starkest example of this is modified water bodies. Because of the engineered nature of these water bodies (where government policy is usually not intended to remove modifications) these can never achieve good ecological status. But valuable improvements can be made in modified water bodies and this should be reflected in an alternative classification for these.

Strategic direction for the water industry

Q20. What role do you believe the government can play in providing strategic direction for the water industry?

By 'strategic direction' we mean, for example: the Strategic Policy Statement / the Strategic Priorities and Objectives Statement; Government targets (e.g. in the Environment Act 2021 and the Plan for Water in England only); the Price Review Forum (Wales only). This is not an exhaustive list.

The existing Strategic Policy Statement (SPS) set by Defra currently gives Ofwat a lot of leeway to regulate how it sees fit. There is a balance to be struck here, as a strong independent regulator is an important part of the way that water regulation is intended to operate. An independent regulator should in theory be able to take a longer-term view than one that is responding to the shorter-term goals of elected politicians. However, Ofwat has struggled to act in the long-term interest of customers and the environment to the detriment of the sector – in particular in relation to asset health investment and the lack of a clear approach on how to delivery Net Zero.

It is important therefore to ensure that strategic direction is set for the long-term for the sector. The 25 year environment plan for example does this for some aspects of environmental delivery. Strategic direction on other issues such as resilience standards is also needed.

We set out recommendations on how the SPSs for Ofwat and the future ones planned for other regulators could usefully set the strategic direction for the sector in the papers attached to this response. Please see 'Regulating for the long-term: Regulator Accountability', 'Regulating for the long-term: Asset Health', 'Regulating for the long-term: Mitigating and Adapting to Climate change', 'Regulating for the long-term: Financial Resilience and Investability', 'Regulating for the long-term: Long-term Planning' and 'Regulating for the long-term: Catchment Management' for further details and our recommendations.

Q21: What changes, if any, should be made to how the government provides strategic direction for the water industry?

☐No changes are needed

☒Changes are needed

☐Don't know

If you selected that changes are needed, please describe what changes you feel are needed and why.

The challenge for the government in setting a strategic direction for the industry is that the water sector is large, complex and is responsible for a broad range of societal objectives. What is more the breadth of the sector means that there a large number of disparate stakeholders with different priorities and means to contribute to those objectives.

This has resulted quite naturally in different initiatives, targets and planning approaches being created to focus on individual issues without necessarily brining it all together at an industry or (broader) sector level. Pragmatically this may well need to continue to be the case. But the more that can be done to bring together a single vision for the sector with a clear hierarchy of priorities the better. This relates in particular to how strategic direction and targets are set to inform the water industry's long-term planning activities – see 'Regulating for the long-term: Long-term Planning'.

Q22. Do you believe there are barriers to effective long-term water industry planning? If so, what factors do you believe are preventing effective long-term water industry planning? *(Please select all that apply)*

We are interested in understanding the factors that limit effective planning within the water industry to meet its duties and deliver its functions both now and in the future.

When thinking about planning, please consider price review business planning, drainage and wastewater management plans, water resources management plans and planning as part of the water industry national environment programme (in England) or National Environment Programme (in Wales).

☐There are no barriers to effective long-term planning

☐Limited clear guidance from UK and Welsh Governments on priorities and how to manage trade-offs.

☐Limited timebound, specific and measurable targets (e.g. for water outcomes such as water quality and water supply, or wider outcomes such as net zero, nature-based solutions, circular economy).

☒Regulators are not adequately supporting effective planning (e.g. through guidance, scrutiny)

☐Unclear what duties and functions other stakeholders (e.g. local authorities) are expected to deliver to contribute to plans.

☒Issues with data and assumptions (e.g. inconsistent or inadequate scenarios and assumptions across plans, data on asset performance not adequately collected).

☐Engagement with customers and environmental or local groups (e.g. too much engagement, too little, engagement is not meaningful, engagement is not local)

☒Regulatory requirements don't support sufficient long-term certainty or respond well to emerging issues/policy changes

☒Plans don't interact well together (e.g. duplication, decisions/timelines/asks conflict, and/or decisions aren't sequenced in the right order across plans).

☐Don't know

☐Other – please specify below

If you selected other, please specify below

Q23: What changes, if any, would help water companies to use planning frameworks more effectively to fulfil their duties and deliver their functions?

Timely guidance from regulators is needed to ensure all important factors can be taken into account in strategic planning frameworks. For example, delays in WINEP guidance at PR24 meant significant late changes were needed to our environmental investment plans and hence our business plan late in the process.

Alignment of strategic planning framework timetables so that plans can be developed in a mutually supporting sequence.

Alignment of key assumptions across planning frameworks would enable better integration across planning areas.

Assessment to ensure that long-term planning frameworks cover the full range of long-term priorities for the water sector.

See ‘Regulating for the long-term: Long-term Planning’ for further information.

Section 3: Questions on Chapter 3 – The Regulators

Introduction

The water industry is responsible for providing clean drinking water and collecting and treating wastewater. This ensures the protection of public health and the environment. The regulatory model is designed to oversee water companies to ensure they deliver statutory requirements and government policies and targets. The regulatory model is made up of organisations including:

- The Environment Agency (EA) in England and Natural Resources Wales (NRW) in Wales - the principal environmental regulators
- The Drinking Water Inspectorate - the drinking water regulator who ensures the quality and sufficiency of public drinking water supplies
- Water Services Regulation Authority (Ofwat) – primarily the economic regulator who ensures consumer interests are protected, and that water companies properly carry out their statutory functions and are financed to do so.

The current regulatory model has evolved over time driven by changing public expectations in relation to the environment and concerns about the performance of water companies.

The commission is seeking views on potential changes to the overarching regulatory model. This includes but is not limited to:

- Whether it is necessary to review the respective statutory duties and responsibilities of regulators
- Whether government guidance to the regulators should be strengthened
- Whether new or expanded regulatory coordination mechanisms could be introduced
- Whether it is necessary to review the capability and funding arrangements and of the regulators
- Any views on options around merging regulators or establishing new authorities

Q24: How would you rate the performance of the water regulatory framework?

☐Performing very well

☐Performing well

☐Performing averagely

☒Performing poorly

☐Performing very poorly

☐Don’t know

Q25: To what extent do water regulators coordinate effectively in the regulation of the water industry?

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don’t know

Q26: What changes, if any, do you consider are needed to the framework of water regulators to improve the regulation of the water industry? Please consider both potential benefits and costs of any proposed changes.

Please answer and explain below, providing supporting examples or evidence, where possible

As set out in the papers attached to this response, we do not consider that the framework of regulators (in as much as who the regulators are) needs to be significantly changed. However, we do consider that the roles and responsibilities of the regulators, particularly in relation to setting guidance and in long-term planning and decision making needs to be clarified. We also consider that the accountability of the regulators could be strengthened – in particular for Ofwat – but that this needs to be done while preserving the independence of regulators.

Please see 'Regulating for the long-term: Regulator Accountability', 'Regulating for the long-term: Asset Health', 'Regulating for the long-term: Mitigating and Adapting to Climate change', 'Regulating for the long-term: Financial Resilience and Investability', 'Regulating for the long-term: Long-term Planning' and 'Regulating for the long-term: Catchment Management' for further details and our recommendations.

Q27: To what extent do you think the water industry regulators have the capacity, capabilities and skills required to effectively perform their roles?

Please provide information to support your views on the capacity and capability of regulators, including, where possible, supporting evidence and examples (max 500 words)

The Environment Agency does not have the capacity – number of people – to deliver what it needs to. In PR24 the EA repeatedly delivered guidance documents and decisions later than needed to inform the price review process. For example Northumbrian Water received a decision about interventions to address nutrient neutrality within weeks of the business plan submission deadline (2 October 2023), several months after this could meaningfully have been taken into account in the business plan. Earlier in the process, guidance documents for a large number of WINEP drivers where also delivered late. This is likely to be explained by a lack of appropriate resource, but may also be affected by insufficient governance around producing this guidance in a timely manner.

Ofwat's resource requirements depend on the complexity of the regulatory regime it designs. As it keeps making the regime more complex (See 'Our reflections on lessons learnt from PR19', Ofwat, December 2020, pp. 5, 11, 99-107.) it may or may not have the resources it considers it requires, but this is at least in part within its own control.

Where Ofwat is lacking capability is in the technical areas of its core expertise of economic regulation. In particular, it does not have the engineering expertise to develop a roust approach to asset risk management in house, which is why we recommend that this is developed by a third party. (See 'Regulating for the long-term: Asset Health'.)

We also consider that Ofwat does not have the necessary expertise in carbon assessment, accounting or management needed to drive the sector forward. The approach adopted at PR24 was limited, and evidence from companies' own plans shows that the sector is not on track to deliver the reductions in greenhouse gas emissions needed to keep on track to reach Net Zero. To some extent this is not surprising; Ofwat as the economic regulator should be able to rely on the Environment Agency (and NRW in Wales) to make the case for managing greenhouse gas emissions. But the Environment Agency's risk averse approach to other local environmental issues means that it is focused on end-of-pipe solutions rather than balanced outcomes including on Carbon. We discuss this further in 'Regulating for the long-term: Mitigating and Adapting to Climate Change'.

Section 4: Questions on Chapter 4 - Economic regulation

Introduction

The provision of water and wastewater services is, in the main, a natural regional monopoly, in which the scope for competition is very constrained. Economic regulation is in place to prevent any abuse of monopoly powers, such as high costs and poor service, and to incentivise the investment the water system requires.

Ofwat's Price Review process is intended to substitute for competition in the water sector. This is composed of 3 key building blocks: setting base and enhancement cost allowances for the amount water companies may spend; setting the Weighted Average Cost of Capital (WACC); and setting additional performance incentives e.g. Outcome Delivery Incentives (ODIs) and Price Control Deliverables (PCDs).

The following questions explore how effective Ofwat's economic regulatory measures are and what changes could be made to enhance their effectiveness in delivering core outcomes for the supply of drinking water and managing wastewater, as well as broader environmental, public health and economic growth outcomes.

When answering these questions, please provide supporting examples or evidence, where possible.

Q28. To what extent do you think the economic regulatory framework is delivering positive outcomes?

☐To a great extent

☐To some extent

☒Very little

☐Not at all

☐Don't know

Q29. How do you think the Price Review process should balance the need to keep customer bills low with the need for infrastructure resilience? (*Infrastructure resilience is the ability of an organisation's infrastructure, and the skills to run that infrastructure, to avoid, cope with, and recover from disruption in its performance*)

Please answer and explain below, providing supporting examples or evidence, where possible

Ofwat was given the resilience duty in the Water Act (2014). However, this has not had the desired effect of significantly increasing the resilience of the sector. As we argue in 'Regulating for the long-term: Asset Health', a new approach is needed to managing asset risk. This is going to cost customers more. And as can be seen from water company Long-term delivery strategies, this forms one part of an overall picture of rising bills for at least the next 25 years. In some scenarios we estimate that by 2050 combined water and wastewater bills could be as much as 4.3% of the median income in the North East – meaning a significant proportion of the population would move into water poverty under most definitions. (See 'Shaping our future: Out long-term strategy 2025-50', Northumbrian Water, October 2023, pp.117-118.)

To avoid pushing more people into water poverty we will need to do three things. The first is to deliver only those investments that are needed, and to do so in the most efficient way. This will require a detailed understanding of resilience requirements and the setting of resilience standards. See 'Regulating for the long-term: Asset Health' for more information.

The second is to engage with customers and other stakeholders to change the narrative around the cost of water and wastewater services. In the same way that consumers don't consider paying more for an iPhone than a landline to be pushing them into 'telecoms poverty' we need to show that the investments we are making water and wastewater services more valuable, and therefore worth paying more for.

The third thing is to ensure that the lowest income customers are not left behind. The sector needs to provide support for customers to ensure no customer is left in water poverty – recognizing that the definition of water poverty may need to adapt as the value of the service increases as discussed above. A national social tariff would be an effective way of ensuring that all customers with low incomes are protected.

Q30. What, if any, changes could be made to the Price Review process to better enable the water industry to deliver positive outcomes?

Please answer and explain below, providing supporting examples or evidence, where possible

We consider that changes are needed to the price review process across a range of areas to deliver positive outcomes. Please see ‘Regulating for the long-term: Regulator Accountability’, ‘Regulating for the long-term: Asset Health’, ‘Regulating for the long-term: Mitigating and Adapting to Climate change’, ‘Regulating for the long-term: Financial Resilience and Investability’ and ‘Regulating for the long-term: Catchment Management’ and ‘Regulating for the long-term: Long-term Planning’ for further details and our recommendations.

Q31. What, if any, changes could be made to the Price Review process on assessing and setting base expenditure to effectively support infrastructure maintenance?

Please answer and explain below, providing supporting examples or evidence, where possible

Please see ‘Regulating for the long-term: Asset Health’ for our recommendations on how to improve the assessment of risk from assets and how to effectively fund their maintenance.

Q32. What, if any, changes could be made to the Price Review process on assessing and setting enhancement expenditure to effectively support infrastructure improvements?

Please answer and explain below, providing supporting examples or evidence, where possible

The principle of assessing enhancement expenditure through a combination of comparative models and deep dives is reasonable. However, this has to be done in a sensible way – using comparative models where projects really are comparable across companies (such as water quality monitors) and not where projects are very different (such as phosphorus reduction schemes). Similarly, deep dives should not just seek to cut costs or scope, but instead seek to establish the right efficient costs to deliver projects in practice. We would expect Ofwat to be able to improve on and learn from the PR24 approach.

In some cases, where investment is not driven by specific statutory requirements, nationally set standards could help. For example, on climate change adaptation there are no clear standards or expectations on water companies – and so Ofwat struggles to understand and accept the need for this type of investment (or where it accepts this is needed, it is not clear how far this resilience should go). This is much easier with standards – for example, the requirement in water resources planning to ensure that water supplies are sufficient to meet a 1-in-500 year drought. Ofwat is not the right place to make such policy decisions, and this is perhaps why it feels uncomfortable doing so. Some of these issues could be addressed by independent technical experts setting resilience standards for the sector, including for weather related risks impacted by climate change, as discussed in ‘Regulating for the long-term: Asset Health’.

Q33. What, if any, changes could be made to the Price Review Process on assessing and setting the Weighted Average Cost of Capital (WACC) to effectively attract investment in the water industry?

Please answer and explain below, providing supporting examples or evidence, where possible

We consider the issue of investability to be key to securing financial resilience and the long-term investment needed to deliver the ambitions for the sector. We explore this issue in ‘Regulating for the long-term: Financial Resilience and Investability’.

To attract the debt & equity to finance the future investments will require Ofwat to benchmark and set WACC to ensure expected returns are competitive against the alternative investments in equity across other sectors (e.g. energy networks, infrastructure projects), both UK and overseas. Ofwat’s approach to date has only focused on the specific WACC parameters of the water industry, with too little attention paid to the alternatives for infrastructure investors, in what is a competitive market to attract investment.

Q34. What, if any, changes could be made to the Price Review process on assessing and setting performance incentives to effectively secure infrastructure delivery? *This could be across Outcome Delivery Incentives (ODIs) to effectively deliver for customers, the environment and public health; and/or across Price Control Deliverables (PCDs), for example*

Please answer and explain below, providing supporting examples or evidence, where possible

The key issue with setting performance commitments, is that historic performance is not always representative of the future performance. This is particularly so, when performance moves closer to 100%, or 0, for example the number of internal flooders or minutes lost in relation to interruptions to supply over 3 hours. Simply applying a linear line to historic trends will overestimate future improvements. A logarithmic trend is more likely to be closer to future performance. Further to this, the setting of costs to achieve future performance, particularly as performance reaches 100% needs to take into account the most likely exponential costs it could take to achieve the last bit of performance. For example, companies may have single internal flooders who are far removed from being cost effective to remove the risk of flooding. These outliers need to be accounted for when setting cost allowances and performance metrics.

Customer bills

Customers need to know that their bills are acceptable, particularly for the most vulnerable in society. It is the responsibility of Ofwat to ensure the interests of customers are appropriately balanced with the needs of the water companies to be able to properly finance their functions. They do this through the Price Review process, where water and sewerage charges are set for 5-year periods.

Bills have reduced by 15% in real terms since 2014-15[1], however, the need for increased investment in infrastructure will result in larger bills over the period of Price Review 2024. These increases come at a time of declining public trust and satisfaction in water companies. There is also a regional variation in bills, with customers paying differing amounts for their water, depending on where they live. Whilst most households have a water meter and therefore pay for the water they use, a significant minority do not.

The Commission is seeking views on potential changes in relation to the fairness of water bills. This includes, but is not limited to:

- Improving transparency for customers to help improve trust, for example, by explaining how the money from bills is used by water companies and how bills are set.
- Increasing the use of smart water meters to help customers better understand their water usage and improve water efficiency.
- Exploring innovative water charging to support affordability and/or efficient use of water.

Q35. **To what extent does the economic regulatory framework deliver acceptable water bills for customers?**

(Please select one)

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don't know

Q36. **What, if any, changes would help ensure customers are paying fairly for the water they use?** *(Please select all that apply)*

[1] Ofwat bills data provided directly to the Independent Water Commission. The reduction is calculated between 2014-15 and 2022-23

☐No changes are needed

☐Improve transparency for customers on how money from bills is used

☒Increase the use of smart water meters

☒Explore innovative water charging (such as rising block tariffs or other innovative tariffs) to support affordability and/or efficient use of water.

☐Don’t know

☐Other (please specify)

If you selected other, please specify below

Customer protections

Customers also need to know that they will receive a good level of service in return for their money. Whilst the provision of an uninterrupted supply is a key expectation of customers, they also expect clear communication, the quick resolution of problems, and accurate billing.

In addition, there are a wide range of customers who may require financial or practical support from their water companies. This could include households with people of pensionable age, someone who is pregnant or has young children, people with a mental health condition or a disabled person, have difficulty in communicating, and those on low-income. Despite some recent improvements, the awareness and take-up of the various initiatives to support these customers remains low.

The commission is seeking views on potential changes in relation to customer protections on service provision and support for vulnerable customers. This includes but is not limited to:

- Ensuring that customer matters are investigated and, where necessary, enforcement action taken, to incentivise water companies to improve their service provision.
- Increasing the accountability of water companies' handling of complaints to drive an improved experience for customers.
- Introducing a single social tariff for England and Wales with the aim of providing a fair, consistent and sustainable support for customers who struggle to afford their water bill.
- Ensuring that water companies proactively offer support to customers who may be eligible.

Q37. To what extent does the regulatory framework protect customers from poor service?

(Please select one)

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don't know

Q38. To what extent does the regulatory framework ensure that vulnerable customers are effectively supported?

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don't know

Q39. **What, if any, changes to the regulatory framework would better incentivise water companies to deliver and maintain high customer standards?** *(Please select all that apply)*

☐No changes are needed

☐Ensure customer matters are investigated and, where necessary, enforcement action taken.

☐Greater accountability for water companies' handling of complaints.

☐Don't know

☒Other (please specify)

If you selected other, please specify below

In considering what changes could be made to better incentivise companies to perform well and maintain the high standards, we need to take account of the costs to the customer. Investigations, data collection etc. all take time from individuals in the company that reduce the time those individuals have to get on with the job of improving performance. Clearly investigations are necessary to ensure companies are undertaking the job correctly. One thought is to perhaps take a longer view of regulation, currently the view is relatively short term with the focus on 5-year periods, where companies are incentivised to target those measures with greatest benefit - and this often comes at the expense of other areas.

Q40. What, if any, changes to the regulatory framework would improve support for customers in vulnerable circumstances? *(Please select all that apply)*

☐No changes are needed

☒Introduce a single social tariff for England and Wales.

☐Ensure a proactive approach by water companies in identifying customers eligible for additional support

☐Don’t know

☐Other (please specify)

If you selected other, please specify below

Financial resilience

Financial resilience is the ability of companies to weather shocks to capital structure, spending, revenue and liquidity. Some companies are experiencing challenges today with financial resilience.

A range of factors influence water company financial resilience. Companies appear to have been hit by recent cost pressures from inflation and regulatory fines. Historical decisions taken by water companies about debt levels also appear to have played a role in current challenges. The evidence on the relationship between debt raised and investment delivered is complex and contested.

The Commission is seeking views on potential changes to support water company financial resilience. This includes, but is not limited to:

- Changes to the Price Review process to support financial resilience
- Changes to the regulatory approach to companies' debt levels
- Changes to financial oversight, including a more supervisory approach
- Changes to the way in-distress companies are managed (for example, providing the water regulators additional discretion over how penalties are issued)
- Changes to the Special Administration Regime (for example, Ofwat providing guidance on SAR thresholds)

Q41. To what extent is change required to the economic regulatory framework to support water companies' financial resilience?

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don't know

Q42. Which of the following changes to the economic regulatory framework, if any, would improve outcomes for the water industry? *(Please select all that apply)*

☐No changes are needed

☒Changes to the Price Review process to support financial resilience

☐Changes to the oversight of water company debt (for example, 'capping' company debt levels)

☐Changes to financial oversight of companies (for example, moving to a more supervisory model as defined in the Call for Evidence)

☐ Changes to the way in-distress companies are managed (for example, providing the water regulators additional discretion in their enforcement regime)

☐ Changes to the Special Administration Regime (for example, providing guidance on the thresholds for the SAR)

☐Don't know

☐Other (please specify)

If you selected other, please specify below

Q43. Do you think there is evidence on the historical relationship between debt, dividends, and expenditure at water companies that the commission should be looking at?

Please answer and explain below, providing supporting examples and evidence, where possible.

On debt, average water sector gearing has fallen over 2015-24 and has remained stable within a 5% range of 67%-72% throughout. Analysis indicates that this represents an efficient range supported by comparisons with infrastructure project finance.

With respect to dividends the evidence does not support the broad public perception of excessive dividends. Sector dividends have been declining over the last 9 years and have reached the point where almost half the sector is not paying a dividend at all. The average sector dividend yield for the last 9 years (2015-24) is 5.4%.

In terms of investment, over 2015-24, the industry has spent over £4.5bn more than the level assumed in Price Reviews, which suggests that it is the level of regulatory expenditure allowance rather than industry underspending that has been the key challenge for the industry.

[Data extracted from Ofwat MFR & WCP reporting 2015-24: https://www.ofwat.gov.uk/regulated-companies/resilience-in-the-round/monitoring-financial-resilience/ & https://www.ofwat.gov.uk/regulated-companies/company-obligations/outcomes/

Whilst there may be examples of higher sector dividends from 10-20 years ago, it does not seem to us to be constructive to revisit these in retrospect. Ofwat have recently introduced licence conditions that require dividends to be explicitly linked to performance, which would deals with any perception of excessive or unearned dividends.

We therefore believe that the most useful way to keep debt & gearing at current levels is to attract new equity to finance the increased capital programme for 2025 onwards. To attract this equity will require Ofwat to benchmark and set equity returns against the alternative investments in debt and equity across other sectors, both UK and overseas.

Investment

In a given year, water company costs typically exceed revenues as investment is financed by debt and equity over time. The current and future investment need for the water sector is significant; Ofwat consider that £12.7 billion of equity will be required between 2025-2030, and companies forecast they will need to raise £45 billion in debt.

The attractiveness of the sector to investment is driven by the level and stability of returns investors can expect to get. These appear to have been declining since privatisation. At the same time, there are some public concerns that returns have been too high. Assessing returns in the sector is inherently challenging, and the Commission is seeking evidence on how returns compare between the water industry and other comparable sectors (for example, energy).

The Commission is seeking views on potential changes to support investment. This includes, for example:

- Changes to the Price Review process to support investment
- New mechanisms to underpin and/or constrain returns

The Commission is also interested in the impact public and political perceptions of the water industry have had on the attractiveness of the sector to investment.

Q44.To what extent does the economic regulatory framework support or hinder investment into the sector?

☐Significantly supports investment

☐Somewhat supports investment

☐Neither supports nor hinders investment

☐Somewhat hinders investment

☒Significantly hinders investment

☐Don’t know

Q45. How do financial returns in the water sector compare to other similar sectors (for example, energy)?

Please answer below and provide evidence and examples, where possible.

The UK regulators measure financial returns as real Return on Regulatory Equity (RORE). For the energy sector, RORE has averaged 9.8% over 2021-24.

See: https://www.ofgem.gov.uk/sites/default/files/2025-02/RIIO-2-Regulatory-financial-performance-data-file-2023-24.xlsx

Over the period 2020-24, the water sector has experienced returns of 2.78%. This is due to an operational underperformance of -3.4%, which reflects the unrealistic targets set in the 2019 Periodic Review.

See: https://www.ofwat.gov.uk/wp-content/uploads/2024/11/Monitoring-Financial-Resilience_2023-24_Data.xlsx

This disparity makes attracting new investment in the water industry more difficult, and requires equity returns more commensurate with the higher risk in the water sector.

Q46. What options, if any, would incentivise investment in the water sector? *Please answer below and provide evidence and examples, where possible.*

We believe it is possible to attract the investment required for the industry to deliver the ambitious capital programme for AMP8 and beyond. To do so will require a fair return for investors, in particular, a recognition that equity investment has greater risk than debt and requires a reasonable premium in line with historical precedent and other sectors.

This would require Ofwat to confirm that it is an explicit regulatory aim to ensure that targets are set to allow an average company to meet them, and for some companies to be able to outperform them. All regulatory decisions & interventions both at the Periodic Reviews and between them will need to be made considering the need for a fair balance of risk & return across the sector.

For more information see , ‘Regulating for the long-term: Financial Resilience and Investability’.

Q47. How does the public and political portrayal of water companies in the media and elsewhere affect the attractiveness of the water sector to investors?

☐Positively affects the attractiveness of the water sector to investors

☐Does not affect the attractiveness of the water sector to investors

☒Negatively affects the attractiveness of the water sector to investors

☐Don’t know

☐Other (please specify)

If you selected other, please specify below

Competition

Competition has been introduced into the water industry by Ofwat, and encouraged by successive governments, to help ensure private companies deliver investment and services for a fair price.

As the water sector is a natural monopoly, competition will always be constrained. The commission has heard varied feedback about how effective existing schemes have been and could be in the future. Some schemes appear to have delivered benefits (for example, enabling housing development), whilst others appear to face obstacles (for example, legal constraints, limited awareness).

The Commission is seeking views on potential changes that could be made to the competition regime. These include, but are not limited to:

- Changes to the New Appointments and Variations market to reduce administrative burdens (for example, relaxing requirements on Ofwat to consult on all New Appointments and Variations licensing applications)
- Changes to the business retail market, to focus on where it is most beneficial (for example, limiting the business retail market to large customers)
- Changes to the business retail market, to ensure efficient use of water (for example, updating water tariffs)
- Changes to Direct Procurement for Customers and/or Specified Infrastructure Projects Regulations, to ease and expand their use (for example, relaxing the criteria for Specified Infrastructure Projects Regulations usage)

Given different approaches historically between England and Wales, the Commission is also interested in where different approaches might be taken in England and Wales, as well as where there may be opportunities for convergence.

Q48. To what extent should further competition in the water industry be encouraged through regulation?

Please answer below and provide evidence and examples, where possible.

Our response in this area relates to England only.

Competition is a potentially powerful tool; in the right place and implemented in the right way it can result in better outcomes delivered more efficiently.

However, there has been a historical tendency to treat water and wastewater as being the same as energy – due to the actual similarities in the regulatory regimes and the

superficial similarities in what the businesses deliver. It is incredibly important to recognize the physical differences between water and energy that mean that there is not a direct read across from where markets work in energy to where they will work in water.

The key difference is that water has a low value density; that is to say water is heavy and cheap.

Electricity, and to a lesser but still great extent gas, have a high value density. The cost of transporting electricity and gas over large distances is small compared to the value of the commodity. This is why it is economically rational to import electricity to the UK from Europe and gas from the middle east, the USA and even sometimes Australia.

Water on the other hand is much more expensive to move compared to its value. It is therefore mostly moved using gravity, and only pumped where absolutely necessary. This has had knock on implications for the design of the networks and the water company areas – which are set up around river basins so that water and wastewater can flow downhill.

Water is also not homogenous. Water in different areas of the country will have different chemical properties. So switching water supplies and flows in the network can have a detrimental impact on customers as taste and odour will differ, and discolouration can occur due to variations in the dissolved minerals in water passing through pipes.

The implications for market design are that:

- Any given customer will have limited local supply sources. While bulk supplies across regions are beneficial, they will occur as long-term arrangements – generally with each entailing significant infrastructure investment, not rapid rebalancing as can happen in energy markets.
- Existing market arrangements do not promote short-term changes in bulk supplies to meet acute water stress. A market intervention that takes account of the relative risk to supplies in different company areas from such changes in transfers may be needed to drive this behaviour if needed.
- Because any given customer will get their wholesale supply from a limited range of sources mostly owned by the same company, retailers will face a fairly static charge per megalitre (£/Ml). This means that, unlike in energy where retailers have access to national markets to source power and gas, there is very limited to no opportunity for retailers to make efficiency gains through effective engagement with wholesale markets. This is due to the nature of the product not a failure of the market. Opportunities to innovate and add value in water retailing are therefore more limited than in other utility markets.

Opportunities for bioresources trading do exist – as energy can be extracted from bioresources the value density of the product is higher than water. But the market is

likely to be economic at most at a local rather than national level. Treatment through AAD is relatively capital intensive and so the market is likely to involve longer term contracts than a spot market. Bioresources also cannot be combined with AAD for other waste streams due to environmental regulation restrictions, which inhibits the integration with wider waste markets. NWG has actively sought opportunities to treat our neighbours' bioresources, but we have so far had limited opportunity to do so.

The market for new connections and new appointments and variations (NAVs) has shown that competition can work in this area. However, as NAVs acquire more customers – and so grow in size – and their assets age, they begin to look more like the WaSCs and WoCs. At some point this market will need to be reviewed to ensure that customers have the same level of protection as customers of the WaSCs and WoCs and that we do not store up issues of underinvestment in asset health for future customers.

Q49. Which of the following schemes, if any, have <u>failed</u> to provide effective levels of competition and efficiency? *(Please select all that apply)*

☐New Appointments and Variations (NAVs)

☐Self-Lay Providers (SLP)

☒Business Retail Market

☒Water bidding market

☒Bioresources market

☐Direct Procurement for Customers (DPC)

☐Specified Infrastructure Projects Regulations (SIPR)

☐None

☐Don't know

Q50. Which of the following changes to competition schemes, if any, would improve outcomes for the sector? *(Please select all that apply)*

☐No changes are needed

☐Changes to the New Appointments and Variations market to reduce administrative burdens (for example, relaxing requirements on Ofwat to consult on all New Appointments and Variations licensing applications)

☒Changes to the business retail market, to focus on where it is most beneficial (for example, limiting the business retail market to large customers)

☒Changes to the business retail market, to ensure efficient use of water (for example, updating water tariffs)

☐Don't know

☐Other (please specify)

If you selected other, please specify below

Q51: To what extent would greater market tendering of infrastructure delivery projects improve outcomes?

Please answer below and provide evidence and examples, where possible.

It is not clear that the DPC approach used by Ofwat has been particularly effective, with some projects showing that this was not necessarily an efficient approach. In some cases, there will be benefits in close links between assets and how they operate, to take advantage of synergies (for example, we deliver programmes such as mains replacement, lead replacement, and leakage reductions together). This can also include managing river basins as a whole, where some of the biggest challenges are in co-ordination across multiple stakeholders. However, water companies work with their supply chain in partnership to deliver infrastructure all the time. Sharing cost and outcome incentives with the supply chain can help to support innovation and efficiency in how projects are delivered, and to pick up benefits we might not otherwise achieve (including wider benefits such as improving river water quality).

Section 5: Questions on Chapter 5 - Water Industry Public Policy Outcomes

Introduction

Regulation has been introduced over the past 30 years to deliver government objectives in relation to drinking water, protecting the environment and securing long term water supplies. Requirements on water companies, particularly in relation to the environmental regime, have grown over the past 30 years and have become increasingly complex. We are interested to understand in which areas the legal and regulatory requirements placed on water companies are effective/ineffective and/or where they create perverse outcomes, and/or where there may be gaps. We are interested to know if, and if so how, these requirements could be improved.

When we say legal requirements on water companies, we mean statutory requirements related to their status as water companies (not including for example general duties under companies' legislation or public health legislation) and their duties under common law, including in relation to nuisance. When we say regulatory requirements, we mean requirements imposed on water companies by the various regulators. In some cases, the tools used by regulators are directly related to legal requirements on water companies (such as enforcement powers), whereas other tools used by regulators attempt to influence companies' behaviour but may not relate directly to a legal requirement on companies (for example, Ofwat's Outcome Delivery Incentives).

Q52. Do you believe that legal and/or regulatory requirements would benefit from review or consolidation? *If so, please explain your answer and provide evidence and examples, where possible*

Reviewing existing legal and regulatory requirements to ensure they are appropriate and without contradiction would be prudent, given the evolution of legislation since privatization.

In particular Ofwat's and the EA's separate investigations into Wastewater compliance has highlighted some significant inconsistencies, for example different regulatory views on what is required to comply with the Urban Wastewater Treatment Regulations (UWWTR). As a result, a potentially significant gap exists between the requirements of environmental permits and regulatory guidelines (for example the SOAF) and what some regulators think is required to comply with the law.

This significantly undermines trust in the standards and guidelines which companies have previously been seeking to comply with. This creates a lack of clarity over what the required standards actually are and a disconnect between allowed funding (based on previously published guidelines) and the activity that companies actually have to undertake to remain compliant with the law.

As we set out in 'Regulating for the long-term: Regulator Accountability' the government should provide clarity on which regulators have responsibility for delivering and overseeing regulatory guidelines and permits. These should be sufficient to ensure companies are compliant with the law. Ofwat's approach to setting funding allowances should be consistent with these.

Protecting the environment

Environmental regulation for the water industry is in place to protect the environment from harm and mitigate damaging activities by water companies. Environmental standards have been introduced at the EU level and by the national governments. As the principal environmental regulators in England and Wales respectively, EA and NRW issue permits and licences setting rules and conditions to secure compliance with requirements.

In these questions we are interested in views on the regulatory framework specifically as it relates to water companies.

The Commission is seeking views on potential changes that could be made to the environmental regulatory regime for the water industry. These include, but are not limited to:

- A review and rationalisation of the environmental legislative framework for the water industry
- Changes to address emerging threats
- Enhanced monitoring, including reform of operator self-monitoring
- Expanded use of inspections and audits
- Swifter enforcement

Q53. Do you believe that the system of environmental regulation, monitoring and enforcement is ensuring water company compliance with environmental standards?

(Please select one)

☒To a great extent

☐To some extent

☐Very little

☐Not at all

☐Don’t know

Q54. Which of the following changes to water industry environmental regulatory requirements, if any, would improve outcomes from the sector? (Please select all that apply)

☐No changes are needed

☒A review and rationalisation of the water industry environmental legislative framework

☐Legislative reforms to address current and emerging threats

☐Don’t know

☐Other (please specify)

If you selected other, please specify below.

Q55. Which of the following changes to the water industry environmental regulation, monitoring and enforcement framework, if any, would improve outcomes for the sector? *(Please select all that apply)*

☐No changes are needed

☐Enhanced monitoring, including reform of operator self-monitoring

☒Expanded use of inspections and audits

☒Swifter enforcement

☐Don’t know

☐Other (please specify)

If you selected other, please specify below.

Delivering clean drinking water

Securing clean drinking water is fundamental to public health. The DWI is responsible for assessing the quality of drinking water in England and Wales and taking enforcement action if standards are not being met. Water companies are consistently meeting the regulatory standards for drinking water with 99.97% of samples in England and 99.96% of samples in Wales complying with the regulatory standards in 2023. However, to ensure that the increasing pressures of population growth, climate change and challenges with ageing assets can be fully accounted for, stakeholders have raised a small number of areas where the system could perform even better. This includes water company risk management; a need to update water quality standards to ensure they remain world leading; approach to dealing with legacy contaminants such as lead; the extension of regulatory powers and tackling backlogs in product approvals to better support innovation in the sector.

The Commission is seeking views on potential changes that could be made to support the regulation of drinking water quality. These include, but are not limited to:

- Whether updates to drinking water quality standards are necessary to ensure that world leading standards are maintained
- Whether any changes to DWI's regulatory powers should be explored to better regulate new water supply mechanisms and approaches
- Addressing regulation 31 supply chain challenges to support innovation

Q56. What changes, if any, could be made to the drinking water regulatory system to maintain world leading drinking water quality? *(Please select all that apply)*

☐No changes are needed

☐Updates to drinking water quality standards

☐Changes to DWI's regulatory powers to better regulate new water supply mechanisms and approaches

☐Addressing regulation 31 supply chain challenges to support innovation

☐No changes needed

☐Don't know

☒Other (please specify)

If you selected other, please specify below.

High levels of drinking water quality are currently maintained across England. However, to maintain high quality drinking water over the long-term we need to manage the impact of long-term issues including the impact of climate change and asset health. A practical plan is also needed for the eradication of lead pipes from all parts of supply is needed – including customer side supply pipes.

As we discuss in ‘Regulating for the long-term: Long-term Planning’ we therefore consider that the DWI’s long-term planning framework needs to be expanded to create Water Quality Management Plans (WQMPs) that are given the same weighting when considering future investment needs as WRMPs and DWMPs.

Securing resilient water supply

In light of climate change and population growth, the security of long-term water supply is critical to the economy. We need secure and resilient supplies of water for people and the economy, whilst ensuring the environment is protected. There is projected to be a substantial water supply gap by 2050 if no action is taken. Water companies are responsible for the supply of water in their area and deliver their duty by developing Water Resources Management Plans and Drought Plans every 5 years. To deliver long term water supply, water companies need to reduce demand as well as increase supply.

The Commission is seeking views on potential changes that could be made to the water resources regulatory regime. These include, but are not limited to:

- integrated water management framework to improve the management of the water
- changes to regulatory responsibilities or introduction of new requirements or standards to oversee delivery of the water company supply and demand activity
- abstraction reform
- new water demand and efficiency policies

Q57. To what extent is the overall water regulatory framework securing resilient long-term supplies of water?

(Please select one)

☐To a great extent

☒To some extent

☐Very little

☐Not at all

☐Don’t know

Q58: What changes, if any, could be made to the overall water regulatory framework to ensure it can secure a resilient long-term supply of water? *(Please select all that apply)*

☐No changes are needed

☐Integrated water management framework to improve the management of the water system

☐Changes to regulatory responsibilities or introduction of new requirements or standards to oversee delivery

☐Abstraction reform

☐New water demand and efficiency policies

☐Don’t know

☒Other (please specify)

If you selected other, or want to provide additional views, please specify below

As we set out in ‘Regulating for the long-term: Long-term Planning’, we consider that greater join up is needed between strategic planning frameworks. Common assumptions / scenario inputs should be agreed centrally to be applied across all strategic planning frameworks including WRMPs, DWMPs and Water Quality Management Plans (if introduced) for common inputs including population forecasts and climate change.

Infrastructure and supply chain resilience and security

Water companies need resilient and secure infrastructure and supply chains to deliver on their core duties. Infrastructure resilience is the ability of an organisation's infrastructure, and the skills to run that infrastructure, to avoid, cope with, and recover from disruption in its performance. Infrastructure security is the practice of protecting systems and assets against physical and cyber threats.

The commission has heard conflicting evidence on the sector's resilience (for example, with disagreement between companies and Ofwat on whether companies have been appropriately funded to maintain assets).

Initial engagement has also highlighted potential concerns about the maturity of the sector's security arrangements, as well as whether funding decisions and regulatory oversight are adequately delivering a secure sector.

Supply chain concerns have also been raised regarding the ability to deliver ambitious new infrastructure programs and whether risk is appropriately allocated for critical dependencies (such as chemical supply).

The Commission is seeking views on potential changes that could be made to support infrastructure resilience. These include, but are not limited to:

- Changes to the Price Review to support infrastructure resilience (for example, calculating base expenditure with reference to asset condition, or linking base expenditure to investment plans)
- Changes to the scope and enforcement of existing infrastructure requirements (for example, strengthening requirements on companies to map assets)
- Setting infrastructure resilience standards (for example, requiring companies to prepare for a defined level of disruption)

The Commission is seeking views on potential changes that could be made to support infrastructure security. These include, but are not limited to:

- Changes to the Price Review to ensure adequate coordination on security expectations
- Changes to existing legislation, such as Security Emergency Measures Direction and cyber security regulations to close gaps (for example, giving powers in relation to security of wastewater infrastructure)

- Changes to the enforcement of security regulations (for example, providing the DWI with powers to issue directions under Security Emergency Measures Direction)

The Commission is seeking views on potential changes that could be made to manage risks from supply chains. These include, but are not limited to:

- Changes to planning processes to ensure supply chain constraints are factored (for example, factoring supply chain into planning decisions)
- Changes to cross-government policy on supply chain constraints (for example, agreeing investment plans with other sectors)
- Changes to the Price Review process to address supply chain constraints (for example, moving from a 5-year Price Review process)
- Setting government guidance on managing supply chain disruption
- Requiring companies to take greater steps to reduce dependencies (for example, onshoring chemicals production)

Q59. To what extent does the overall water regulatory framework support or hinder infrastructure resilience? When considering your answer, please think about future pressures including factors such as climate change and population growth.

☐Significantly supports infrastructure resilience

☐Somewhat supports infrastructure resilience

☐Neither supports nor hinders infrastructure resilience

☒Somewhat hinders infrastructure resilience

☐Significantly hinders infrastructure resilience

☐Don’t know

Q60. To what extent does the overall water regulatory framework support or hinder infrastructure security? When considering your answers, please think about evolving security threats such as cyber security. ,

☐Significantly supports infrastructure security

☒Somewhat supports infrastructure security

☐Neither supports nor hinders infrastructure security

☐Somewhat hinders infrastructure security

☐Significantly hinders infrastructure security

☐Don’t know

Q61. To what extent does the overall water regulatory framework support or hinder effective management of supply chain risks? When considering your answers, please think about disruption in and constraints from supply chains.

☐Significantly supports effective management

☐Somewhat supports effective management

☒Neither supports not hinders effective management or

☐Somewhat hinders effective management

☐Significantly hinders effective management

☐Don’t know

Q62. What changes, if any, could be made to the overall water regulatory framework to better support infrastructure resilience? *(Please select all that apply)*

☐No changes are needed

☒Changes to the Price Review to support infrastructure resilience (for example, calculating base expenditure with reference to asset condition, or linking base expenditure to investment plans)

☒Changes to the scope and enforcement of existing infrastructure requirements (for example, strengthening requirements on companies to map assets)

☒Setting infrastructure resilience standards (for example, requiring companies to prepare for a defined level of disruption)

☐Don’t know

☒Other (please specify)

If you selected other, please specify below

As we discuss in ‘Regulating for the long-term: Asset Health’, we are supportive of setting infrastructure resilience standards.

In addition to the above – longer term commitments from Ofwat about long-term investment programmes and infrastructure maintenance are needed. This should be set over decades. The Construction Leadership Council estimates that committing to long-term programmes could unlock £430m of growth; setting long-term commitments and targets for maintenance could unlock a further £260m (Ofgem and Ofwat could unlock an extra £2.3bn of growth every year - Utility Week)

Q63. What changes, if any, could be made to the overall water regulatory framework to better support infrastructure security? *(Please select all that apply)*

☐No changes are needed

☐ Changes to the Price Review to ensure adequate coordination on security expectations

☒Changes to existing legislation, such as Security Emergency Measures Direction and cyber security regulations (for example, giving powers in relation to security of wastewater infrastructure)

☐Changes to the enforcement of security regulations (for example, providing the DWI with powers to issue directions under Security Emergency Measures Direction)

☐Don’t know

☐Other (please specify)

If you selected other, please specify below

Q64. What changes, if any, could be made to the overall water regulatory framework to better manage risks from supply chains? *(Please select all that apply)*

☐No changes are needed

☐Changes to planning processes to ensure supply chain constraints are factored (for example, factoring supply chain into planning decisions)

☐Changes to cross-government policy on supply chain constraints (for example, agreeing investment plans with other sectors)

☒Changes to the Price Review process to address supply chain constraints (for example, moving from a 5-year Price Review process)

☐Setting government guidance on managing supply chain disruption

☐Requiring companies to take greater steps to reduce dependencies (for example, onshoring chemicals production)

☐Don't know

☒Other (please specify)

If you selected other, please specify below

Supply chains would be supported by long-term commitments from regulators, including consistent and long-term requirements on outcomes and environmental requirements. This doesn't necessarily need a move away from five-year price controls, but it should include some certainty from regulators about long-term programmes and outcomes that should be met. This supports supply chains by giving them confidence in how to build skills and capacity, without risking this changing rapidly.

Innovation and technology

Innovation is defined here as the full process of invention, application, and adoption, and it involves a range of investment efforts in the form of research, development, demonstration, dissemination, and training.

Historically, there have been concerns about the levels of innovation in the water sector and its approach to innovation

The commission has also heard that risk-aversion from both regulators, the government and water companies could be stifling the introduction of innovative approaches and technologies as more ‘certain’ engineering approaches are favoured over newer, less tested options.

The commission is gathering views on changes to the regulatory framework to support innovation. These include, but are not limited to:

- Changes to the way companies and regulators approach risk (for example, introducing a regulatory ‘sandboxing’ tool)
- Changes to regulation to allow flexibility on delivery approaches Changes to the Price Review process to support innovation (for example, treating research and development spending separately in the Price Review)

The commission is also interested in views on opportunities from new technologies to transform water company and regulator approaches.

Q65. To what extent does the overall water regulatory framework currently support or hinder innovation?

☐Significantly supports innovation

☐Somewhat supports innovation

☐Neither supports nor hinders

☒Somewhat hinders innovation

☐Significantly hinders innovation

☐Don’t know

Q66. Which of the following changes in the sector, if any, would enable innovation outcomes? *(Please select all that apply)*

☐No changes are needed

☒Changes to the way companies and regulators approach risk (for example, introducing a regulatory ‘sandboxing’ tool)

☒More outcome based regulation to allow flexibility on delivery approaches

☒Changes to the Price Review process to support innovation (for example, treating research and development spending separately in the Price Review)

☐Don’t know

☐Other (please specify)

If you selected other, please specify below

Q67. What opportunities, if any, do new technologies present for companies and the regulators?

We have a strong innovation culture at NWG and support our colleagues to develop new ideas through the early stages into adoption at a company level and beyond. We have a network of Innovation Ambassadors across the business and we run an annual Innovation Festival which brings together thousands of innovators from across and beyond the sector to solve the challenges we face. We have demonstrated that novel adoption of existing technologies and the development of new tools both create opportunities for the water sector.

Digital technologies – Artificial Intelligence (AI) and Machine Learning (ML) in particular – offer companies and regulators the opportunity to make smarter, faster decisions through real-time data, improve environmental and customer outcomes, and reduce costs and greenhouse gas emissions. They also enable more targeted regulation, greater transparency, and early detection of risks—supporting a shift from reactive to proactive approaches across the sector.

To be successful these technologies need to be supported by greater data sharing across regulators and water companies. Where appropriate this data should be made public, and where it is sensitive sufficient protections should be put in place.

Unfortunately these technologies also create opportunities for third parties with malicious intent to cause significant harm to water companies and customers. It is

therefore imperative that the sector is funded to invest in a proportionate level of cyber security and digital resilience as these risks increase.

There is also significant scope for non-digital technologies, such as use of algae in wastewater treatment[2] to create new opportunities for the water sector.

[2] See: Algae: The green machine for sustainable wastewater treatment

Section 6: Questions on Chapter 6 - Ownership

Introduction

The English and Welsh ownership model has evolved since 1989.

There has been significant public debate about the extent to which ownership models for water companies impact their performance against public policy objectives. Initial research on other countries has failed to generate clear conclusions on whether ownership change would drive improved outcomes.

The Commission would like to gather evidence on the following areas in relation to ownership:

- What the impact, if any, of mergers between companies (consolidation) has on company performance.
- What the impact, if any, of public listing versus private ownership is on company performance.
- What the impact, if any, of company structures – like Whole Business Securitisation – is on company performance.
- What the impact, if any, of different types of investors (for example, private equity firms, pension funds) is on company performance.
- How effective Dŵr Cymru Welsh Water's not-for-profit model has been, and what the risks associated with this model are.

Q68. What impact, if any, has consolidation of water companies had on their performance?

While larger companies do benefit from economies of scale, we do not believe there is an optimal size of water company. Portsmouth Water is one of the smallest water companies, yet it outperforms many much larger water companies.

Q69. What impact, if any, does whether or not a water company is listed on the stock exchange have on their performance?

We do not believe there is a preferable form of ownership. Northumbrian Water has been publicly listed in the past and is now privately owned. We do not believe this changed the underlying performance of the company.

There are advantages of being part of a large group such as CKI Infrastructure. We regularly exchange ideas and experiences with group companies in other infrastructure networks.

Our majority owner, CKI has a secondary listing on the London Stock Exchange, and we comply with all the Governance requirements that apply to listed companies.

We note that in 2001, Hyder, the publicly listed owner of Welsh Water got into financial difficulty, so a listing is not a guarantee of financial resilience.

Q70. What impact, if any, do complex company structures like Whole Business Securitisation have on water company performance?

Northumbrian Water has a relatively simple corporate structure with no securitization, and we support transparency of ownership, governance and decision making.

We see no link between company structures and performance. For example, Welsh Water have one of the lowest levels of gearing in the industry yet are classed as 'lagging behind' in Ofwat's 23-24 water company performance report.

There are important protections for customers in place, such as Conditions K & P of the licence, which has protected water company assets and services in the past in the case of insolvency of the parent company.

Q71. What impact, if any, does the type of investor (for example, private equity firms, pension funds) have on water company performance?

We do not believe there is a preferable form of ownership or investment. See Q69 response.

Ownership (for Wales only)

The following 2 questions are targeted at those who live in Wales or are part of an organisation that operates in Wales.

Q72. How effective has Dŵr Cymru Welsh Water's not-for-profit model been in driving improved outcomes?

N/A

Q73. What are the risks associated with Dŵr Cymru Welsh Water's not-for-profit model?

N/A