

RESPONSE TO OFWAT CONSULTATION

FUTURE WATER & SEWERAGE CHARGES 2010-2015: DRAFT DETERMINATION

SUMMARY

We welcome publication of the Draft Determination and believe it is a positive step towards a Final Determination that will mean a good deal for water users and the environment. We will continue to work with Ofwat and our other partners to ensure that our priorities are included in the Final Determination.

In particular, we are pleased that:

- over 99 per cent of the National Environment Programme (NEP) is included in the Draft Determination
- all catchment schemes proposed in the NEP and water company business plans have been included in the Draft Determination
- our approach to metering has generally been supported and Ofwat has continued to encourage water companies to improve the justification for metering so that more can be included in the Final Determination
- a balanced view has been taken to water efficiency schemes and resource development.

However, we want to see the following issues explicitly dealt with in the Final Determination:

- all necessary actions to enable water companies to deliver their published final water resources management plans
- further reductions in leakage
- further water efficiency measures for those water companies who have made additional proposals that have not been included in the Draft Determination
- a consistent approach to understanding, managing and where appropriate increasing resilience to flood risk
- sufficient planning and schemes to allow companies to demonstrate that they are acting to manage sites with a high risk of sewer flooding as a priority
- assurance that sufficient capital maintenance has been allowed so there is no reduction in environmental performance.

Water companies pay the Environment Agency charges which are set to recover the costs of managing water resources and administering abstraction. Increases in abstraction charges are planned to enable us to pay compensation to companies for the costs of revoking or modifying licences for abstractions that cause environmental damage. An allowance in the PR09 settlement should be made for companies having to incur the cost of funding compensation some time before licence reviews take place, compensation is paid and the companies incur the expense of making the

necessary modifications to their abstractions. We want to see this charge increase (the Environmental Impact Unit Charge “EIUC”) included within the Final Determination. It also needs to be recognised that companies may incur expenditure as a consequence of changes to abstraction licences.

We will continue to work with Ofwat and water companies to make sure that the schemes and actions included in the Final Determination are implemented and monitored so that any performance issues are addressed in a timely fashion.

1.0 INTRODUCTION

- 1.1 The Environment Agency is the statutory body responsible for water resources and quality management across England and Wales. We are the leading advisor on the environment for both Governments. In England we have a Strategic Overview for all types of flood risk and expect to see a proposal for an enhanced oversight role for Wales in the forthcoming Floods and Water Bill.
- 1.2 With partners and other stakeholders, we work to make sure that the environment is protected and, where appropriate, improved and that water is managed in a sustainable way. Our vision is “A better place for people and wildlife, for present and future generations”. Through our functions we have a statutory duty to contribute to sustainable development.
- 1.3 We welcome the opportunity to contribute to this consultation. Throughout the Periodic Review we have also worked with water companies and other stakeholders to ensure our requirements are understood and included within water company business plans and the Draft and Final Determinations.
- 1.4 Our priority for PR09 is to secure the best deal for the environment and consumers both now and for future generations. We have four key priorities to inform water companies’ business plans and Ofwat’s determinations: balancing supply and demand; the National Environment Programme (NEP); maintenance, improvement and protection of infrastructure; and adaptation to and mitigation of climate change.
- 1.5 We recognise that in the current economic climate it will be difficult for some customers to pay their water bills. As the environmental regulator we have a duty to secure the necessary improvements to water company assets and operations. When setting our requirements for PR09 we have made sure that every environmental improvement included in the plans is one which is necessary, addresses a known problem and is based on evidence that action is required. In addition we have been working with water companies to make sure that they are taking the most cost-effective approach to delivering environmental improvements. We have been working with water companies and Ofwat to make sure that our requirements such as for supply-demand and resilience to flooding that are outside the NEP will also deliver real benefits to customers.

- 1.6 We expect water companies to meet their statutory and other environmental obligations. We expect them to work with Ofwat to understand and address the challenges set out in the draft determination. Where we have concerns about specific company issues in the Draft Determination (DD) we will discuss these separately with the company and with Ofwat.

2.0 THE ENVIRONMENT AGENCY'S RESPONSE

National Environment Programme

- 2.1 The National Environment Programme (NEP) is a programme of actions and projects that water companies need to complete to meet their environmental obligations. This will lead to a healthier water environment – cleaner rivers, lakes, bathing and coastal waters. Among other things, it includes actions to improve the quality of water that is discharged from sewage treatment works to either rivers or the sea, prevent chemicals from entering groundwater and ensure that abstraction of water does not have an adverse impact on habitats which are protected by law.
- 2.2 We have worked closely with Natural England, Countryside Council for Wales and the water companies when developing the requirements set out in the NEP. This has ensured clarity of our requirements and that the necessary evidence for the requirements is in place.
- 2.3 We are pleased that more than 99 per cent of the NEP for both Water Resources and Water Quality is included in the DD. We expect all of the requirements of the NEP to be included within the Final Determination (FD) and are working with Ofwat to ensure that this will be the case for those actions that are not included in the DD. We have a number of queries about the status of some of the water resources related NEP schemes. We are seeking further clarification from Ofwat about which schemes have been included to ensure a common understanding between ourselves, Ofwat and the water companies.

Catchment Schemes and Investigations

- 2.4 Water companies are well placed to contribute to, and develop, innovative, integrated catchment based solutions to achieve multiple benefit, for example, through partnership approaches to address diffuse water pollution which will deliver reduced costs of raw water treatment. Such measures can also contribute to several outcomes including climate change adaptation and mitigation, water resource management, enhanced biodiversity as well as environmental water quality improvements. The Environment Agency, Drinking Water Inspectorate, Natural England and Ofwat have worked together to encourage water companies to develop catchment schemes and investigations for inclusion in PR09 as these can complement other initiatives on land management already underway such as Catchment Sensitive farming. We are pleased that many companies have taken this approach.

- 2.5 We are pleased that all the catchment investigations and schemes that were in the NEP and proposed in the final business plans have been included within the DD. We would like to see these decisions carried through to the FD. We will work with Ofwat, the Drinking Water Inspectorate, Natural England, Water UK and the water companies to monitor and report on the effectiveness of the catchment schemes and investigations. This will mean that we are better able to promote their inclusion in future periodic reviews.

Water Resources - Supply-demand balance

- 2.6 We expect water companies to ensure secure water supplies for people and industry, as well as play their part in helping to protect the environment. This means companies should manage demands for water better to reduce the pressures of abstraction on the water environment, be more resilient to the future uncertainties of climate change, reduce the carbon footprint of their own operations and help their customers reduce energy use.
- 2.7 The PR09 process has been running alongside the statutory water resources management planning (WRMP) process. We are pleased that Ofwat has made its determinations using the water companies' final business plans and taking into account the draft Water Resource Management Plans and Statements of Response.
- 2.8 Within England, ten water companies have been asked to publish their final WRMPs. We expect the actions contained in these plans to be included in the FD. We will work with Ofwat to make sure that companies have provided sufficient evidence and information to produce a FD that enables them to implement their final WRMPs.
- 2.9 The remaining water companies have not yet been asked to publish their WRMPs because they are subject to requests for more information, hearings or inquiries or because of the timing of the WRMP process in Wales. We expect the necessary mechanisms to be in place (for example through the change protocol) to allow incorporation of any changes required when the final WRMPs are produced by the remaining companies.

Water resources – Metering

- 2.10 We believe household metering is essential for the long term sustainable use of water resources. It will help give people the right incentives to reduce per capita consumption and manage the impacts of their water use. Water resources are already stressed in many parts of England and we expect pressures to increase with growth in housing, population and climate change.
- 2.11 We are pleased that Ofwat has included most of the metering proposals put forward by companies in the DD. Ofwat has again asked companies to consider the wider benefits of metering and there is scope for more metering to be included in the FD. We urge companies to work with Ofwat and ourselves to provide further evidence to improve the case for metering and to show how the benefits apply to their own plans.

- 2.12 Metering has wider benefits to the overall management of scarce resources, particularly in the south east of England and we would like to see a faster pace of metering in this area. We would also like to see the challenges made by Ofwat to metering in the south east resolved in time for the FD and will discuss this with Ofwat and the water companies. Ofwat has challenged companies to consider the wider costs and benefits of metering and we believe that if all companies included this in their plans it would result in a higher and more optimal rate of metering across the south east.

Water resources – Leakage

- 2.13 Companies have made excellent progress in reducing and controlling leakage over the last decade. Total leakage in England and Wales reduced rapidly after its peak in 1994/5. Leakage is now 1820 MI/d lower - enough to supply over 12 million people. A reduction of national leakage levels of around 70MI/d is planned by 2015. These forecast reductions in leakage are disappointing and we believe that more needs to be done. To have the same level of leakage in 2030 as today is not acceptable. We are disappointed by the limited leakage reduction in the DD.
- 2.14 We will work with Ofwat now and in future to develop an improved method of deciding an acceptable level of leakage. We urge companies to work with Ofwat and ourselves to do more to demonstrate their case for improved leakage reduction to be included in the FD. We will discuss the detail of these issues further with Ofwat and the companies concerned.

Water resources - Water efficiency

- 2.15 We believe that managing the demand for water goes hand in hand with developing new water resources when water companies are meeting the supply-demand balance. We are pleased that Ofwat has included water efficiency savings that together with other measures provide a balanced approach in company plans between managing demands and investing in new resources. We especially welcome that for six companies Ofwat has included additional water efficiency measures. These will help customers save water and manage their bills, as well as help to maintain the supply demand balance. Two additional water efficiency proposals were excluded from the DD and we will work with Ofwat to understand the best approach for the companies concerned to improve the additional water efficiency proposals.

Water resources - Abstraction Charges

- 2.16 Water companies pay the Environment Agency charges that are set to recover the costs of managing water resources and administering abstraction. Increases in abstraction charges are planned to enable us to pay compensation to companies for the costs of revoking or modifying licences for abstractions that cause environmental damage. An allowance in the PR09 settlement should be made for companies having to incur the cost of funding compensation some time before licence reviews take place, compensation is

paid and the companies incur the expense of making the necessary modifications to their abstractions. We want to see this charge increase (the Environmental Impact Unit Charge - "EIUC") included within the Final Determination. The existing estimate of the compensation liability for SSSI, Biodiversity Action Plan and 'local' driver schemes is £200m. This is to be funded through the EIUC element of abstraction charges. This estimate may change as schemes are progressed.

- 2.17 We believe that allowance should be made for companies having to incur the cost of funding compensation some time before licence reviews take place and compensation is paid. We are concerned that while the DD recognises that abstraction charges levied by the Environment Agency are likely to increase at a faster rate than inflation over a number of years to recover the compensation, no allowance has been made for the actual process of raising and then paying compensation. It also needs to be recognised that companies may incur expenditure as a consequence of changes to abstraction licences.
- 2.18 Our EIUC charging scheme was approved by Defra, Welsh Assembly Government, HM Treasury and Ministers following three public consultations. HM Treasury advice is that the Environment Agency must be able to meet the anticipated compensation liability in full in advance of starting the licence review process for individual schemes. There is a cap on our charges that limits the rate at which we can build up sufficient funds to review licences. The licence review process is expected to be lengthy. There will be a delay between raising funds through charges and paying back in compensation. Our charging schemes are regional so there will not be a perfect match between the compensation raised and paid back to each company.

Capital maintenance

- 2.19 Water company assets need to be maintained to ensure that they are in a serviceable condition and to ensure that the water industry can continue to deliver the environmental improvements achieved since 1989. This includes taking actions to prevent pollution incidents, maintain compliance with environmental regulations and adapt to environmental change and growth. We support an increase in maintenance but need to be reassured that it is targeted using appropriate priorities which take into account the impact on the environment. We expect companies to make the necessary investments in maintenance so they can meet their statutory obligations and prevent environmental damage. Increases in pollution incidents are not acceptable. We welcome the reassurance that Ofwat expects water companies to meet their statutory obligations and protect the environment.

Climate Change

- 2.20 One of the biggest challenges faced by the water industry is climate change. Companies will need to adapt to the effects of climate change and will also need to manage their carbon emissions. We agree with Ofwat's view that we all need a better understanding of climate change scenarios before there is

significant investment on water resources schemes justified on the grounds of climate change. We will work with Ofwat and the water companies to make the best use of the recent UK Climate Projection scenarios (UKCP09) and to develop a common understanding of what is required to justify investment. Once the need for any of these investments has been proved, we do not want to see any delay in their implementation.

- 2.21 For climate change mitigation, we are pleased with the way carbon accounting and costing has been incorporated in this price review. We will support Ofwat in using the potential of this information to drive future carbon reductions. We welcome the increases in renewable energy generation, particularly through sewage sludge programmes. We fully support this and the benefits it will bring to customers and the environment, but we believe more could be delivered, particularly through wind and other technologies. We will continue to discuss the barriers to this with Ofwat so that we can develop a way forward and more can be delivered in future.

Growth

- 2.22 If housing growth leads to the capacity of existing infrastructure being exceeded, then environmental degradation may result, and further growth will be constrained. We expect Growth plans over the PR09 period to be aligned to Regional Spatial Strategies or more recent Government projections. We are pleased that Ofwat has supported the majority of proposals made by companies to meet the demands for growth in their areas. We are reassured that Ofwat has allowed additional expenditure where they do not think companies have made sufficient allowances for growth in sewage treatment capacity. Plans for increases in demand for water due to growth are managed through the statutory Water Resources Management Planning process and our comments on this are given above.

Resilience

- 2.23 In future, water companies will need to play a greater role in planning for, and managing the consequences of flooding and other extreme events on their services. Climate change experts predict that in future there will be hotter, drier summers, warmer, wetter winters and rising sea levels. Flooding of pumping stations and treatment works can disrupt crucial services to homes and businesses.
- 2.24 We welcome the proposals that have been included within the DD to increase resilience to flooding, covering both network resilience and asset specific flood resilience. We do have concerns that all the actions that are required may not have been included within the DD, e.g. to assess fully and manage the potential flood risk to their assets and activities. We expect water companies to understand and develop plans to address the risks to their water supply and sewerage networks, especially critical assets. We want the companies to be more open with us about the risks to these networks so that we can work with them to address those risks. We want to understand clearly how the residual risk varies within individual companies and throughout England and Wales.

- 2.25 Ofwat has challenged companies on the basis of the quality of their submissions and whether or not actions deliver sufficient benefits for customers. Regardless of the allocation within the DD we expect companies to carry out the necessary work to understand the risks to their assets, take action to manage / mitigate the risks identified where required and publish reports on progress. We expect Ofwat and water companies to consider the risk of environmental damage within their assessment and approach to increasing resilience of their infrastructure.
- 2.26 We have had detailed discussions with Ofwat on what we believe should be implemented within the period.
- 2.27 This is the first time that resilience to flood risk has been expressly considered in a Price Review. The DD is a welcome step forward but we would be very concerned if important measures that have not been funded are not considered for another five years. Where investigations justify additional schemes between 2010 and 2015, we do not want to see any delay and will expect them to be implemented within the period. We would like reassurance that the necessary mechanisms are in place for these items to be brought forward (for example via the Change Protocol) where additional funding is required.

Sewer Flooding

- 2.28 Sewer flooding causes high levels of distress and unacceptable impacts. It is a symptom of overloaded sewers. This area, together with related surface water management, will become ever more challenging because of the impacts of climate change and increased growth and development. We want companies to target investment in a strategic way, and that where appropriate, water company and flood management authorities to plan and implement schemes together to provide a holistic approach to flood management. This is particularly relevant with Government's priority for Surface Water Management, where water companies have a vital contribution to make. Such an approach will bring benefits to water companies by reducing the surface water inputs to sewer systems and the carbon footprint associated with treating the water.
- 2.29 We want to see companies use approaches that are based more fully on an assessment of future as well as current risk and more clearly demonstrate that they are acting to manage high risk as a priority. We want Ofwat to support this approach. This will help companies provide adequate capacity in their sewerage systems to prevent sewer flooding and other damaging environmental impacts such as sewer overflows. In their strategic direction statements several companies say their long-term aim is to eradicate internal sewer flooding altogether. There appears to be limited progress towards meeting these aims within the DD. We have specific concerns about a number of schemes and will work with Ofwat and the water companies to enable our requirements to be supported in the FD.

Implementation and Monitoring

- 2.30 Effective monitoring of projects and schemes is essential for us to understand the progress towards the outcomes to be delivered between 2010 and 2015. It will also help us understand the benefits of schemes and inform future periodic reviews. We will work with Ofwat and water companies to make sure that the schemes and actions included in the FD are implemented and that any performance issues are addressed.
- 2.31 We will explore with Ofwat how actions that are not explicitly detailed within the DD, such as some resilience schemes and investigations, can be monitored by regulators such as the Environment Agency, Natural England, the Drinking Water Inspectorate or Ofwat themselves, to ensure that the required outcomes are achieved and recognised, in a clear and transparent way.

FURTHER INFORMATION

Further information or background to this response can be obtained from Angela Wallis, PR09 Policy Manager, either by telephone on 01733 464554 or by e-mail at angela.wallis@environment-agency.gov.uk

September 2009