



House of Commons
Environment, Food and Rural
Affairs Committee

**Future flood and water
management
legislation**

First Report of Session 2010–11

*Volume I: Report, together with formal
minutes, oral and written evidence*

*Additional written evidence is contained in
Volume II, available on the Committee website
at www.parliament.uk/efracom*

*Ordered by the House of Commons
to be printed 15 December 2010*

Environment, Food and Rural Affairs Committee

The Environment, Food and Rural Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Environment, Food and Rural Affairs and its associated bodies.

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The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume.

Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee are Richard Cooke (Clerk), Lucy Johnson (Second Clerk), Sarah Coe (Committee Specialist—Environment), Rebecca Ross (Committee Specialist—Agriculture), Clare Genis (Senior Committee Assistant), Jim Lawford and Mandy Sullivan (Committee Assistants) and Hannah Pearce (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the Environment, Food and Rural Affairs Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5774; the Committee's e-mail address is: efracom@parliament.uk. Media enquiries should be addressed to Hannah Pearce on 020 7219 8430.

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Summary

Over five million properties in England are at risk of flooding. At the same time, the UK faces increasing economic and environmental challenges in securing clean, reliable and affordable water supplies. The forthcoming Water White Paper and Natural Environment White Paper present welcome opportunities for the Government to define a comprehensive and holistic approach to flood and water management. However, the extended first Parliamentary session must not delay the introduction of any arising legislation, if regulatory changes are to be made without disrupting the water price-setting process.

Flood Management

Adequate and stable funding must be available to those charged with putting legislative measures into practice. The Flood and Water Management Act 2010 (FWMA) places new responsibilities for planning for and responding to flood events upon public agencies, including local authorities who must balance these new duties with other demands on their limited budgets. These demands potentially include increased contributions to local flood defence projects if some of these are to proceed in the next few years. We believe that councils should aim to give flood protection work the same level of priority it is accorded by the Government.

With an £8 return for every £1 spent, timely investment in flood defences provides significant economic as well as social returns. We welcome the priority Defra places on protecting flood defence budgets and the efficiency targets that will help to better protect some 145,000 homes by 2015. Nevertheless, the £2.1 billion capital funding allocated under the Comprehensive Spending Review (CSR) for the next four years represents a cut to planned spending on defences. Simply to maintain the current level of protection in the face of increasing flood risks requires increased investment and the significant CSR cuts will increase concerns that funding on flood defences remains inadequate. The debate on how to ensure that beneficiaries pay a greater proportion of the costs of flood defences is at an early stage, thus it is by no means certain that any shortfall in public funding can yet be made up by private contributions. Ministers must spell out how the Government's aim of focussing public funding on those communities at greatest risk who are least able to protect themselves will be achieved in practice. Defra should place a statutory duty on Fire and Rescue Service Authorities to ensure that these bodies prioritise flood rescue work within their constrained budgets.

While a blanket ban on new development in areas of flood risk is not practicable, the Water White Paper should set out a clear framework for planning policy in such areas, including how the costs of providing flood defences for new developments should be apportioned. Government and the insurance industry must work urgently to reach agreement on the broad terms under which the industry will agree to provide households with flood insurance cover after the current 'Statement of Principles' expires in 2013.

The greater use of sustainable drainage schemes (SUDs) is supported but councils dispute the level of resources available to them to fulfil their FWMA duties to adopt and maintain SUDs. Defra should undertake further work into how SUDs responsibilities should be allocated and funded. Any Internal Drainage Board reform should be on an incremental,

localised basis, not on a “one size fits all” approach. Defra should consider the potential for these Boards to use their resources to undertake river course maintenance on behalf of the Environment Agency.

Water Management

The Water White Paper offers the opportunity to set out clear proposals to sharpen the regulatory framework so that it is better able to respond to future challenges and provide a stable basis for the long term future of the water industry.

We recommend that the Water White Paper should:

- put strengthening the views of customers at the heart of its regulatory reform proposals;
- set out clearly the extent to which social tariffs are intended to be used to help customers who have difficulty paying their bills and how the interests of all bill payers will be balanced with the needs of this group of customers and in a way which is fair to other bill payers;
- set out how the Government will address higher household water charges caused by the need for large-scale capital investment in some regions, such as the South West of England. The solution must not simply redistribute these higher costs within the region yet it must also be fair to all customers nationally. Several solutions could achieve this including a hybrid approach whereby a social tariff is applied across the country but is weighted to recognise substantial regional variance in bills, and
- propose a clear strategy for implementation of a wider programme of metering and variable tariffs to help spur water efficiency while protecting those on low incomes from unaffordable price rises.

Furthermore the Water White Paper should:

- propose stronger measures to enable water companies to recover bad debts, which are costing each customer who does pay their bill an extra £12 a year;
- pave the way for measured introduction of competition into the water industry, which maintains certainty for investors over the future regulation and structure of the industry, and
- set out specific proposals to enable the wider value of water to be reflected in policies and charges, including a clear programme for reform of the abstraction licensing regime, and urgent action to improve water quality to meet EU Water Framework Directive objectives.

Waste water management

Water and sewerage companies must be given stronger powers to act on misconnections to the sewerage system. Ofwat must scrutinise carefully the costs to customers from water companies taking over responsibility for private sewers and lateral drains.

Introduction

Aims of the inquiry

1. Ensuring that people in England and Wales have clean, reliable and affordable water supplies, and that action is taken to minimise the threat of and respond effectively to flooding, are central Department for the Environment, Food and Rural Affairs (Defra) responsibilities. On coming to power, the Government announced its intention to implement the findings of the Pitt Review to improve flood defences,¹ as well as to prevent unnecessary building in areas of high flood risk. It also committed itself to reform of the water industry in order to enhance competition and improve water conservation. In September 2010 Defra announced a public consultation prior to publication in June 2011 of a Water White Paper. It has also announced that it will publish a Natural Environment White Paper by spring 2011.

2. In September 2010, we launched an inquiry to assess progress on flooding and water management policy, with the aim of identifying key priorities for these White Papers. The Committee sought evidence from interested parties and invited submissions on:

- which of the key issues covered by the consultation into the draft Flood and Water Management Bill and by the Walker Review,² and the Cave Review,³ should be taken forward as legislative priorities;
- the further policies which are required to ensure flood and water management which delivers optimum social, economic and environmental outcomes, and
- any issues related to the Flood and Water Management Act 2010 (including sustainable drainage systems) and to the transfer of private sewers and lateral drains.

3. We received 34 written submissions and held three oral evidence sessions. The first of these was held on 13 October 2010, taking evidence from Ofwat and the Consumer Council for Water. On 20 October we took evidence from the Environment Agency and Water UK, the body which represents water and sewerage companies in England and Wales. On 3 November we took evidence from Richard Benyon MP, Defra Parliamentary Under-Secretary of State for Natural Environment and Fisheries.⁴ We would like to thank all those who gave us evidence in person or in writing.

4. While acknowledging that these are inter-related topics, we set out below our findings firstly on flood management policy, and secondly on water management, including waste water management, policy.

1 Sir Michael Pitt, *Learning Lessons from the 2007 Floods*, December 2007.

2 Anna Walker, *The Independent Review of Charging for Household Water and Sewerage Services; Interim Report*, June 2009.

3 Professor Martin Cave, *Independent Review of Competition in Water Markets; Final Report*, April 2009.

4 The Minister was accompanied by Sonia Phippard, Director, Water, Floods, Environmental Risk and Regulation, Defra.

1 Flood management

Background to flood management policy

5. The Environment Agency (EA) estimates that 2.4 million properties are at risk of flooding from rivers and the sea in England, of which 1 million are also susceptible to surface water flooding, with a further 2.8 million properties susceptible to surface water flooding alone. In all, around 5.2 million (one in six) properties are at risk of flooding. Of these, some 500,000 are classified as being at “significant” risk (i.e. there is a greater than 1 in 75 probability of a flood occurring in any one year).⁵ The EA calculates the expected annual cost of damage to residential and non-residential properties in England at risk of flooding from rivers and the sea to be more than £1 billion.⁶

6. The ability of flood water to disrupt lives and livelihoods was brought sharply into focus by the flood events in Cumbria in 2009 and in Cornwall in November 2010. The Cumbrian floods were estimated to have cost around £276 million, while early estimates put the costs of the Cornish floods at potentially £12 million.⁷ On an even greater scale, in summer 2007 floods in parts of England and Wales led to the deaths of 13 people, with some 49,000 households and nearly 7,000 properties flooded. Overall the 2007 floods cost around £4 billion.⁸ The subsequent independent review conducted by Sir Michael Pitt at the Government’s request made a large range of recommendations on how to better prepare for and respond to flood events.⁹ The Government accepted the Pitt Review in full and initiated work to implement the key recommendations, in particular by enacting the Flood and Water Management Act (FWMA) in April 2010. Despite this, flood management policy was a work in progress at the time of the general election in May 2010 since the FWMA had not yet been commenced. Furthermore, there were a number of issues which Defra consulted upon alongside the draft Flood and Water Management Bill but which, due to lack of parliamentary time, were not included in the final legislation.

Commencement of the Flood and Water Management Act 2010

7. The first commencement order for the FWMA has been laid and measures are being commenced in phases, from September 2010 onwards.¹⁰ Further commencement dates are expected to be announced shortly. For example, the Government is working towards most

5 The Environment Agency uses three main flood risk categories: “Low risk” equates to a less than 0.5% chance of flooding in any year at that location (i.e. a one in 200 chance in any given year), “Moderate risk” equates to a 0.5-1.3 % chance (i.e. a one in 200 to 1 in 75 chance in any given year), “Significant risk” equates to a more than 1.3 % chance (i.e. a one in 75 chance or more in any given year). Environment Agency, *Flooding in England: A National Assessment of Flood Risk*, 2009.

6 Environment Agency, *Flooding in England: a National Assessment of Flood Risk*, 2009, p 6.

7 “Huge cost of Cumbria floods revealed days after fresh destruction hits Cornwall” *The Guardian*, 19 November 2010.

8 Environment Agency, *The costs of the summer 2007 floods in England, Project Summary*, January 2010, p V. Total “out of pocket” costs were £4 billion, with some £2.5 billion borne by households (of which 75% was recovered through insurance claims) and some £1 billion borne by businesses (of which some 90% was recovered through insurance claims).

9 Sir Michael Pitt, *Learning lessons from the 2007 floods*, June 2008, p 3. [This report is subsequently referred to as “The Pitt Review”].

10 The Flood and Water Management Act 2010 (Commencement No. 1 and Transitional Provisions) Order 2010 commenced certain measures from 1 September and others from 1 October 2010.

local authority responsibilities for flood risk management being ready to come into effect from April 2011. The Act establishes a new framework of roles and responsibilities for key bodies to ensure an effective, joined-up response to flooding threats and events. It gives the Environment Agency overall responsibility for flood management strategy,¹¹ while county or unitary councils become Lead Local Flood Authorities (LLFAs) leading the co-ordination of flood risk management in their areas, including preparation of plans to manage surface water flooding.¹²

8. Some provisions will not be enacted until later in 2011 or in 2012, given the need to consult on the detailed application of these measures, such as those on sustainable drainage systems (SUDs) which we address below.

Resourcing flood management work

9. Effective practical implementation of flood policy objectives requires adequate resources for both the management activities of those charged with preparing for and responding to flood events, such as preparation of strategies and flood risk management plans, and for capital projects, principally building and maintaining flood defences.

Local authority funding

10. The EA emphasised to us the importance of local authorities in delivering local flood risk management.¹³ A key plank of the FWMA is that local authorities are expected to take on the role of Lead Local Flood Authority, including taking responsibility for surface water, ground water and ordinary watercourse flooding.¹⁴ Defra has committed itself to “fully funding new net burdens” on local authorities,¹⁵ a point re-iterated by the Secretary of State for the Environment, Rt Hon Mrs Caroline Spelman MP, who told us that Defra had allocated funding from its own budgets to local government since “it isn’t reasonable to ask local authorities to do things without resourcing them correctly”.¹⁶ Defra’s Director General, Environment and Rural Group, Peter Unwin, told us that the Department had given councils some £21 million for next year and £36 million for subsequent years to cover extra responsibilities under the FWMA.¹⁷ In addition, Defra told us that this year local authorities were spending some £100 million from their formula grant on flood activity.¹⁸

11 The Environment Agency published its draft national strategy on 24 November 2010, with a consultation running until February 2011. Defra/Environment Agency, *Reducing the threat, building resilience, empowering communities; Consultation on a national flood and coastal erosion risk management strategy for England*, November 2010.

12 Defra webpages. www.defra.gov.uk

13 Ev 62 Note: Volume I of this report contains written evidence submitted by only those witnesses who also gave oral evidence to the Committee. Additional written evidence is contained in Volume II to this report available on the Committee’s website at www.parliament.uk/efracom. Such evidence is referenced as ‘Ev w’.

14 Flood and Water Management Act 2010, Sections 6 and 9.

15 Defra fact sheet, Flood and Water Management Act 2010: Funding for local authorities, Defra webpages. www.defra.gov.uk/environment/flooding

16 Minutes of Evidence taken before the Environment, Food and Rural Affairs Committee, 16 November 2010, HC 611-i, Q 3.

17 As above.

18 Q 192

11. However, we received a great deal of evidence questioning Defra's assumptions about the funding levels necessary for local authorities to undertake their enhanced roles. Somerset County Council, for example, considered that the £36 million funding did not reflect the full costs to councils of implementing the new burdens placed on them by the FWMA.¹⁹ Devon County Council stated that surface water flooding accounted for some 46% of the flood risk to properties, however, councils (who are tasked with managing such flooding) only received some 6% (£36 million) of overall flood funding. It recommended the establishment of a single "Flood Risk Management" pot combining EA money and new surface water, ground water and ordinary watercourse funding. This should be shared out based on "flood zone risk and surface water vulnerability".²⁰ Essex County Council also wanted revenues, from either charges such as the General Drainage Charge or from Regional Flood and Coastal Committee (RFCC) scheme funding, to be made available for surface water flood work.²¹ The need for sufficient funding for councils was endorsed by water industry companies such as Severn Trent Water,²² and by the insurance industry. The Association of British Insurers (ABI) considered that the Government should ensure that sufficient funding sources were available as part of a long-term funding strategy which should be set out as soon as possible.²³

12. On 24 November 2010, after we finished taking evidence, Defra published a consultation document which set out in more detail the principles under which it was proposed that funding for flood defences would be secured in future.²⁴ Amongst its proposals is the suggestion that capital grants should be available for surface water flooding work since "all sources of risk, and projects sponsored by all operating authorities, should be treated and valued equally on a benefits and damages avoided basis".²⁵

13. Under the Comprehensive Spending Review (CSR), on average, central government funding to councils is set to decrease by 26% over the next four years, although the decrease in funds available is estimated at 14% if projections for council tax levels are taken into account.²⁶ Ring-fencing of most revenue grants will end from 2011-12, and local authorities will have to make their own choices about where to direct funding according to their local priorities.²⁷

14. Both new and existing flood management legislation can only be effectively implemented if those charged with putting it into practice have adequate and stable funding. Under the Flood and Water Management Act 2010 local authorities will have a leading role in local flood work and will have to balance this new area of responsibility with

19 Ev w30 Note: Volume I of this report contains written evidence submitted by only those witnesses who also gave oral evidence to the Committee. Additional written evidence is contained in Volume II to this report available on the Committee's website at www.parliament.uk/efracom. Such evidence is referenced as 'Ev w'.

20 Ev w8

21 Ev w19

22 Ev w27

23 Ev w23

24 Defra, *Consultation on Future funding for flood and coastal erosion risk management in England*, November 2010.

25 As above, p 12.

26 HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, p 50.

27 HM Treasury, *Spending Review 2010*, Cm 7942, October 2010, p 50.

other demands on their limited budgets, including the potential need to make increased contributions if some local flood defence projects are to proceed in the next few years. **We believe that councils should aim to give flood protection work the same level of priority that the Government has spelt out in the Coalition Agreement. We recommend that Defra and the Department for Communities and Local Government review local authorities' spend on flood management work in April 2012.**

15. We have not been able to examine in detail the impact of the Comprehensive Spending Review on local authority flood management work, nor the potential implications for this work of the Government's proposals for funding of surface water management projects. In view of the level of concern over the sufficiency of council funds to meet their new flood responsibilities, we will wish to return to this issue in future.

Sustainable drainage systems

16. A specific responsibility placed on local authorities under the FWMA is to adopt and maintain sustainable drainage systems (SUDs) for new properties.²⁸ The provision of SUDs for new developments, and where possible for existing developments, is widely supported by organisations such as the EA, since they aid effective surface water drainage in an economically and environmentally-friendly manner.²⁹ Much of the evidence we received, including that from the Local Government Association (LGA), supported the Act's position that local government should be responsible for SUDs since this would enable councils to establish a closer link between drainage and planning.³⁰ However, some water companies disagreed with the FWMA's approach. Yorkshire Water for example, said that water and sewerage companies should own and manage SUDs since this was a core activity for such companies, and they were also able to recover the associated costs through sewerage bills. It considered it to be "counter intuitive" to transfer responsibility for private sewers to water companies whilst at the same time creating new drainage responsibilities for local authorities.³¹

17. Evidence submitted to this inquiry reveals widespread concern among local authorities about their ability to fund SUDs' adoption and maintenance. The Impact Assessment (IA) published alongside the Flood and Water Management Bill assumed a level of savings from a separate policy which councils strongly dispute will accrue to them.³²

18. The LGA was critical of Defra's methodology and conclusions since the IA was based on a 2002 survey which had only secured a 12% response rate from local authorities. It cited Defra's caveat at the time that the survey's figures could "only be used as a guide" yet the Department had used it to conclude that councils would realise some £50 million in

28 Flood and Water Management Act 2010, Section 32 and Schedule 3. Note: this provision is awaiting commencement following further Defra work on arrangements for adoption and maintenance of SUDs, including technical guidance.

29 Environment Agency, sustainable drainage webpages. www.environment-agency.gov.uk

30 Ev w36

31 Ev w45

32 This policy is the proposed transfer of private sewers to water and sewerage companies as set out in Defra's document published in August 2010, *Consultation on draft regulations and proposals for schemes for the transfer of private sewers to Water and Sewerage Companies in England and Wales*.

savings to spend on SUDs work.³³ The LGA quoted a number of councils which had calculated that they would accrue only a fraction of Defra's assumed savings from the transfer of sewers. For example, Leeds City Council said it spent £28,000 on private sewers in 2008–09 while Defra estimated that council's spend to be some £760,000 a year.³⁴ Councils including Devon, Cornwall, Lincolnshire and Essex County Councils and Calderdale Council reinforced these concerns in their evidence to us.³⁵

19. The LGA also considered that the IA was out-of-date as savings to councils would have been further reduced since 2002 due to significant amounts of housing having left local authority control.³⁶ The Association considered it "essential" to establish a sustainable, long-term funding mechanism for SUDs maintenance and replacement. It proposed a model by which surface water drainage revenue collected by water and sewerage companies for those properties served by sustainable drainage systems could be passed to councils for funding SUDs maintenance.³⁷

20. Defra told us that the 2002 survey represented the "best evidence available" and that issues such as variations in the levels of local authority involvement in private sewerage and cost recovery had been taken account of in calculating the £50 million figure.³⁸ It said that the LGA had not offered an alternative estimate. Defra said it wanted to "achieve a fair outcome for both local authorities and the taxpayer" and had set up a joint review panel with the LGA, as well as committing to fund the maintenance of adopted SUDs while options for a longer-term funding mechanism were considered.³⁹

21. The principle of local authorities recovering costs, both immediate and continuing, associated with new developments from developers is an established one. The Planning Policy Statement on Development and Flooding (PPS 25) states that, where surface water drainage systems are provided solely to serve any particular development, their construction and ongoing maintenance costs should be "fully funded by the developer".⁴⁰ Commuted sums could therefore be negotiated with developers to meet the ongoing costs of maintaining SUDs.

22. We support the development of sustainable drainage systems (SUDs) for new properties and their retro-fitting where feasible since they are a cost-effective, environmentally beneficial method of providing drainage. In implementing the SUDs provisions in the Flood and Water Management Act 2010, Defra must take into account the diversity of views as to who should be responsible for SUDs maintenance and the strong concerns many local authorities have about securing long-term funding for this. We are concerned that Defra's calculation of the level of resources it expects to be available to councils as a result of the transfer of private sewers is not based on

33 Ev w38

34 Ev w38, Ev w39

35 Ev w19, Ev w7, Ev w29, Ev w20, Ev w17

36 Ev w35

37 Ev w37

38 Ev 72

39 Ev 73

40 Commuted sums can be included in Section 106 agreements, under the Town and Country Planning Act 1990.

robust data and that councils will therefore not be adequately recompensed for their new duties on SUDS. We recommend that Defra undertakes further work on its model for the ownership and funding of SUDs, including the extent of the potential for local authorities to recover costs from developers.

Fire and Rescue Authorities' flood duties

23. The emergency response (including that by the EA) to the summer 2007 floods was estimated to have cost £27 million.⁴¹ The Pitt Review examined the role for Fire and Rescue Authorities in responding to flood events and recommended that the “Government should urgently put in place a fully funded national capability for flood rescue, with Fire and Rescue Services playing a leading role, underpinned as necessary by a statutory duty”.⁴² The Fire Brigades Union (FBU) argued that, as flood rescue is not a core function, there was a need for a statutory duty on Fire and Rescue Authorities to undertake such work, as recommended by the Pitt Review, and that this could be implemented via an order under Section 9 of the Civil Contingencies Act.⁴³ The FBU was concerned that, despite £2 million funding from Defra for flood rescue capability, “none” of the money had been spent on fire-fighter training or personal protective equipment and there was less equipment available than at the time of the 2007 floods.⁴⁴

24. Defra told us that the Pitt Review was “not categorical about the issue of statutory duty” and referred to Sir Ken Knight’s review of the Fire and Rescue Services’ (FRS) response to the 2007 floods which concluded that such a duty was not necessary. Defra considered a duty could be counter-productive since other responders would “withdraw from the response” due to lack of statutory duty on them, which would lead to increased pressure on FRS funds. It did not, however, rule out introduction of a statutory duty.⁴⁵ The Minister also told us that if there were a local failure from prioritising statutory over discretionary matters, or if the “wrong priorities” were adopted, then Defra had a “national responsibility” to make sure the Pitt Review recommendations were followed through.⁴⁶

25. In November 2010 Defra announced that a further £2 million was being provided to help fund emergency services’ flood rescue work.⁴⁷ At the same time the Department launched the first phase of its “Exercise Watermark” to test the preparedness of agencies to respond to flood events.⁴⁸

41 Environment Agency, *The cost of the summer 2007 floods in England*, January 2010.

42 *The Pitt Review* p 180.

43 Civil Contingencies Act 2004.

44 Ev w4

45 Ev 71

46 Q 202

47 “New funding for local flood rescue teams”, Defra news release, 17 November 2010. Core FRS funding is provided via Revenue Support Grant. Defra has setup a flood rescue grant scheme under its national project to improve flood rescue capability across England and Wales so that a comprehensive emergency response can be deployed and coordinated between all flood rescue service providers, including public, private and voluntary organisations.

48 In March 2011 Defra will hold a wide-ranging exercise (Exercise Watermark), delivered by the EA, to test the arrangements across England and Wales to respond to all aspects of severe, wide-area flooding. It will test core aspects of the National Flood Emergency Framework and pan-regional and national response arrangements.

26. We welcome the launch of Exercise Watermark and the additional £2 million of funding from Defra towards emergency services' flood rescue work but recognise that this represents only a fraction of the potential costs to these authorities of preparing for and responding to flood events. We are concerned that the lack of a statutory duty for Fire and Rescue Authorities could jeopardise their flood preparation and response work, given pressures on them to direct their limited funding towards fulfilling non-discretionary duties. We recommend that the Government places a duty on Fire and Rescue Authorities to undertake specified flood rescue preparation and response work, and that provision of adequate resources for this work is included under the funding formulae applied to emergency services.

Funding for flood defences

27. Previous Defra Ministers accepted EA estimates that funding on flood defences needed to double by 2035 to maintain current protection levels.⁴⁹ A Government report in 2004 calculated that by the end of the century, increased risk of flooding due to factors such as climate change and urban development could increase the annual cost of flooding from £1 billion to £2 billion at today's prices, if flood management programmes were to be increased in line with the rising risk. However, costs could go up to around £27 billion if they were not.⁵⁰ A considerable part of Defra's capital budget has in recent years been allocated to flood management work such as building and maintaining flood defences. For example, in 2008–09 around £347 million, or 55% of the Department's total capital budget, was allocated to such work.⁵¹ The EA states that every £1 spent on most new flood defence schemes generates an £8 return in the long term,⁵² for example through avoidance of the costs of restoring property and assets after flooding. Defra describes this as amongst the highest value for money achieved by public sector investment.⁵³ Graph 1, below, sets out overall expenditure over the past decade on English flood risk management work.

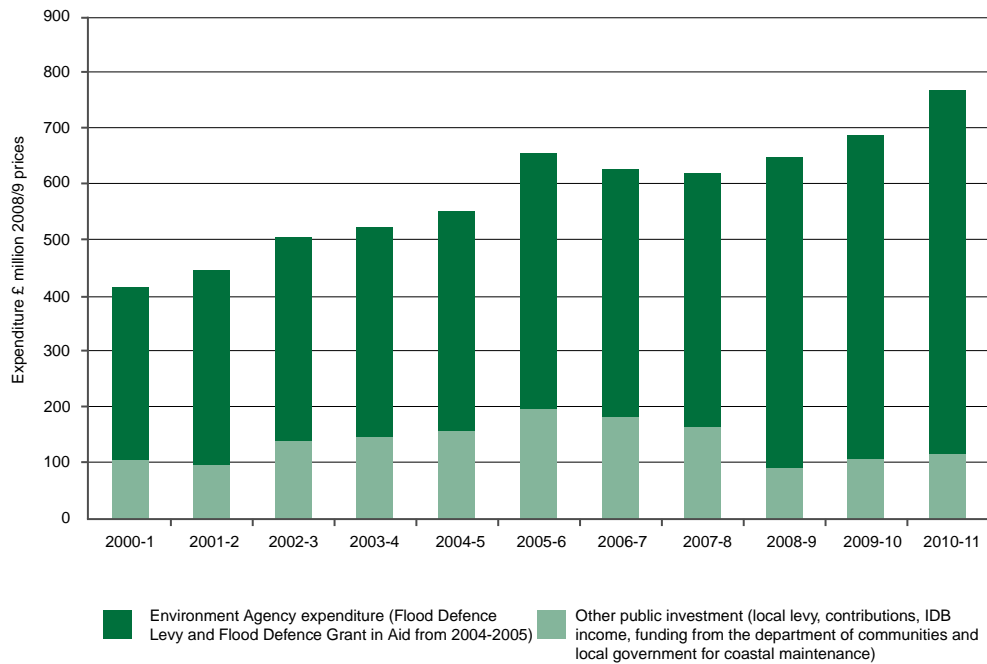
49 Defra pre-election flood webpages, www.defra.gov.uk/environment/flooding.

50 Office of Science and Technology, *Foresight: Future Flooding*, 2004.

51 Defra, *Departmental Report 2009*, CM 7599, June 2009.

52 Environment Agency, *Flooding in England: A National Assessment of Flood Risk*, 2009, p 5.

53 Defra, *Future funding of flood and coastal erosion risk management in England*, November 2010, p 9.

Graph 1: Expenditure on flood risk management in England, 2000 to 2010

Source: Environment Agency, *Flood Risk Management in England, 2009*

28. The Minister said prior to the CSR announcement that protecting flood and coastal erosion defence budgets was a priority. However, he warned that the Government could not be expected to meet the estimated £20 billion cost of funding defences for every property at risk. The Minister is reported to have said that some communities in high-risk coastal areas would have to be sacrificed due to rising sea levels and erosion.⁵⁴ He told us that “the idea that we could surround all our coastlines that are vulnerable to coastal erosion by steel and concrete in perpetuity and defend every house was a notion that was wrong from the outset”.⁵⁵

29. In October 2010, the CSR announcement provided top-line information on the level of funding for flood defence work for the period 2010–11 to 2014–15. Defra plans to spend some £2.1 billion better protecting 145,000 homes by the end of this period.⁵⁶ The Secretary of State clarified that the 145,000 figure was the number of “additional homes” that the Government had committed itself to protecting within the CSR period.⁵⁷ The EA will also work to achieve efficiency savings on capital investment in flood defences of 15% by 2014–15.⁵⁸ The Secretary of State told us that Defra had secured a “very good outcome” from the CSR capital bidding process, particularly since the previous Government had been committed to 50% savings on its overall capital budgets. She claimed that it was a “very good return on public investment when public money is spent defending people’s homes”.⁵⁹ However, whatever the previous administration’s spending plans may or may

54 “Flood protection will escape worst of cuts”, *Insurance Times*, 7 October 2010.

55 Q 173

56 HM Treasury, *Spending Review 2010*, CM 7942, October 2010, p 64.

57 Minutes of evidence taken by the Environment, Food and Rural Affairs Committee, 16 November 2010, HC 611-i, Q 53.

58 As above

59 As above, Q4

not have been, £2.1 billion represents an 8% annual reduction over the next four years, compared to the previous four years' spend, or around a 17% reduction on the previous Government's funding for flood defence work in 2010–11.⁶⁰

30. Further detail on budgets from April 2011 for specific Defra bodies, including for the EA, will be provided in due course. Nevertheless, the Environment Agency's Chairman, Lord Smith of Finsbury, believed that the CSR meant that flood defence projects on site could finish but there would be "some difficulty" starting new flood defence projects over the next year or two. He also believed that revenue funding would be sufficient to maintain current emergency response levels—an "absolute" EA priority.⁶¹ He expected the EA to be able to "maintain a very strong maintenance programme".⁶² He suggested that of the 500,000 homes at significant flood risk, the CSR settlement would allow increased protection to some 45,000.⁶³

31. The evidence reflected the debate that has been started about the basis on which flood defences are funded and the potential to improve the allocation of costs to reflect the benefits to private individuals and organisations. For example, Yorkshire Water argued that accessing private capital to support flood defence investment should be explored, as this would release public sector resources to be spent in other priority areas.⁶⁴ The Minister gave us assurances that flood defences would not be sold off but he placed emphasis on partnership working to "empower communities",⁶⁵ arguing that local people should be able to contribute since it meant they were better protected from flooding, and that this should be reflected in their insurance premiums.⁶⁶ He said that injecting alternative funding could make schemes viable that would not be pursued if funded solely from public sources.⁶⁷ Defra also believed that the EA's practice of seeking funds where appropriate from those who stand to be major beneficiaries of new and improved flood defences allowed Government funding to be "spread further and achieve more overall".⁶⁸

32. Defra's consultation document on funding flood and coastal erosion risk management work, published on 24 November, aims to implement the Pitt Review recommendation that "local investment in flood risk management should be allowed and encouraged".⁶⁹ It proposes that from April 2012 new principles should apply for the allocation of grant-in-aid to reflect the Government's view that "the private as well as public nature of benefits suggest that costs should not fall to the general taxpayer alone".⁷⁰ Although at present some

60 Defra webpages set out the previous Government's planned funding for 2010–11 of £764 million, of which £100 million was estimated to come from local authority budgets, some £354 million from EA capital and some £275 from EA resource budgets. www.defra.gov.uk/environment/flooding

61 Q 77

62 Q 78

63 Q 79

64 Ev w45

65 "Flood protection will escape worst of cuts", *Insurance Times*, 7 October 2010.

66 Q 177

67 Q 171

68 Ev 70

69 Defra, *Future funding of flood and coastal erosion risk management: Consultation on the future capital grant-in-aid allocation process in England*, November 2010, p 3.

70 Defra and Environment Agency *Consultation on a national flood and coastal erosion risk management strategy for England*, p 11.

95% of costs are met by central Government, nevertheless existing local levy powers mean that local communities are already funding some schemes, and have often needed to fully fund projects where central grant-in-aid has not been available.⁷¹

33. Under the new approach, some grant-in-aid will be available to all projects but 100% funding will only be provided to projects that deliver “sufficient benefits”.⁷² Where more projects are seeking grant-in-aid than is available within a particular region, Defra proposes that Regional Flood and Coastal Committees can “raise local levy to pay the flood defence grant-in-aid contribution needed to avoid the projects having to be deferred, or the full project costs if no other funding is forthcoming”.⁷³ The consultation document states that the proposals will give communities more choice, but that providing funding additional to grant-in-aid would be “voluntary”.⁷⁴

34. Defra claims the new approach will give “greater certainty” over Government investment and enable it to focus support on those “most at risk and least able to afford to protect themselves”.⁷⁵ Nevertheless, Defra recognises that the existing EA process has been an efficient way of delivering national priorities and exploiting economies of scale.⁷⁶

35. We are concerned about the future adequacy of funding for flood defences given the need to increase investment in order simply to maintain the current level of protection in the face of flood threats which may be increasing as a result of climate change. We note the priority Defra places on protecting flood defence work and welcome its provision of more than £2 billion over the next four years for such work. We welcome the focus on improving procurement to deliver 15% efficiency savings in Environment Agency flood defence budgets which was designed to help to deliver improved protection to 145,000 properties by 2015. However, it is an inescapable fact that the CSR funding settlement represents a cut to flooding budgets. This is against a background where funding for flood defences has been judged to be inadequate.

36. Given the considerable sums of capital spending being invested into flood defences in the UK, we believe it is essential that Defra regularly reviews the evidence base on which projections of increased flood risk are based. No model projecting changes in sea level or changing weather patterns can ever be perfect for all time and if future evidence were to emerge which conflicted with the original projection or, for instance, suggested that the pace at which sea levels were rising was starting to slow, then the Department should take account of such evidence.

37. Whilst Defra’s recently published consultation document on the future funding of flood and coastal erosion risk management gives substance to the debate as to how to

71 Defra, *Future funding of flood and coastal erosion risk management: Consultation on the future capital grant-in-aid allocation process in England*, November 2010, p 18.

72 As above, p 12.

73 As above, p 18.

74 As above, p 10.

75 Defra and Environment Agency *Consultation on a national flood and coastal erosion risk management strategy for England*, p 26.

76 Defra, *Future funding of flood and coastal erosion risk management: Consultation on the future capital grant-in-aid allocation process in England*, November 2010, p 9.

ensure that beneficiaries provide a higher proportion of the funding for flood defences, proposals are at an early stage of development. We conclude that it is right that beneficiaries such as developers should help fund new schemes, but it is by no means certain that any shortfall in central Government funding will be made up at this stage by contributions from other sectors, particularly the local government sector which is already contributing to funding many local flood defence projects. Clear principles and methods must be agreed urgently amongst all interested parties to secure funding from all sources to meet the Government's flood defence objectives in the next few years since timely investment in flood defences provides significant economic and social returns. We note Defra's assurance that public funding will be focussed on those communities at greatest risk who are least able to protect themselves and recommend that Ministers spell out in their consultation response how such communities will be identified and how their protection will be achieved in practice.

38. We recommend that the Environment Agency provides the Committee with an update in May 2011 on how the allocation of Defra's CSR funding will impact on its flood programmes and by the end of 2011 on how its efficiency programme has impacted on its flood defence work.

Flood insurance

39. One of the main sectors calling for action to maintain flood defence spending is the insurance industry. The Association of British Insurers (ABI) estimated that by 2035 another 350,000 properties would be added to the 500,000 properties currently at "significant" flood risk unless steps were taken now. It considered the FWMA to be a "vital step towards better protection for home owners and businesses" which fulfilled part of the 2008 'Statement of Principles' agreement between the ABI and the Government on the provision of flood insurance (see annex). This agreement enables the insurance industry to provide up until the end of June 2013 flood insurance to the vast majority of households and small businesses, both those located in areas where flood risk is not significant (ie less than a 1 in 75 annual probability of flooding) or in areas at "significant flood risk" where the EA has announced plans to reduce the risk for those customers to a level "below significant" within five years.⁷⁷ This agreement does not, however, apply to new properties built after January 2009 since the ABI encourages developers and customers purchasing a property in a new development to ensure that it is insurable for flooding. Nevertheless, the ABI also considered that binding targets should be placed on the EA to reduce the number of properties at significant flood risk.⁷⁸ RSA Insurance Ltd considered that the present agreement would not be renewed in its existing form after it expired in June 2013 since the Government needed to demonstrate a clearer "commitment to continuing, planned investment in spending on flood defences".⁷⁹

40. These views were echoed by the LGA who warned that, should the insurance industry withdraw its agreement to provide flood risk cover to the over 5 million properties in flood risk areas, there was a "danger of creating blight, unbalancing the housing market and

77 Ev w23 (See annex for text of 2008 Revised Statement of Principles, 2008–2013).

78 Ev w24

79 Ev w42

undermining social cohesion”.⁸⁰ However, the Secretary of State saw “no reason” why anyone should not be able to insure their property”.⁸¹ The Minister called for the insurance industry to work with the Government to “encourage homes and properties to be resilient to flooding”.⁸²

41. There is an urgent need for the Government to reach agreement with the insurance industry on the provision of flood insurance to millions of homes and businesses in flood risk areas since the current ‘Statement of Principles’ is set to expire in 2013. The renewed agreement should ensure that investment in flood resilience measures by householders is reflected in the insurance premiums they pay. Defra should provide the Committee with an update on progress on this within six months.

Agriculture and flood defences

42. We received evidence about the contribution that agricultural landowners make towards achieving flood management objectives. The National Farmers’ Union (NFU) noted that, since 75% of England and Wales was agricultural land, farmers’ involvement in management of flood risk was “crucial” but it emphasised that “services they can offer do not come without a cost”.⁸³ The NFU considered that agricultural land should not be seen as a “free resource” (for example for temporary storage of floodwaters) and welcomed the clause in the FWMA permitting arrangements to be made for financial or other support for “action taken by persons in respect of risk of, or in preparing to manage the consequences of, flooding or coastal erosion”.⁸⁴ The Minister recognised that proper compensation was owed to landowners. Wetting farmland in order to protect properties from flooding imposed “a lot on the farming community” hence the industry’s views needed to be taken into account.⁸⁵

43. No specific outcome measures in relation to agricultural benefits and food security are included in the current flood defence cost-benefit calculations. The Minister told us that such measures would “divert resources away from protecting people and property and other sectors of the economy that tend to suffer much greater damages than agriculture when flooding takes place”.⁸⁶ Defra noted that less than 2% of the damage suffered in the 2007 floods was incurred by the agricultural sector, despite the floods occurring close to harvest time. It told us that there was “no evidence” that flood events represented a threat to food security in the UK, and that agricultural benefits were appropriately valued within the existing appraisal and prioritisation system.⁸⁷

80 Ev w36

81 Minutes of evidence taken by the Environment, Food and Rural Affairs Committee, 16 November 2010, HC 611-i, Q 56.

82 Q 183

83 Ev w33

84 Flood and Water Management Act 2010, Section 1, 3 (g).

85 Q 195

86 Ev 70

87 As above.

44. Regional Development Agencies (RDAs) have been the bodies responsible for socio-economic scheme management under the Rural Development Programme for England (RDPE).⁸⁸ Peter Unwin, Director General, Environment and Rural Group, Defra told us that the department would take over this responsibility when the RDAs were abolished, without affecting delivery to farmers”.⁸⁹ The Secretary of State believed that it would not be possible to place responsibility with Local Enterprise Partnerships (LEPs), the “obvious vehicle for delivery”, whilst the LEP “map was evolving”. By taking responsibility centrally, Defra could assure the European Commission that public resources were being properly applied to the purpose for which they were intended and were being properly “controlled and audited”.⁹⁰

45. While the evidence suggests that the impact of flooding on agriculture is not as costly as on other sectors, greater recognition of the value of flood defence works undertaken by agricultural landowners is needed. The Water White Paper and Natural Environment White Paper must fully reflect the potential role of agricultural practices in assisting the achievement of flooding objectives. Where agricultural land is used for flood defence and mitigation purposes, the owners and farmers should be properly compensated.

46. We note with concern that final arrangements have yet to be made for administering payments under the Rural Development Programme for England after the abolition of the Regional Development Agencies. Defra should set out clearly in its response to this report how it will manage the transitional arrangements in order to ensure that this inter-regnum does not hinder work to encourage landowners to implement measures to support water management and flood defence work.

Planning to mitigate flood risk

47. We received evidence from a range of bodies endorsing the aim of reducing flood risk to new developments. The ABI, for example, suggested that the best way to avoid creating new flood risk is to stop development in high flood risk areas, but that, where development is needed in such areas, higher minimum standards should be applied to buildings, including for design features. It welcomed current planning policy, as set out in the Planning Policy Statement on Development and Flooding, PPS 25,⁹¹ which strengthened requirements for flood resilience in new developments. However, it was concerned that the new localism focus should not lead to any increase in “unwise developments in high risk

88 The Rural Development Programme for England is jointly funded with the EU under the European Agricultural Fund for Rural Development with a budget of £3.9 billion over 2007–13. £3.3 billion is for agri-environment and other land management schemes aimed at improving sustainability, biodiversity, access and water quality. Some £600 million is for improving the competitiveness of agriculture and forestry and enhancing rural opportunity. www.defra.gov.uk.

89 Minutes of evidence taken by the Environment, Food and Rural Affairs Committee, 16 November 2010, HC 611-i, Q 103.

90 As above, Q 104

91 Planning Policy Statement 25, *Development and Flood Risk*, is published by the Department for Communities and Local Government. <http://www.communities.gov.uk/publications>

areas”.⁹² PPS 25 also allows local authorities to negotiate commuted sums to cover the costs of increased flood risk from new developments.⁹³

48. The Government’s Coalition Agreement set out a broad aim to prevent “unnecessary building in areas of high flood risk”, but provided no specific definition of what constituted “unnecessary building”.⁹⁴ The Minister told us that there was a need to look at more flexible approaches to development, such as providing some money to protect properties for only 20–30 years as opposed to a period of 100 years.⁹⁵

49. While a blanket ban on development in areas at risk of flooding would clearly be the most direct method of ensuring that new properties are not affected by flooding, this is not a practicable approach given limited land availability, particularly in those areas where development pressures are highest. It is important to direct development to low flood risk areas as much as possible, but, where development is essential in higher flood risk areas, sufficient attention must be given to mitigation measures. Planning authorities must also recognise the need for the costs of any flood defence measures provided for those properties that are constructed in high flood risk areas to be borne, at least in part, by those such as developers who are beneficiaries. **We recommend that the Water White Paper set out a clear framework for planning for new developments in flood risk areas, building on existing planning policy, including principles for the apportionment between public agencies and private beneficiaries of the costs of providing flood defences for new developments.**

Internal Drainage Boards

50. Internal Drainage Boards (IDBs) play a key role in flood prevention in the nearly 10% of the country where ongoing watercourse and drainage management is needed to keep water levels within acceptable limits. The Boards are independent, statutory bodies responsible for land drainage in areas of special drainage need, covering 1.2 million hectares of lowland England.⁹⁶ There are currently some 160 IDBs in England and Wales, concentrated in East Anglia, Yorkshire, Somerset and Lincolnshire. Although it included no specific proposals, the consultation document published with the draft Flood and Water Management Bill stated that IDB reform might be necessary to address concerns over some Boards’ accountability and accessibility. The document claimed that some IDBs operate “solely or primarily for the benefit of farmers” to the “detriment of nature conservation”.⁹⁷ However, it also referred to Defra’s recent process of modernising IDBs, including amalgamation of Boards, to reduce costs and to more closely match them to river catchment units in line with the concept of holistic water management.

92 Ev w24

93 Department for Communities and Local Government, Planning Policy Statement 25, *Development and Flood Risk*.

94 HM Government, *The Coalition: our programme for government*, May 2010, p 17.

95 Q 174

96 Defra, *Draft Flood and Water Management Bill*, Cm 7582, April 2009. Internal Drainage Boards operate under the provisions of the Land Drainage Act 1991 and have powers to secure drainage and water level management of their districts, including flood defence works on ordinary watercourses.

97 As above, p 72.

51. We received evidence both for and against reform of IDBs. In favour were organisations such as the Royal Society for the Protection of Birds (RSPB) who said reform was “long overdue” since Boards needed a sustainability duty and their membership needed to better reflect local authority and environmental interests.⁹⁸ Some organisations supported the concept of extending IDB roles, for example the EA was interested in working with Boards on extending their role into management of main rivers in IDB areas.⁹⁹ Against reform were bodies such as the NFU who considered radical reform to be unnecessary given IDBs’ successful track record. It considered the Bill’s consultation proposal to be a blunt instrument, although there was scope for improved engagement by Boards with their stakeholders.¹⁰⁰

52. The Minister told us that while IDBs were a “wonderful example of local community spirit and voluntary activity” undertaken by committed people with local knowledge, some Boards could operate better if they were amalgamated.¹⁰¹ The Minister was wary of the potential enlargement of the IDB role into main river management, since he did not want to “fix something that is not broken”.¹⁰² Although measures on reform of IDBs were not included in the FWMA, the Government has included enabling provisions in the Public Bodies (Reform) Bill currently going through Parliament to allow reform of IDBs at a subsequent date by delegated legislation.¹⁰³

53. Internal Drainage Boards are already seeking to maximise the impact of their work including through implementing improvements to their structure. However, the broader question as to the necessity or otherwise of more substantial reform of IDBs was left unresolved at the time of the last election. We favour a localised, incremental approach to any reform as opposed to a “one size fits all” model imposed centrally. We recommend that the Water White Paper set out the broad principles for the evolution of the relationship between IDBs and other agencies with drainage functions over the next 5 years, allowing for local implementation according to the specific needs of each area. Defra should consider allowing IDBs to retain levy money currently paid to the Environment Agency for maintenance of river courses so that IDBs can use their skills and equipment to undertake these functions directly where appropriate to local circumstances.

98 Ev w21

99 Q 83

100 Ev w33

101 Q 204

102 Q205

103 Public Bodies (Reform) Bill.

2 Water Management

Background to water management policy

54. The UK is facing increasing pressure on its ability to maintain economic and environmentally sustainable water supplies. The main challenges include changing weather patterns, population increases in areas of water stress, and environmental demands including those related to meeting the requirements of EU Directives such as the Water Framework Directive,¹⁰⁴ and the Urban Waste-Water Treatment Directive.¹⁰⁵

55. In 2008, the previous Government set out its vision for water up to 2030—*Future Water*—and initiated work on a number of its key policy strands. However, water policy was a work in progress at time of the General Election in May 2010. In particular, while final reports had been submitted to Ministers, the Government’s response was awaited to two key independent reviews:

- the Independent Review of Charging for Household Water and Sewerage Services by Anna Walker,¹⁰⁶ (the Walker Review), and
- the Independent Review of Competition and Innovation in Water Markets, by Professor Martin Cave,¹⁰⁷ (the Cave Review).

56. The Government announced in August 2010 that it was reviewing regulation of the water industry to assess whether the current framework, including Ofwat’s statutory duties, remains fit for purpose. The review will also assess the effectiveness of the Government’s guidance to Ofwat, how well statutory duties and guidance are translated through Ofwat’s decision-making and the extent to which the regulator has contributed to the achievement of sustainable development. The outcomes of this review will feed into the Water White Paper to be published in June 2011. Our inquiry, whilst not explicitly addressing regulatory structures, examined a number of issues where regulatory changes might be required.

Charging for household water and sewerage services: the Walker Review

57. Household customers do not have a choice over who supplies their water and sewerage services, rather they are supplied by the company serving their region. The 22 monopoly water and sewerage companies (WaSCs) serving English and Welsh customers,¹⁰⁸ are

104 Directive 2000/60/EC of the European Parliament and of the Council establishing a framework for the Community action in the field of water policy (known as the EU Water Framework Directive).

105 Directive 91/271/EEC of 21 May 1991 concerning urban waste-water treatment.

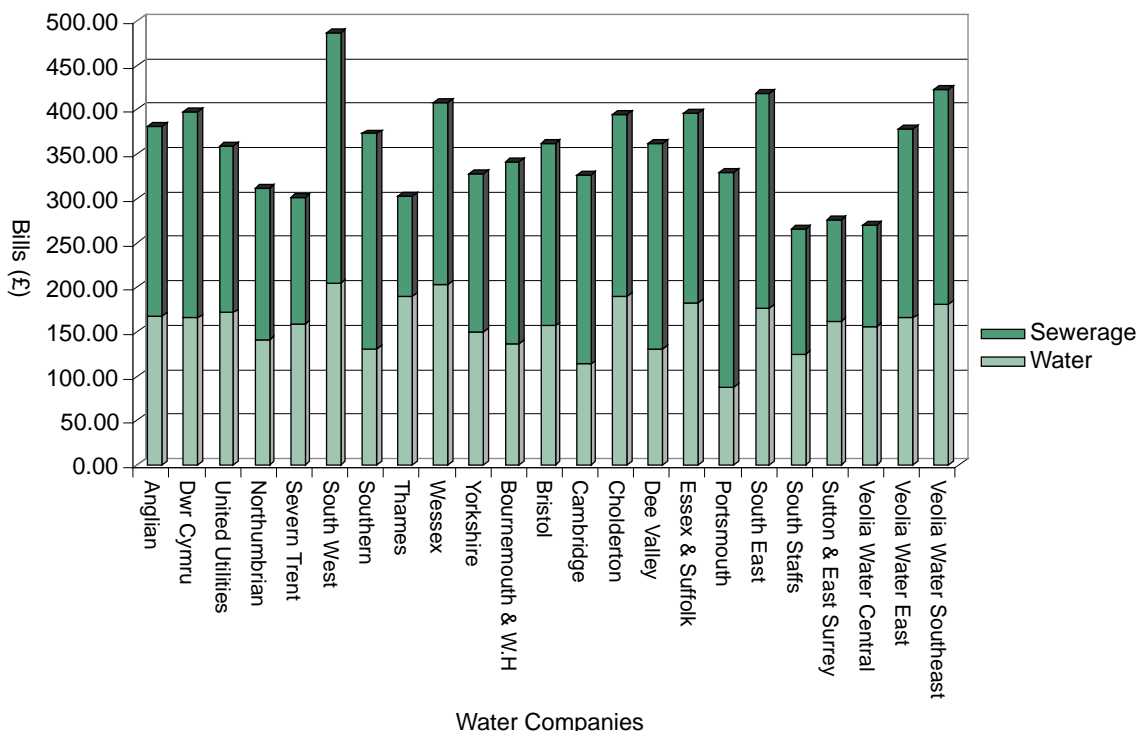
106 Defra, *The Independent Review of Charging for Household Water and Sewerage Services; Interim Report*, June 2009. (Referenced further as *Walker Review Interim Report*). *The Walker Review Final Report* was published in December 2009.

107 Professor Martin Cave, *Independent Review of Competition in Water Markets; Final Report*, April 2009. (Referenced further as *The Cave Review Final Report*).

108 Of the 22 companies regulated by Ofwat, 10, including Welsh Water (the single, not-for-profit water and sewerage company in Wales), are combined water and sewerage companies (WASCs) while 11 are water only suppliers. Scotland and Northern Ireland each have a single, publicly owned, water and sewerage company, subject to separate regulatory regimes.

regulated by Ofwat.¹⁰⁹ The regulator uses company performance comparisons as a basis for five yearly periodic reviews under which annual price limits are set for each company.¹¹⁰ In 2008–09, the average combined household water and sewerage bill was £331, some £700 less than the average energy bill.¹¹¹ Average combined bills for 2010–11 will be £333.¹¹² The charges householders pay vary considerably across the English regions however, depending on the company providing the service (see graph 2 below).¹¹³

Graph 2: Combined water and sewerage average household bills 2010–11



Source: Ofwat webpages, www.ofwat.gov.uk/publications/tariff/

58. Additionally, the charges paid by customers of the same company may vary considerably depending on whether they are charged on a metered or a rateable value basis.¹¹⁴ Nationally, the average unmetered bill for combined water and sewerage services is £362, while the average metered bill is £309.¹¹⁵

59. In August 2008, the then Government commissioned Anna Walker to undertake an independent review of charging for household water and sewerage services in order to

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

110 Walker Review Interim Report, p 24.

111 Ofwat webpage, How customers are Charged 2008–09. www.ofwat.gov.uk

112 Ofwat webpage, Average Household Bills: 2010–11. www.ofwat.gov.uk/consumerissues

113 Ofwat webpage, Combined water and sewerage bills. www.ofwat.gov.uk

114 Water companies recover their costs in four ways: charges based on the rateable value of the property, charges based on the volume of water consumer, charges based on assessment (where customers would like to be metered but cannot be), and WaterSure which is a scheme for vulnerable customers in England (ie low income households with high essential usage).

115 Ofwat webpage, Average household bills 2009–10. www.ofwat.gov.uk

identify potential options for future charging regimes.¹¹⁶ A key issue she addressed was water supply affordability. Although there is no formal definition of affordability, those who spend more than 3% of their disposable income (before housing costs) on water and sewerage costs are frequently classified as being in ‘water poverty’.¹¹⁷

60. The Walker Review final report published in December 2009 made recommendations on a range of charging issues impacting on household water affordability, including social tariffs and levels of bad debt, metering and regional price variations (including the high level of average bills in South West England). Ms Walker concluded that, whilst the current charging system still worked, it needed updating to ensure that “people continue to regard it as fair, that essential water and sewerage services are affordable to all and to ensure we can meet the future significant challenges of climate change”.¹¹⁸ In this short inquiry we did not aim to address Walker’s work in detail but assessed the key areas on which the Water White Paper should focus.

Customer engagement

61. Central to Walker’s conclusions was the need for consumers’ views to be taken into account by the regulator when setting prices. The Consumer Council for Water (CC Water) told us that their input had achieved a £1 billion better deal for water customers in the 2009 price review, compared to that achieved under the 2004 review held prior to the establishment of the organisation.¹¹⁹ However, much of the evidence we received, including that from Water UK, referred to the need to better incorporate customers’ views in the price setting process. Both CC Water and Ofwat focussed on the need to build on customer engagement in view of the regional monopolies held by water companies.¹²⁰

62. Witnesses such as CC Water proposed specific improvements. The organisation told us that Ofwat must be motivated to involve customers through a performance indicator based on customer satisfaction. It considered that this would create the right incentives for water companies to focus on their customers.¹²¹ Yorkshire Water was in favour of further discussion on negotiated settlements.¹²² Such settlements have been suggested as an option by the All Party Parliamentary Group on Water, drawing on the experiences of US and Canadian utilities where user groups and utilities have pro-actively negotiated settlements covering pricing, investment, quality of service and efficiency incentive schemes.¹²³

63. The Government is currently undertaking a review of Ofwat and the role of CC Water. In addition, the Cabinet Office announced in October 2010 that, following its review of public bodies, further consultation would be undertaken on the merger or abolition of a

¹¹⁶ *Walker Review Interim Report*.

¹¹⁷ *Walker Review Interim Report*, p 111.

¹¹⁸ *Walker Review Interim Report*, p 1.

¹¹⁹ Ev 58

¹²⁰ Ev 59

¹²¹ Ev 59

¹²² Ev w45

¹²³ “Let Ofwat and CC Water negotiate the regulatory settlement”, *Utility Week*, 14 November 2008.

number of bodies representing consumers including Consumer Focus,¹²⁴ and the Office of Fair Trading.¹²⁵

64. Despite successes in securing a good deal for customers, there is considerable scope for better integrating customer views within the price setting process. We recommend that the Water White Paper puts at its heart the strengthening of customer representation, and should include proposals for a regulatory mechanism which better links customer priorities with regulatory outcomes. In determining the final structures of organisations such as the Consumer Council for Water, the Government should recognise the value of an independent body that is able to challenge the regulator’s approaches.

Social tariffs

65. The FWMA included provisions for water companies to be able to provide social tariffs for some customers.¹²⁶ Many witnesses, including Water UK, Anglian Water and Severn Trent Water, urged the Secretary of State to produce the required guidance at the earliest opportunity to enable them to introduce such tariffs.¹²⁷ Water companies such as Thames Water and Yorkshire Water also urged the Government to improve information sharing between water companies and central and local government, as a precursor to introducing a social tariff.¹²⁸ The Minister, however, noted that a key question was how much a water company should be expected to act as an “arm of the Government’s welfare programme”,¹²⁹ and Ofwat considered that it would be fairer to provide social assistance through national taxation.¹³⁰

66. Social tariffs can help to ameliorate the impact of rising bills on low income customers, however opinion is divided as to whether such assistance should be funded through a levy on water customers’ bills or from central taxation as part of the welfare and benefits system. We consider that if social tariffs are to be funded from water bills, the desirability of helping individuals must be balanced with the interests of other customers who pay their full bills plus the additional costs of providing such assistance. The Water White Paper must spell out clearly the extent to which the Government envisages that national social tariffs will be used to address problems low income customers face in affording their water bills.

124 Consumer Focus was launched in October 2008 and incorporated the former energy consumer body, Energywatch.

125 “Quango reforms herald new age of accountability in Government”, Cabinet Office news release, 14 October 2010.

126 FWMA Section 44 provides that an undertaker’s charges scheme under s 143 of the Water Industry Act 1991 may include provision designed to reduce charges for individuals who would have difficulty paying in full. The Minister must issue guidance which balances “the desirability of helping individuals who would have difficulty paying in full with the interests of other customers”.

127 Ev 64, Ev w26, Ev w28

128 Ev w31, Ev w44

129 Q 262

130 Ofwat, *A drain on society—what can be done about water debt*, October 2010, p 12.

Metering

67. Metering is the usual method of charging for water in most other European countries, but in the UK more than two-thirds of customers receive bills based on the rateable value of their home.¹³¹ However, each year around a further 2% of customers switch to a metered supply.¹³² Currently, levels of metering vary widely across the country, with, for example, some 70% of South West Water’s customers being metered compared to only some 10% of Portsmouth Water’s customers.¹³³

68. Ofwat considers that metering all customers is the fairest way of paying for water used. We received a wide range of evidence in support of further metering, for example from CIWEM who supported “near universal metering”,¹³⁴ and the RSPB who recommended “full compulsory metering in England and Wales by 2020, with tariffs that protect vulnerable customers, deter waste and reflect environmental impact”.¹³⁵ Metering is particularly important in areas where water resources are tight, such as in the South East of England, since metered customers tend to use less than those whose bills are based on the rateable value of their home.¹³⁶ Charging by volume is recognised to be a key tool in driving more efficient use of water and a company in an area of water stress can already impose metering if this is found to be cost-effective.¹³⁷ Furthermore, with sufficient levels of metering, there is potential to introduce variable tariffs which reflect the volume of water used. We did not consider this method of charging in this inquiry but clearly there are a number of potential options other than simply charging a set unit price, such as rising block tariffs, which can provide more sophisticated price signals to drive demand reduction.¹³⁸

69. There are potential drawbacks to widespread metering since there are costs associated with installing meters and some customers will see their bills rise, particularly those who are high non-discretionary water users on low incomes. CC Water told us that it wished to see metering implemented “without customer backlash”.¹³⁹ However, it pointed to conflicting evidence of customer views—on the one hand some 57% of customers said that metering is the fairest basis for charging for water services, yet 27% of customers opposed metering and only 40% supported making it mandatory. CC Water argued that there was need for a “pace of implementation that customers will support,” as well as protection for those least able to pay.¹⁴⁰

131 *Walker Review Interim Report*, p 59.

132 *Walker Review Interim Report*, p 70.

133 *Walker Review Interim Report*, p 71.

134 Ev w14

135 Ev w22

136 Ofwat, *Metering: Position Statement*, 2006.

137 Water Industry (Prescribed Conditions) Regulations 1999, as amended.

138 A rising block tariff provides a stepped series of prices for water supply with charges rising with increased consumption.

139 Ev 60

140 Ev 60, referring to *The Consumer Council for Water Charging Research 2007*, ORC International, April 2008.

70. Additionally, as recognised by Thames Water, there may be difficulties with fitting water meters in flats, although the company told us it was working with manufacturers to develop meters that can be used more widely in such circumstances and was liaising with property developers to ensure that new properties, including blocks of flats, are built to allow individual water metering.¹⁴¹ This was an issue noted by the Minister who told us that Walker was clear that “we should not go towards universal metering”, due to issues such as complications with metering blocks of flats.¹⁴² Walker’s overall conclusion was that, whilst there was a strong argument for “early and potentially compulsory” metering in areas where water is scarce, the case for metering is “less compelling” where water is not in short supply.¹⁴³

71. Metering has a key role to play in helping to reduce water demand. Such reduction is essential given increasing pressure on water resources in some parts of the country. The current approach of introducing metering in a piecemeal manner means that the charging system is under stress, with those on unmetered supplies bearing a progressively higher proportion of costs. A comprehensive, robust and fair charging system for the future is needed with higher levels of metering forming the central pillar.

72. More widespread introduction of metering will mean there are winners and losers and some, including groups of vulnerable customers, could see significant rises in their bills. It is therefore important that the costs of metering be kept to a minimum, and this can best be achieved through a planned, area-based programme of introduction. Variable tariffs to incentivise more efficient use of water could help to keep bills down for many customers. We recommend that the Water White Paper set out a clear strategy for implementation of metering and for variable tariffs to help spur water efficiency.

Regional price variations

73. One of the central issues addressed by the Walker review was the variation in charges paid by householders across the country, with particular reference to South West England. Walker’s report said that:¹⁴⁴

Since privatisation, the [South West] region has had to install significant new sewerage infrastructure in order to upgrade to a level that is similar to the rest of the country. Because of where they started, more investments in infrastructure per customer have been made, so price rises have been more significant, and prices in that area are now the highest in the country (at least 50% higher than the average).

74. Walker noted that the average annual bill for a South West Water customer was £490 compared to £343 for a customer living elsewhere in the country. She also found that, at £723 a year, unmetered customers in the South West have much higher bills than metered customers, who pay on average £401 a year, and that customers faced a price rise of 29%

141 Thames Water, FAQs: Assessed Household Charges, Thames Water webpages. www.thameswater.co.uk

142 Q 257

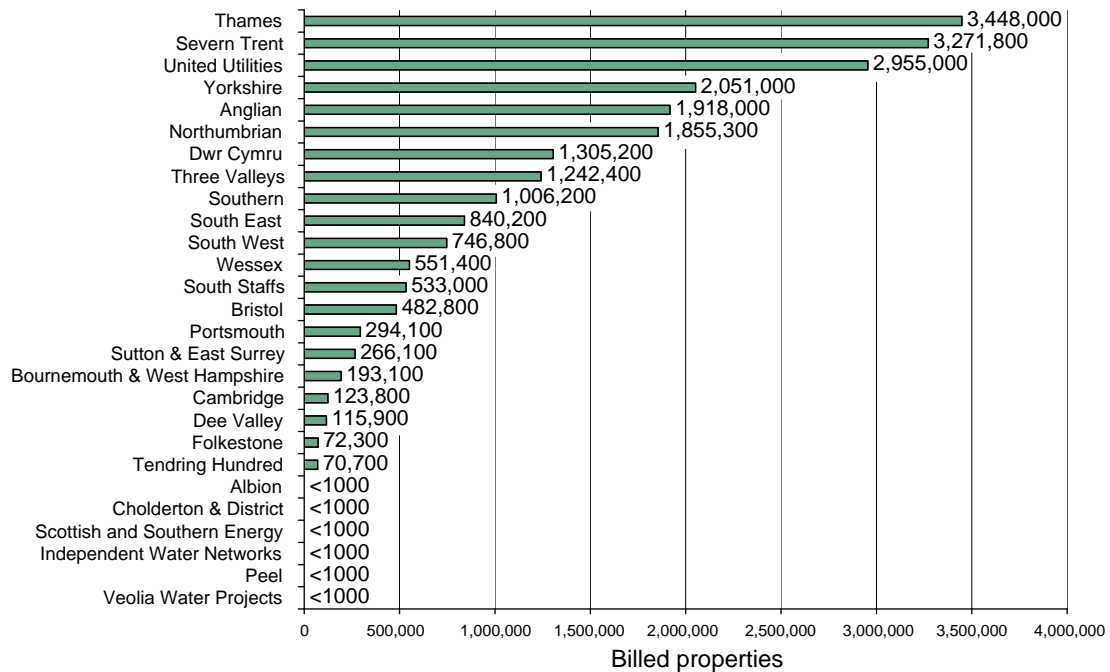
143 *Walker Review Interim Report*, p 2.

144 “Publication of Independent Final Report on Charging for Household Water and Sewerage Services”, Walker Review press release, 8 December 2009.

over the next five years.¹⁴⁵ There was currently a high level of metering in the South West—about 70%—which was expected to rise to over 90% by 2024–25. At the same time, the area had certain characteristics that reinforced affordability problems, such as a high rural population, over 22% of the population being of pension age, and disposable income being about 10% lower than the UK average.¹⁴⁶ Additionally, as the UK’s top tourist destination, in peak weeks the local population increased by 25% and demand for water was a third higher than for the year as a whole.

75. A factor exacerbating price differences across the country is the wide variance in the number of customers each company has amongst whom to spread the costs of any necessary capital investment. For example, Thames Water has the highest customer base, with nearly 3.5 million billed properties, whilst South West Water has only some three quarters of a million properties (see graph 3 below).

Graph 3: Number of billed properties per company



Source: Ofwat, *Advice from Ofwat to the UK Government on the question of a threshold for legal separation of appointed companies’ retail businesses in the water and sewerage sectors.*

76. The Walker report broadly endorsed regionally-set prices which reflected the significant difference in costs faced by companies due to their local circumstances. Nonetheless, it set out a number of possible options for addressing the level of prices paid by customers in the South West of England.¹⁴⁷

- Implementation of a one-off or other financial adjustment by Government to address the specific circumstances of South West Water at the time of privatisation, and the resulting implications for water bills in the South West Water area;

145 Walker Review Final Report, December 2009, Chapter 14.

146 As above.

147 Walker Review Final Report, p 162.

- Adjustment of bills in the South West Water area through contributions by other water customers across the country, and
- A package of proposals for South West Water customers, potentially taking account of seasonal issues and cost drivers and a package of proposed affordability measures.

77. Ofwat was tasked with undertaking further work to help inform Defra’s decisions, including specific examination of the following options which would entail a shifting of resources into the South West:

- A one-off financial injection to the South West (taxpayer funded);
- A debt guarantee (taxpayer funded);
- An annual transfer of funds (funded by water customers nationally);
- A national social tariff (funded by water customers nationally), and
- Seasonal tariffs (funded by visitors to the South West region).

Additionally, Ofwat has examined methods of redistributing costs within the South West, such as rebalancing costs between household and commercial customers, and a targeted social tariff paid for by South West Water bill payers.

78. CC Water told us that customers would prefer tax revenues to be used to bring prices into line with other regions but recognised that this was unlikely in the current financial climate, so social tariffs would be needed. It noted that customers in the South East of England could see bills could go up by £200 as a result of compulsory metering, so vulnerable members of this group of customers also needed protection through such tariffs. The organisation also noted that customer acceptance would be needed if any new tariffs created additional cross-subsidies.¹⁴⁸ The Minister considered that the £100 a year higher than average charges paid by those in the South West were a “product of a mistake and also a product of geography”.¹⁴⁹ He recognised that this was an issue for those on lower incomes but was cautious over a tariff that would “take money from somebody in Newcastle who may be on benefits to pay a water charge payer in the South West who may be a millionaire”. This was an issue he needed to sort out “before we start to talk about single banded amounts being transferred around the country”.¹⁵⁰ However, Mr Benyon also recognised that a “solution that remains within the South West” would not satisfy South West MPs.¹⁵¹

79. Ofwat’s evidence addressed the issue of how environmental improvements should be paid for, noting that to date water customers had borne most of the Water Framework Directive implementation costs and that it was important for all responsible parties to bear their share of such costs. It considered that strong regulation would be needed to reflect the

148 Ev 59

149 Q 278

150 Q 272

151 Q 277

‘polluter pays’ principle and at the moment there was “no incentive on those responsible for causing pollution to consider alternative options”.¹⁵²

80. Water UK told us that a “measured pace” for programmes would ensure that overall prices were acceptable to customers but that an “innovative approach” to regulation was also needed to incentivise exemplary environmental and sustainability performance.¹⁵³ The link between environmental improvements and customer prices also underpinned some other witnesses’ concerns about who determines environmental policy. Thames Water, for example, stated that “responsibility for environmental and social policy decisions should rest with the Government” and noted that, while set up to be an economic regulator, Ofwat’s remit had broadened.¹⁵⁴

81. The issue of whether and how regional customers should bear the costs of nationally important environmental projects was considered in 2009 by the previous EFRA Committee. Our predecessors concluded that “Ofwat and Defra have so far failed to make the argument that regional variations in the costs customers must bear for environmental investment are fair and appropriate”. The Committee also recommended that Defra examine how changes might be made to the way investment in the water industry is paid for when it is “directly and expressly for the purpose of improving environmental standards for national benefit”.¹⁵⁵

82. Higher water charges in some parts of the country reflect the historical levels of pre-privatisation investment in infrastructure, population density and other largely circumstantial factors. This has had a particular impact on customers living the South West of England. Ofwat is conducting research into the impact of the various Walker Review options for addressing higher prices for household water customers in the South West. The decision on which option to adopt will be a matter of judgement, and will have to reflect the political choices about burden-sharing. There is no obvious or pain-free solution. Nevertheless, it is essential that this issue is resolved as a priority. **We would not wish to see a solution to water prices in the South West region which merely redistributes the costs among customers within the region, nevertheless Ministers must ensure that any solutions help to protect low-income customers across the country. Although the South West region presents the most immediate problem, large-scale capital investment is likely to be needed in a number of regions in coming years to meet environmental requirements with consequent impacts on bills for many other customers. We recommend that the Water White Paper set out a sustainable, long-term set of principles for determining how the costs of nationally significant environmental projects should be paid for in future. To balance the needs of those in regions with disproportionately high water bills with the need to be fair to other customers elsewhere in the country, the solution could lie in a number of options which include some form of hybrid option applied nationally which has elements of social tariff to**

152 Ev 53

153 Ev 65

154 Ev w32

155 Environment, Food and Rural Affairs Committee, Fifth Report of Session 2008–09, *Ofwat Price Review 2009*, HC 554, p 43.

help those in greatest need but which is weighted to recognise the substantial regional variance in bills when compared to the national average.

Bad debt

83. Unlike the framework for the supply of energy, whereby householders enter into a contract with their chosen energy company, water companies have no contract with their customers. Rather, the Water Industry Act 1991 stipulates a duty for undertakers (water companies) to supply households in their areas. Disconnection or the use of flow-limiting devices are currently prohibited for domestic customers.¹⁵⁶ In comparison to other utilities, the water industry carries high levels of household debt. Some 4.3 million household customers are in debt to water companies, compared to around 1.1 million customers with outstanding bills for electricity and 0.8 million with unpaid gas bills, despite the higher average bills for energy supplies. Additionally, the overall level of debt within the water sector is higher, with some £930 million owed by water customers nationally, compared to £223 million for electricity and £179 million for gas customers.¹⁵⁷ This debt costs each water customer who does pay their bill around £12 every year. The Walker Review proposed a number of solutions including measures to empower companies to identify those responsible for bills, improved monitoring of company performance on debt management and better sharing of information between local government and water companies on vulnerable customers.¹⁵⁸

84. We received evidence from a number of organisations, including CC Water, about the need to implement the proposed Walker recommendations to “help those who are struggling to pay or facing unfairness in how they are being charged for water”.¹⁵⁹ Section 45 of the FWMA, which requires owners of rented properties to supply information to water companies on who is liable to pay bills, were regarded by Water UK as a “good first step” for tackling bad debt.¹⁶⁰ However, Anglian Water urged that stronger sanctions be available for use against “wilful non-payers”.¹⁶¹ It suggested that the right abolished in 2000 for water companies to cease supply to “those who are able but who deliberately choose not to pay” should be reinstated, that the use of trickle-flow devices should be enabled,¹⁶² and that landlords should be made directly liable for bills with an extension of this requirement to all properties, not just residential ones.¹⁶³

85. However, Thames Water, while advocating a review of companies’ powers to pursue debt from customers “able but unwilling to pay their bills,” considered that domestic disconnection is “rightly not an option for water companies”. Instead it urged exploration

¹⁵⁶ Water Industry Act 1991, section 52.

¹⁵⁷ Water UK, *Debt and affordability*, 17 October 2008.

¹⁵⁸ *Walker Review Interim Report*, p 142.

¹⁵⁹ Ev 59

¹⁶⁰ Ev 64

¹⁶¹ Ev w28

¹⁶² Trickle flow devices are those which reduce the flow of water to a customer. Their main use is to cause inconvenience whilst maintaining basic health and hygiene requirements and so prompt payment from the customer. The Water Industry Act 1999 made it illegal for water companies to use such devices or to disconnect supplies to any dwelling occupied by a person as his only or principal home. www.ccwater.org.uk

¹⁶³ Ev w28

of other ways to create a disincentive for “repeated and wilful non-payment”, such as enabling water companies to pursue debt through Magistrates courts.¹⁶⁴

86. The Flood and Water Management Act 2010 has provided some new tools to enable water companies to collect payment from some customers more effectively. But further measures are needed. Some customers who fail to pay their water bills fall into the ‘can’t pay’ category, but water companies need stronger options to pursue those who ‘won’t pay’ since it costs every customer who does pay an additional £12 a year to subsidise non-payers. **We recommend that the Water White Paper set out proposals to fortify the ability of water companies to recover debts from those able to pay. These could encompass measures such as enabling water companies to secure tenant information from landlords of all types of property (not just residencies), enabling water companies to pursue debtors through Magistrates courts and instituting a contractual basis for household water supply which defines enforceable customer responsibilities.**

Competition and innovation: the Cave Review

87. In 2008 the Government appointed Professor Martin Cave to lead an independent review of competition and innovation in water markets. His final report, published in April 2009, recommended that water companies should be required to separate out their retail activities for both household and non-household sectors.¹⁶⁵ The Government set out its response in the 2009 Budget,¹⁶⁶ welcoming the review’s findings which it said would be taken forward in England following consultation with stakeholders on the implementation of:

- The separating out of large water undertakers’ household and business retail operations to increase competition and deliver efficiencies in the supply of water to business users. Further work by Ofwat would establish whether it would be appropriate to introduce a threshold below which companies should not be obliged to separate;¹⁶⁷
- A package of further reforms to the water supply licensing regime, including giving Ofwat the power to determine the criteria for setting charges;
- Reform of the mergers regime for water, and
- Reform of the ‘inset’ regime that allows a supplier to replace another under certain circumstances.

88. The Government accepted the Review’s conclusions that the current case for extending competition to households was not convincing. Although the Government indicated a wish to pursue the Cave reforms, the opportunity was not taken to include measures in the FWMA.

164 Ev w31

165 Professor Martin Cave, *The Independent Review of Competition and Innovation in Water Markets: Final Report*, April 2009 (referenced further as *The Cave Review Final Report*).

166 HM Government, *Building Britain’s Future: Budget 2009*, 22 April 2009.

167 Ofwat concluded that there did not appear to be a “strong case” for a threshold but, if the Government were minded to introduce one, it should be set at 50,000 billed properties.

89. The current legislative framework allows competition in some aspects of water supply. For example, the ‘inset regime’ established in 1990 gives some customers choice, for example where a site which is to be developed has no existing water supply, but to date only 18 such appointments have been made.¹⁶⁸ Cave concluded that current restrictive conditions limited the use of such inset agreements, and that the ‘common carriage’ model of competition introduced in 2005 was “flawed in conception and implementation”.¹⁶⁹ Ofwat told us that the current framework was “too restrictive” in its prescription of the method by which charges can be determined for newcomers wishing to access the water market. This needed to change if more competition was to be introduced.¹⁷⁰

90. In Scotland, the Water Services etc (Scotland) Act 2005 established the Water Industry Commission for Scotland (WICS) with the power to set charges so as to allow Scottish Water to deliver the Scottish Government’s objectives for the industry at the lowest reasonable overall cost.¹⁷¹ This Act also created a framework for competition for supply of the non-household market, with no location or size restrictions. WICS believed that this had delivered lower charges, better customer service and environmentally-friendly initiatives to around 45,000 business and public sector organisations (approximately 40% of the non-household market).¹⁷²

91. We received evidence from a range of organisations on the potential for competition in England to deliver similar benefits. CC Water argued for a lower eligibility threshold and improved opportunities for eligible customers to switch suppliers.¹⁷³ It noted that survey evidence suggested that 84% of large and 69% of small businesses were supportive of competition in principle. The organisation argued that the current regulatory framework was no longer fit for purpose and was limiting the potential for further innovation.¹⁷⁴ WICS agreed that the current regulatory framework needed to be replaced and argued that step-by-step competition should be introduced in England and Wales.¹⁷⁵

92. Water UK, representing water and sewerage companies in England and Wales, believed that further water trading would result in “more efficient use of water resources, giving customers greater security of supply at lower financial and environmental cost”. While legislation was not needed to capture these gains, the organisation believed that present regulatory incentives discouraged companies from developing the existing market for bulk supplies which might offer efficiency gains by “reducing the need for investment in resources and assets” due to the potential for better use to be made of existing supplies.¹⁷⁶ Water companies reinforced this view. SSE Water argued that Ofwat needed to be more

168 *The Cave Review Final Report*, p 98. The local incumbent water company can be replaced by another undertaker (an inset appointee) in certain circumstances, principally where a site is unserved or where the user is likely to use at least 50 megalitres a year (England) or 250 megalitres (Wales).

169 *The Cave Review Final Report*, p 6.

170 Q 14

171 Ev w9

172 Ev w10

173 Ev 59

174 Ev 60

175 Ev w10

176 Ev 65

pro-active to secure appropriate behaviour by incumbent water companies. It considered that the regulator had been reluctant to use its powers to promote and streamline the current competitive framework, and that a legislative priority was the overhaul of the competition framework.¹⁷⁷ Defra argued that wider competition had the potential to “reveal the value of water more effectively” than the current system which led to the recovery of narrow water management costs only.¹⁷⁸

93. However, there are risks. Water UK emphasised the need for the regulatory regime to continue to support investor confidence and to provide companies with the scope to pay new and existing investors a “reasonable rate of return” since, without confidence, the rates of return investors required could increase, “impacting either on sustainability programmes or customers’ bills”.¹⁷⁹ Thames Water saw a risk that “some reforms could jeopardise investors’ abilities to make a reasonable return, undermining the incentives for future investment”.¹⁸⁰ Press coverage of Severn Trent’s interim results in November 2010 referred to utilities analysts’ views that uncertainty for investors in the sector was likely to remain until publication of the Government’s White Paper.¹⁸¹

94. Increasing competition in water supply will not solve all the problems of rising water prices, but we note the strength of support for the view that benefits are to be had by a measured introduction of competition into the water industry in England. Although the structure of the water industry in Scotland is very different, we were impressed by the benefits delivered to customers through competitive pressures on the industry. However, the water industry has legitimate concerns that changes to the regulatory and competitive regime could incur costs which outweigh savings, particularly if uncertainty over changes were to increase companies’ cost of capital. It is therefore vital that competition in the water industry is introduced at a measured pace. The Water White Paper must set out clearly how greater competition will be balanced with maintaining confidence by investors in the future structure of, and regulatory controls over, the industry.

95. Our predecessor Committee expressed concerns in its investigation into the 2009 Price Review about the potential impact of uncertainty on the water supply industry and therefore also upon customers.¹⁸² The timetable within which changes to the legislative and regulatory framework can be made is tight if there is not to be disruption to the price setting process. Ofwat believed that summer 2011 publication of a White Paper would be very helpful since it could then form part of the framework for price setting. However, if legislation were to be required as a consequence, then Ofwat would want to know “very quickly” what the legislative timetable would be in order to provide “clarity and a road map”.¹⁸³ The Minister told us that Defra’s draft Structural Reform Plan committed it to bring forward legislation by November 2012, but, with the earliest start date for the second

177 Ev w16

178 Ev 70

179 Ev 65

180 Ev w31

181 “Water, water everywhere. Severn Trent leads the way with results”, *The Daily Telegraph*, 22 November 2010.

182 Environment, Food and Rural Affairs Committee, Fifth Report of Session 2008–09, *Ofwat Price Review 2009*, HC 554.

183 Q 15

Parliamentary session now likely to be May 2012, this represented a “fairly tight schedule”, albeit an achievable one.¹⁸⁴ He added that there was a possibility of getting some elements of legislation into the current parliamentary session, but that he would prefer to get in “as much comprehensive legislation” as possible.¹⁸⁵

96. There is a short time during which changes to the regulatory regime can be made if price-setting processes are not to be disrupted with consequent costly uncertainty for the water supply industry. We are concerned about the potential for slippage in the timetable for any water legislation necessary to implement the Water White Paper proposals, particularly in respect of proposals to change the structure of the water supply industry. We recommend that the Government sets out how its timetable for introducing necessary statutory provisions will enable key provisions to be in place in time to allow a smooth transition to the next price control period starting in 2015.

Environmental and economic sustainability of water supply

97. In England, average water use is around 150 litres of water per person per day, higher than average usage in other European countries with a similar climate,¹⁸⁶ yet the average water availability per person is lower than in many Mediterranean countries.¹⁸⁷ Across England and Wales many river catchments are already over-abstracted or over-licensed. Consumption of water in the South East of England is the highest per capita in England, yet the region is classified as seriously water stressed and, furthermore, is predicted to have the highest levels of growth. At present, there is no mechanism to enable water supply constraints to be taken into account within the planning system for new developments. Water companies consider that they should be included in the list of statutory consultees with whom planners are required to liaise when making decisions on planning applications for new developments since large-scale new developments in water-stressed areas, such as South East England, could lead to “deeply unsustainable communities”.¹⁸⁸

98. Defra and the Department for Communities and Local Government should consider further the potential for the planning system to ensure that new developments do not jeopardise water supplies in areas of water stress, for example by placing a statutory requirement on all those making applications for developments consisting of more than 10 homes or on sites larger than 1 hectare to consult water and sewerage companies.

99. Current policies lead to a pricing regime under which water users are charged for the basic costs of supply. Many commentators argued for a mechanism that allows prices more accurately to reflect the overall value of water as a resource. Ofwat, while asserting that the regulatory framework has worked well so far, believed there was a need to value water to “drive better investment decisions, sustainable management of water resources and

184 Q 167. Defra’s Business Plan published in November 2010 revised this date to April 2013.

185 Q 168

186 *Walker Review Interim Report*, p 31.

187 Environment Agency, *Household metering: position statement*, November 2010.

188 “Sustainable communities don’t take water for granted”, Water UK press release, 11 February 2003.

efficient use of water”, and that this would lead to better decisions which favoured managing demand and leakage over building new supplies such as reservoirs.¹⁸⁹

100. Environmental bodies supported this approach. For example, the EA told us that they supported legislation to improve the allocation of water and to achieve a more sustainable balance between supply and demand choices.¹⁹⁰ Waterwise, the water efficiency NGO, argued that the current regulatory structure was not fit for purpose, partly due to its “bias towards capital expenditure”, and proposed measures such as reform of abstraction licensing, a scarcity charge, and a longer-term investment framework, to reflect the full, long-term value of water.¹⁹¹ Natural England also criticised the current system under which water pricing is “based only on costs of supply and administration rather than the full economic cost of water supply, which includes the full externalities and user costs of supply”.¹⁹²

101. Defra told us that it wanted to see “all future options, supply-side and demand”, assessed and noted that the current model of economic regulation provided a “strong artificial incentive for capital intensive solutions such as supply-side options”. It considered this situation to be unsustainable since it posed a risk to the long-term security of supply. Defra further argued that the current framework led to an “inadequate valuation” of the water environment. Healthy rivers provided an essential service to society and the economy and better use should be made of scarce and uncertain resources.¹⁹³

Abstraction regime reform

102. Several witnesses argued that reform of the abstraction regime in particular would assist in assigning a broader value to water resources. This issue was addressed by the Cave Review which concluded that the current abstraction licence and discharge consent regimes failed to ensure that “resources are used efficiently and sustainably” and recommended that the EA should be given new powers to tackle over-abstraction and to encourage the trading of licences.¹⁹⁴ While the consultation document published by Defra with the draft Flood and Water Management Bill referred to abstraction licensing reform, proposals were not brought forward in the Bill introduced into Parliament.¹⁹⁵

103. The EA told us that the current abstraction regime might not provide a “sufficiently strong price signal to reflect water stress and the true value of the water environment”.¹⁹⁶ The RSPB considered that all licences should be time-limited, have flow-rate restrictions and, where environmental damage could occur, licences should be able to be amended or revoked. However, the NFU had concerns over the draft Bill’s proposals for extension of time-limited abstraction licences, which it considered were “not fit for purpose or

189 Ev 53

190 Ev 63

191 Ev w2

192 Ev w6

193 Ev 70

194 *Cave Review Final Report*, p 3.

195 Defra, *Draft Flood and Water Management Bill Consultation Document*, Cm 7582, April 2009.

196 Ev 63

compliant with the rules of better regulation”. While the organisation acknowledged the need to secure and allocate water resources in a “fair and transparent way for everyone”, it thought that the proposals were “far from adequate or well thought through in terms of their impact”, particularly on the farming sector.¹⁹⁷

104. Future challenges for water supply in some parts of the UK include the impact of climate change, population growth and new development on water availability. To ensure adequate, clean and affordable water supplies in the long-term, the UK must place sustainability at the heart of its water policies. The previous Government’s policy documents included laudable ambitions in this respect but insufficient progress has been made in putting in place specific mechanisms to achieve these aims in practice. The forthcoming Water White Paper must set out specific measures that will enable the wider value of water to be reflected in policies and charges. It should include proposals for amending the regulatory framework for determining prices so that demand-side measures can be better incentivised. The White Paper must also set out a clear programme for reform of the abstraction licensing regime, with a long-term aim of introducing water trading. This must explain how a fair transition to any new regime is managed, including recognition of the rights of those with existing abstraction licences.

Water efficiency

105. In November 2010, a group of environmental NGOs, the Blueprint for Water Coalition,¹⁹⁸ published a call for water efficiency targets to be included in the Water White Paper.¹⁹⁹ The Adaptation Sub-Committee of the Committee on Climate Change has also called for water efficiency to be driven forward in the White Paper. Evidence submitted to our inquiry from a number of organisations further supported the need for improved water efficiency, given the likelihood of increased future pressures on maintaining affordable supplies. For example, Waterwise called for an overall per capita consumption target to be set, delivered through water service companies.²⁰⁰

106. The previous Government said in response to our predecessor’s report on Ofwat’s 2009 price review that it was minded to explore a water efficiency obligation.²⁰¹ The current price control formula, covering the period from 2010–11 to 2014–15, includes two elements which require water companies to achieve water savings—firstly through the Base Service Water Efficiency (BSWE) target whereby all water companies must save one litre per property per day, and secondly through a Sustainable Level of Water Efficiency (SELWE) whereby companies can consider additional water efficiency if it “forms part of a sustainable, economic approach to balancing supply and demand” with an appropriate allowance by Ofwat in its price limits.²⁰² Regina Finn, Chief Executive of Ofwat, told us that

197 Ev w33

198 Blueprint for Water is a campaign of Wildlife and Countryside Link which comprises a range of Non-Governmental environmental organisations including the National Trust, Waterwise, WWF, the Wildlife Trusts and the RSPB.

199 Blueprint for Water Coalition, *Blueprint for Water 2010*, November 2010.

200 Ev w1, Water services companies are those which do not simply sell water but also provide services such as efficiency advice.

201 Environment, Food and Rural Affairs Committee, Fourth Special Report, *Ofwat price review 2009: Government response to the Committee’s Fifth Report of Session 2008–09*, HC 1023, October 2009.

202 Ofwat webpages, Water efficiency targets 2010–11 to 2014–15, www.ofwat.gov.uk/pricereview

the current water efficiency targets would lead to the industry gaining “more water out of the savings side than are [needed on] the resource development side” during 2010–15.²⁰³

Water and energy efficiency

107. Water use accounts for a high percentage of household carbon emissions, not just in terms of its direct use (some 23% of the carbon emissions from home heating relate to water heating), but also in terms of the energy used to source, transport and process water before it reaches the home and afterwards when it becomes waste water. Waterwise, along with other organisations including the Blueprint for Water Coalition, stressed the need to join up energy-saving and water-saving approaches, for example under the Government’s ‘Green Deal’, in order to maximise carbon savings.²⁰⁴ The RSPB argued for an explicit link between activities on water and energy efficiency. However, in the view of the Chartered Institution of Water and Environmental Management (CIWEM), the current regulatory framework “works to preclude a joined-up approach”.²⁰⁵

108. Water saving through greater efficiency of use will become increasingly important, especially in parts of the country where climate change and population growth will lead to significant constraints in supply. We consider that the regulatory framework under which water prices are set must be reformed to include stronger water efficiency targets for water supply companies. We recommend that regulatory bodies work more closely together than they have to date to ensure that energy-saving and water-saving initiatives are not developed in isolation. The regulators and industries should grasp the opportunities to learn from each other’s experiences and develop joint approaches which might most effectively engage customers.

Water quality

109. Improving water quality is a key aspect of Defra’s 2008 *Future Water* vision, with action driven in large part by the need to meet the requirements of two key EU Directives—the Water Framework Directive (WFD),²⁰⁶ and the Urban Waste-Water Treatment Directive.²⁰⁷

110. Witnesses highlighted the need to improve water quality. The RSPB recommended that the forthcoming water strategy recognise the potential for operating authorities to enhance the status of water bodies when implementing WFD requirements.²⁰⁸ However, we also received evidence pointing to likely problems with meeting WFD targets, principally the 2015 water quality targets. In July 2010, the National Audit Office (NAO)

203 Q 25

204 The Green Deal was announced by the Government in May 2010 and sets out a programme of energy efficiency measures for householders. As announced in the Government’s National Infrastructure Plan in October 2010, it will also include water efficiency measures.

205 Ev w14

206 Council Directive 2000/60/EC.

207 Council Directive 91/271/EEC.

208 Ev w21

published a report setting out problems with tackling diffuse pollution.²⁰⁹ That report concluded that, while good progress had been made in reducing the impacts of point source pollution,²¹⁰ insufficient progress had been made on reducing diffuse pollution from sources such as agriculture and urban surface water. The NAO was critical of EA work to date and made a number of recommendations for improvement. Defra's evidence to us highlighted the need to focus on ecosystem, not just point source, pollution,²¹¹ and indeed the Department is undertaking a number of programmes to address diffuse pollution, including those with the agricultural community such as the Catchment Sensitive Farming Programme.²¹²

111. The cost of meeting the WFD's requirements are considerable, in part due to the methods adopted within the Directive for judging water quality. We did not consider these costs in detail in this inquiry but Ofwat stated that in its 2009 price review it had allowed over £130 million towards meeting WFD targets between 2010 and 2015. The Environment Agency estimated that costs associated with implementing the WFD up to 2027 could be between £30 billion and £100 billion, depending on the approach taken. Despite this level of investment, the UK was only likely to see 26% of rivers achieving "Good Ecological Status" (GES) by the WFD target date of 2015.²¹³

112. Domestic water customers currently pay some 82% of the costs of implementing measures to meet WFD requirements, and they might be expected to meet the majority of future costs unless a mechanism is adopted to implement the 'polluter pays' principle more accurately.²¹⁴ Ofwat told us that the agricultural community was paying only some 0.8% of the Directive's costs to the UK even though, as the EA reports, agricultural diffuse pollution had been responsible for 32% of WFD "failures". Ofwat argued that the UK Government should support a change in the GES system to make WFD targets achievable at an acceptable economic cost. The system should be revised to remedy the distorting effect of the one out, all out rule which gave the UK a low GES score despite huge investment. Currently considerable progress could have been made on the majority of factors but a failure on one specific criterion meant overall failure to meet the WFD target.²¹⁵

113. The UK is in danger of missing the Water Framework Directive's (WFD) challenging targets for water quality. Urgent action is required not just from the water supply industry, but from a range of individuals and organisations including rural and

209 Comptroller and Auditor General, Environment Agency, *Tackling diffuse water pollution in England*, HC 188, July 2010.

210 Water pollution derives from two sources: point source pollution, which comes from a single identifiable source such as a factory or sewage treatment works; and diffuse pollution which comes from multiple dispersed sources, such as agricultural land and road run-off.

211 Ev 68

212 Defra's Catchment Sensitive Farming Programme aims to reduce water pollution from agriculture by encouraging land management that keeps diffuse emissions of pollutants to levels that are consistent with the ecological sensitivity and uses of rivers, groundwaters and other aquatic habitats, both in the immediate catchment and further downstream. In 2009–10 Defra spent some £12.9 million on delivering the programme in England.

213 Annex V of the WFD defines Good Ecological Status in terms of the quality of the biological community, the hydrological characteristics and the chemical characteristics of a water body. To meet biological community quality levels, only minimal anthropogenic impacts are allowed.

214 Ev 57

215 Ev 57

urban landowners and industries. The WFD's methodology for measuring water quality is problematic and could be imposing costs which are out of proportion to the level of environmental benefit delivered. We recommend that the UK Government initiates a review within the EU of the scope to achieve the environmental improvement aims of the Water Framework Directive and Urban Waste-Water Treatment Directive in a more cost-effective manner.

114. The Water White Paper should set out proposals, with a costed timetable, as to how current EU water quality targets could be met and who will bear the costs, including measures to engage landowners and industries from all sectors in addressing diffuse water pollution.

Waste water management

Connections to the public sewerage system and misconnected drains

115. Management of the public sewerage system is the responsibility of water and sewerage companies (WaSCs), or, in some cases, sewerage companies. Witnesses, including Thames Water,²¹⁶ and Water UK,²¹⁷ raised with us a number of the challenges of managing this system under the current legislative framework and called for implementation of the Pitt Review recommendation to end the automatic right for properties to connect to the public sewerage system.²¹⁸ The ABI considered that sewerage companies should be consulted about the capacity of their system to adequately drain water from new developments before planning permission is given.²¹⁹ This is the situation in Scotland where Scottish Water has the statutory right to be consulted about planning applications for new developments. The FWMA does not confer a statutory right for English and Welsh WaSCs to be consulted when planning applications are made for new developments, however it does amend the Water Industry Act 1991 to require those wishing to connect to the drainage system to meet conditions, including construction standards.²²⁰ These provisions, while commenced on 1 October 2010, require Ministers to make regulations in order for them to be implemented and allow for Defra to issue guidance to undertakers (WaSCs).²²¹

116. **Water and sewerage companies are responsible for managing the public sewerage system in their areas so it is vital that they have adequate powers to permit or disallow connections, particularly where they will incur additional costs as a result of connections from new developments. Defra should give water and sewerage companies a statutory right to be consulted over planning applications for new developments where these include connection to the public sewerage system. Defra should also produce guidance within three months of regulations being made under the Flood and**

216 Ev w31

217 Ev 64

218 *Pitt Review Interim Report*, recommendation 10, p 133.

219 Ev w23

220 Flood and Water Management Act, Section 42. This section was commenced in October 2010 and regulations are awaited.

221 Flood and Water Management Act 2010, Section 42.

Water Management Act to enable water and sewerage companies to make early use of agreements on the adoption of new drainage systems.

117. Between 0.6% and 2% of household drains are currently incorrectly connected to the main sewerage system and WaSCs believe that they should have greater control over rectifying such problems.²²² Currently WaSCs have the power to disconnect misconnections but no right either to redirect connections to the correct sewer nor to require the misconnections to be rectified. Instead, companies must liaise with the local authority which are the only bodies with the powers to require a householder to put misconnections right. WaSCs argued that bringing forward the draft clause consulted on alongside the draft Flood and Water Management Bill but not in the event pursued, would resolve their concerns in a straightforward manner.²²³ However, the Minister told us that while rectifying misconnections was the “one area of Pitt that we have not followed through”, he wished to “test a non-regulatory route” first, making greater attempts to work with white goods manufacturers, building standards representatives and the Building Research Establishment.²²⁴ However, Defra previously said that giving water and sewerage companies responsibility for systems, yet requiring them to go through local authorities to rectify problems, represented a “complex and inefficient” process and it considered that the proposed legislative changes would enable the companies to trace and solve problems.²²⁵ The Department said that misconnections were a significant source of pollution and were a cause of many WFD failures.²²⁶

118. The current legislative framework does not give water and sewerage companies adequate powers to put right problems with drains and sewers that have been incorrectly connected. Given the significant contribution of such misconnections to water pollution, water and sewerage companies need strengthened rights so that they can rectify connection problems without having to involve third parties. We recommend that the measures included in the consultation on the draft Flood and Water Management Bill be brought forward for legislation at the earliest opportunity.

Private sewers and lateral drains transfer

119. Defra is currently consulting on proposals to transfer ownership of private sewers and lateral drains to water companies, with the result that the costs of maintaining them would in future be borne by all water customers.²²⁷ Water UK estimated that the proposal would cost each customer around £5 to £14 per annum,²²⁸ although Ofwat have calculated that the average increase in bills by 2019 would be only £8.²²⁹ Defra’s Impact Assessment (IA) for this proposal estimated the costs to WaSCs over 40 years to be £40 billion

222 Defra, *Draft Flood and Water Management Bill consultation document*, Cm 7582, April 2009, p 106.

223 Ev w31. FWMA draft clause 253.

224 Q 211

225 Defra water quality webpages. www.defra.gov.uk/environment

226 As above.

227 Defra, *Consultation on Draft Regulations and Proposals for Schemes for the Transfer of Private Sewers to Water and Sewerage Companies in England and Wales*, August 2010.

228 Water UK, Q and A on private sewers. www.water.org.uk.

229 Ev 56

(undiscounted), of which £1 billion represented the one-off capital expenditure expected to arise within the first five years.²³⁰

120. The rationale behind the proposals seems to be broadly accepted. Thames Water, for example, told us it welcomed the proposal since it removed uncertainty about responsibility for this aspect of drainage. However, the company warned that the impact could be significant due to the scale of assets involved.²³¹ Thames would increase its sewer network by some 60% to a length of over 67,000 km. However, a wider concern expressed in much of the evidence we received was that the extent and condition of the sewers and lateral drains to be caught in the transfer is currently largely unknown. Some witnesses, including Thames Water, criticised the current lack of certainty on how costs are to be recovered and asked that Ofwat provide clarity on this.²³² Ofwat told us that the level of uncertainty meant that, although companies could recover costs if they proved to be “material” before the next price limits are set, actual data would be needed to justify any application by water companies to increase charges. Ofwat’s guidance issued to WaSCs stated that “on the Government’s current timetable for the transfer, it is unlikely that [Ofwat] would consider it appropriate to take account of estimated transfer-related costs before September 2013 at the earliest.” Relevant costs beyond 2015 would be picked up as part of the normal price-setting process.²³³

121. Defra’s consultation document makes reference to the large but disparate independent drainage repair sector, noting that smaller firms were most likely to be affected by sewer transfers. The market was estimated to be worth at least £272 million per annum overall, shared between some 1,600 to 2,000 firms in England and Wales. However, there is potential for some businesses to undertake sub-contracting work for WaSCs and the IA noted that “no licences or other stringent new measures or processes for small businesses were being introduced with the transfer”. The IA also stated that the proposals could create new opportunities and open new markets for other small businesses, such as those in training, health and safety audit, scheduling and account management.²³⁴

122. The transfer of private sewers is a technical issue that might have passed below the radar of many water customers even though it could cost them an additional £5–£14 a year. What concerns us more, however, is the lack of certainty about the potential costs of the transfer since no detailed assessment has been made as to the scale and condition of the infrastructure affected. We would not wish to see the proposed transfer delayed. However, Ofwat must explain when and how further clarity will be provided on the costs companies will pass on to their customers and the safeguards in place to protect customers from unreasonable increases in charges. The regulator must also ensure that water and sewerage companies explain clearly to their customers the reasons for the charges and how these have been calculated.

230 Defra, *Consultation on Draft Regulations and Proposals for Schemes for the Transfer of Private Sewers to Water and Sewerage Companies in England and Wales Impact Assessment*, August 2010, p 15.

231 Ev w32

232 Ev w32

233 Ev 56

234 Defra, *Consultation on Draft Regulations and Proposals for Schemes for the Transfer of Private Sewers to Water and Sewerage Companies in England and Wales*, August 2010, pp 23–25.

3 Conclusions

123. We welcome the focus that the Government is giving to the vital policy area of water and flood management. The recommendations in this report will assist Defra in developing proposals for the Water White Paper and Natural Environment White Paper to be published in the first half of 2011.

124. The Flood and Water Management Act 2010 is the focus of a number of our recommendations on flood policy. Commencement of the Act's provisions which have not yet been brought into effect must be a priority. We have made a number of recommendations about the implementation of specific measures in the Act, such as those relating to sustainable drainage systems. Defra must address more general concerns about how public bodies under tight budgetary constraints can fulfil their leadership and strategic roles on flooding. To cut back significantly on flood defence infrastructure spending could be a classic example of short-term savings leading to much greater long-term costs. Future flood defence work must be sufficiently resourced in accordance with a balanced approach to risk management.

125. A number of our recommendations relate to aspects of water management which the forthcoming Water White Paper should address, and where legislative measures might be needed. In particular the White Paper should develop proposals to implement the findings of the Walker Review on charging for household water and sewerage services and the Cave Review on competition and innovation in water supply. It should also include specific, practical proposals to ensure that the price of water captures the full range of externalities, particularly those relating to sustainability and environmental protection, in order to drive the right investment decisions by the water industry and the most beneficial behaviours by customers. This will entail a range of measures in areas such as metering, charging for household water supply and water trading.

126. The Ofwat review is central to the development of many sustainable water management policies, and it is clear from the evidence we received that the regulatory regime needs to be sharpened to enable it to respond better to the challenges of the future. The Water White Paper provides the opportunity to reform regulation to provide a stable basis for the long-term future of the water industry and we look forward to the Government bringing forward comprehensive legislation during 2011, to reach the statute books by 2012, well in advance of the next review of water prices. We would wish to further consider issues raised in this report in the light of proposals contained in any such legislation.

Annex

ASSOCIATION OF BRITISH INSURERS: REVISED STATEMENT OF PRINCIPLES ON THE PROVISION OF FLOOD INSURANCE

The Government and the insurance industry have agreed that the conditions should be in place to enable the insurance market to be able to provide flood insurance to the vast majority of households and small businesses efficiently and without the specific commitments below from 1 July 2013. Thereafter, the industry will continue to work with existing customers to explore insurance options for domestic property and small business customers where the flood risk is significant and no public plans are in place to defend the property.

Until 30 June 2013, ABI members commit to:

- Continue to make flood insurance for domestic properties and small businesses available as a feature of standard household and small business policies if the flood risk is not significant (this is generally defined as no worse than a 1.3% or 1 in 75 annual probability of flooding);
- Continue to offer flood cover to existing domestic property and small business customers at significant flood risk providing the Environment Agency has announced plans and notified the Association of British Insurers (ABI) of its intention to reduce the risk for those customers below significant within five years. The commitment to offer cover will extend to the new owner of any applicable property subject to satisfactory information about the new owner.

It is important to note that:

- The premiums charged and policy terms will reflect the level of risk presented and are not affected by this commitment;
- This commitment does not apply to any new property built after 1 January 2009: the ABI encourages developers and customers purchasing a property in a new development to ensure that it is insurable for flooding. The ABI intends to publish guidance on insurance for new developments in autumn 2008.

This commitment is subject to annual review that will consider progress in resolving the areas of continuing work and implementing the Government's commitments and to additional review in the event of any significant external shocks, such as a reduction in the availability of flood reinsurance or major changes in the UK insurance market.

July 2008

Conclusions and recommendations

Local authority funding

1. We believe that councils should aim to give flood protection work the same level of priority that the Government has spelt out in the Coalition Agreement. We recommend that Defra and the Department for Communities and Local Government review local authorities' spend on flood management work in April 2012. (Paragraph 14)

Sustainable drainage systems

2. We support the development of sustainable drainage systems (SUDs) for new properties and their retro-fitting where feasible since they are a cost-effective, environmentally beneficial method of providing drainage. In implementing the SUDs provisions in the Flood and Water Management Act 2010, Defra must take into account the diversity of views as to who should be responsible for SUDs maintenance and the strong concerns many local authorities have about securing long-term funding for this. We are concerned that Defra's calculation of the level of resources it expects to be available to councils as a result of the transfer of private sewers is not based on robust data and that councils will therefore not be adequately recompensed for their new duties on SUDS. We recommend that Defra undertakes further work on its model for the ownership and funding of SUDs, including the extent of the potential for local authorities to recover costs from developers. (Paragraph 22)

Fire and Rescue Authorities' flood duties

3. We welcome the launch of Exercise Watermark and the additional £2 million of funding from Defra towards emergency services' flood rescue work but recognise that this represents only a fraction of the potential costs to these authorities of preparing for and responding to flood events. We are concerned that the lack of a statutory duty for Fire and Rescue Authorities could jeopardise their flood preparation and response work, given pressures on them to direct their limited funding towards fulfilling non-discretionary duties. We recommend that the Government places a duty on Fire and Rescue Authorities to undertake specified flood rescue preparation and response work, and that provision of adequate resources for this work is included under the funding formulae applied to emergency services. (Paragraph 26)

Funding for flood defences

4. We are concerned about the future adequacy of funding for flood defences given the need to increase investment in order simply to maintain the current level of protection in the face of flood threats which may be increasing as a result of climate change. We note the priority Defra places on protecting flood defence work and welcome its provision of more than £2 billion over the next four years for such work.

We welcome the focus on improving procurement to deliver 15% efficiency savings in Environment Agency flood defence budgets which was designed to help to deliver improved protection to 145,000 properties by 2015. However, it is an inescapable fact that the CSR funding settlement represents a cut to flooding budgets. This is against a background where funding for flood defences has been judged to be inadequate. (Paragraph 35)

5. Given the considerable sums of capital spending being invested into flood defences in the UK, we believe it is essential that Defra regularly reviews the evidence base on which projections of increased flood risk are based. No model projecting changes in sea level or changing weather patterns can ever be perfect for all time and if future evidence were to emerge which conflicted with the original projection or, for instance, suggested that the pace at which sea levels were rising was starting to slow, then the Department should take account of such evidence. (Paragraph 36)
6. Whilst Defra's recently published consultation document on the future funding of flood and coastal erosion risk management gives substance to the debate as to how to ensure that beneficiaries provide a higher proportion of the funding for flood defences, proposals are at an early stage of development. We conclude that it is right that beneficiaries such as developers should help fund new schemes, but it is by no means certain that any shortfall in central Government funding will be made up at this stage by contributions from other sectors, particularly the local government sector which is already contributing to funding many local flood defence projects. Clear principles and methods must be agreed urgently amongst all interested parties to secure funding from all sources to meet the Government's flood defence objectives in the next few years since timely investment in flood defences provides significant economic and social returns. We note Defra's assurance that public funding will be focussed on those communities at greatest risk who are least able to protect themselves and recommend that Ministers spell out in their consultation response how such communities will be identified and how their protection will be achieved in practice. (Paragraph 37)
7. We recommend that the Environment Agency provides the Committee with an update in May 2011 on how the allocation of Defra's CSR funding will impact on its flood programmes and by the end of 2011 on how its efficiency programme has impacted on its flood defence work. (Paragraph 38)

Flood insurance

8. There is an urgent need for the Government to reach agreement with the insurance industry on the provision of flood insurance to millions of homes and businesses in flood risk areas since the current 'Statement of Principles' is set to expire in 2013. The renewed agreement should ensure that investment in flood resilience measures by householders is reflected in the insurance premiums they pay. Defra should provide the Committee with an update on progress on this within six months. (Paragraph 41)

Agriculture and flood defences

9. While the evidence suggests that the impact of flooding on agriculture is not as costly as on other sectors, greater recognition of the value of flood defence works undertaken by agricultural landowners is needed. The Water White Paper and Natural Environment White Paper must fully reflect the potential role of agricultural practices in assisting the achievement of flooding objectives. Where agricultural land is used for flood defence and mitigation purposes, the owners and farmers should be properly compensated. (Paragraph 45)
10. We note with concern that final arrangements have yet to be made for administering payments under the Rural Development Programme for England after the abolition of the Regional Development Agencies. Defra should set out clearly in its response to this report how it will manage the transitional arrangements in order to ensure that this inter-regnum does not hinder work to encourage landowners to implement measures to support water management and flood defence work. (Paragraph 46)

Planning to mitigate flood risk

11. We recommend that the Water White Paper set out a clear framework for planning for new developments in flood risk areas, building on existing planning policy, including principles for the apportionment between public agencies and private beneficiaries of the costs of providing flood defences for new developments. (Paragraph 49)

Internal Drainage Boards

12. Internal Drainage Boards are already seeking to maximise the impact of their work including through implementing improvements to their structure. However, the broader question as to the necessity or otherwise of more substantial reform of IDBs was left unresolved at the time of the last election. We favour a localised, incremental approach to any reform as opposed to a “one size fits all” model imposed centrally. We recommend that the Water White Paper set out the broad principles for the evolution of the relationship between IDBs and other agencies with drainage functions over the next 5 years, allowing for local implementation according to the specific needs of each area. Defra should consider allowing IDBs to retain levy money currently paid to the Environment Agency for maintenance of river courses so that IDBs can use their skills and equipment to undertake these functions directly where appropriate to local circumstances. (Paragraph 53)

Customer engagement

13. Despite successes in securing a good deal for customers, there is considerable scope for better integrating customer views within the price setting process. We recommend that the Water White Paper puts at its heart the strengthening of customer representation, and should include proposals for a regulatory mechanism which better links customer priorities with regulatory outcomes. In determining the final structures of organisations such as the Consumer Council for Water, the

Government should recognise the value of an independent body that is able to challenge the regulator's approaches. (Paragraph 64)

Social tariffs

14. Social tariffs can help to ameliorate the impact of rising bills on low income customers, however opinion is divided as to whether such assistance should be funded through a levy on water customers' bills or from central taxation as part of the welfare and benefits system. We consider that if social tariffs are to be funded from water bills, the desirability of helping individuals must be balanced with the interests of other customers who pay their full bills plus the additional costs of providing such assistance. The Water White Paper must spell out clearly the extent to which the Government envisages that national social tariffs will be used to address problems low income customers face in affording their water bills. (Paragraph 66)

Metering

15. Metering has a key role to play in helping to reduce water demand. Such reduction is essential given increasing pressure on water resources in some parts of the country. The current approach of introducing metering in a piecemeal manner means that the charging system is under stress, with those on unmetered supplies bearing a progressively higher proportion of costs. A comprehensive, robust and fair charging system for the future is needed with higher levels of metering forming the central pillar. (Paragraph 71)
16. More widespread introduction of metering will mean there are winners and losers and some, including groups of vulnerable customers, could see significant rises in their bills. It is therefore important that the costs of metering be kept to a minimum, and this can best be achieved through a planned, area-based programme of introduction. Variable tariffs to incentivise more efficient use of water could help to keep bills down for many customers. We recommend that the Water White Paper set out a clear strategy for implementation of metering and for variable tariffs to help spur water efficiency. (Paragraph 72)

Regional price variations

17. We would not wish to see a solution to water prices in the South West region which merely redistributes the costs among customers within the region, nevertheless Ministers must ensure that any solutions help to protect low-income customers across the country. Although the South West region presents the most immediate problem, large-scale capital investment is likely to be needed in a number of regions in coming years to meet environmental requirements with consequent impacts on bills for many other customers. We recommend that the Water White Paper set out a sustainable, long-term set of principles for determining how the costs of nationally significant environmental projects should be paid for in future. To balance the needs of those in regions with disproportionately high water bills with the need to be fair to other customers elsewhere in the country, the solution could lie in a number of options which include some form of hybrid option applied nationally which has

elements of social tariff to help those in greatest need but which is weighted to recognise the substantial regional variance in bills when compared to the national average. (Paragraph 82)

Bad debt

18. We recommend that the Water White Paper set out proposals to fortify the ability of water companies to recover debts from those able to pay. These could encompass measures such as enabling water companies to secure tenant information from landlords of all types of property (not just residencies), enabling water companies to pursue debtors through Magistrates courts and instituting a contractual basis for household water supply which defines enforceable customer responsibilities. (Paragraph 86)

Competition and innovation: the Cave Review

19. Increasing competition in water supply will not solve all the problems of rising water prices, but we note the strength of support for the view that benefits are to be had by a measured introduction of competition into the water industry in England. Although the structure of the water industry in Scotland is very different, we were impressed by the benefits delivered to customers through competitive pressures on the industry. However, the water industry has legitimate concerns that changes to the regulatory and competitive regime could incur costs which outweigh savings, particularly if uncertainty over changes were to increase companies' cost of capital. It is therefore vital that competition in the water industry is introduced at a measured pace. The Water White Paper must set out clearly how greater competition will be balanced with maintaining confidence by investors in the future structure of, and regulatory controls over, the industry. (Paragraph 94)
20. There is a short time during which changes to the regulatory regime can be made if price-setting processes are not to be disrupted with consequent costly uncertainty for the water supply industry. We are concerned about the potential for slippage in the timetable for any water legislation necessary to implement the Water White Paper proposals, particularly in respect of proposals to change the structure of the water supply industry. We recommend that the Government sets out how its timetable for introducing necessary statutory provisions will enable key provisions to be in place in time to allow a smooth transition to the next price control period starting in 2015. (Paragraph 96)

Environmental and economical sustainability of water supply

21. Defra and the Department for Communities and Local Government should consider further the potential for the planning system to ensure that new developments do not jeopardise water supplies in areas of water stress, for example by placing a statutory requirement on all those making applications for developments consisting of more than 10 homes or on sites larger than 1 hectare to consult water and sewerage companies. (Paragraph 98)

Abstraction regime reform

22. Future challenges for water supply in some parts of the UK include the impact of climate change, population growth and new development on water availability. To ensure adequate, clean and affordable water supplies in the long-term, the UK must place sustainability at the heart of its water policies. The previous Government's policy documents included laudable ambitions in this respect but insufficient progress has been made in putting in place specific mechanisms to achieve these aims in practice. The forthcoming Water White Paper must set out specific measures that will enable the wider value of water to be reflected in policies and charges. It should include proposals for amending the regulatory framework for determining prices so that demand-side measures can be better incentivised. The White Paper must also set out a clear programme for reform of the abstraction licensing regime, with a long-term aim of introducing water trading. This must explain how a fair transition to any new regime is managed, including recognition of the rights of those with existing abstraction licences. (Paragraph 104)

Water and energy efficiency

23. Water saving through greater efficiency of use will become increasingly important, especially in parts of the country where climate change and population growth will lead to significant constraints in supply. We consider that the regulatory framework under which water prices are set must be reformed to include stronger water efficiency targets for water supply companies. We recommend that regulatory bodies work more closely together than they have to date to ensure that energy-saving and water-saving initiatives are not developed in isolation. The regulators and industries should grasp the opportunities to learn from each other's experiences and develop joint approaches which might most effectively engage customers. (Paragraph 108)

Water quality

24. The UK is in danger of missing the Water Framework Directive's (WFD) challenging targets for water quality. Urgent action is required not just from the water supply industry, but from a range of individuals and organisations including rural and urban landowners and industries. The WFD's methodology for measuring water quality is problematic and could be imposing costs which are out of proportion to the level of environmental benefit delivered. We recommend that the UK Government initiates a review within the EU of the scope to achieve the environmental improvement aims of the Water Framework Directive and Urban Waste-Water Treatment Directive in a more cost-effective manner. (Paragraph 113)
25. The Water White Paper should set out proposals, with a costed timetable, as to how current EU water quality targets could be met and who will bear the costs, including measures to engage landowners and industries from all sectors in addressing diffuse water pollution. (Paragraph 114)

Connections to the public sewerage system and misconnected drains

26. Water and sewerage companies are responsible for managing the public sewerage system in their areas so it is vital that they have adequate powers to permit or disallow connections, particularly where they will incur additional costs as a result of connections from new developments. Defra should give water and sewerage companies a statutory right to be consulted over planning applications for new developments where these include connection to the public sewerage system. Defra should also produce guidance within three months of regulations being made under the Flood and Water Management Act to enable water and sewerage companies to make early use of agreements on the adoption of new drainage systems. (Paragraph 116)
27. The current legislative framework does not give water and sewerage companies adequate powers to put right problems with drains and sewers that have been incorrectly connected. Given the significant contribution of such misconnections to water pollution, water and sewerage companies need strengthened rights so that they can rectify connection problems without having to involve third parties. We recommend that the measures included in the consultation on the draft Flood and Water Management Bill be brought forward for legislation at the earliest opportunity. (Paragraph 118)

Private sewers and lateral drains transfer

28. The transfer of private sewers is a technical issue that might have passed below the radar of many water customers even though it could cost them an additional £5–£14 a year. What concerns us more, however, is the lack of certainty about the potential costs of the transfer since no detailed assessment has been made as to the scale and condition of the infrastructure affected. We would not wish to see the proposed transfer delayed. However, Ofwat must explain when and how further clarity will be provided on the costs companies will pass on to their customers and the safeguards in place to protect customers from unreasonable increases in charges. The regulator must also ensure that water and sewerage companies explain clearly to their customers the reasons for the charges and how these have been calculated. (Paragraph 122)

Conclusions

29. We welcome the focus that the Government is giving to the vital policy area of water and flood management. The recommendations in this report will assist Defra in developing proposals for the Water White Paper and Natural Environment White Paper to be published in the first half of 2011. (Paragraph 123)
30. The Flood and Water Management Act 2010 is the focus of a number of our recommendations on flood policy. Commencement of the Act's provisions which have not yet been brought into effect must be a priority. We have made a number of recommendations about the implementation of specific measures in the Act, such as those relating to sustainable drainage systems. Defra must address more general concerns about how public bodies under tight budgetary constraints can fulfil their

leadership and strategic roles on flooding. To cut back significantly on flood defence infrastructure spending could be a classic example of short-term savings leading to much greater long-term costs. Future flood defence work must be sufficiently resourced in accordance with a balanced approach to risk management. (Paragraph 124)

31. A number of our recommendations relate to aspects of water management which the forthcoming Water White Paper should address, and where legislative measures might be needed. In particular the White Paper should develop proposals to implement the findings of the Walker Review on charging for household water and sewerage services and the Cave Review on competition and innovation in water supply. It should also include specific, practical proposals to ensure that the price of water captures the full range of externalities, particularly those relating to sustainability and environmental protection, in order to drive the right investment decisions by the water industry and the most beneficial behaviours by customers. This will entail a range of measures in areas such as metering, charging for household water supply and water trading. (Paragraph 125)
32. The Ofwat review is central to the development of many sustainable water management policies, and it is clear from the evidence we received that the regulatory regime needs to be sharpened to enable it to respond better to the challenges of the future. The Water White Paper provides the opportunity to reform regulation to provide a stable basis for the long-term future of the water industry and we look forward to the Government bringing forward comprehensive legislation during 2011, to reach the statute books by 2012, well in advance of the next review of water prices. We would wish to further consider issues raised in this report in the light of proposals contained in any such legislation. (Paragraph 126)

Formal Minutes

Wednesday 15 December 2010

Members present:

Miss Anne McIntosh, in the Chair

Tom Blenkinsop
Richard Drax
George Eustice

Mrs Mary Glendon
Neil Parish
Amber Rudd

Draft Report (Future flood and water management legislation), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 126 read and agreed to.

Annex and Summary agreed to.

Resolved, That the Report be the First Report of the Committee to the House.

Ordered, That the Chair do make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No.134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till 11 January 2011 at 10.30 am

Witnesses

Wednesday 13 October 2010

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Tony Smith , Chief Executive, Consumer Council for Water	Ev 12

Wednesday 20 October 2010

Lord Smith of Finsbury , Chairman, David Rooke , Acting Director of Flood and Coastal Risk Management and Ian Barker , Head of Water, Environment Agency	Ev 19
Chris Loughlin , Chairman, James Bullock , Director of Economic Regulation and Market Reform and Sarah Mukherjee , Director of Environment, Water UK	Ev 25

Wednesday 3 November 2010

Richard Benyon MP , Parliamentary Under-Secretary of State for Natural Environment and Fisheries, and Sonia Phippard Director, Water, Floods, Environmental Risk and Regulation, Department for Environment, Food and Rural Affairs	Ev 34
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2	Consumer Council for Water	Ev 58
3	Environment Agency	Evs 62, 64
4	Water UK	Evs 64, 67
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2	Gillie Bolton	Ev w1
3	Waterwise	Ev w1
4	The Fire Brigades Union (FBU)	Ev w3
5	Ewan Larcombe	Ev w4
6	Natural England	Ev w6
7	Devon County Council	Ev w7

8	Water Industry Commission for Scotland (WICS)	Evs w9, w50
9	Cornwall Council	Ev w11
10	Plumb Centre, Wolseley UK	Ev w12
11	The Chartered Institution of Water and Environmental Management (CIWEM)	Ev w14
12	SSE Water Ltd	Ev w16
13	Calderdale Council	Ev w17
14	Essex County Council	Ev w19
15	Lincolnshire County Council	Ev w20
16	The Royal Society for the Protection of Birds (RSPB)	Ev w21
17	Association of British Insurers (ABI)	Ev w23
18	Severn Trent Water	Ev w26
19	Anglian Water	Ev w28
20	Somerset County Council	Ev w29
21	Thames Water	Ev w30
22	National Farmers' Union (NFU)	Ev w33
23	Local Government Association (LGA)	Evs w35, w37
24	Pete Berry	Ev w40
25	RSA Insurance Group plc	Ev w42
26	The Fire Brigade Union Parliamentary Group	Ev w43
27	Yorkshire Water	Ev w44
28	Tim Farr	Ev w46
29	Staffordshire County Council	Ev w48

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–11

Second Special Report	Dairy Farmers of Britain: Government response to the Committee's Fifth Report, Session 2009–10	HC 401
First Special Report	The National Forest: Government response to the Committee's Fourth Report, Session 2009–10	HC 400

Oral evidence

Taken before the Environment, Food and Rural Affairs Committee on Wednesday 13 October 2010

Members present

Miss Anne McIntosh (Chair)

Tom Blenkinsop
Thomas Docherty
Bill Esterson
George Eustice

Mrs Mary Glendon
Neil Parish
Dan Rogerson

Examination of Witnesses

Witnesses: **Regina Finn**, Chief Executive and **Keith Mason**, Director of Finance and Networks, Ofwat (The Water Services Regulation Authority), gave evidence.

Q1 Chair: Good afternoon. May I welcome Regina Finn from Ofwat. Thank you very much for joining us today. Would you like to introduce your colleague for the record?

Regina Finn: Thank you. This is Keith Mason, Director of Finance and Networks at Ofwat.

Q2 Chair: I am going to ask about the previous Government's policy, but following your submission—thank you for your help with this inquiry—may I ask how Ofwat balances its social and economic roles?

Regina Finn: Balance is at the core of what we do. Our job is to protect the interests of water customers now and in the long term, and the way we do that is by seeking to make decisions that deliver a sustainable water sector. That means a sector that will meet customers' needs today but also allow the needs of future customers to be met. We see that as having three legs. There is environmental sustainability, which means we have to live within our environment, but it is also important that we have social sustainability. That means customers need to be both aware of what they are paying for and willing to pay their bills, so bills should be as affordable as possible across the board. Then we need to balance that with the third aspect of sustainability, which is financial sustainability. That means making sure the water sector can continue to build on the £90 billion investment it has already made over the past 21 years to continue to deliver that sustainable contract in the long term. We take all of those aspects into account when we set price limits, which is essentially the price and service contract that each company has to deliver over a five-year period. We balance those issues. We listen to customers' views. We did extensive customer research as we set the price limits this time around. We heard what customers told us about the difficult economic times they were in; we heard what the markets told us about the need to ensure that investment was stable; and we heard what the companies told us about what they needed to do to deliver their services. We struck a balance that I think is a fair one and has been accepted. It meant that bills, before inflation, were set broadly flat over a five-year period for an investment package of more than

£22 billion over the same period. That is a pretty good outcome for customers, and the feedback was that customers were fairly satisfied with that. That is what we do at a high level. In the long term we need to make sure that our regulatory tools and framework are fit for purpose to deliver that sustainability in the face of significant challenges that the sector sees ahead. I think there is general acceptance of those challenges: climate change; population growth; the stressed economic times; the need for further investment; continued environmental drivers; and indeed customers' demands for high levels of service and, at the same time, concerns about affordability.

Q3 Chair: How do you think that the views of the customer would best be heard in the process?

Regina Finn: Over the past number of years we have worked to develop how we take into account customers' views, specifically in the price-setting process. In our most recent price round we did extensive joint research with all the other stakeholders: Defra, the Welsh Assembly Government, Consumer Council for Water, the Drinking Water Inspectorate and the Environment Agency, the whole range of stakeholders. That was very helpful because we were able to consider the views in those surveys when we came to set prices and understand customers' views on willingness to pay. However, there is a challenge ahead in terms of how we can strengthen customer engagement in the price review process. Earlier this year we launched a project to review how we use our price-setting tools in future, and one stream of that is about customer engagement. We are looking at a range of options on constructive engagement, negotiated settlement and understanding customers' preferences and choices to see whether there is a more effective way to ensure that customers can be communicated with and we can understand their views during the process.

We also want to work on using the views of customers when we look at how we carry out compliance reporting. Therefore, when we look to see how companies are meeting what their customers want them to do, rather than have a data-heavy approach where we examine every company every year, we look at how we can better hear from customers what

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their concerns are in terms of the service they receive so that we can take a more risk-based and targeted approach and listen to customers that way and engage them. We have done a number of bits of research. A number of academics have done some papers for us, which we shall be publishing next week, along with a draft report on how we might take forward this process. We are conscious that quite a lot of reviews are going on at the moment, both institutional reviews, reviews of the competition and consumer framework, and indeed a review of the water regulatory framework proposals for a Water White Paper. We shall have regard to all those developments, too.

Q4 Chair: Could you outline what you think the benefits are of having a separate regulator for the water industry?

Regina Finn: I have worked at regulating a whole range of industries. I have regulated the telecoms industry, electricity, post, gas and indeed broadcasting in various jurisdictions, so for me the concept of economic regulation has some commonality across networked industries where there are particular monopolies that you want to regulate to deliver for customers. What I have found in all the sectors in which I have worked is that there are also individual characteristics that you need to learn about. When I joined Ofwat three or four years ago I was new to the water sector. I certainly had a good understanding of economic regulation because I had been doing it for all my career, but there were water-specific issues that it was important for me to learn about. There is some sectoral expertise quite specific to the different sectors, and I think it is important to have that.

I will be perfectly frank and will not give an opinion on institutions because you can create any institution you want. What is important is that you have that specific sectoral expertise, wherever it sits, in order to ensure that your regulation is fit for that sector, you understand the long-term challenges that the sector faces and you can make sure your regulatory tools drive the right behaviours for customers and the environment in the long term.

Q5 Chair: What would your message be to Defra on the outcome of its review? How would you like to see the end of the review process leave Ofwat? What do you think the timetable should be, without impacting on the next price review?

Regina Finn: Timetables are tight. We set price limits for a five-year period but, frankly, it is a big, three-year process. We will have to publish how we are to set price limits by the end of 2012 so that companies can start to understand what they need to do and we can start the engagement process. But I think we have a fantastic opportunity between now and then because we have just set price limits for five years so we have quite a stable environment. We will be setting them again from 2012. We will have to talk about it before then, but from 2012 we will start the process to set them from 2015.

We have a very good opportunity with the Water White Paper, the Natural Environment White Paper, which has water aspects to it, the Defra review of Ofwat, in which we are very pleased to participate,

and our own review of our tools that we have been carrying out since we last set price limits. We think that together all those need to look at how we can make this regulatory regime a more flexible, modern one that can adapt to the really big challenges—climate change, weather volatility, flooding and drought—where we do not know what they will deliver for us. We do not know what the outcome will be but we would like clarity from the outcome and any legislative proposals within that window. We think that is doable.

It would be good if the various reviews and the policy look at the sector helped us look at our tools, such as our licensing system, which is 20-odd years old. We have 20-plus different licences, each of which has different terms and conditions. There is a lot of legal redundancy in there; frankly, it is lawyer heaven when you try to start using them. We could usefully have a much more simplified, modern, streamlined, modular licensing system that would be clearer for companies, for us to enforce and for customers to understand to what they are entitled.

To come back to your first question, it would also be useful if the review focused on how we can best engage customers and the policy framework around customers. That includes the Government's position on social policy and social assistance for water customers, just as in other income-deprived areas in the country. It would be very useful for us to understand Government policy around that so that we can build the appropriate frameworks on which to deliver over time, and, again coming back to what you said, to make sure that we have systems and processes to ensure customers can be heard and are at the heart of this. If there are changes to that aspect of the regime we want to make sure we can capture and have access to that customer voice by hearing what customers are complaining about, understanding the issues they are raising with their companies or making sure we can keep that intelligence as part of the regime.

Q6 Chair: Do you think that the previous Government got the assessment right in their policy paper *Future Water* for 2030? Were there bits that they should have implemented but have not? How do you think this was reflected in the legislative framework?

Regina Finn: We were very pleased that *Future Water* tried to grapple with putting the whole story together around water and waste water because it is a huge sector and it is fundamental to our economy as well as our health and lives. We thought it was a really good first step. It did start to highlight the challenges, and we now have a pretty common consensus on those challenges, so that is very positive. It paved the way for important further works. Work was done by Anna Walker and Martin Cave in their reviews, so it started some of that going.

In the period of time between then and now, through our dialogue with our stakeholders, we have learnt how crucial valuing water is at the centre of developing our policy and frameworks around water. That was certainly touched on, but probably we did not develop it then as well as we have now. Essentially, if we do not really understand the

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environmental, economic and social value of water, we do not necessarily make the right decisions about how we use it. I am not talking here just about customer pricing but about the companies that have to deliver the infrastructure. They know the cost of collecting it, treating it and moving it around, but not necessarily the relative value of it between a water-scarce area and a water-rich area, so the concept of understanding and valuing the resource is perhaps something that could be developed.

In the light of more experience and what we have learnt in the period since *Future Water*, the point you raised about understanding the role of the customer and how the customer's voice can be engaged is something that could be developed further. The final point is that obviously a lot of actions have not moved forward because they were the subject of further work and none of the recommendations—apart from a few from Anna Walker's or Martin Cave's reviews—has yet been taken forward into proposals for legislation. That has not been done.

Q7 Mrs Glendon: You have talked a lot about improving the engagement process. From all the work you are doing, have you been able to identify customers' priorities?

Regina Finn: Yes, in that we do an awful lot of research with stakeholders. We did a lot of joint research throughout the periodic review process. One of the difficult things in engaging with all customers in the country is that you have a lot of voices and it is very hard to hear them all, so we needed to try to use surveys to do that and ensure we used a common set of surveys so all stakeholders understood customers' priorities, because if you do your bit of research and I do mine we may well get different views. That was an important way to make sure we could understand customers' priorities.

We also asked all companies to do customer research locally so they could understand customers' priorities when they put together their business plans. CC Water also does research on customers' priorities and publishes that and we also have access to their views, which is very helpful. That has been reasonably successful. There are difficulties with it. One of them is that it is inter-generational, so you have today's customers and we must protect the interests of tomorrow's customers and tomorrow's customers are not there to tell us their priorities, so that is a balancing act we need to do. The other issue is that we have tended to survey customers as a whole.

One of the things we are now learning when looking at how we might improve engagement is that they are not all the same; different types of customers have different priorities—for example, large and small businesses, small and medium sized enterprises (SMEs) and household customers—and different customers have different priorities in different areas, and their priorities change over time. Because we did a number of surveys over time, we captured information that was as up-to-date as possible when setting price limits. The challenge for us now is how we can make that a richer and more-informed debate with customers going forward, so we think there is more to be done.

Q8 Mrs Glendon: This is a different aspect of the customer's point of view. You have also mentioned changing the regulatory burden and making it more flexible. How can that change be balanced with the need to retain the customer's confidence in any regulatory outcomes?

Regina Finn: That is absolutely right. The first priority of which we are always aware is that our job is to protect customers' interests. Where they do not have any choice, customers need somebody to protect their interests. As you have just alluded to, they need to believe that somebody is protecting their interests. We need to do that and ensure that they are aware of it. When we talk about simplifying the regulatory burden and potentially reducing data collection, we would not make a change in our processes; that would not be beneficial or enhance our outcomes. The outcome we want is to deliver for customers now and in the long term. We want to ensure that we do that in the most efficient, value-for-money, effective way, and we think the continued heaviness of the way we look at data might not be the best way. We are not looking at changing it for the sake of changing it; we just think there may be better ways to do it, better ways to serve the customer interest, and better ways to hear those customers and focus our limited resources on the things that customers want us to focus on rather than a kind of blanket approach to everything.

Q9 Dan Rogerson: Mary's first question to you was about what customers' priorities were and you set out quite clearly the methodology of how you consult and also said there was a range of responses. Are you able to give us a flavour of what those priorities are?

Regina Finn: The first priority for customers remains, frankly, safe, clean drinking water. We all turn on the tap and take it for granted after so many years, but if you ask customers to think about it they will say that the most important thing is that that water keeps coming out of the tap and that it is safe, clean and they know they can rely on it and do not have to worry about it. They want that at affordable prices; prices they feel are fair. They are certainly willing to pay for it but they want to feel they are paying the right amount. You will remember that when we did this research in the price review period we went through the credit crunch and all of that economic uncertainty and we saw customers' priorities changing a bit. They became concerned about some of the investment that we call discretionary. There were some things they wanted; they wanted a certain amount of resilience; they wanted to be sure they had back-up supply; and they wanted the environment to be clean, but they were second-order priorities and the primary priority was safe drinking water. Keith, do you have anything that you want to add to that?

Keith Mason: Only to say that the point about safe, reliable drinking water was clearly well ahead of any other priority that they had. One that was very specific for certain groups of customers was sewer flooding. It affects only a very small minority of customers but when it happens it is not pleasant, so clearly those who were affected thought that was very important to them. We have tried to address that by including

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within price limits just over £1 billion to do that, but it does become very expensive. That is probably the only other one I would draw out.

Q10 Chair: I have one small question about Ofwat's view. Obviously, if customers do not pay their electricity, telephone or other bills they will be cut off. Obviously, bad debt is growing incrementally and all the paying customers are paying quite a bit. If everybody has the right to water, but those who can pay won't, what should we be doing?

Regina Finn: You are right. The difference with water is that if household customers, not businesses, do not pay their water bills they cannot be disconnected. That is a clear policy decision for which there is obviously a good reason because you cannot do without water; it is essential for life and health. It contributes to a difficulty in the sector, and revenue outstanding is much higher in this sector than, for example, in the energy sectors; currently, it is running at £1.59 billion or £1.6 billion. For those who do pay, bad debt adds about £12¹ to their bills. The point we would make here is that in that group of people who are in bad debt there are some who are seriously vulnerable and have genuine difficulties in paying their bills; they have an affordability problem, and we need to identify and target those vulnerable customers. We believe that is very important. It is only when we do that that we gain the legitimacy to try to tackle those customers who frankly can afford to pay but just do not pay. They think they are ripping off the water company by not paying, but they are ripping off their next-door neighbour who is paying.

We put forward some proposals in the last legislative round, and through the Flood and Water Management Act, about how we could better tackle that by giving water companies some tools to do it. For example, that included a tool better to identify whom to chase for the bill when they do not pay, so there is a hierarchy: if you cannot find the tenant because they have done a skit, you can eventually find the landlord and somebody who has a liability to pay that bill, and there are a number of variations on that. I know that is subject to discussion and needs regulations, but we think that those tools would give water companies slightly better means to collect bad debt.

Let me not be complacent here: water companies really need to get better at this as well; they need to focus on collecting this bad debt, but sometimes it can cost more to chase the bad debt than what we get back, so we understand there is a cost-benefit there. We think it is important that the proposals that were accepted in the primary legislation but are being consulted on and need regulations are brought forward. There will always be more that water companies can do and that is partly about them getting to know and understand their customers better. The third point would be that, if we do focus on those genuinely vulnerable customers and try to help and protect them, it will be easier and people will understand when water companies try to collect outstanding bad debt.

Q11 Chair: Have you had any indication that this will be included in the White Paper?

Regina Finn: My understanding is that the White Paper will look broad-brush at the priorities for the water sector as a whole, including Government social policies, so I would assume that the social goods that Government want out of the water sector would be included in that. But even before that there is an opportunity to move this forward because this is the opportunity to put the tools in place through regulations, and I think that is in train at the moment.

Q12 Thomas Docherty: Going back to the point you made earlier about how water is perceived, I think the phrase often used is "valueless commodity". You said that you felt it needed to be challenged. For example, we recognise that there is both a monetary and environmental cost to electricity. Could you expand on what steps you think should be taken to get that across to the customer?

Regina Finn: There are two aspects to this. There is the end customer, the household customers who use water and their understanding of its value, and, from the point of view of our regulatory framework, there is a need to ensure that the sector that is delivering the water understands the value. Just to unpick the two of them—both are very important—this sector has invested £90 billion and that is what the average bill of £339 goes to pay for. It is a huge amount of money, and it is going to be more. In deciding what to invest in, water companies make choices, and when they make choices they add up the costs and benefits. For example, in a water-scarce area or where a river such as the Thames is over-abstracted and we do not want to abstract more from that river, clearly, water has a value there, but there is not a monetary value on it. Then we have areas of the country where there is excess water. If a company in the Thames area that has to satisfy its customers thinks it will have a water shortage, it may well want to build a new reservoir or desalination plant because those are the options. As you say, the water it takes out of the environment is not valued. If there was a relative value on that compared with an area where water is plentiful, instead of building a desalination plant it might build a pipeline and move some water from the water-rich to the water-poor area.

That is a made-up example, but we think it is important to use some market forces to reveal that value within the value chain so that companies can make sustainable investment choices. That means they should not invest in things we do not need but in things we do need, and we think that should be at a lower cost to customers overall. That is the first place where we see valuing water as being of fundamental importance. We think the tools are perhaps a degree of water trading between companies and the ability to trade abstraction licences. We have a project with the Environment Agency to help develop that.

At the customer end, undoubtedly there is more we need to do in terms of customers' understanding of how valuable the product is. The purist approach is to say that you respond to price signals and if the price goes up you will be more careful about it, and that is true to a degree. We do see that metering customers

¹ Note by witness: Recent 2009–10 figures show that this figure is now £14.

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gives them fair signals about how much they are using and then they can understand to conserve water, and that is true to a degree. But one of the things we want to learn more about—it is part of the work we are doing and in our review—is whether there are other ways to engage with consumers and help them change their behaviour. The buzzword is ‘nudge economics’ or ‘behavioural economics’, which just means: how can we understand what drives the choices that customers make so we can help inform their behaviour? It is not always just price; it is many other things as well. We think that is a piece of research and work we need to do. We think water companies need to do it and engage with their customers. We have set water efficiency targets that require water companies to drive water efficiency through their customer base and get them to use water more efficiently. We have done a number of things there already, but there is more to be done on how customers see and value water.

Chair: We shall be coming to some of these items.

Q13 Tom Blenkinsop: Has Ofwat quantified the potential benefits to be gained from lowering the threshold for competition in water supply?

Regina Finn: We provided input to the Cave review. Martin Cave’s review did a cost-benefit analysis on lowering the threshold to allow for competition, so the answer is, “No, but yes,” in that we provided data and information for Martin to do that cost-benefit analysis and worked with him and his team. That is why Martin Cave’s report to the Government based on that cost-benefit analysis showed a positive net benefit and recommended that the threshold be reduced, so we gave that information and helped do that analysis.

Q14 Tom Blenkinsop: Could Ofwat have been more proactive in progressing competition under the current legislative framework given the anticipated benefits for the customer?

Regina Finn: We have highlighted that the current legislative framework has difficulties. When we talk about the areas where we would like to see change they are to give us more flexible and proactive tools to develop the competitive regime. Having been through market liberalisations before, I recognise that it is very reactive. The current regime says that somebody really has to want to come into the market; they have to come along and try to negotiate getting into the market and only when it all fails can they go to Ofwat and only then can Ofwat try to help. Traditionally, when you are trying to open a market that is a huge barrier and cost for a new company. It has no guarantee that it will get in; it has no idea if it will get over the hurdles.

We would like to see a more structured framework whereby ex ante—that is, up front—a new entrant can see how he can get into the market, what the terms and conditions are, what it has to do, how to get a licence, how to connect and what it has to pay. We have been working on that. Under the legislation we are not allowed to set ex ante prices—it is too restrictive—but we have been preparing the ground as to how we would do a lot of that on the basis that, if the Cave recommendations were to be taken forward,

we would be able to develop the tools to do that. We think it is a bit restrictive, including the cost principle that sets the access-pricing regime and restricts how we can do that. Could Ofwat do more? We can always do more, but I think that the framework as it is will not work; it does need change.

Q15 Tom Blenkinsop: Earlier you brought up the point about customer-led intelligence and priorities. How will you ensure that customer interests are protected during the review of your organisation? What do you believe is a reasonable timeframe for the review and the knock-on changes that will obviously affect it?

Regina Finn: In the first instance we are reviewing how we use our tools and throughout that our central ethos and duty is to protect the interests of consumers now and in the long term, so I can assure you that customers’ interests are at the heart of everything we do when we look at how we use our tools. When we look at the wider review of Ofwat that Defra is doing, how we sit within the broader water policy framework, ultimately even in the White Paper, and how all of that work is taken forward, we will be making sure that in our representations and submissions the interests of the consumer are strongly represented because that is what we are there to do. There are other routes by which the consumer voice will be heard: through CC Water, to whom you will be talking later, and business forum customers as well. They can stand up and give their own views in that review, which is good, but in so far as we continue to have a duty to protect customers I can assure you we will do everything in our power to make sure their interests are represented.

The timetable is a bit tight before we come to set price limits again. Ideally, if the review carries on over the winter and Christmas we would like to see it coming out with ideas in time to feed into the White Paper which will be published in the summer. If that is published in the summer we think that will be very helpful, because we will be able to think about that as we set our framework for setting prices. I think that timetable would work. The one wild card is that, if some of the issues in the White Paper need legislative proposals, we would want to know very quickly what the legislative timetable would be for that to provide clarity and a road map. You can deal with change but usually you need a road map to manage it.

Q16 Tom Blenkinsop: Just one last question: if water companies are to be required to separate retail from network operations what is Ofwat’s calculation of the impact on water companies’ costs?

Regina Finn: First, we have developed a system called accounting separation whereby we get companies to account for their retail business and their network business. That is one of the first things we need to do to try to understand costs. Second, we have asked companies for their views of the costs of separating out their business. We know there is a wide range. Some companies that have structured their business with a separate customer arm can do it quite easily because they have their billing systems and account managers. They have set it up that way

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anyway. Other companies have not set it up and think it will be a more difficult job because they have to separate out their retail units. That is a function of how a company runs its business and sets itself up. It is not necessarily a function of separating a business; it is a function of where they are coming from. That will differ from company to company. We look to companies in the first instance for their estimates of that.

Keith Mason: I think the proportion of total costs for a company represented by retail is not that large; on average it is probably only 10%. As Regina said, there is a wide spread around that and for some companies it is much smaller than 10%; for some companies it is a lot bigger. In those companies where it is quite large they have to work out exactly why their costs are so high, but it is just not a big proportion of the total costs. Some companies have structures such that it will be easier for them to move; others do not, and perhaps others have taken time. They probably do these things only once every 10 years, but they have to upgrade their customer billings systems in any event, and those with more modern systems will probably find it easier to do than those that still have relatively old systems.

Q17 Chair: In your view is the Scottish model working?

Regina Finn: The Scottish model has given us quite a lot of information and is very helpful. We are conscious it is coming from a different base because it is one company that is publicly owned and has split off Scottish Business Stream, which is the business side of serving business customers of that publicly owned company. There are then a small number of competitors in there. We hear from colleagues in Scotland—we look at what they are doing quite frequently—that that has driven down overall costs and driven up quality of service significantly. I hear personally from big customers that it is the driven-up quality of service that has been the most outstanding thing for them. They are so pleased to get one electronic bill for their site instead of 560 paper bills, and that is a benefit to any business; it is taking a cost out of the business at a difficult time. We have heard that anecdotally. We certainly have seen figures that show that the total cost has been driven down; and we have heard from some of the English water companies that have become competitors up there. They feel that there are some learning points to come out of it for our sector as well, so overall the answer is, yes, it is working and delivering benefits. It is not an exact map across to what we do in England because we have a different situation, but there are good lessons to be learned.

Q18 Neil Parish: You have talked a bit about the Anna Walker report. One of her conclusions was that the current charging system is creaking at the seams. Does Ofwat agree? Under what circumstances should water companies be mandated to require all customers to have metered supply? Should these be intelligent meters in all cases? The final facet of the question is: how does Ofwat think the regulatory framework can help to keep down the costs of metering and ensure

that affordability is not compromised for larger water users on low incomes?

Regina Finn: The first thing to say is that the charging system that we have, albeit we can bring it into disrepute, has delivered an awful lot of benefits and water bills are a hell of a lot lower than energy bills. The average water and sewerage bill at £339 is a lot lower than the average energy bill, so we start from a good position. We think Anna is right in that the issue of affordability and the level of a water bill for some customers is now on their agenda whereas it may not have been in the past, so we think that is true. It is also true that we see other pressures on the system. Where a company has already metered a high proportion of its customers and they have moved on to metered charges there is a consequential impact on the unmetered customers because their bills are going up. Those issues are creaking; I agree we need to address those. We need to address the core issue of affordability and find out who is vulnerable and having difficulties and have a framework to help them. We also need a framework to help manage the impact of that metering roll-out. One example is Southern Water. We have approved near-universal metering roll-out for them. When they started to consider how they would do that we found that it would have big impacts on some customers. Some would be big winners; some would be big losers, and we have made the company work very hard on a transition programme that helps manage the transition; otherwise, it will not be acceptable to customers. We think that customer legitimacy is very important when you change charges.

As to metering generally, we think it is the fairest way to pay. The rateable value system that we use is creaking and the inherent cross-subsidy in it, depending on the size of the house you live in, is not well targeted; it does not necessarily help the people who need it most. We think that is true. Anna recommended that companies should be able to meter compulsorily where it is cost-beneficial. Clearly, that is a policy choice. It is a choice for ministers and so it is not one that we would make, but we will help with the analysis to see whether that would be more cost-beneficial for customers. The argument is that, for example, at the moment in a water-stressed area companies can choose to meter compulsorily and that is why Southern is doing it. If it were cost-beneficial to roll out meters by street instead of by individual household, then under Anna's proposals it would be possible to do that. I know that is a proposal on which ministers will be consulting over the winter in parallel with preparations for the White Paper. That is a policy choice.

As to what we can do, with Southern it is almost like working with a test case. We can gather that data and information about what happens when you do this to help inform the policy choices of ministers. That is really important. We are learning a lot from the process that Southern is going through. We can help with development of these transitional mechanisms whereby tariffs will be phased in over time, and I think that within any framework the Government sets around social policy on affordability we can implement anything like that that helps target

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vulnerable people. If you are moving on to more meters you will be unwinding cross-subsidies for people who do not need them and some people who do need them. You need to find those and make sure that they are helped through that transition. We are working closely with Southern as a case study and we will work with other companies that want to do more compulsory metering. Following any final decision by ministers on how this is to be rolled out, our job will be to make sure the evidence base and cost-benefit methodology is clear and helps inform those decisions.

Q19 Neil Parish: But you would largely support metering?

Regina Finn: We would agree that metering is definitely the fairest way to pay and I think customers also agree with that. The main issue is that customers generally like choice, so compulsion feels uncomfortable to them, but they recognise that it is the fairest way to pay.

Q20 Neil Parish: What regulatory changes are required to reduce the level of bad debt for water? We talked about £12 on the customers who do pay, and we talked about the people who cannot pay, but how can you distinguish between those who can't pay and those who won't pay?

Regina Finn: If we could do that, we would not have £1.6 billion of revenue outstanding. That is exactly the difficulty with which water companies are grappling. Frankly, they are in the front line; it is their customers. We are a small organisation regulating 20-odd companies around the country. It is those 20-odd companies that have a relationship with their millions of customers. They are the ones that need to understand their customers better and the characteristics of the "won't pay". Some of them do: some of them are transient student populations, some of them are tenants and things like that, but we think that in the first instance it is a matter for companies to do that. What we do is collect information on their bad debt collection policies and how they do this. We publish best practice; we compare them and try to show them the best of the best. We continually drive forward new ways to do it, but we cannot do that; we are not in the front line; companies must do it.

From a regulatory point of view we have supported the introduction of proposals to make landlords more responsible because they account for a big bunch of the 'won't pay', if I may call them that. Rather like the energy bill, if there is somebody with whom the water company has a relationship effectively, they can seek payment from that individual. Consultation is taking place at the moment on draft regulations on that point. Ultimately, a water company does not have a contract with its household customer in the way you would have a contract with your energy supplier. The water company does not have a contract; it has a duty to supply the premises. It may be there is a possibility of making that relationship more contractual in future. It is not, strictly speaking, a water regulation issue; it is a customer contract issue that could be considered in the longer term.

Q21 George Eustice: On the subject of the Walker review and specifically the South West, Anna Walker recognised there was real unfairness there, and, as a result, bills in the South West are significantly higher. What options are you looking at now seriously? I know that the Government has asked you for feedback in this area.

Regina Finn: Anna was asked to look at this issue. In the South West water customers pay the highest bills in the country. Anna identified, broadly speaking, three groups of options and they are the ones we have been looking at, but we have looked around the margins. The three groups of options are: first, if there were to be a financial injection into the South West, such that all bills could be reduced by a flat £50, how could that be done? We have had a look at that and how much it would cost. It would cost about £750 million. That would have to come from somewhere. That is not a choice we would make; obviously, that is a policy choice, but an injection of about £750 million would reduce bills overall. We have modelled that and we will be providing that data to Defra Ministers.

The second set of options—there is a whole subset within it—is to do with what you might call a cross-subsidy. Anna suggested there could be a cross-subsidy from water bill payers in the rest of the country to the South West. We have modelled what that might look like and we are working on the figures to see how much that cross-subsidy would need to be to bring bills down by about £50. We have to remember a couple of things. First, even by bringing bills down by an average of £50 they will still be among the highest in the country. Second, what is the rationale for any such cross-subsidy? What is the basis and reason for that cross-subsidy? Clearly, there would have to be equity and fairness. If the cross-subsidy was to pay for an environmental good we would have to consider whether there might need to be other cross-subsidies in future to pay for environmental goods, so the comparison is: if the cross-subsidy was to pay for the environmental good of clean beaches in the South West there might be an argument to say that the building of the Thames Tideway tunnel to clean up the Thames river is an environmental good and there should be a national cross-subsidy for that. Therefore, there is a question for policymakers as to what they want around that, but we are modelling those options so as to provide the evidence of who would be impacted, how much it would cost and how much money that would bring into the area. There are a number of options around that.

The final set of options as to what could be done is focused less on the high bills and just reducing everybody's bills. Remember, some people in the South West can afford their bills, but there are some who genuinely have affordability issues because of those high bills. That set of solutions is a different one. There we are looking at whether there are any packages of options, including water efficiency advice, or particularly targeted subsidies, or assistance for vulnerable customers in particular, that could help with their bills, which would address the affordability concern, but not necessarily the overall concern about

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high bills. There are lots of subsets or variations within that, but broadly speaking those are the three areas on which we are punching the numbers.

Q22 George Eustice: To press you on the second one, from memory I think Anna Walker's report estimated that to get a reduction of £50 to £100 in the South West it would add about 13p per month to the average household bill in other parts of the country. Are your figures in that ballpark?

Regina Finn: We are working on the figures. We have talked to a number of MPs in the South West before about this work, and we have said we will share that work with them at the same time we share it with ministers. I think we shall be doing that on the 21st of this month. I do not have the final figures yet, but you are very welcome to come along to that briefing. At the moment I think our figures will show—they are still moving—that the amount on everybody's bill around the country would be a couple of pounds and it would reduce bills in the South West only by about £50. I put a caveat on those numbers because we are still finalising them, but we shall be talking through those numbers with both the Minister and South West MPs to explain what it looks like.

George Eustice: You will appreciate that the second option is the favoured and fairest one as far as we in the South West are concerned. When it comes to the criteria, clearly the point is that the real unfairness came about because, when South West Water was privatised, inadequate account was taken of the fact that EU legislation was around the corner that would require it to do this work. It was not just an environmental improvement; it was required by law. Obviously, that is the difference between that and the Thames project to which you referred. It is also the fact that, because of the very low population in the South West, that unfairness has led to a huge spike in bills, whereas London with a population of millions can absorb it more easily.

Q23 Neil Parish: Can I add to that? The big problem in the West Country is that it has 3% of the population and 30% of the beaches.

Regina Finn: I am not arguing here about history, gentlemen; my job is to implement the regulatory regime within the framework of the policy that Government sets, and that is what we are going to do. I am suggesting that we need to be coherent and consistent. We will model the numbers and show the options. It is not our decision; obviously, it is a policy decision. Our job is to work within the Government's policy framework and be accountable to Parliament, which we will do. What we have agreed to do is share the information with this Committee, other MPs and Ministers so everybody understands the impacts. Anna did look at why bills are so high. Frankly, one of the key reasons bills are high is that in the South West there was no sewerage system and the population was dumping sewage straight into the sea. That was what we did and to do that in a modern society is not acceptable. I think that is the core reason.

Q24 Dan Rogerson: Based on that, Ofwat having been the regulator over the period since privatisation,

do you think it has done a good enough job for the people in the South West in terms of regulating and allowing that disparity to occur? I appreciate the reasons for not calling for legislative change and for something like this to happen earlier. How has Ofwat responded to this over the past 20 years?

Regina Finn: Frankly, not just Ofwat but the regulatory regime as a whole has served customers extraordinarily well. Looking back 20 years not just at the South West but elsewhere in the country, I think we had a reputation as the dirty man of Europe; we had appalling river and water quality; pretty poor customer service; we had crumbling and, in some cases, no infrastructure, which was the case in the South West; a need for investment; and no money. The independence, transparency and certainty of the regulatory regime that was set up enabled £90 billion to be invested in the sector. I said earlier that customers' priority is that the water coming out of the tap is clean. They have become so used to it because of that regime. Average bills have been kept about £110 lower than they would have been without the regulatory regime. That rigour has applied to the South West just as it has applied to the rest of the country. Working within the policy framework and delivering on our duty to protect consumers now and in the long term, I believe Ofwat has done a pretty good job within the framework it has been given. There is more to be done in future and that is why we are now talking about reviews. I think there are opportunities and challenges we need to rise to, but we are lucky because we have quite a good platform on which to do that.

Q25 George Eustice: I want to move on to the second point about water efficiency on which you touched earlier. Do you think that Ofwat's remit needs to be changed to reflect that and give it greater focus? A second linked point, which you also touched on, is about the market incentives to prioritise water efficiency. You talked about abstraction licences. Can you expand a little on how that might work?

Regina Finn: To be honest, our overarching duty allows us as an organisation to have a vision called Sustainable Water, which is about long-term sustainability for the environment, customers and the sector's security. I think that enables us to consider the role of water efficiency and its importance because it is one part of a bigger picture. I do not think we need any change in duties, and the evidence for it is that, for example, we have imposed water efficiency targets on companies, which never existed before; in other words, we have required them to deliver more water efficiency over time. In the five-year periodic review, along with water efficiency targets, metering and fixing leakage, we shall gain more water out of the savings side than the new resource development side. Therefore, it is already well embedded in our vision and in our communication with companies on how they do their business planning that we must make this sustainable, and that includes managing water wisely and efficiently.

That message is there. I do think, as I said earlier, there is a lot more to do here. The concept is one of valuing a scarce resource and making sure we use it

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wisely, not just in terms of how it comes out of the tap but in terms of where we take it from and move it to, how far we move it and whether we build a new large reservoir or move some water around. Those choices need to be informed more by the long-term sustainable impact that they have on our environment and society. That is what I mean by revealing the value of water in what we call “upstreams” where choices are being made about what to invest in. The example I gave was that a company might decide that if it needed extra water it would be cheaper to buy it from a neighbouring company as opposed to building a new reservoir or treatment plant. If two companies on either side of their boundary needed more treated water, you might find them both building treatment plants, on each side, with the carbon impact that has and the investment cost to the two sets of customers, whereas one plant and a sharing of water might be sufficient, but because there is not a value on the water those companies cannot make that calculation and do not have an incentive to deliver the more sustainable solution. That is where we want to see potential change in the framework and do more and drive a flexible framework that will help companies make better decisions in the long term.

Q26 Chair: What is your view on water abstraction?

Regina Finn: Water abstraction and the licensing of it is done by the Environment Agency, so clearly the Environment Agency is in the lead here. We have had a project going with the Environment Agency which itself is looking at how we can deliver a more sustainable level of abstraction. There are parts of the country where there is over-abstraction, as in too much water has been taken out; there are parts where there is over-licensing. Maybe not all of it is being used but it is licensed to be used. We have been working with the Environment Agency to try to help them develop tools to restore a more sustainable abstraction level. We have been exploring with them the possibility of abstraction licence trading whereby, if the holders of the licences can trade them, the water will be used in the more valuable areas and the unsustainable abstractions, which will be high cost, will be traded out. That is a nice idea but it is a complex one. That is a long-term project on which we are working with the Environment Agency. Clearly, we have a common goal, which is to get the water valued and used efficiently for society and the environment, but we recognise that it is a complex issue on which we need to work with them.

Q27 Chair: The Environment Agency is looking for a voluntary approach on the sharing of information on water supply and demand purposes, particularly for energy, agriculture, navigation, industry and commerce. Do you go along with that view, and do you think there is a role for Ofwat as a regulator in that regard?

Regina Finn: Our role is the economic regulation of the water industry. We do not have a role in regulating the other sectors that abstract and use water. Clearly, there is a wider stage that the Environment Agency needs to consider as opposed to the area that we regulate which is just water companies. There are

significant interactions between water companies as water users and abstractors. I think they account for about half the water that is abstracted. As you say, there are power companies and everybody else who have abstraction licences. Our view is that better information and clearer processes for trading licences should help, and that is part of the project we are talking about.

Q28 Bill Esterson: I want to ask about linking energy saving and water efficiency and get your views on the regulatory issues and what prospects there are for Ofwat and Ofgem (Office of the Gas and Electricity Markets) to work more closely together.

Regina Finn: This is a really interesting topic; there is a lot we do not know about yet but there is a good deal of potential.

Keith Mason: Heating water in the house accounts for about 25% of electricity bills. We think that is a very important link and one that is perhaps not made across both parties. We also think that smart meters, to which we referred before—but we did not pick up the point—could be useful, and we are exploring with Ofgem how we can piggyback a little bit on their roll-out of smart meters and learn from what they are doing there. There is a cost-benefit point to smart meters in that they give you a lot more information. They certainly give the companies a lot more in terms of good or different types of tariffs that they cannot do now. They are more expensive to buy and put in, but they certainly have operating cost savings. Therefore, there is a cost-benefit trade-off, but it is important that we explore with Ofgem how we can join together because there are a lot of links between water and energy, not least the point about heating water, which produces a lot of carbon and is expensive for customers.

Regina Finn: To add to that, we have worked with Ofgem as they have developed what they call their Smart Meter Prospectus to make sure it is possible, in the case of water, for that information at some stage in the future to be sent over the same data protocol so as not to close down options. The extra bit in this is that you have energy and water but, interestingly, you have carbon. If you could reduce your water wastage and maybe not heat as much water and then let it cool down again and, therefore, save energy, you would also save carbon, so there could be a virtuous cycle here. How smart meters will deliver that information and help us get there I do not know, but potentially it is quite exciting.

Q29 Bill Esterson: What about some of the current barriers where companies cannot claim credits for savings from the same device?

Regina Finn: We have talked to Waterwise, the Energy Savings Trust and Ofgem about that. We can see the concern there and we are working to try to see if there is a way to resolve it. We agree that is something that needs to be dealt with. We are conscious of it and are trying to deal with it.

Q30 Tom Blenkinsop: In terms of joined-up thinking, recommendation 39 of the Pitt review says: “The Government should urgently put in place a fully

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funded national capability for flood rescue, with Fire and Rescue Authorities playing a leading role, underpinned as necessary by a statutory duty.” Do you think if that was put in place it would reassure local authorities about further expansion of sustainable drainage systems?

Regina Finn: Obviously, the Pitt review talked about Sustainable Drainage Systems (SUDS) and other drainage issues but was talking much more widely about flooding of the landscape. The issue of a national flood authority or the Environment Agency’s role is outside our remit. It is for Government to decide what structures it wants to put around that. For us the important thing is the word “sustainable”, so it is how we can make our drainage system sustainable in the long term. We have all seen what happens with floods. Keith mentioned customers’ priorities. If there is sewer flooding it is an absolutely awful thing to happen to anybody. We need to think about how we can manage that, and sustainable urban drainage systems are a part of that because they are necessarily a way of stopping water getting into the drainage system and causing flooding.

We have encouraged and allowed water companies to adopt those or build on them where they are the best solution instead of building more sewers because, frankly, digging up all the sewers and making them super-sized will not make this problem go away, and it would be enormously costly. I think our role is to ensure that the sewerage companies try to make sure they deliver their services in the most sustainable ways. Michael Pitt’s review talked a lot about who is responsible for these things and joining up these things a bit better. I know that the Flood and Water Management Act went some way towards implementing those recommendations. Our view would be that there is more to be done to clarify rules and understand who is responsible for what beyond water companies. I am not talking just about water companies here; you mentioned local authorities. I think—

Q31 Chair: I want to come in here because this is my pet subject. You will recall that at the Committee stage there was a proposed amendment that did not find favour. Does Ofwat have a view about who should own SUDS in all their various forms, whether they are highway, ponds or whatever? First, who should own them? Second, who should maintain them? Should it be the local authorities or the water companies? I think it would be a mess to do both, but do you have a view?

Regina Finn: Our view is that the problem with SUDS means an awful lot of things. In some cases it is a big engineering project and a water company should build it because it is exactly part of its infrastructure, and it really helps in terms of being cost beneficial, diverting flood water and making sure it does not go into its drains. We would encourage them and allow them to have it, manage it, fund it and for customers to pay for it. I think water companies largely have the expertise to deal with that type of asset and they should do that.

I am not sure that water customers should pay for, and therefore water companies should manage, every type

of SUDS because some are local solutions, which I think are more appropriate to local authorities. I think the key here is the one you have hit upon: who has the skill-set to maintain and manage these things? That is the bit that needs to be clarified, along with who pays for them. You can do that a number of ways. We see a lot of contracting and out-sourcing. You get people who are good at something and you pay them to do it. From our point of view you will not be surprised to hear that the important thing is to protect water customers and make sure they are paying for the service they get, not for protection for other people, and we would be keen that that be clarified.

Q32 Chair: There are two points. One is existing SUDS as you have mentioned. The worry is that we do not know where they are, who necessarily who owns them and whether they are being maintained at all. The other is future SUDS. I do not want to put words into your mouth, but it strikes me that the local authority should be responsible for the planning and development of new SUDS, but responsibility should pass to the water companies both to engineer them and maintain them afterwards. But it strikes me that in the Bill the difference between existing and future SUDS is a bit of a grey area. Do you agree?

Regina Finn: My concern—I think we said it at the time—is that the entity that is planning and requiring somebody to spend money to do something should be the entity that is responsible to the people who have to pay for that. We would be very concerned if water companies or local authorities were able to tell sewerage companies to build things, whether or not those companies wanted to or thought it was a good idea, and that had to be paid for by the sewerage companies’ customers. We do not think that would be a good result for customers. Essentially, if you take away accountability—effectively, the sewerage companies are accountable for draining their areas—and let somebody else dream up what to do you break that link. That is a very bad thing for customers. We think that is extremely important.

In terms of new SUDS, water companies may plan and opt to use SUDS because they are cost beneficial; they are the best thing to do instead of building a new sewer or link. We think that is absolutely sensible. We would be concerned if a local authority decided that a SUDS was needed, but it was not cost beneficial and it should not be there, and the water company was somehow required to deliver that asset. That would be unfair to customers. I think it is the governance that needs to be sorted out. Who is accountable? Whoever makes the decision should be accountable to the customers who have to pay for it.

Q33 Chair: But in one sense do not the same people who pay either way? All of us are either council taxpayers in the area of the SUDS or water company customers. The question is how the funds are raised.

Regina Finn: What I am saying is that, through our regulation, a water and sewerage company has a responsibility to ensure they deliver fairly for their customers. They have a responsibility to listen to their customers and show that something is cost beneficial for those customers. We already have a situation

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where sometimes, because of legislation, a water company has to do something that is not cost beneficial, so customers have to pay for it. It may be an environmental improvement for which they have to pay. That is a difficult issue. What I am trying to say is that, in terms of the choice of what needs to be built, where, why and how much it will cost, the entity that is doing that should be the one responsible for collecting the money and paying for it; otherwise, you lose accountability. We are part of the public sector. It is hard to hold a public sector organisation accountable for a spend that it does not have to justify because it is coming from somebody else's bill. That is what is important.

Q34 Chair: What would you like to see in the comprehensive Water Bill that we are expecting after the White Paper? Do you have any indication of when we might expect it?

Regina Finn: What we are really positive about is the nature of the reviews that are taking place now and their timing. It is a good opportunity for us to think about how we can improve the regime and make it more sustainable, to use that buzzword. We will be feeding our views on the key issues into the Water White Paper response and the Defra review, but, if I were to focus at quite a high level on some of the things that we think are important, the first one would be that we need the tools to ensure we reveal the value of water throughout this value chain and start to understand how companies can make the best possible investment decisions now and for future generations. We think there are a number of tweaks to the legislation that would be needed to help us do that, and we will be explaining those. That includes using market forces where we can through water trading and the possibility of an interface with the Environment Agency around abstraction licences. I think that will be a very important area for any future legislation to look at.

The second area that we think is very important is that we do not want to write legislation every two years; we want to ensure that we put in place a framework that will stick the pace and will be flexible enough as the challenges that we know are there become real. We know there is climate change and weather volatility. We do not quite know how it will pan out, but we need to be ready to adapt to that. Therefore, I think we need a modern, transparent and potentially simplified regulatory regime. To come back to the example about licences: instead of having quite a complex set of 21 old licences that has grown up over 21 years, with different clauses everywhere, if we

streamline them into a more modern, modular licensed approach we can perhaps have a more flexible regulatory regime so it is clearer to everybody what their obligations are and it will allow us to manage it more effectively.

The third set of things that probably needs to be there is essentially what was left over from Martin Cave's and Anna Walker's reviews—the issues that were not tackled because of the time through the Flood and Water Management Act. I think they are important issues about innovation, giving business customers the choice that they really want right now, particularly when they are trying to survive in a tough economic climate, and affordability, social policy and frameworks for social assistance for vulnerable customers. All of those matters raised in the two reports would be the third area I would like to see addressed in this legislation.

Q35 Chair: To be clear, you think they require legislation and have not been fully dealt with?

Regina Finn: Some of them do, yes.

Q36 Chair: I want to ask a very technical question. Where a plumber has repaired a wastewater pipe in someone's home and unfortunately it has been connected to the surface water system, which clearly should not happen because it is causing damage to the main infrastructure, in your view who should pay?

Regina Finn: This is the issue of misconnection and whether there should be some regime to deal with it. Keith, do you want to handle that?

Keith Mason: I think we will have to come back on that one. Initially, you would go back to the person who had misconnected it in the first instance. That will probably be the developer. One suspects they are unlikely to be around some time later, but perhaps we can write to you on that particular point.

Q37 Chair: That would certainly be helpful. One other point on which perhaps you can write to us is the percentage of non-paying domestic customers. I think it is well documented, but can we have that figure for our inquiry?

Regina Finn: The percentage of bad debt that comes from domestic households?

Q38 Chair: Yes.

Regina Finn: We will get that for you.

Chair: Thank you both for being so generous with your time. I am sure we will have many opportunities over the coming months and years to invite you back.

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Examination of Witness

Witness: **Tony Smith**, Chief Executive, Consumer Council for Water, gave evidence.

Q39 Chair: Good afternoon, Mr Smith. Thank you very much indeed. Could you introduce yourself for the record?

Tony Smith: My name is Tony Smith and I am Chief Executive of the Consumer Council for Water. We are the organisation that represents business and domestic water customers in England and Wales.

Q40 Chair: At the outset can you say how strong a voice for consumers you believe the Consumer Council for Water is?

Tony Smith: I think it has been pretty strong. We have been going for five years. We have tried to find out what the customers' priorities are and make sure we address those forcefully and as quickly as possible. As was touched on earlier, their priorities are about safe and reliable water supply, a sewerage system that works, value for money, competition for business customers and, increasingly, the problem of affordability, particularly in the South West.

What have we done to move forward those things? We played quite a big part in the previous price review in 2009. We negotiated with each of the water companies to try to get them to frame their business plans and proposals to Ofwat in a way that addressed their customers' priorities and were bounded by what customers would accept in terms of prices. Obviously, that varied quite a lot across the country. In the South West there was a lot less acceptance of price increases, but the end result was that the companies put forward plans to Ofwat that were much better than in the past; they were much more customer-focused, and probably £1 billion better for water customers than in previous price reviews. That is worth £55 a customer. Therefore, Ofwat received business plans that were much more customer-focused and, if you like, regulated by the water companies themselves, because they realised that we would tell their customers what we thought of those plans.

The other key measure was that we tested customers' views of the whole process of the regulatory system. We found over 80% acceptability of the outcome of the review. Interestingly, that measure has never been done before in the history of price reviews, so we have no idea what customers thought of previous price reviews. We know they liked this one.

I think the second area is improvement of service for customers. We encouraged the companies and Ofwat to put in the right priorities for customers. You heard Ofwat refer to over £1 billion for sewer flooding. We have negotiated with Ofwat and the water companies a new incentive system for customer service and complaint handling. In turn we have put pressure on the poorly performing water companies in terms of complaints to such an extent that complaints are now rapidly dropping. Customers now tell us that complaint handling in the water industry is twice as good as that in the energy industry. That sounds good but it still has a long way to go before it is right for customers.

Q41 Chair: Given the comments you have made, would you say that was down to your organisation or the regulatory framework?

Tony Smith: Both. We have tried to pull the right levers. We are a very small organisation. We cost the water industry about £5 million and they pay according to the number of customers they have. It is all about trying to get other organisations to do the right thing. We have tried to put pressure on the companies to do the right thing in terms of accountability to their customers. We have also tried to influence the regulators, not just Ofwat but the Environment Agency and Drinking Water Inspectorate, to address customers' priorities. We have tried to get Ofwat to change its approach to regulation. I mentioned the incentive regime; that is quite a powerful tool that causes companies to do the right things. That has had a good contributory effect on things like complaint handling and companies' focus on customer service.

Q42 Chair: What would you like to see coming out of the Ofwat review and, through it, how do you believe customer interests can best be represented?

Tony Smith: The really important thing we would want to see echoes, to a reasonably large extent, Ofwat's view that the regulation over the past 20 years has delivered pretty well for customers, but our comment would be that, for it to be fit for purpose in future, it needs to be much more customer-oriented for two reasons. One is the nature of the regulator. You have heard Ofwat say that it is the economic regulator. Therefore, it is really good at looking at the economics, and those are the sorts of discussions you have just had. If one considers the nature not just of Ofwat but all economic regulators, Consumer Focus did a recent report that rated regulators. It asked the question: how customer-focused are the regulators? The answer across the piece is: not very. Therefore, the focus of the customer needs to be balanced against all the other conflicting things that are going on in the industry. Ofwat said—I think it is absolutely right—that it has to balance all the pressures on the industry. If you think of them as a set of scales, on one side you have the quality regulators telling the water companies that they have to do a lot to improve their systems, which is usually high cost; you have 22 water companies with lots of information about their businesses and they are very convincing; and you have a relatively small number of investors and lenders to the industry. That is a very powerful lobby all pushing effectively against the customer. On the other side of the scales you have 25 million customers—individuals and businesses—who are relatively uninformed and not too interested in water issues, except when prices go up or something goes wrong—apart from the South West probably—but it is quite important that those pressures on the one side of Ofwat's scales are counter-balanced by a strong, concerted and independent consumer view.

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Ofwat has to do two things: it must protect customers, as you heard Regina Finn say, but it must also finance the functions of the water companies, which means it has a slightly conflicting set of objectives that it must deliver. It is really important that you have a strong consumer view in this slightly weird industry. You have price setting every five years and it is a very particular process. The drivers of price increases are all about improving the environment and drinking water, and other pressures that we have talked about here. I hesitate to say that we are a bit 'techie' but we need to be so we can represent water customers and bring their views to the party in a way that water companies and Ofwat will listen to them.

Q43 Chair: What is your understanding of the likely role for Consumer Council for Water following the review on arms-length bodies?

Tony Smith: Whatever happens, I think it is really important that that strong and independent counter-balance is there. It need not necessarily be the Consumer Council for Water, but it definitely needs to be there in a strong form in order to avoid problems of legitimacy in future. Probably the biggest issue for water customers going forward is the whole question of legitimacy and value for money. If you ask customers what they think of the service in the water industry it is pretty good; if you ask them what they think about value for money it is pretty much on a par with energy, and energy is not rated very highly by customers as a whole.

The problems are particularly acute in the South West where you could argue that the regulatory system is beginning to lose legitimacy. There are very high levels of concern. That is a big worry anyway today so we have to fix that one, but the problem is that other areas may also have problems if, as expected, prices continue to rise in future. What customers are really concerned about is rapid price rises of the sort we saw particularly in the South West and they cannot see anything for it. Therefore, the issue of legitimacy is very important. Whatever happens, a consumer body needs to be there to put forward issues not just about prices but also about the quality of the service and improvements to it. That is a really important thing for the next 20 years of successful regulation in the water industry.

Q44 Chair: In terms of delivering regulatory regime changes, would you like to see something in the Water White Paper just to ensure the balance comes down in favour of water customers as opposed to water companies' shareholders?

Tony Smith: We would like to see three fundamental things in the White Paper. One is that the regulatory system becomes more customer-focused than it has been in the past for the reasons I have just given. The second is that large business customers and SMEs are very keen on competition, and I think we need to make progress on that. Domestic water customers are less concerned about it, but business customers definitely want to see progress on competition. The third area is the whole issue of affordability. We need to resolve that problem because now one in six customers tell us that they find their bills unaffordable,

and in the South West it is more than half of customers.

To an extent the issue of affordability in the water industry has for many years fallen between the cracks of water companies, the regulator and Government. We had a lot of input into the Anna Walker review and we think that the bones of the solution are there. We have done a lot of research into these issues, including the South West issue. Customers' starting point would be that it is really for the Government tax and benefit structure to put in an adequate system. However, they also recognise that the system is probably inadequate for two reasons: first, the very big differences in prices; and, second, changes that are to come. If you start to roll out metering, particularly if you do it compulsorily, there will be very rapid effects on some customers' bills, up to £200. Therefore, the issue of affordability really needs to be addressed.

The other big strategic thing for the country as a whole is that whereas customers generally are reasonably receptive to paying for further improvements into the future—environment, flooding, resilience and maintenance—the people who are less receptive are, naturally enough, those who struggle with their bills today. As that proportion rises the level of discontent about future price rises increases dramatically. Taking a 20-year view, the risk must be that the regulatory system could lose legitimacy, and of course the whole system is based on customers' willingness to pay.

Q45 Thomas Docherty: As to the timings of these things, the next period price review will take place in 2012.

Tony Smith: It will probably start in 2012.

Q46 Thomas Docherty: What would be the most helpful timing of the White Paper to coincide with that review?

Tony Smith: As soon as possible for exactly the reason you give. The price review will probably be set in 2014, which means that it will be very intense in 2012 and in reality will probably start in 2011. I think that is one reason for a degree of clarity for Ofwat, particularly if the White Paper included things about their approach to consumers and changing regulation. That is quite an urgent piece. The second urgent thing is affordability, because companies are already considering social tariffs as they roll out their metering programmes. They are wondering whether to use existing legislation—in other words, the Flood and Water Management Act—or whether something will come in a White Paper and subsequent legislation that they need to think about then. There are, therefore, issues today that are important for customers and those water companies.

Q47 Tom Blenkinsop: The previous Government kept you separate from Consumer Focus, recognising the value of having a separate body championing water customers' interests in the 2009 price review. How do you see your role going forward particularly given the review of Ofwat?

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Tony Smith: Yes. We think it is important to be separate from Ofwat for the reasons I gave. There is a danger if you have a captive consumer body inside the regulator, which Ofwat had for the first 15 years—after privatisation they had their own consumer body inside the organisation—that they have to do two things: finance their functions and protect customers. Inevitably, that can cause a bit of internal friction, so it needs to be separate for that reason. One of the crucial things we did in the previous price review was to try to encourage water companies to take greater accountability before their customers for their plans. We would want to encourage that even more in the future. Therefore, rather than do the customer research that we did last time with Ofwat and others, we would try to encourage them to do it in a reasonably standard way. As Regina Finn said earlier, we cannot afford to have different types of customer research because then you cannot compare it, but, if we can encourage the companies to be much clearer with their customers and put forward their plans to their customers, we think it would have an incentive effect on the companies themselves, because if it is hidden from the customers they will have a tendency to bid. In the past there has been a tendency for companies to bid high and then Ofwat will reduce their proposals. What we really want is a situation where the companies themselves put forward reasonable plans. Inevitably, Ofwat play an important role in that to ensure that the plans put forward are efficient, but, as far as the customers' view is concerned, we would like to work with the companies to try to ensure that every plan is based on customers' views. I reckon that in the previous price review we got about half the companies to do that; we want to get the other half to do it. Therefore, half the companies' plans were good; the others were, to an extent, bidding. We want 100% of plans where companies would be happy to stand up and say that these are the plans and they have their customers' agreement.

Q48 Bill Esterson: I want to go back to your comment about the role of the revenues and benefits system. I thought for a minute you were to talk about some kind of water benefit rather like Council Tax Benefit. Is that the thinking?

Tony Smith: It could be.

Q49 Bill Esterson: I want to tie that to the issue of customers in one part of the country potentially subsidising customers in another. That seems to be wrapped up in the same issue.

Tony Smith: Yes. One way of doing it is to have a tax and benefits-oriented system for water customers. The reason we suggested that as an option—we were pragmatic enough to realise that it might not be acceptable in the current circumstances—is that customers would start by saying that is probably the best answer because then it is progressive and it can address those who really need it. That is the starting point. However, this is where you need to do research and push customers to make they understand the issues, so they are no longer typical customers at this point. The research we have done shows that if you go beyond that and ask about some of the issues to do

with water customers, particularly in the South West, or customers across the country who have trouble paying, or concessions for site area charging—which we may come on to later—when customers understand the reasons for it they are receptive to those sorts of things within fairly limited amounts of money. Therefore, the questions you asked Ofwat earlier about subsidising the South West would become very important. Customers say that, yes, they will pay a little extra for these various social tariffs, if you like, but it is a limited amount, it must be specifically for problems to do with water and nothing else and it needs to be transparent. Although customers start off by saying that the tax and benefit system is the right answer, if you say that that will not come up with the goods you can convince them that there is an alternative, but it will not be easy to convince people in the round through the media or whatever way you try to talk to customers. It is possible to do it.

Chair: We are coming to this, so if there is a separate point on it that we will not cover later we can deal with it, and then I will turn to Dan.

Q50 George Eustice: I just want to ask a very simple question: how engaged are you in the development of the White Paper on this issue?

Tony Smith: On the South West issue?

Q51 George Eustice: On the Water White Paper that Defra is putting together. Have you engaged with the Minister or had the chance to explain your concerns to Defra?

Tony Smith: We have talked about the top issues for water customers with the Minister, and we have been invited by Defra officials to give our top 10 issues for consideration in the White Paper. Obviously, we knew we were coming here. We would expect to be pretty closely engaged as it develops.

Q52 Dan Rogerson: It is nice to see you, Tony. You said in your written evidence that one of the reasons customers suffer is that there is not competition.

Tony Smith: Yes.

Q53 Dan Rogerson: Have you had a chance to quantify what you think the benefits would be of competition? Do you think the Cave review goes far enough, or are we talking about more than that in terms of allowing householders access to a market in the same way as energy customers?

Tony Smith: We did a lot of work with the Cave review and worked closely with them on their cost-benefits and customers' views. I think the customer view splits up into various customer segments. The most urgent thing is to get competition for business customers. Martin Cave suggested retail competition. That will be a step in the right direction, as we have seen in Scotland. Our only question is whether that will deliver enough to fulfil the expectations of those customers because, as Ofwat said, the retail competition element accounts for only about 10% of the price of the bill. In some cases customers' expectations are higher than that, so they may end up

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being disappointed. We should, nevertheless, pursue that.

If we go to the other extreme, interestingly domestic customers are very ambivalent about the issue of competition, largely because of their experience of the energy market. We find that initially a small majority of customers say they are in favour of competition, but when they understand how it would work and the similarities with energy they break down as follows: one third of customers still want it; a third definitely do not want it; and a third in the middle say they are not very sure or have no opinion on it. For that reason, we do not strongly advocate domestic customer competition until the business customer competition has proved itself. I think that is pretty much where Cave came out and we therefore agree with that.

Q54 Dan Rogerson: Is legal separation rather than functional or total separation of retail from the upstream activities the most effective way?

Tony Smith: To be honest, we are not sure. That would definitely be a question for Water UK. I worked in the energy sector just as competition was coming along. I can see the cultural benefits of splitting up the businesses. In energy, eventually one is moving towards complete competition across the whole market, so it was well worth it then. Here we are talking at least initially about something that is much more limited. Cave pointed out that it took about 17 years to pay back the costs of legal separation. You have to ask the question: is that worth while? I think accounting separation is a step in the right direction because it puts a discipline on the people inside those businesses to understand their customers and costs better in serving those customers. If that is the compromise—that it is not too costly but it begins to impose discipline on managers—that is probably the right answer, but it is not an area in which we have particular expertise and we rely on others to answer those questions.

Q55 Dan Rogerson: To come back to the South West, as we have from time to time this afternoon, do you think there would be potential gains in terms of equalisation of the costs of providing these services across the country if you could in some way look at a network with retail on top of that; in other words, if that infrastructure was conglomerated into some form of national way of doing it?

Tony Smith: I suppose our concern is that, like energy, customers may think they are getting competition and therefore their bills may go down. What happens is that there are underlying pressures to push prices up. In the case of energy it is gas and oil prices; in the case of water it is all the investments that must be done. I still think those underlying pressures will be there. It is an interesting point you make about having a national—

Q56 Dan Rogerson: To take energy, if a power station is built and the energy is sold on to the grid, people who live near that power station do not find that suddenly they have to pay for the costs of the power station.

Tony Smith: But the nature of water is that it is localised. Water sources and the sewerage system are both very localised. I am not quite sure that the cost dynamics in the water industry are similar to that, but I think the solution for the South West is: is there a legacy problem that needs to be resolved? If so, who pays for it? Our only concern is the point made by Ofwat, which is the precedent issue. Where does it end?

Q57 Thomas Docherty: I have a very quick point on competition and its merits in the domestic sector. Scotland does not have domestic competition, so will you be looking at that model as well as the competition model? Are you looking at what works in Scotland for domestic customers? My understanding is that, compared with the English regions, Scottish customers have the third lowest bills and a pretty good level of satisfaction.

Tony Smith: We work with Scotland a lot. Although there are differences for the reasons you give they are also comparable. At the moment Scotland is ahead of England and Wales in terms of competition, so we have to catch up in that regard. We advocate a drop down to a level that is not all business customers because we do not think the systems could cope at the moment. I think there are 1.2 million businesses in England and Wales and the systems for switching between companies just would not be able to cope with it. We advocate dropping down to about 25,000 customers. We would want to see that it works and delivers what customers want to see and then consider domestic competition very much as Cave suggested. Therefore, you prove the system works and delivers and then you consider rolling it out for water customers because of the level of domestic water customer concern about competition.

Q58 George Eustice: The Walker review said that the current charging system is creaking at the seams. Is that analysis one that you share?

Tony Smith: We would, yes. There is a need to move gradually towards water metering, and we would agree that that is the fairest way to charge customers. There are issues about the pacing of the moves towards water metering and protection for the customers who will lose out, but probably the biggest area of creaking is the lack of adequacy of the arrangements to protect customers who cannot pay and the South West issue.

Q59 Neil Parish: I see that the consumer council wants meters implemented without consumer backlash. Fifty-seven per cent of customers say they like it; 27% say they do not want them put in; and 40% support the introduction, so there seems to be an anomaly there. The question is: do you want this mandated, and do you think they should be smart meters?

Tony Smith: Customers favour in principle the idea of a water meter. Most of them want a choice. The difference in the numbers arises because, if you start to talk about compulsory metering, inevitably the percentage of customers who are wary of that rises dramatically. More than one quarter of customers

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would be against compulsory metering. Some of that is just fear, which you can overcome over time by word of mouth. As customers get more bills—sorry, meters—they become more positive about them.

Q60 Chair: A Freudian slip there!

Tony Smith: Yes. They get over that because they hear from their neighbours that they think a water meter is a good thing. But there needs to be protection for customers who genuinely will suffer. This takes us back to the social tariffs point. In some cases it is probable that there will need to be transitional arrangements as well. If you have very rapid compulsory metering, you need to ensure you do not get a backlash. If you go from low to high levels of metering very quickly, the customer reaction is likely to be quite harsh unless you have the right protections in place.

Should it be mandated? Yes, it should. First, obviously, it should be in the areas of water shortage. Should it be smart meters? There are some advantages to smart meters, obviously not least that they are being rolled out in energy at the moment, but I think the case for their use in water is not yet proven. We have not really done any business case on it and so we do not know how far a customer would observe a smart meter. We know that customers will react to knowing what is on their bill, how much it was compared with the previous year and how it compares with the bill of a customer having similar characteristics, but you do not need a smart meter to give you that information. We need to trial smart meters pretty quickly so we start to get an early view of the benefits. If it is justified, we should roll it out.

Q61 Neil Parish: We seem to be South West-dominated. If we had a national levy that helped pay for the beach clean-up in the South West, which amounted to £2 per person for customers in the rest of the country, could it be sold to those other customers, or not?

Tony Smith: I am afraid the answer is: it depends on other things that are happening. We ask customers about social tariffs across the whole country; we ask them about the South West issue and about concessions for site area charging. When you help them go through the thinking about why they needed to do this, they said, in the round, “Okay, a few pounds for those things.” It depends on what else is happening to their water bill. If their water bill is rising for other reasons, for example the switch from private sewers over to water companies, or indeed any other price increases in future, they will be less receptive, so a lot depends on what else is happening. To answer your question straightforwardly, yes, I think it can be sold but it will not be easy.

Neil Parish: Thank you. That is the answer I wanted.

Q62 Dan Rogerson: On the issue of social tariffs, you have been cautious about the potential level of support. How do you think Ofwat can ensure that guidance to water companies maintains the right balance?

Tony Smith: I think Government can be clearer in its guidance to Ofwat about what it expects the regulator

to do and the role of social tariffs paid for by the water customers. I think that would be helpful. Even if that did happen, however, we have a concern about the legitimacy of an economic regulator, or a privatised water company, coming forward with proposals on social tariffs unless those proposals are backed by that water company’s customers. It goes back to the point that, if we are to be in a position to respond to the occasional angry customer asking why he should pay for this, we need to be able to say that customers in the round support these things. Remember, if you leave it just to the economic regulator or privatised water company, customers have no choice unlike energy, so that has quite a big effect on their receptiveness. If it is being imposed on them it is almost like a tax, so for the customer legitimacy is really important. The approach we advocate is what we call consumer-led regulation where we test things on customers in a particular company’s area. This is a good example of where you need to do that to retain legitimacy.

Q63 George Eustice: I think we have covered some of the areas I was going to talk about. I want to ask specifically about the issue of precedent about which you and Ofwat seem to have a concern. Is it beyond the wit of man to have a threshold whereby if one were within a certain variance against the national average water bill, one would not be eligible for some kind of cross-subsidy, whereas if there is a substantial variance against the average, you would? Therefore, you would not have lots of trivial variances with everyone making claims, but where you had a major dislocation of, say, 50%, which is happening in the South West, the system would recognise that?

Tony Smith: I am sure it is possible to do that. There are two issues here: one is the absolute level against alternative water company customers—obviously, customers in the South West are an acute problem—and the other is the speed of increase. I heard reference earlier to the Thames Tideway. At the moment Thames customers’ bills are among the lowest in the country but very rapidly they will rise probably by £50 or £60 as a result of the Thames Tideway, which is a multi-billion-pound project. I think there are two issues: one is the absolute level as against other companies and the second is the speed of the increase.

Q64 George Eustice: Do you think it would be possible to write into a set of guidelines or regulations some kind of guidance that tidied that up?

Tony Smith: I think that is an issue for Government but, yes, in principle it could be done.

Neil Parish: Could sparsity of population also be added in?

Chair: Rurality as well.

Q65 Tom Blenkinsop: In the main you advocate collective consumer solutions as opposed to individual consumer solutions to these problems?

Tony Smith: Yes. In the absence of competition it is not either individual customer or everybody. What we have tried to do with the water companies and the regulator is highlight the fact that, as in any other

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market, there are customer segments that take different views about these things. A problem in the past with the water industry is that as soon as you reach 51% agreement, “That’s okay then, we’ve done it,” rather than understanding that although the majority of customers might support something there is a sizeable minority that does not. We need to understand why that is and how you are to overcome it.

You are right that in the absence of competition we are advocating a need to listen to customers in the customer segments. If there is one thing that is true over the past 20 years in the water industry it is that customers have not been listened to enough, and that is one of the upshots we are now talking about. Although customers are reasonably happy with the service they are not happy with value for money and we need to listen to that. One of the things we shall suggest for the White Paper is that the regulator should have a measure of outcome. Regulation should be much more outcome-focused. One of the key outcomes that the regulator should look for, among other things, is the measure of customer satisfaction with the service and value for money provided by the water industry. Those are crucial measures about how well the water companies are doing and how well the regulatory system is working for water customers. That is one of our strong suggestions for the White Paper and to this Committee.

Q66 Mrs Glindon: Perhaps another side of fairness and customer satisfaction is how bad debt is tackled. Why should all customers carry £12 for all those who either cannot pay or, moreover, will not pay?

Tony Smith: That is a big concern for us and the industry. A number of things can be done to help. One is that at the moment the companies can, if the costs of bad debt rise, come back for an increase in price. It is called an interim determination and is a regulatory process. We do not think that is right. To let costs rise does not incentivise companies. We think that incentive should stop. We suggested that in the previous price review and Ofwat did not listen to that point.

The companies can do more themselves. There are broadly three groups of customers who have problems with debt: there are those who cannot pay; those who won’t pay; and there is a very big group of customers in the middle who find it difficult to pay because they are not very well organised with their money. That is not just about water; it is about customers’ handling of money across all their bills. We think that provides a big opportunity for water companies to work with those customers and help them manage their debts and not get into debt in the first place. We also think that the extension of the DWP’s Water Direct scheme would help. At the moment customers can use the Water Direct scheme if they have already been in debt. The problem is that it does not help customers who may get into debt. The scheme allows the money for the water bill to come off before the benefits are paid to the customer, so it is top-sliced and goes direct to the water company. We think—customers agree with this—that helping them not to get into debt in the first place by doing that would be a helpful development.

We think there are a number of things that the regulator could change by a fairly modest tweak of DWP rules and that the companies could do.

Q67 Mrs Glindon: To come back on fairness, obviously to help people clear their debts is fine, but is not that kind of direct payment perhaps a way of capturing the people who cannot pay but not solving the issue of the people who won’t pay? It seems harsher on those who already have limited incomes, while I understand it is a way of getting some payment back.

Tony Smith: I totally agree. I suppose the encouraging thing is that the customers who won’t pay are a relatively small proportion, but that is not to understate the size of the issue. To go back to the discussion about social tariffs, mention was made earlier of disconnection. We would be concerned if there was any restoration of the right to disconnect while there are insufficient protections in place for customers who cannot pay. If those protections were put in place, there is a stronger case to be tougher on those people who won’t pay, which is your point. We would agree with that, but the protections need to be there first.

Q68 Bill Esterson: How would you identify the people who won’t pay? From what you say, you would use some of the same approach with those people as you would perhaps with the people who are not so good at managing their money. However big or small a group that is, clearly it is a key group of people.

Tony Smith: Companies do that all the time already. It is not true to say that they do not have fairly tough sanctions against customers who won’t pay. They cannot disconnect but there are county court judgments and charges on properties, which is a pretty significant penalty they can impose on customers. They are trying to identify these people all the time. Many of them will be working with people like Citizens Advice Bureau and so on to try to identify them and differentiate between those who are not very good at managing their money and those who just won’t pay, so they are already doing that to a reasonably large extent. The debate is about what you do with those people at the end of it.

Q69 Chair: Not unconnected to what you said in response to Mary Glindon, if water efficiency measures could be encouraged, which is the reverse side of bad debt, do you think that Ofwat’s remit needs to be changed to deliver that? I know Anna Walker has done a lot of work on this, but do we need legislative changes to bring that about?

Tony Smith: I am not sure you need legislation to do that. It could well be written into guidance to Ofwat, but I am not sure legislation is necessary. I am not an expert but I would have thought it could be—

Q70 Chair: Just the regulations under it?

Tony Smith: Yes.

Q71 Chair: In terms of the legislative framework, you mentioned once or twice the White Paper and

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looked ahead to the bigger Bill. What do you believe the legislative priorities are in regard to the Act that was adopted this year and prospectively for the future Act?

Tony Smith: Far and away the most important thing is to make progress on the flooding issue. When that Bill was going through Parliament we accepted that it was very narrowly based and did not address the issues of affordability and competition because customers were telling us in the research we did on flooding that this was an urgent issue that needed to be resolved. Therefore, making progress with the Michael Pitt recommendations was a real priority. I think implementation of those things, so there is clarity about who should do what—the responsibilities—and various other elements to help with flooding, is definitely the priority.

Q72 Chair: That is very helpful. Referring to the debate on SUDS, who do you believe should pay for maintenance? Do you believe there is a distinction between existing SUDS, where it is quite likely their full extent is unknown, and SUDS yet to be developed?

Tony Smith: I think the costs should fall on those who are responsible for delivering whatever the benefit is locally, so if it is a water company and a problem that is being resolved through SUDS it should be the water company; if it is the local authority it should be the local authority. It is important that the relevant body is sufficiently incentivised to minimise the problem in the first place. To split it up artificially is I think philosophically incorrect.

There is some concern that, over 20 years of a privatised water industry, water customers are seen as a bit of a soft touch relative to other payers of bills. We have talked about the South West. Were the hurdles to be gone through in agreeing to the directives that went into the legislation that drove those bills given the same degree of scrutiny as other things had taxpayers been paying for it? Anna Walker pointed out that there has been a tendency for Government to sign up to directives from Europe, for environmental improvements and so on, without understanding the impact on the end customer. Therefore, things happen every few years which have significant effects on water customers' bills and they are piled on top of other things: maintenance programmes, private sewers, social tariffs and so on.

Q73 Chair: To press you on SUDS, there is a whole host of issues to which we can revert to probably under the Natural Environment White Paper. As to those responsible for delivering, if it is a pond or a highway for surface water runoff, which in most cases

was the main cause of flooding in 2007, the end is to stop the water going into someone's home or to stop a dam bursting downstream. Can you be a bit clearer?

Tony Smith: Whoever is responsible for managing that watercourse or feature should be the one who funds it.

Q74 Chair: I may be completely wrong, but I get the impression that often these things are planned and then just left. What I want to see emerge from the legislation, which I hope you agree with, is that if it is infrastructure for surface water runoff, would it not be more appropriate for the water company to take responsibility? I quite accept that planning should remain the responsibility of the upper tier, but I believe that the 2010 Act is very fuzzy on it and we need greater clarification.

Tony Smith: Yes, as long as that does not involve water customers artificially paying for something that is somebody else's responsibility.

Q75 Chair: We can debate this when we see more concrete proposals. Given there is now consultation on private drains and sewers and we still do not know their extent in each water company area, in your view what would be the cost to water companies and what should be done to minimise the cost to individual water customers of the transfer of private sewers? Obviously, one cohort of customers will be delighted because they are offloading the responsibility on to someone else; for others the cost will be spread. I am told that the amount is very small, but that might differ according to each water company area.

Tony Smith: Estimates vary, mainly because water companies do not know what is coming their way. I have seen estimates of between £3 and £14 per bill, so it is a reasonably sizeable amount. This comes on top of the view that customers were getting reasonably flat bills over the next five years so this will be a bit of a shock. As you say, there will be some benefits to customers, so there is quite an important issue of communication. Again, it reinforces the need to address the problem of affordability because this just adds to that issue. We have suggested in our response to consultation on the subject that one of the things missing at the moment is one set of vulnerable customers who will not benefit from the transfer: those who live in residential caravans and things like that. We suggest that they be included in the regulations.

Chair: That is very helpful. Your comment about environmental responsibilities is something we would like to revert to, but we thank you for being so generous with your time today and for being here to present evidence to us. We are very grateful.

Wednesday 20 October 2010

Members present:

Miss Anne McIntosh (Chair)

Tom Blenkinsop
Thomas Docherty
Bill Esterson
George Eustice

Mrs Mary Glendon
Neil Parish
Amber Rudd

Examination of Witnesses

Witnesses: **Lord Smith of Finsbury**, Chairman, Environment Agency, **David Rooke**, Acting Director of Flood and Coastal Risk Management, Environment Agency, and **Ian Barker**, Head of Water, Environment Agency, gave evidence.

Q76 Chair: Good afternoon and welcome to you, Lord Smith. It is a great pleasure to see you before the Committee. Just two points: it is possible there will be some votes, but we will come back as quickly as we can and I ask for your forbearance. I also apologise in advance that the acoustics in the room are not the best, so bear that in mind. Lord Smith, may I invite you to introduce your colleagues for the record?

Lord Smith of Finsbury: Thank you very much indeed, Chair. First, I apologise if I cough and splutter at various stages during the course of our evidence, but I am suffering a little from a sore throat. As to my two colleagues, David Rooke is our Director of Flood and Coastal Risk Management, and Ian Barker is Head of Water within the Environment and Business Directorate. As you will know, I am Chairman of the Environment Agency.

Q77 Chair: Let me put a very general question at the outset. We have just had the Chancellor's Comprehensive Spending Review. Are you able to say at this stage how it will impact on your work?

Lord Smith of Finsbury: You will have seen the broad figures put in place for Defra. Although we do not yet know the precise figures that will flow from that for the Environment Agency for each of the next four years, it is a fairly safe assumption that broadly they will be in the same order of magnitude of required savings that the Department as a whole will have to find. I can say two things. We have been told very specifically that over the four-year period there will be £2.1 billion for flood defence capital work. The expectation of the Government is that that will help to provide increased protection for something in the order of 145,000 additional households. At this stage, we think it means that we can certainly continue with everything that is currently on site to finish. It means that we will probably have some difficulty in starting new flood schemes over the course of the next year or two, but that picture will get rather better towards the end of the spending period. We also know that funding will be sufficient in revenue terms within the flood and coastal risk management field to maintain current standards in terms of emergency response. For us, that has always been an absolute priority. The spending review enables us to maintain that professional response.

Q78 Chair: Where does maintenance fall in the scheme of things?

Lord Smith of Finsbury: We have said to the Secretary of State throughout the process of discussion in preparation for the spending review that, for us, maintenance of existing flood defences is even more important than the construction of new flood defences. We believe that that priority has been recognised within the spending review. We do not yet know the precise figures in order to be able to give you 100% assurance on that, but our belief is that we will be able to maintain a very strong maintenance programme.

Q79 Chair: About 500,000 homes and properties are at risk, so you will be able to protect the 145,000 that are most at risk.

Lord Smith of Finsbury: The 145,000 is additional to the degree of protection that existing properties have. David will tell me the exact figure for the total number of houses that we estimate are at risk of flooding from rivers and sea.

David Rooke: It is about 2.4 million.

Lord Smith of Finsbury: At the moment, of those how many have some degree of protection?

David Rooke: Most have some degree of protection. We estimate that about 500,000 are at what we call significant risk, and within the current targets set by the previous Government, we would aim to provide increased protection to some 45,000 of those properties at significant risk in the current spending review. Clearly, we need to talk to Government about their aspirations for the next spending review.

Q80 Chair: Where do you think that this will put you with the insurance industry and the statement of principles?

David Rooke: The flood summit held by the Government a few weeks ago set out basically three work streams: working with Government, ourselves, the insurance industry and other major stakeholders to go back to Ministers in March with some proposals for how the insurance sector could continue to play a role in taking its share of risk vis-à-vis the Government's share of risk and vis-à-vis the public's share of risk, with a view to a further flood summit next July, as the Minister announced. That work has already started and will pick up pace to meet the March deadline.

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Q81 Chair: Last week's announcement about the arm's length bodies said that you will be undergoing substantial reform, including a radical overhaul of back office and support functions. Perhaps you could say a little about that—I know it is early days. In addition, is there any move to take policy formulation back into the Department?

Lord Smith of Finsbury: On the first point, we have already been undertaking very substantial reform of our structures, the administration part of our work and the way in which we go about it, over the past couple of years. We have accelerated that over the past six to nine months, so the process of reform is already well under way and will continue. It involves, among other things, at least a 25% reduction in cash terms in the costs of our communications, evidence, human resources and finance directorates—all the back office functions—and also a serious look at the restructuring of our environment and business directorate, which delivers all the pollution control and water quality work. That is already under way, so the substantial reform to which the announcement last week primarily referred is ongoing and will deliver both savings and greater efficiency in the organisation.

Just to touch on policy, the other major requirement that the Government have placed on us is to engage actively with both the localism and big society agendas. Again, those are things we are already doing. We need to do more and to be better at that, and the process is also ongoing.

In relation to policy formulation, the Government have consistently made it clear that it is their role to make environmental policy, which we entirely agree with. They have also made it very clear to us that they will continue to want us to advise them in an expert and professional way about all the factors that they will need to consider as they draw up their determination of policy. We are more than happy to oblige them in that respect.

Q82 Chair: What plans do you have for regional offices of the Environment Agency?

Lord Smith of Finsbury: As some colleagues will probably know, we are currently in the process of merging our Thames and Southern regional offices into an overall south-eastern region. That will deliver cost savings of about £1 million a year, and it probably also makes geographical sense for the way we go about our work. The other regions, certainly for the foreseeable future, will remain as they are, and the work at area level will very much continue as at the moment. We will have to make savings of course, but within the balance of our national, regional and area office responsibilities, we want to put the emphasis on work that has an environmental outcome as near to the ground as possible.

Q83 Chair: In terms of imaginative ways of funding, and particularly for maintenance projects, would you consider favourably my idea that you work with the Internal Drainage Boards (IDBs), which have the resources and the engineers, and allow them to do some of this?

Lord Smith of Finsbury: I am always eager to seize ideas from your good self, Chair, and this is one on

which we are already working actively. The Association of Drainage Authorities, which represents IDBs, have approached us with a proposal to look seriously at the possibility of some IDBs taking over some responsibilities for some main rivers. We are keen to explore that possibility. We are working with them to develop some pilot projects to see how this works on the ground, and I am sure that this is something we will be able to take forward.

Q84 Chair: In terms of localism, how do you wish to engage with interested parties, particularly local communities, in decisions on funding major flood defence works?

Lord Smith of Finsbury: Under the Flood and Water Management Act, all our flood defence programmes have to be signed off by the regional flood and coastal committees. We very much welcome that process. We are also at a more local level than the regional level. Whenever we now embark on finding solutions to flooding issues in communities, we take a very different approach from perhaps the historical approach of the agency and ensure we work with local communities. We share information and options with them, and we try to come to an agreed solution, rather than one that they might feel was being imposed on them. In addition, we have now established a network of liaison officers at a senior level within the organisation for each local authority around the country. There will be a point of contact for each local authority at senior level within the agency so that we can make a reality of the localism objectives of the Government.

Q85 Bill Esterson: Can you outline some of the risks associated with the sorts of cuts and efficiencies that you have been describing?

Lord Smith of Finsbury: The risks that our work seeks to mitigate all the time are those of destruction to the environment, be that from flood, pollution, harmful emissions, or the illegal or damaging disposal of waste. In all those respects, we will try to ensure—it will be difficult—that, despite having less money with which to do it, we maintain our absolutely core environmental responsibilities. As soon as we get the precise figures from Defra for the agency over the next four years, we will look very precisely at what that means in terms of staffing levels, activities and what we do.

Q86 Bill Esterson: What is your assessment so far of the risks to individual communities? Perhaps you can say something about the kind of work that other organisations might be able to take on that you will not be able to continue.

Lord Smith of Finsbury: We are very keen to ensure that we can improve partnership working with other organisations, including other statutory bodies, such as Natural England. To take a very simple example, at the moment many farmers face regular inspection visits from the Environment Agency, the Rural Payments Agency and Natural England. From their point of view, it would make much better sense to have a single co-ordinated visit by one person carrying out functions on behalf of all three bodies, so

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we are going to look intelligently at how we can smarten up the way in which we operate with other bodies within the Defra network. In addition, we are looking at whether what might broadly be described as civil society bodies, such as rivers trusts, can be entrusted with work to maintain and enhance the quality of rivers that we might no longer be able to carry out directly ourselves.

Q87 Bill Esterson: To ask one last follow-up question, a very significant level of redundancies will bring in-year costs. What assessment have you made of those costs and their impact on your other work?

Lord Smith of Finsbury: We have certainly been making very detailed assessments of what the costs, as well as the benefits, of change are likely to be. Because we started the process of taking back office costs out of the organisation quite early on, we have a modest amount of funding in our budget in the current year to enable us to have in place enhanced voluntary redundancy arrangements, and we shall be sharing those with our staff very shortly. That will, hopefully, enable us to get at least some of the process under way reasonably quickly.

Bill Esterson: And the impact?

Chair: I thought you said that was the last question.

Bill Esterson: I got only half the answer.

Q88 Chair: We can come back.

On flood alleviation schemes for flood defence purposes, do you believe that the economic impact on agricultural land is sufficiently well recognised and that the outcome measures need to be amended properly to reflect that?

Lord Smith of Finsbury: It is, of course, not our place to determine what the outcome measures should be—that is a matter for the Government. It is certainly the case at the moment that, on the cost-benefit analysis we have to undertake for any flood defence scheme, the protection of property—especially people's houses—achieves a much higher benefit-to-cost ratio than the protection of agricultural land. I am acutely aware, because I am told it frequently by those within the farming community, that in some parts of the country this is regarded as an unfair balance. My answer would be that when resources are increasingly limited, you must have some means of determining priorities between different elements of protection, and it will be up to the Government to make a choice between those.

Sitting suspended for Divisions in the House.

On resuming—

Q89 Chair: I apologise sincerely. I think that we are now clear. I suggest we take as many questions as we can, and perhaps we may crave your indulgence and ask you to reply in writing to any that we not able to cover, with a view to finishing your session at 5 pm.

Lord Smith of Finsbury: Of course.

Q90 Chair: There is one last question from me for the moment. Some, such as the ABI, have asked whether binding targets should be set to reduce the number of properties and businesses at significant flood risk. Do you share that view?

David Rooke: The previous Government were opposed to that position. As far as we are aware, the only targets enshrined in law are in the Climate Change Act. The debate that we have had with the ABI, and that the ABI had with the previous Government, was around whether there should be similar targets. The difficulty with setting a statutory target with no funding to meet it is that there is no guarantee it can be met, so we would like to have similar continuing dialogue—at the end of the day it is a matter for Government, not ourselves—on that with the ABI. The previous Government did not support the position, and there needs to be dialogue so that the new Government can take a position.

Q91 Mrs Glendon: Given the significant additional responsibilities allocated to local authorities for flood management, including surface water flooding, is there a need radically to realign the way in which limited resources for flood work are distributed? Is there merit in the suggestion made by one council of adopting of a single flood risk management funding pot for all public funds that would be allocated on the basis of an area's flood risk zone and surface water vulnerability?

Lord Smith of Finsbury: My answer is that there does not need to be a radical realignment of funding structures. However, the responsibility that the new Act places on local authorities to be the lead for surface water flooding issues in their areas is one that will require local authorities to make decisions themselves about how to allocate funds that might be necessary. We will want to work very closely with them, and also the water companies, in drawing up surface water management plans for each individual local authority area. Work on those plans is now beginning. I think that about 76% of them are now under way, although obviously there is a lot of work still to be done on them. One of the problems with flooding and trying to balance countering surface water flooding with countering river and sea flooding is that, on the whole, river flooding poses a threat across local authority boundaries, as does sea flooding, whereas surface water flooding tends to be more localised and concentrated. Therefore, making sure that the right pots of funding are available for the right solutions in each case is, I think, what needs to be achieved.

Q92 Mrs Glendon: I think the issue for local authorities, most definitely, is funding.

David Rooke: To add to what Lord Smith has said, in terms of the approach to funding, local authority boundaries generally do not follow catchment boundaries. There needs to be a catchment approach so that you do not get a situation where water is being shunted from one local authority into the downstream local authority. The other difficulty with a pot for local authority funding is the lumpiness of the capital expenditure, because you could do a big scheme and then might not need to do something for 10 or 15 years. The way in which funding is distributed at the moment—Ministers decide how much money we and local authorities get—is that we can manage that

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lumpy capital expenditure on a prioritised need across the country.

Q93 Chair: To move to sustainable urban drainage systems, during the passage of the Flood and Water Management Bill there was a debate about Sustainable Drainage Systems (SUDS). In your view, Lord Smith, who should be responsible for both the ownership and, more especially, the maintenance of SUDS? Should it be the water companies or local authorities?

Lord Smith of Finsbury: Our view is very much that local authorities are probably the most appropriate bodies to take that responsibility because they are able to have an overview of the needs of their areas and the Act gives them the lead responsibility in relation to surface water flooding. I do not know whether David wants to add to that.

David Rooke: We believe that local authorities are best placed to be the SUDS-approving body. Sustainable drainage needs to take place at the early stage of spatial planning, and clearly local authorities are heavily involved in that. There is interaction with developers at an earlier stage. SUDS have a stronger link with other parts of local authorities' remit, such as highways etc., and local authorities are better equipped to engage with local residents. Therefore, we support local authorities being the SUDS-approval body and having responsibilities for SUDS rather than water companies, but water companies, and indeed the Environment Agency, are consultees in that process, and local authorities in their SUDS-approving role will need to take into account input from both water companies and ourselves.

Q94 Chair: But you recall the proposition was that local government would own and water companies would maintain, so water company customers would be responsible but the local authorities would dictate. That seems inherently wrong.

David Rooke: The guidance on how all this will work under the Act is still to be produced by the Government, but local authorities would have overall responsibility for approving SUDS.

Q95 Chair: For planning and approving?

David Rooke: For planning and approving SUDS, yes.

Q96 Chair: I can accept that, but when it comes to maintaining them, do you find some merit in the argument that water companies might take on the responsibility?

David Rooke: I think that we will need to wait to see the guidance that comes out as required under the Act.

Q97 Amber Rudd: Looking ahead to future flood and water management legislation, are there any priorities or important issues that you think we have not properly considered and should be considered going forward?

Lord Smith of Finsbury: A number of issues that were discussed prior to the appearance of the Flood and Water Management Bill were not included in the Bill when it finally came before Parliament. In the floods area, none of them are show-stoppers. There is one personal issue about which I feel very strongly—

I proposed to previous Ministers that it should be included. It relates to the existence, especially on parts of the east coast of England, of large caravan sites that are at serious risk of flooding from the sea. If a major surge comes down the North Sea, that could put very large numbers of summertime caravan dwellers, many of whom are elderly and not very mobile, at considerable risk. One of the proposals I made was that there should be a responsibility on the owners of caravan sites to have plans for the evacuation and removal of people to safety in the event of any imminent flooding event. That did not appear in the Bill. I think that the present Government are seeking to find non-statutory ways to achieve the same objective. If that is possible, it will certainly be an awful lot better than nothing.

Q98 Amber Rudd: If we are thinking of non-statutory ways of achieving things, do you think, when it comes to flood risk, that guidance is sufficient for planning rather than legislation?

Lord Smith of Finsbury: The problem with planning is that there will always be features specific to the individual location, individual application and the nature of the development. It would not be possible, as Sir Michael Pitt pointed out in his report, to say that no development should ever take place in a flood plain, but there will be circumstances where a development is wholly inappropriate in a particular location in a flood plain. There might also be cases where a development with resilience built in might be a sensible thing to envisage, so I think this is an area where guidance and the planning control available to the local authority is the best route to go down rather than a blanket statutory approach.

Q99 Neil Parish: Further to that, what about the idea of farmers or landowners being paid to take water onto their land to alleviate possible floods to towns and houses? At the moment, they are compensated only for loss of earnings rather than managing water. What is the Environment Agency's view on that?

Lord Smith of Finsbury: The principle of enabling flood sinks to be used higher up a catchment to protect communities further down is a major element of our armoury against flood risk. It can often be a lot better and more affordable to do that than to build more concrete defences further down. At the moment, the nature of the compensation regime for agricultural land volunteered for such purposes is laid down by the Government. Whether the compensation should be enhanced would be a matter for Defra to decide. I do not think that we have encountered too great a resistance from the farming community in assisting us in this respect, and in these circumstances we always try to work as closely with that community as we can.

Q100 Neil Parish: I go on to Internal Drainage Boards. Do you think that there needs to be improved legislation? What is your attitude towards them, because very often local knowledge of how to drain an area is very useful? I will broaden the question: what is the attitude of the Environment Agency to keeping rivers properly open and dredged, especially

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in lowland areas? Sometimes that can be a huge aspect of flooding, especially in parts of Somerset.

Lord Smith of Finsbury: In a moment I will ask David to comment on IDBs. On dredging, when I first became Chairman of the Environment agency just over two years ago, I was told repeatedly that dredging made no difference to flood risk from a watercourse. I did not believe that because it seemed to me there would certainly be many occasions when dredging could make a difference. We have now conducted a range of research pilots to look at particular circumstances where we do dredging and to measure precisely the impact that that has on flood risk. The answer, perhaps unsurprisingly, is that there are quite a number of occasions when dredging will be of use for a flood risk prevention purpose, and some instances where it does not make any difference at all. It depends very much on the nature of the soil, the speed of flow of the river, the nature of the vegetation around the river and so on. What we now need to do is to make sure that, in those cases where dredging will help, we do it, or at least make sure that it gets done.

Q101 Neil Parish: And consider it?

Lord Smith of Finsbury: Yes.

Q102 Neil Parish: And drainage boards?

David Rooke: We have a good working relationship with drainage boards and work closely with them.

Q103 Neil Parish: A good working relationship?

David Rooke: Yes, that is generally the case. As the Chairman said earlier, we are co-operating with the Association of Drainage Authorities to use the new powers under the Act whereby we can transfer functions between drainage bodies, so we can perform each other's functions. We can share data—we do it anyway but there is now legislative backing for that to happen—and basically we can ask drainage boards to take over responsibility for main rivers in the future. As Lord Smith indicated earlier, we are looking at some pilots to enable that to happen. We are also talking to the Association of Drainage Authorities about whether new Internal Drainage Boards can be created where they perhaps used to be but no longer are, and they can take over responsibility for drainage that primarily provides an agricultural benefit, which will enable us to concentrate our resources in the urban areas.

Neil Parish: I would welcome that.

Q104 Chair: Lord Smith, at the flood summit, you said you would do some work on the comparative costs of soft and hard flood defences. Would you be able to share that work with the Committee?

Lord Smith of Finsbury: As we develop our knowledge of where the best cost-benefit lies in any particular circumstances, we will certainly be very happy to share it with the Committee.

Q105 Chair: A particular issue is why flooding land should be more expensive than building a physical flood defence.

Lord Smith of Finsbury: As a general observation, the deliberate flooding of land in order to retain water higher up a catchment ought to be rather cheaper than building hard, concrete physical defences. It depends on the individual circumstance, of course, but on the whole that tends to be a more cost-effective approach. There are, however, quite a number of circumstances in which we need to do both.

Q106 George Eustice: I want to move on to water quality and pollution. The Water Framework Directive clearly sets some quite challenging targets on water quality. Do you think there is anything in the criticism that the future water strategy is not fit for purpose and has not given sufficient priority to water quality?

Lord Smith of Finsbury: You are absolutely right to identify the fact that the Water Framework Directive gives some very challenging targets. The number of parameters against which we have to measure water quality has risen as a result of the Directive from seven to 34. Measuring good ecological status is on a “one out, all out” basis, so if you fail on one of the 34 measures, you do not achieve good ecological status. This is challenging stuff. To add to that, over the course of the past 20 or 25 years, as a result of very substantial investment by the water and sewerage companies, the big point source pollution that has affected our rivers has been very effectively tackled. There is still more to do on that, and within the PR09 water period—over the course of the next four to five years—further investment is due to be made, which we very much welcome. The real emphasis is now probably needed on tackling diffuse pollution from a variety of different sources, some of it agricultural runoff and some of it urban runoff. By definition, because it is coming from a host of different places, it is much more difficult and expensive to tackle. What the water strategy attempts to do is the best job it can, given limited resources, to undertake that work. It will not be perfect, but it is a very good start in making improvements in the ecological quality of water.

Q107 George Eustice: I know that the National Audit Office has been critical of your work in terms of locating the causes of diffuse pollution. Is there anything you want to say about that? To come back to the Water Framework Directive and the 34 criteria you mentioned, can you or David give an idea of some of the new things that have been added against which you are now being judged, and also whether there is a problem with the WFD itself in that it does not distinguish between water quality, as most people would understand it, and their definition of it?

Lord Smith of Finsbury: On the National Audit Office report, the NAO did indeed criticise us for not having taken an active enough role over the recent past in relation to diffuse pollution. They recognised that the way in which we had drawn up the new water strategy took us in a much better direction in this respect, and we are determined to prove that we have brought about the improvements in our activity that they sought.

In relation to the 34 parameters, everyone across Europe is in the same boat, if you will forgive the

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use of a rather inappropriate metaphor. Prior to the introduction of the Water Framework Directive, about 75% of rivers in England were in good ecological condition, whereas overnight, with the implementation of the Directive, that came down to 27%. I shall rely on Ian to give you some examples of the 34 parameters—I hope.

Ian Barker: As Lord Smith outlined, the terrific improvements in water quality that we have seen as a result of water company investment started to expose all the other issues that were damaging the ecology—the aquatic life—within rivers, the reasons for which we had not really previously understood. The Water Framework Directive has helped us to understand the full breadth of influences on rivers and also ground waters. In terms of rivers, for example, one thing that has come to the fore in particular is hydromorphology, which means the channel shape, the substrate and so on. If one imagines a river channel, if it is a trapezoidal concrete channel, it does not really matter very much what the water quality is or how much flow is in it, because it will never support a flourishing ecology in the way we imagine a healthy, sparkling river. So channel shape, barriers to fish migration from historical weirs and so on are all an important part of the work that we need to do for the Water Framework Directive. It has also given us a whole range of parameters in terms of the ecology we would expect to see living in a river and whether it matches what we would expect to see in a river of that type. To this end, we have successfully implemented the first round of river basin management plans—we are one of the few countries in Europe to do so to time—and it is now a good time for us to take stock and say, “What didn’t we understand to the extent we would have liked for the first cycle of plans?” With that in mind, we have instigated 8,500 investigations, many of them related to diffuse pollution, better to understand the range of pressures on our rivers that cause them not to meet the higher standards of the framework directive.

Q108 Tom Blenkinsop: Lord Smith, do you still face legal action on the implementation of the Water Framework Directive?

Lord Smith of Finsbury: As far as I am aware, the legal action has been suspended, so the answer is no.²

Q109 Tom Blenkinsop: Have you and Defra assessed the risk of further legal action as a result of budgetary cuts?

Lord Smith of Finsbury: We are ever mindful of the fact that, with European directives, if we fail assiduously to endeavour to implement them, we may face infraction proceedings. One of the challenges we face over the course of the next four years is the implementation of directives. About 80% of the pollution legislation that we have to implement comes from Europe. None of that has changed, but the resources we have to address those requirements will

be less, so we must become much more efficient at doing it.

Q110 Tom Blenkinsop: What assessment have you and Defra made of the risk of any future legal challenges?

Lord Smith of Finsbury: We will always endeavour to avoid any legal challenge if we possibly can. Sometimes that might require major investment. The classic example is the Thames tideway tunnel, which is part of the proposed response to the Urban Wastewater Directive. That will mean a massive investment by Thames Water.

Q111 Chair: For the benefit of the record, those proceedings would have been started under the previous Government.

Lord Smith of Finsbury: Yes.

Q112 Tom Blenkinsop: Does Ofwat’s remit need to be changed to focus more on environmental outcomes, including the delivery of greater levels of water efficiency?

Lord Smith of Finsbury: Of course, the Government are currently undertaking a review of the powers and responsibilities of Ofwat. My personal view is that the concentration on an incentive to the water companies to sell more water is not necessarily sensible in the light of the pressure on water resources over the next 20 to 30 years owing especially to climate change, but also population increase and development. There will be increasing pressure on water resources and reflecting that within Ofwat’s responsibilities would make a lot of sense, but that will be a matter for the Government to consider as part of the review that they are undertaking.

Q113 Tom Blenkinsop: How can the price control setting framework be changed to incentivise environmentally-friendly investment, such as demand-side measures?

Ian Barker: As Lord Smith outlined, the price control and incentives currently reward investment in capital schemes—resource developments and pouring concrete generally to add to the company’s asset base—rather than schemes that might be more sustainable in the long term. In recognition that most water industry investment is around for a century or more—we are still living off the fruit of Victorian labours in many ways in the water industry—we need to take a long-term view, and arguably a bias towards capex does not do that. There is also a growing recognition that perhaps the best and most sustainable solutions are not those that involve major capital schemes, but those dealing with the problem at source. We were very pleased to see in the previous price round that Ofwat funded more than 100 catchment schemes where water companies would work with land managers to understand the root causes of pollution so that they could then help to eradicate those and reduce treatment costs. In that way, one is treating land management as part of the solution rather than as part of the problem, and looking at low-carbon and long-term sustainable solutions, rather than more traditional engineering ones.

² Note by witness: As far as I am aware, the legal action is currently suspended, as Defra and the claimants have agreed a consent order extending the timetable for filing papers with the court.

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Q114 Tom Blenkinsop: That was going to be my next question. Does the current water strategy and regulatory framework give enough emphasis to joined-up energy and water-saving approaches?

Lord Smith of Finsbury: The answer is that, at the moment, the framework probably does not give enough recognition to the carbon impact of water use, development, transport and delivery, as well as water use in the home, especially the use of hot water, which counts rather heavily towards our country's overall carbon footprint.

Q115 Tom Blenkinsop: Finally, can you elaborate on the point in your written evidence about adopting a voluntary approach to planning water resources across different sectors such as agriculture, navigation, industry and energy? How would that work in practice?

Lord Smith of Finsbury: We need to look at water use as a whole for the future because of the impact of

climate change and increasing water stress that we will face over the next 20 or 30 years. Water is used for drinking, agriculture and industry, and there is making sure it does not flood. There is a whole range of ways in which water needs to be considered. It seems to me that making sure that everyone works together is absolutely essential.

Chair: We will have to terminate this session now. Thank you very much for your patience. We would like to submit some written questions. I would also like to ask you to consider as part of the written questions, in response to newspaper reports, whether you believe the infrastructure for which you are currently responsible should remain in public hands, and when you expect the guidelines to be published. We will add that to the questions. Thank you very much. We will hear the next witnesses as soon as we come back.

Sitting suspended for a Division in the House.

On resuming—

Examination of Witnesses

Witnesses: **Chris Loughlin**, Chairman, Water UK, and Chief Executive of South West Water, **James Bullock**, Director of Economic Regulation and Market Reform, Water UK, and **Sarah Mukherjee**, Director of Environment, Water UK, gave evidence.

Q116 Chair: We will recommence. Mr Loughlin, thank you very much for being with us and being so patient. In welcoming you, may I ask you to introduce your colleagues for the record?

Chris Loughlin: Thank you, Chair. My name is Chris Loughlin. I am the chief executive of South West Water, from where many Committee members might recognise me. I emphasise, however, that I am here in my other capacity as Chairman of Water UK. I will be speaking on behalf of the whole industry rather than South West Water, so perhaps you would bear that in mind.

May I introduce my colleagues, both of whom are from Water UK? Sarah Mukherjee is Director of Environment for Water UK, and James Bullock, as you can see, is Director of Economic Regulation and Market Reform. We are delighted to be here and to have the opportunity to speak to you. We hope to have a good conversation.

Q117 Chair: Thank you very much indeed. I apologise for the delays that have tested your patience. Do you think that, in the proposed White Paper on the regulatory regime, the balance between benefits accruing to water customers as opposed to benefits accruing to water company shareholders should be addressed?

Chris Loughlin: Yes. It is probably the unanimous view of all the water companies that the regime at the moment—we have had it since privatisation—has been very successful and that, in the round, it has delivered successfully the objectives of privatisation some 20 or 21 years ago. Therefore, I think we would say that the regime is not fundamentally broken; it has been very fit for purpose. It is also the unanimous view of all the water companies, however, that there are fundamentally new challenges facing the water

sector, as you have just heard from your previous witnesses, and that now is a good time for reflection and some changes to the regulatory regime. That is what forms the submission of our evidence to the Committee, which you have already seen. More particularly, our document *Meeting Future Challenges*, which was published a few months ago, lays out a practical blueprint of suggestions for such amendment.

The challenges that we see ahead of the industry probably fall into four basic themes, one of which—particularly and most strongly—is that the water industry feels very much at the sharp end of the climate change debate in terms of both adaptation and mitigation. We believe that is one of the most fundamental new challenges that face the industry.

There is also a range of demographic challenges: population growth; higher customer expectations; and lower tolerance of risk of failures or interruptions than perhaps 20 years ago. The willingness and ability to pay is perhaps diminishing ahead of us. A point not envisaged at the time of privatisation was that the industry would be cash-negative for a number of years and then would return to being cash-positive. Despite the size of investment over the past 21 years or so—£85 billion or £90 billion—it is envisaged that that will carry on especially with the challenges of climate change, so we do not see that the switch to a cash-positive regime lies in the immediate future.

I think the final challenge is that the ability to mitigate some of the price pressures on our customers has been diminished to some extent because the efficiency gains from privatisation have started to plateau. There is more to do, but the immediate efficiency gains are probably behind us. There are four or five main themes in *Meeting Future Challenges* for the changes we would like to see in the regime. Certainly, a main

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theme for us is giving customers more influence in pricing and ongoing investment decisions. Probably the evolution of the regulatory regime since privatisation has seen a slight crowding out of the customer voice, too. We would like to see that re-established and reaffirmed. Making sure that the services for both clean water and waste water are affordable for all is certainly an issue ahead of us rather more acutely than before, so we would like to see some measures to help in that area.

There should also be a measured pace for environmental changes so that at the time environmental directives are being considered at European or indeed national level, a full impact assessment is perhaps made to see whether there is a willingness and ability to pay on the part of customers and, therefore, implementation can be paced accordingly.

A very important issue, which was touched on by a previous witness, is an attempt to realign the incentive regimes in the current regulatory regime to make sure that they formally and completely align with Government policy and Government priorities in terms of the water space. *Meeting Future Challenges* was an excellent document in our opinion, but it would be very useful if the Government could reaffirm that as a policy statement for the future and then re-examine the incentives to make sure they are properly aligned, because they have drifted out of alignment in our opinion. Finally, there will be a continuing need for capital investment by shareholders and debt providers over the years to come, so ensuring that we have a proposition for investors to continue to invest in the sector is one of the priorities.

Q118 Chair: In terms of timing, bearing in mind that the price review is coming at a particular date, what do you think is the window of opportunity to make the regulatory changes?

Chris Loughlin: You quite rightly say the clock is ticking as we speak, and a probable amendment to the regime that we foresee in some sense is the process of the five-year price review, which seems to take three years, so the timetable to get guidance from Ofwat and for the companies to consider what new policy changes might be applicable is such that we would probably need that guidance fairly soon. Early into 2012, it would probably start to get a bit tight.

Q119 Chair: How do you respond to the criticism that water companies are earning too high a rate of return and generating excess profits that could be addressed by an even tighter, tougher price control formula?

Chris Loughlin: As I just said, the level of investment in the industry over the past 20 or 21 years since privatisation has been in the range of £85 billion to £90 billion, all taken from external non-governmental funds. That has been a big feature of the industry for the past 20 or 21 years. Even if every single customer paid us absolutely on time every time, which you will know is not the case at the moment, there would still be a need to raise extra finance in the financial markets going forward. There is a competitive market for

raising finance and we have to provide an investment proposition to investors that is attractive enough for them to participate in our industry.

To give that some colour, generally speaking our investors are pension funds, which like the long-term nature of our industry. If you were in a private pension fund, you would like to invest your money in something that gave you a reasonable rate of return. If it did not, you would take your money somewhere else, and that is exactly the circumstance we are in at the moment.

Finally, the regulator, Ofwat, has just concluded a five-year price review. One of its main considerations is the appropriate rate of return for companies and therefore their shareholders, so they have just finished that exercise.

Q120 Tom Blenkinsop: Have you quantified the benefits of water trading?

Chris Loughlin: as you know, the Cave review, in which the previous Government called for evidence about that and the potential for introducing competitive markets into the water sector, considered that there might be some potential gains and benefits from water trading. We as Water UK have not made a quantification of that, but I emphasise that water trading happens now all over the country in various forms. Reservoirs are shared between water companies. I would go back to my main theme, which is what we say in *Meeting Future Challenges*, that the incentive regime needs to be realigned to increase the possibility and incentive to trade between regions. There is a regime in place if a water company brings forward a proposal for a new reservoir or some further abstraction. Obviously, the onus is on us to make sure that is the most cost-effective way. That is what the current regime does. There are arrangements for incentives at the moment, but part of our submission is that we think they could be sharpened up.

Q121 Tom Blenkinsop: Can you give some examples of the regulatory barriers that currently discourage companies from developing the existing bulk supply market? How could they be addressed?

Chris Loughlin: James might give you more colour on that. I think the regime is in place at the moment, but certainly one of the main amendments we might like is one that readdresses the balance between capital and operating costs.

James Bullock: At present, many of the incentives do not encourage companies to trade; they are encouraged to pour concrete and build supplies for their local customers. That is something that could be addressed in the price reviews to make it more common. Effectively, the balance between the capex and opex incentives is a relatively simple measure that could remove some of the disincentives that occur at the moment.

Chair: We will be back as soon as we can.

Sitting suspended for a Division in the House.

On resuming—

Chair: Thank you, ladies and gentlemen. I apologise for that. Perhaps we may carry on.

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Q122 Mrs Glindon: What are the likely impacts on company costs, including company costs of capital, from further development of competition in the water supply industry?

James Bullock: If you change the structure of the industry so that there are lots more competitive forces flying around, it is generally agreed that inevitably there will be a significant increase in the cost of capital. Professor Martin Cave suggested in his report that it was possible that the increase in the cost of capital would be sufficiently large that it would outweigh some of the efficiency benefits that might be achieved through competition. Therefore, it is a very significant issue and, absent some dynamic benefits as a result of competition, those increased costs would definitely work their way through into customers' bills. The extent to which the cost of capital increases depends very much on the nature of the reforms that would be introduced. What it points to is that there must be very careful examination of the expected costs and benefits if we are to introduce a wholesale restructuring of the market to allow for a large number of new players.

Q123 Mrs Glindon: Does legal separation, rather than functional or full separation, of retail from upstream activities represent the most cost-effective option?

James Bullock: It remains to be seen what the precise form of that might be, but I think that any form of separation, whether it is legal, structural or even accounting, is quite an intrusive activity and a strong intervention in a private company. Private companies normally organise themselves in the way they see fit. Legal separation, in particular, introduces a whole raft of complexities. For example, some companies have finance that includes covenants that would be under great strain, and potentially broken, if those companies were split into two. Therefore, the finance of the company might fall away and the new companies that you have created would then have to look for new sources of finance. That is just an example of how companies operate in the current framework, and if you impose a new framework, it will introduce a lot of complexity. If we were sitting here on the eve of privatisation and thinking about a suitable structure for the companies, that might be an appropriate time to think about legal and functional separation and so on. We are not at that point. We are 20 years further on from privatisation, and a large amount of money has been invested in the sector, given the existing structure.

Q124 Chair: Do you believe that the Scottish model is working?

James Bullock: There are lessons to learn from Scotland, obviously, and it is interesting to see how that is working through. As I understand it, there have not been significant price or cost savings. There are some reports that suggest there have been changes in terms of quality of service, but obviously Scotland started from a slightly different place from the companies in England and Wales anyway. It is an interesting model and we look to see what is

happening, but I do not think it is something you can just transplant to England and Wales.

Q125 Neil Parish: You note the potential gains from upstream water trading. Have you quantified the benefits of water trading?

Chris Loughlin: We did talk about it to some extent. We note that Cave, in the review of the interaction of competitive force in the water industry, said that there were potential benefits in introducing water trading. Our answer would be that there is already a lot of water trading going on between the companies as we speak, and there are arrangements in place that mean it is happening now. We would argue, in line with our opening remarks, that incentive arrangements would need to be modified. That was what we said in *Meeting Future Challenges*. We would very much like to see the incentive arrangements enhanced so that the continuing transfer of water between water companies could be encouraged.

Q126 Neil Parish: Walker concluded that the current charging system was creaking at the seams. Do you agree?

Chris Loughlin: The phrase "creaking at the seams" is not mine—it might be one used by someone else—but certainly there are issues in the water charging system to be addressed, particularly as we see a switch from rateable value-based to metered charges. The unwinding of the cross-subsidies puts customers in real difficulties. There are pressures from affordability and willingness to pay that need to be addressed. One of the main themes in our submission to the Committee and also in *Meeting Future Challenges* is that we would like to see the introduction of more flexibility in this area.

Q127 Neil Parish: You talked about meters. Do you think your companies should be mandated to require all customers to have metered supplies, and should these be intelligent meters in all cases?

Sarah Mukherjee: I think there is general agreement across the industry that water metering is the appropriate direction of travel, but water companies are very different and, as in life, one size does not necessarily fit all. Water resources are all very different and they are all part of the calculations that companies make. Having said that, there are lots of metering pilot projects going on around the country, and we as an industry are learning from that on a daily basis. It is fair to say that the industry is managing the resources well. A company in one of the drier parts of the country has 20% more people living in its area than 20 years ago and yet—through metering, as well as other water efficiencies and increasing resilience—it has ensured that mean daily demand is the same today as it was then.

To pick up the point about water resilience, perhaps I may talk a little about catchment management, which I think is a central theme. Many companies are working on this. I am a relative newcomer to the industry. A lot of the projects taking place are pretty inspirational both in their innovation and the way they try to work across the board with farming communities and other landowners to try to get right

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the balance between the water we take out and the conservation and agricultural needs of our beautiful country. There is also passion in the industry about this. One catchment officer to whom I spoke fairly recently said he was working hard with conservation groups because he wanted his area to be an exemplar of land management and conservation. He spoke about that with so much feeling.

Water companies—I think this is key—use their geographical links in a positive way to drive forward these catchment management projects. The key point is that they are responsible for that area and work very hard with people, and it is in their interests to make sure that the water is as clean and usable as possible when it is delivered to the customer. For example, there is a project in the north-east that is looking at water colour. It is doing some quite amazing things. It uses helicopters to reseed peat lands. There is something called grip blocking—I did not know what it was until a couple of days ago. Grips are drainage areas. Literally, you block it with vegetation, raise the water table and therefore slow down the passage from sky to tap. And there is environment benefit, of course. The trials show that it is working, but the present regulatory regime encourages companies to build stuff rather than giving these innovative ideas space to breathe.

Q128 Neil Parish: May I go back to the meters? The trouble with meters is that if you are a small family or retired couple you want one, but if you have a large family and small house with a low rateable value, you will not want one. What is your solution to that?

Chris Loughlin: We would like to see more powers to help us with those issues. Companies do many things to help vulnerable customers. I know that you are taking that group only as one particular example. The companies do lots and lots of things: the special WaterSure tariff; help lines; charitable trusts; flexible payment plans; direct payments from benefits; and the promotion and financial support for citizens' advice bureaux. Therefore, the companies are deploying the tools and techniques they currently have in this area, but we would like to see more of them provided both to us and the industry. In that regard, the Flood and Water Management Act, which was passed just before the change of Government, highlighted the need to introduce both regional and national social tariffs. We have yet to see that enabling guidance given to the companies and Ofwat, and one of our submissions to you is to urge you to get that guidance issued as soon as possible.

Q129 Chair: Is that section 45?

Chris Loughlin: It is section 44.

Q130 George Eustice: The Consumer Council for Water gave evidence to us last week. It said that its research showed that water customers in parts of the country would be willing to pay more to fund a social tariff, but probably only a few pounds more. Do you detect any movement in terms of the views of water companies themselves on this issue? Do you have any views about what would be an appropriate tariff or levy on other water customers for this purpose?

Chris Loughlin: I think that the research the Consumer Council for Water has done in the past six months or so—I am not exactly sure when, but certainly in the past year—is very interesting and informative. It has enabled the council to take a more pragmatic view about national and regional social tariffs. We read those results with great interest, and it is new information that probably was not perfectly clear at the time Anna Walker concluded her recent report. When the Government and Defra produce their guidance on which parts of the Walker review they wish to adopt and how, we very much hope that the new research into the acceptability of social tariffs—albeit limited as you say, George—is taken up as part of the guidance that emerges from the Government's deliberations.

James Bullock: The degree of acceptance by consumers is very much a research-based question, and there is then a real policy question about what kind of cross-subsidy the Government would like to see taken forward.

Q131 George Eustice: Are water companies themselves moving this way? One of the points made by the Consumer Council for Water is that if there are big variances in water charges and real problems with affordability, it could potentially discredit the whole pricing system in the water industry. Is that also recognised by the companies?

James Bullock: I think the companies are very keen to address issues of affordability. As Chris outlined, we are working hard to introduce social tariffs, for example, which effectively are a kind of cross-subsidy between consumers. Some consumers will pay slightly more so that others who are less able to pay will pay slightly less. That is something the companies are trying to pursue with Ofwat, but some of the enablers for that do not seem to be there at the moment.

Q132 George Eustice: In getting that balance, what kind of criteria do you think should be used? Should it be the council tax band for the property or income level, or are we talking about means-testing? Have you given any thought to the fairest way to apply it?

Chris Loughlin: This is an area where companies have some opinions, but it is certainly a matter on which the national Government and Defra should make some judgment. I do not think it is appropriate for us to make social policy, but it is clearly appropriate for the Government. There are many ways of designing social tariffs. If the Government can give some guidance both to us and Ofwat, we will be able to design the appropriate tools and techniques that will help us with the vulnerable groups you mentioned at the beginning, but we are really looking for some guidance on the implementation of the Flood and Water Management Act.

Q133 Chair: To take the south-west, which is your primary area, if quite a large part of the population is on fixed or low incomes, you must have a view as to what would be the fairest way to charge them, if there were to be a social tariff. I am sure the Government

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would like to hear your view to help them make up their mind.

Chris Loughlin: As James has said, *Meeting Future Challenges* refers to the desirability of introducing these cross-subsidies. As you know, the powers in the new Act have not yet been implemented. We would have evidence and information to give, as I am sure would Ofwat, about which schemes would target particular groups. Certainly, that is something on which we would like to give evidence to officials to consider, but it is really a matter for them to decide, I think.

Q134 Neil Parish: The problem with a social tariff is that wherever you put the cut-off point, the person just above it with a slightly higher income will have to pay quite a bit more, because of the social tariff, than somebody who has slightly less income. That is always the problem: is it any more affordable for them, or does it make it less affordable for those just above the line? I can understand why you are wriggling in not giving an answer. I know the water companies themselves do quite a bit to try to help those who genuinely cannot pay. How do individual water companies deal with that? Do they deal with it in different ways?

James Bullock: This might be something on which we will come back to you. It probably differs from company to company. All these measures for eligibility, for example, are proxies; none of them is perfect. For example, in telecoms, you can see that access to social tariffs is defined by someone being on certain means-tested benefits. There are good reasons for that and then there are other reasons why it does not seem entirely equitable, but we can come back to you with some examples of what individual companies do in different areas and how they assess the “can’t pay and won’t pay” question. Hopefully, that will be a contribution to the debate and will help make a policy decision in due course.

Q135 Chair: Do you think there is any merit in a national social tariff?

James Bullock: At the moment, the water companies work in a framework where they deliver local water supplies to local customers and bill locally. That is the framework within which we operate. Water companies acknowledge the geographical differences and the particular problems in certain areas, but even if they wanted to do something about it, the framework does not permit that at the moment. Again, we see this as being very much a policy question about the extent to which funding of supplies should be local or national. There are very good reasons why you might want to see some of these national cross-subsidies—I understand that—but there are other drivers. To the extent you do these cross-subsidies and do not allow people to understand the full costs, for example, of living in one area versus another, you encourage more and more people to migrate to that area. It is very much a two-way street.

Q136 Chair: Do you think you have all the information you need to identify vulnerable customers? Do you believe either local government

through housing, or national Government through benefits, would have information that might help you identify vulnerable customers?

James Bullock: There is always more that is possible with that. Clearly, we see more integration or information being supplied by Government in terms of utilities, electricity and gas companies with their social tariffs. In terms of telecoms, again there is a very clear link with the Department for Work and Pensions (DWP) in terms of the benefits people are on and whether they are entitled to a social tariff, so I think there is scope to develop that further beyond what the water companies currently have. Currently, water companies sometimes have great difficulty in identifying who their customers are, so anything the Government can do to help provide that information would be helpful.

Q137 Mrs Glendon: Are water companies fully using their powers to tackle bad debt or are stronger powers needed? Do you think that moving to a more contractual basis for the supply of water to household customers would give water companies more tools to tackle bad debt?

Chris Loughlin: As James was just discussing, I think there is some merit in that—just to amplify the point. The companies are doing very well with the tools they have at the moment. We would like to see some more tools, and I think the Flood and Water Management Act suggested extra tools that would allow us to have more information about who is the identifiable person liable to pay for water charges. Particularly in rented accommodation, we do not have power to know that at the moment. We would like to see the Flood and Water Management Act implemented and guidance from officials to give us those powers. That would be the first practical step in giving us extra powers. Over and above that, there are other ideas we would like to suggest in due course, but I think the first and most pressing thing is the powers passed just recently in the Flood and Water Management Act. It would be very good to get that guidance implemented.

Q138 Mrs Glendon: You mentioned before those who won’t pay and those who can’t pay. Do you think there has been enough to distinguish between both kinds of customer?

James Bullock: At the minute, it is being looked at by individual companies. They have limited information with which to work. I think they do the best they can in difficult circumstances. If there was a strong lead from Government, for example, in terms of saying that these are the people you would expect not to pay and these are the people you would expect to pay—those with benefit entitlements or something like that—that would help, but at present the industry is definitely constrained by the amount of information available.

Q139 Tom Blenkinsop: On that point, do you think there is a role for the Government and/or Ofwat to assist in that?

James Bullock: To assist in?

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Q140 Tom Blenkinsop: In relaying information or assisting you to find out the difference between those who can't and those who won't pay?

James Bullock: One of the benefits of identifying those who can't pay is that you can offer them a social tariff that suits their needs and addresses their difficulties. It is helpful and we see it in other sectors where there is a clearly identified subset of the population that is entitled to social tariff. If we can identify those people, it will give a much clearer steer as to who can't pay their bills and those who just won't pay, because if they are not eligible for the social tariff, the implication is that they could pay if they wanted to.

Q141 Chair: Just to clarify, the information you really want is for the landlord to say who is the person liable to pay the bill, or who the tenant is?

Chris Loughlin: Exactly so; I am sorry if I did not make it clear.

Q142 Neil Parish: Chris, you have on your Water UK hat today.

Chris Loughlin: I fear there is a "but" here.

Q143 Neil Parish: That's right; there's a "but" coming. In the south-west, we have 3% of the population and 30% of the beaches.

Chris Loughlin: Where did you hear that?

Q144 Neil Parish: I understand all you have told me. The bills are probably £50 or £60 higher in the South West Water area because of it. What is UK Water's attitude towards having some sort of national levy that would alleviate the bills in the south-west? It has a lot of retired people. Everybody comes down to the south-west because it is so wonderful and beautiful, as are its beaches. What is the position? I know I am putting you in a slightly difficult position.

Chris Loughlin: In which case James will reply.

James Bullock: Clearly, different companies have different views. I think the question goes beyond the south-west. If you really wanted to go into it, you would start to ask whether the Thames tunnel should be shared more equitably or differently across the country. It is a straightforward policy question, I think. The existing arrangements are that local companies fund local resources and bill local customers in those defined areas. It is very much a policy question for the Government; it is not something for the companies.

Q145 Neil Parish: Do you have a view?

James Bullock: I suspect that different companies would have different views depending on which side of the equation they are.

Q146 Neil Parish: You use the Thames tunnel as an example. I know that the tunnel has a very large cost, but you also have a much larger population to share it. The problem in the south-west is that it has a huge number of beaches and a very sparse population. That is why George and I—and others—would argue we are a special case. I expect a lot of people would say that of me anyway.

James Bullock: The map is very uneven, isn't it? You have some very large areas and some very small ones, and prices happen to be set and averaged across those defined areas. The reason for that is obviously steeped in history in the way the companies were set up and so on. If you wanted to even out the cost across the country, there would have to be a very clear policy decisions by Government and then Ofwat could implement them.

Chris Loughlin: To amplify that, in a general sense, the industry was privatised on a regional basis to give the companies themselves—I would support this—primacy in their relationship with their regional customers so that customers could influence and have knowledge of the priorities for their areas and therefore inform the companies. You could have an entirely different model, which would be an average cost for the whole industry, but to my mind that would probably undermine that primary relationship between customers and the companies, so you would need a balance.

Q147 Tom Blenkinsop: How effective will be the requirements under the price control formula for 2010 to 2015 at improving water efficiency?

Chris Loughlin: On water efficiency targets, we would argue—I am sorry to reference this yet again—that the incentive regime has served us well up until now, but for the new challenges that face us going forward, it needs to be modified. Certainly, we would like to see a greater shift in emphasis, as Sarah has already said, towards operating cost priorities, more demand management and softer catchment solutions. Part of that is water efficiency targets.

Sarah Mukherjee: Exactly. I think that, by their very nature, water companies are aware of the need to look to the long term. As we have already said, climate change, demographics and all these changes are coming in the not too distant future. All companies have a 25-year water resources management plan. It is quite interesting that when you talk to water resources managers, as I have been doing—part of getting into the job is to talk to as many people as possible—we have a day at the office but they have a quarter of a century at the office. You see a particular ground source of water and they will say, "Yes, now it is okay but in 10 years' time we might have this; in 25 years' time we might have this." They are constantly aware of the issues that face the industry.

You must not forget that if you are talking about how better to use a national water resource, that is a challenge for society as a whole. Although companies are very happy to be at the forefront of this in education and public information, we go back to opex and capex. The current regulations provide disincentives for companies to provide water efficiency measures. Recently, I overheard a conversation in our offices between two members involved in water efficiency. They were talking about the price of a tea towel. These tea towels are printed up with water efficiency measures. They're great. People have done the research. People love them because they are using the tea towel when washing up and can see how much water they can save, but the whole conversation between two people from

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different companies was framed about how this fell within the regulatory framework and whether they were stepping outside it if they paid £1.50 or £1.72 for a tea towel that people would use that would put across the water efficiency measure. That sort of thing hampers water companies in trying to get across that water efficiency measure.

Q148 Tom Blenkinsop: Are you saying there should be stronger water efficiency targets, or would they be more regionalised depending on, say, the industry customers of that particular company?

Sarah Mukherjee: I think we really need a framework that allows for best practice and best use and does not encourage disincentives, so you have a regulatory regime that will allow you to do these sorts of water efficiency measures without penalising you for having it as part of your operating costs.

Chris Loughlin: It is the regulatory regime in the round that needs to evolve or be reformed. We do not think that targets per se are necessarily the way forward. Obviously, water companies are only one of the many players involved in water efficiency. A whole range of other people is involved in that, so putting responsibility on the companies alone is not necessarily the way forward. The whole regulatory regime should incentivise more environmentally benign ways of operating, disincentivise capital solutions and, hopefully, place proper pressures on demand-management solutions rather than capital-incentive solutions. That is the regulatory reform we would like to see.

Q149 Amber Rudd: Given your concerns about the automatic right of connection to the public sewerage system, what legislative action do you think needs to be taken, if any?

Chris Loughlin: The Flood and Water Management Act made some helpful changes to the law on the right to connect—I am sorry; I sound a little like a cracked record here. We would really like to see those powers implemented as part of the tools in our toolbox. The first and most obvious thing is that we would like to see those powers implemented. We thought Sir Michael Pitt's review of flooding and drainage made some very useful recommendations and some more useful incentives could be put into the regime. The first one, which did get into the Flood and Water Management Act, about the right to connect and our ability to give more than just advice about someone wanting to connect to the sewerage system is certainly a power we would like to have.

The second one was to do with misconnections. I am not sure whether you fully understand the jargon and what "misconnection" means. The pipes are connected to the wrong ones, as it were, so connected to surface water rather than foul pipes. We would like further powers to be able to intervene when we find misconnections. At the moment we have to go through the local authority, which has some powers, and that can be time-consuming and difficult. We would like to have more powers immediately to intervene and right misconnection problems. Those are two examples of the things we would like to see implemented.

Q150 Chair: What do you understand by Pitt saying there should be an end to the automatic right to connect?

Chris Loughlin: Obviously, that is an exam question about what Pitt says. You probably know better than we do—I don't know. Certainly, as it stands at the moment, it is frustrating for companies to receive planning applications for connecting new facilities and properties to the drainage system, and we have only a "guidance" or advisory role and are not able to give our clear opinions. Ultimately, the developer or customer has the right to connect whether or not our capacity will receive it. That seems inappropriate to us.

Q151 Chair: Would you like to have the status of statutory consultees?

Chris Loughlin: I think we would; that is as far as we would like to go.

Q152 Chair: It is good to get that on the record. Thank you. As to private sewers and drains, are you in a position to tell us, first, how much infrastructure there really is and what the cost to your member companies might be?

James Bullock: Cost estimates are very difficult because, to be honest, until water companies have taken over those assets, they really do not know what they are. It will be a process of discovery over the first couple of years of ownership to understand what those costs are. They will be significant because the infrastructure being taken over is fairly substantial. The other point is that over the next year, or before those assets are transferred, there is not very much incentive for anyone to invest in or maintain them so the assets will probably be in a worse condition at the time the water companies take over ownership than they are today. Costs will be significant; companies are looking into the scale of them, and it is a difficult calculation. The industry believes that those costs really need to be reflected in bills fairly promptly, because the longer you leave it before you reflect those costs, the bigger the step change in customers' bills, ultimately. Our sense is that even though the costs are uncertain, it would make sense, frankly, for people to start budgeting for those costs as they arise.

Q153 Chair: Do you expect another intermediate price review to allow you to reflect this in your costs to the customer?

James Bullock: We are in discussion with Ofwat about that at the moment. Ofwat currently takes the position that no costs should be reflected until they are reasonably certain, so it would expect the companies to bear those costs for a couple of years before they were added to customers' bills. That would be right at the very end of the existing price review, so you would allow the costs to stack up for quite a while. I highlight that what it means is that if you then recover the costs you have allowed to build up for a couple of years, you are looking at relatively large percentage increases in the bill, whereas if you start to reflect some of those costs earlier, even though they are relatively uncertain, you know they are coming and you can make a contribution. Effectively,

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consumers would budget today for the costs being incurred today.

Q154 Chair: Have I understood this correctly? Has Ofwat changed its position on an interim or intermediate review to reflect what will be a significant increase in each individual water company's liabilities?

Chris Loughlin: It is reasonably new information, Chair. We believed we had some guidance from Ofwat up to the end of last week, which is the position James has just outlined—that is to say we would be putting off the potential for increases.

Q155 Chair: Perhaps I will ask the Clerk to share the guidance with the Committee because we have not seen it.

Chris Loughlin: It is reasonably hot off the presses, but my understanding of it is what I am just saying to you.

Q156 Chair: It would have been quite helpful if Ofwat had shared it with the Committee last week because we would then have had the opportunity to question it on that. It is not your problem but ours.

Chris Loughlin: Bear with us if it is not exactly what we have said because it has appeared literally in the past day or two. That is our understanding of it.

James Bullock: I think Ofwat's position on these interim determinations has always been that you have to spend the money and show what the actual costs are before they are reflected in customers' bills, so to that extent I think Ofwat is being consistent. The question is whether that is appropriate in this case where you can see that some increase in cost is certain and the longer you leave it, the more sudden the jolt for consumers with their bills.

Q157 Chair: But I think you are talking about a significant increase in assets that will be reflected in an uplift in the bill?

James Bullock: That is right.

Q158 Neil Parish: Sometimes small developers sell their houses and the people who buy them think they are connected properly to the main sewer, but they then turn out not to be. Do the water companies need some powers to be able to recover some costs from developers as well? Otherwise, if you are not careful, I can see some unscrupulous developers bunging the cost straight onto yourselves?

Chris Loughlin: That is the existing regime. We do not have the automatic right to say yes or no to connection to our sewerage network but the developer can connect. We are not obliged to adopt those drainage connections upstream of our normal bit until we think they are to an appropriate standard. Sometimes we have difficulty getting those funds out of developers. That leads to a stand-off, which is what the provisions try to resolve. That is to say that unfortunate householders should not be left in the position of not knowing whether or not the sewer has been adopted—albeit the legal searches at the time of

purchase should tell them—and whether they are liable for some uplifting of the standards. The measures in the legislation to be implemented next year should remove that difficulty, but of course there are difficulties about the financial implications for customers in the round.

Q159 Chair: I turn finally to SUDS. During the passage of the Bill, local authorities came up with the neat little idea that they would retain ownership but get you to do all the work. Do you have a view on that?

Chris Loughlin: Certainly we would like to see more sustainable urban drainage schemes—we think they are an appropriate way forward. We think that fits in very much with our preferences in terms of more environmentally sensitive and benign operational standards, but the most important thing is to encourage their construction but to make sure—often they are constructed to a good standard—that there is an ability to maintain them and keep them in operation. Whoever is responsible, there should be an appropriate funding regime. Our primary anxiety would be: are we certain that there is an appropriate funding regime for the maintenance of SUDS?

Q160 Chair: In regard to my own area, Yorkshire Water's proposal is that water companies should only manage SUDS. Do the other water companies share their enthusiasm?

Chris Loughlin: There is a variety of views for the reason I have just given, which is that recognition of the funding stream for maintenance would be required as a pre-eminent point to get all the companies to agree that that was the appropriate way forward. There is some anxiety that that might not be the case.

Q161 Chair: Within the price control framework, if we were to ask individual householders to mitigate the risk of flooding, do you believe that could be achieved within the price regime?

Chris Loughlin: Could you repeat that?

Q162 Chair: For example, if they put in flood resilience and flood resistance measures, or indeed water efficiency measures, which I think you will be encouraged to sell to them, do you think that should be part of the price review going forward?

Chris Loughlin: I think we do. Sarah might give you some more colour on this. When the industry met the Secretary of State and Minister about a month ago, we were very interested that they encouraged us to be involved in the green deal for the energy sector, which is in the process of being implemented as I understand it. They gave us some guidance that the green deal would be appropriate for the water companies and encouraged us to be involved. After that leadership, not necessarily all the agencies have joined up and are in a position to say how we would be involved. Sarah, perhaps I have stolen your thunder in saying that.

Sarah Mukherjee: No, not at all; thunder and lightning is appropriate.

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As far as we understand it, it is still possible, rather than definite, that water efficiency measures, and indeed some element of flood resilience, will form part of the green deal. Obviously, in principle, we are very pleased that water efficiency is being given the same priority as energy efficiency. There are lots of communication messages you could do jointly as a result of that. I think the main concern of companies

is exactly where the money will come from, because so far this has not been made clear in any way. We would need a lot more clarity on how this is to be financed and in what way to move forward.

Chair: That is very helpful. I thank everyone who has been involved this afternoon for their patience and for staying so late.

Chris Loughlin: Thank you for listening to us.

Wednesday 3 November 2010

Members present:

Miss Anne McIntosh (Chair)

Tom Blenkinsop
Thomas Docherty
Richard Drax
George Eustice

Neil Parish
Dan Rogerson
Amber Rudd

Examination of Witnesses

Witnesses: **Richard Benyon MP**, Parliamentary Under-Secretary for Natural Environment and Fisheries, and **Sonia Phippard**, Director, Water, Floods, Environmental Risk and Regulation, Defra, gave evidence.

Q163 Chair: Minister, may I welcome you on your first appearance before the Select Committee this afternoon? Would you like to introduce your colleague, briefly?

Richard Benyon: Good afternoon, Chair. It is a great pleasure to be here. I come with Sonia Phippard, who is Director, Water, Floods, Environmental Risk and Regulation at Defra. I would much prefer to let you go straight into questions, if you want. If you want me to say a few words at the outset I am very happy to.

Q164 Chair: Perhaps we can proceed to the questions, but we shall break them into two parts. We shall discuss flood and water management issues separately and try to spend equal time on each. We are very grateful to you for being here as part of our inquiry into flood and water management legislation, and future management legislation as well. Where are we at, in implementing the 2010 legislation, at present?

Richard Benyon: We are quite a long way through implementing the Act. We are about to go out to consultation on various things. The strategy on how we are to fund flood issues in future is very important. Issues relating to the water industry and Cave and Walker will be part of the Water White Paper next year. Do you want us to go through the Act in detail?

Q165 Chair: I am particularly interested in the local authority responsibilities for flood risk management. Are they now in place and are they legally enforceable?

Richard Benyon: They are in place. Some of them do not come into force until future dates, for example April of next year.

Sonia Phippard: Certainly, in terms of the local partnership responsibilities, those will come into force in April 2011.

Q166 Chair: Excellent. Do we now have a fixed date for publication of the White Paper on water? Will that be published in June 2011?

Richard Benyon: In June next year.

Q167 Chair: Minister, you refer to the future Water Bill. In the memorandum you submitted as part of this inquiry, I am a little concerned about the expression “stringent tests on the need for new legislation, as well as the availability of Parliamentary time.” Can you

give the Committee an assurance that you will bring forward legislation before the next Queen’s Speech?

Richard Benyon: We have a commitment in the structural reform plan to bring forward legislation in November 2012. The Fixed-term Parliaments Bill presents us with a challenge because the date for the second Session will not come before May 2012. To get it in that year is a fairly tight time schedule but we think we can do that. There are some elements, such as the Drinking Water Inspectorate’s charging and various changes to internal drainage boards, which are part of the Public Bodies Bill, so that is already moving ahead. I suspect that we can fit in with the programme we have talked about. Whether it gets Royal Assent at that point or at the end of that Session I am not sure, but we hope so.

Q168 Chair: So, there has been some slippage in the programme?

Richard Benyon: It just depends on how we can get something into the revised timetable, because the Second session is now starting a few months later. There is a possibility of getting some elements into this Session because of that slippage, but I would much prefer to get the legislation as comprehensive as possible, rather than slip it too late.

Q169 Chair: So there is no prospect of a draft Bill by, say, this time next year?

Richard Benyon: A draft Bill by November 2011? There could be, yes, because we will have had our Water White Paper.

Chair: That is helpful. Thank you.

Q170 Tom Blenkinsop: Minister, Defra estimated that to maintain the same level of protection as now against river and coastal flooding, funding needs to double by 2035. However, the budget for flood and coastal protection has been cut by 20% over the period of the spending review. How do you propose to meet flood defence needs over the period of this Parliament?

Richard Benyon: I think we want to look at it in terms of outcomes. Over the past spending review period—the last equivalent period of four years—£2.36 billion has been spent across the piece—roughly half capital, half resource spending. Over the next period it will be about £2.1 billion, so that is a cut. But I think it is also about how wisely you can use that money and actively seek alternative funding to be part of that. We

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also have permission from the Treasury to include in our capital spend 120% of capital receipts that we gain from the sale of assets—of real estate property that we have—and there is also the whole process of getting more efficiency out of it. We know we can get 15% more procurement efficiency on our capital budget from the Environment Agency and we think we can access more funding through local schemes and innovative funding solutions. When we talk about actual pounds we must also look at outcomes. The crucial figure that we have got, in accordance with the Environment Agency, is to protect 145,000 homes over this period. I think that is something we can achieve and hopefully improve on as we develop more innovative funding solutions.

Q171 Tom Blenkinsop: I want to pick up on that point. Obviously, the localism agenda goes across all Government Departments at the moment. Can you explain to the Committee how you will better protect 145,000 homes with a 20% cut in the flood defence budget? How does that interact with the localism agenda?

Richard Benyon: First, the way the Government traditionally have spent money on flood resources is to say, “Here is a whole lot of schemes. These are the ones that should go ahead sooner because they give a better bang for your buck; they produce more of a return. For these other ones, there is more work to do to make them viable.” In the past, there has been a very straight line and you either qualify or you do not. We are suggesting that we can give greater clarity by giving alternative funding solutions, which will inject sums of money that will bring those that are not able to go to the right-hand side of that line into the scheme because we can bring in innovative local solutions. I have seen them for myself. The other day I was on the Suffolk coast and I saw really innovative solutions involving the planning system, which have unlocked sums of money that would not otherwise be available to make schemes become viable and give local communities the assurances they need.

I think we have done very well to protect the budget in the way we have. Effectively, it means there is an 8% cut in each year of the period we are talking about. When you think of it in terms of a 50% cut in capital budgets, which was proposed by the last Government and is the case in many Departments, we have managed to restrict that to 34% and protect our resource budget as well. I think an 8% cut over the whole of the four years shows that we can achieve. In terms of outcomes, I think that is very important. The other point is that we are talking here about providing protection and tackling the 5.2 million properties that are at risk from flooding. That is a very long-term process. Whatever Government was in, that is a far horizon that we are looking at. I think that when we get through our economic difficulties we can get back on our track and be where people in this country expect us to be, which is protecting as many homes as possible over the next 10, 20 years.

Q172 Tom Blenkinsop: To go back to the localism agenda and specifically the assurances that you want to give local communities, you are reported as having

said that some communities will have to be sacrificed due to rising sea levels. In fact, you said: “We are not going to be able to protect those communities and we need to think of ways of relocating them. There are communities that are going to disappear.” How will decisions be taken about which communities, and on what basis?

Richard Benyon: For coastal erosion?

Q173 Tom Blenkinsop: Yes.

Richard Benyon: If I may make a rather rash statement, I think that a generation of politicians across several Governments have given assurances—“con” is a rather strong word—that we as a political class couldn’t live up to. The “hold the line” policy and the idea that we could surround all our coastlines that are vulnerable to coastal erosion by steel and concrete in perpetuity and defend every house was a notion that was wrong from the outset. But I think we can be clever about this. For example, the other day at Happisburgh in Norfolk I saw a community that really got how to do it. They were working with the local authority through the planning system, relocating people, doing the sale and lease back of houses and securing the coastline where they could through schemes that can pay. But I am not going to sit in front of you and pretend that there are not properties that will be lost, particularly when you go to the East of England and other parts of the country and see the effect of sea levels now. If we are contemplating rises in sea levels of 30 cm over the next 50 years, you start to see the effect this will have. So we have to be smart but also recognise that there will be local communities that will not be able to qualify, under the strict terms of Government spending that we have had in the past, with wanting 100 years of security. What they are concerned about is 20 years of security. Therefore, we have to allow them to come up with solutions that can protect their homes.

Q174 Tom Blenkinsop: Do you see any specific regional variation in that?

Richard Benyon: Certainly not. I’m just quoting that area because it was one I visited most recently, but there are big problems in the North West and North East; I know there are problems in parts of Somerset and many other areas. I have also looked at the South coast. I have to talk in generalities, but what affects households is their most important possession and their lives. I do not want a system that says you have to take public money in one system or you do not get it at all. If people want to protect their homes for 20 years and they can find some solutions through the planning system—a bit like exception-site housing on the edge of a village—that provide some money to protect those properties, albeit for 20 or 30 years and not 100 years, then we should provide them with a system that allows them to do that.

Q175 Tom Blenkinsop: How will you make sure that the views of all interested parties are reflected in decisions on funding allocations for flood defence works?

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Richard Benyon: I am staggered by the amount of consultation that goes on in Defra. Quite often I ask the question whether we should be undertaking yet another consultation, but I am persuaded that we should. We are uber-consulters, rightly so, because quite often these are very technical matters. In my short time in the job I have learned that when you make a change to one aspect of flood and coastal erosion management you often affect other factors or something down or up the coast or river. If you are protecting a town you can be affecting farmland. So it is vital that we consult. There are no secrets in what we do. There is nothing to hide. We want to be as open as possible, but we also want to get something done, so we will not be hidebound by a determination to consult on everything, but we do want to give everybody an opportunity to influence what we do.

Q176 Tom Blenkinsop: A final question: what proportion of the cost of building new flood defences and maintaining existing ones should be borne by private individuals and organisations, as opposed to the public purse? Will you be selling off flood defences?

Richard Benyon: I noticed a while back some headlines in the papers that we would be selling off flood defences. We have no intention of selling off flood defences. Something to look at in future is whether companies, probably water companies to be frank, might have a contribution to make in terms of constructing and owning flood defences, but we have no plans to sell off existing assets. Would you repeat the first part of your question?

Q177 Tom Blenkinsop: Should the cost of existing defences be borne by private individuals and organisations as opposed to the public purse?

Richard Benyon: What proportion is almost impossible to say, but we think that local people should be able to contribute. There may be a financial advantage for them to do so. If it means they are protected from flooding, that should be reflected in their insurance premiums. If it unlocks some land for regeneration, then there is an advantage to that community and possibly an individual. We want to make sure that we are equitable, because there are communities we seek to protect that are very challenged. There are lots of people on low incomes and, to be frank, we do not want to allow wealthy, middle-class families who can afford it to jump above that line that I talked about earlier. Therefore, we have a formula that will assist those areas where people are on low incomes to be factored into the calculation about how much Government money is being spent and how much we might expect from a levy, if any at all. Some schemes will go ahead and will be funded by the taxpayer, as they always have been.

Q178 Chair: Minister, you referred to real estate property that you are going to sell off. What real estate will you sell off?

Richard Benyon: I can give you an example: the Covent Garden Market Authority. There is nothing secret about this because it has been a long-standing proposal by the previous Government. We think we

will be able to access about £100 million over the next four years from assets as 120% of their sale value, as agreed with the Treasury as part of the CSR process.

Q179 Chair: Can you give us a couple of examples of the local innovative schemes to which you referred?

Richard Benyon: Bawdsey is one that comes to mind. An extraordinary, active local community got together. I mentioned exception-site housing, because it is a familiar feature in rural as well as urban areas; it means that areas that would not otherwise be zoned for housing are made available for affordable housing. In a similar way, in Bawdsey they have found land that would not otherwise be developed. They have ring-fenced the income from that in a local trust and that has gone to be spent on sea defences. I have seen and know of a variety of other types of funding. I am particularly interested in where flood protection unlocks regeneration, and a lot of income can be received by an area for its future economic benefit. That is why we have managed to protect the floods budget the way we have. It has one of the highest returns, in terms of capital spending, of any area of Government funding.

Q180 Thomas Docherty: Minister, the example you gave was, as you said, one that the previous Government had already pencilled. Have you identified any new pieces of estate that you could sell?

Richard Benyon: I do not quite know when the Bawdsey one arose. It was certainly being worked up. I am sorry; you're referring to the sale of assets.

Q181 Thomas Docherty: The example you gave was one that, as you said yourself, had already been pencilled by the previous Government.

Richard Benyon: Sorry; yes. I do not know whether they were identified by the previous Government. I remember the previous Prime Minister had a big sale of assets about three or four years ago—or it was certainly announced; whether it happened, I do not know. All I can tell you is that in our budget—it has been carefully thought through and worked upon with the Treasury and is not a finger in the air—we have £100 million income in our capital spend, which represents 120% of the sale of the assets. I cannot identify others, but Sonia may be better informed than me.

Sonia Phippard: Like many other Departments, one of the things we shall be doing is to look at the estates, offices and other buildings occupied by the entire Defra network to see where we could achieve greater efficiencies of use. The Department as a whole owns a very large number of buildings. I cannot say precisely that it is building x and building y, but there is undoubtedly scope for significant rationalisation.

Q182 Chair: Does that mean you might close down local Defra offices?

Richard Benyon: I know of none that is being considered for closure now. I know that a couple are empty, and through the arm's length body review, there may be some rationalisation of buildings that allows us to market some of those. as and when we

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have more information, I am very happy to share it with you.

Q183 Amber Rudd: Minister, you rightly identified the issue of people wanting to protect their homes as part of the anxiety about coastal erosion. What is your view about insurance premiums in those areas, given that some of people's concerns are simply about getting affordable insurance on their homes?

Richard Benyon: This is the big issue. The other day Defra had a summit on flooding which involved all interested parties and inevitably included coastal erosion as well. The Association of British Insurers (ABI) was of fundamental importance to that meeting. One of the things we have taken on from that is three key working groups, one of which is identifying the need to continue with the existing statement of principles, which comes to an end in 2013. I know this is a great concern to people who live in areas of flood risk. My constituents, who were the subject of surface water flooding, do not live in a floodplain but just having the f-word—flooding—in the history of their property means that immediately they are blighted, to use a strong word, in terms of future insurance. In our very good working relationship with the ABI and their members we want to make sure that we are working towards a system that, first, recognises reward for the householder who builds in resilience or, through their council tax or through taxes, has had money spent in their neighbourhood to protect him or her from flooding; and, second, recognises that this is a partnership and there is a job for Government to do, not just to continue to spend money—and we are—but also to find ways to encourage homes and properties to be resilient to flooding. There is a range of views, many of them coming from abroad, where people seem to be more attuned to the impact of climate than perhaps we have been in the past and try to build in those kinds of things. So it is a partnership. We are not just saying to the ABI, “You've got to continue to insure homes at whatever the risk.” We recognise that they are in business and so we have to work with them to give them the assurance that we are heading in the right direction as well.

Q184 Amber Rudd: Do you think that if there were local initiatives, perhaps like the ones you described, local areas could work towards lower insurance premiums behind those particular initiatives?

Richard Benyon: Yes. Through the Big Society work that is going on we are looking at empowering communities, for example, to work together and achieve an economy of scale that might mean buying their utilities cheaper, but it might also mean buying their insurance cheaper because they are operating as a community. There is huge potential here, but we cannot get away from the fact that, at the end of the day, Government will still be required. We are looking for additionality in this, but we are not escaping from our responsibilities as a Department and as a Government to deliver.

Q185 Amber Rudd: Finally, on that point, presumably the ABI is looking for some sort of

binding targets, but it is not going to get them at the moment. Is that right?

Richard Benyon: Sonia is more up to date on this than me.

Sonia Phippard: I think the ABI, in its press release following the spending review, was very realistic about the challenges faced by the country. The ABI, the Government and the various other players, in terms of talking through the issues, are very realistic about the fact that Government cannot make open-ended and very long-term spending pledges. We need to look at the real problems and the goals we need to achieve, which are affordable insurance, access to insurance, information about insurance and so on. I think we are starting in a realistic place, but that is not to say that the issues are not difficult.

Q186 Tom Blenkinsop: How many communities does the ABI estimate will be unable to secure insurance during the CSR period?

Richard Benyon: First, the statement of principles relates only to buildings that existed before 2009, so there is a whole lot of new build up to 2013 not covered by that. I do not know how many of those, following the end of this arrangement, will be at risk of not having insurance if we do not do anything. Of course, we will not do nothing; we are working extremely hard to try to achieve some kind of successor arrangement. To be honest, I have not begun to calculate what figure we might have to consider, because we are hopeful that we will achieve a new arrangement. That is my rather convoluted reply.

Q187 Tom Blenkinsop: So there is no estimate of how many towns, villages or local communities will potentially be affected?

Sonia Phippard: One of the difficulties is: are we talking about access to insurance, access to affordable insurance and so on? I think one of the issues is to make sure people have information about where insurance can be purchased and the cheapest way of getting hold of it. To go back to one of the previous questions, particularly where a local community has taken an initiative, sometimes going through a broker rather than onto a commodity-seeking website is the best way of getting cheaper insurance. One of the answers is much better information for those who seek insurance, and until we have worked through a lot of the issues, making estimates of numbers is very difficult.

Richard Benyon: The other point is that it is not just about premiums; it is about excess charges as well. Excesses can be set so high that, for certain households, effectively it is no insurance by the time they have replaced all their white goods, settees and everything. It is absolutely not covered. The other thing that struck me when seeing at first hand the floods in 2007 was that my local housing association has an opt-in scheme for household insurance: 50p a week for £5,000-worth of cover. I am encouraging it and, through my new role, raising this with a lot of people to see whether it can have an opt-out scheme—that is, whether it can be a standard part of their rent. It would be clearly defined in their rent book, but they would have to opt out of it. As if tensions are not high

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enough after flooding, if some people have paid 50p per week and get insurance, and their neighbour has not—they might be in a terrible state but rely on charity and handouts—that is a totally unsatisfactory situation. We want to encourage as many people as possible to get into these schemes, particularly low-cost ones, that can provide basic contents insurance on rented property. I think that is a job for local authorities, housing associations and other bodies, with leadership from MPs on this as well. If we can get a system where people can opt out rather than opt in, I think many more homes would be insured.

Q188 Chair: I turn to the EU floods directive, which comes into effect in December 2013. In its submission to the Committee, the ABI has asked that the flood hazard and risk maps, which have to be published for all forms of flooding, should be communicated to those at risk well before you are compelled to do so by EU legislation. Will you be in a position to do that?

Richard Benyon: The Environment Agency has changed its methodology. Are we up to date on this?

Sonia Phippard: I think the answer is yes. The Environment Agency is certainly on track gradually to roll out the remaining mapping, and before 2013 those should certainly be available.

Q189 Chair: Will people be allowed access to the Environment Agency maps without a charge? At the moment, everyone—the Environment Agency, the Ordnance Survey, district councils and insurance companies—is mapping. Will the maps that we have be pooled?

Sonia Phippard: In terms of pooling, I hope that is one of the issues that the various working groups following our flood insurance summit will talk about. I agree that a multiplicity of maps is potentially confusing. As far as I am aware there is no intention to charge for Environment Agency information, but I will check that and we can let the Committee know.

Chair: Thank you.

Q190 Richard Drax: Minister, local authorities are taking on more responsibility for flood management and surface flooding. Is there a need radically to realign the way funding is distributed for flood work?

Richard Benyon: I think that where we create new burdens for local authorities we are required, under the new burdens doctrine, to provide funding for that. Another aspect of work that we have completely protected in the comprehensive spending review is all the work on strategic planning and preparation of plans for lead local authorities, and all the emergency funding and clean-up costs. So local authorities are being required to do work. We have added £2 million to the £10 million they received this year. They will get £21 million next year and £36 million for each year after that for precisely this kind of work. Obviously, it depends on the amount of flood risk. Some local authorities will receive up to £750,000 of that; others will receive less, but it is really important that we recognise that where they have a new burden, they will be funded.

Q191 Richard Drax: For example, one council has adopted Flood Risk Management, which is a funding pot for all public funds. Is there any merit in that? It is then distributed on the basis of the area's flood risk zone and surface water vulnerability.

Richard Benyon: Sir Michael Pitt was very clear about this. He said it was Government's job to create a strategy. We are now at the point of producing our national strategy, consulting upon it and having it agreed. Local authorities are responsible for their strategies. It would be wrong for us to impose too much rigour on exactly how local authorities develop those. The areas are clearly defined in one sense under Pitt and under the Act, but if we can provide them with mapping, as the Chair said, and all the other information they need and a clear national strategy that has gone through a process, then it is for lead local authorities to come forward with that kind of cohesion that exists between central and local government.

Q192 Richard Drax: For example, the EA gets £570 million for flooding every year and local authorities get £36 million, but with more responsibility falling on the local authorities, and with less money, is there not perhaps an argument for greater centralisation of the funding so it can be used effectively to deal with local issues, rather than waiting for a bigger brother, if you like, to push things down to a local level?

Richard Benyon: I see the point you make. The £36 million is to assist them with the development and roll-out of their strategies and what they have to do locally. The other sum of money that the Environment Agency has is capital spend.

Sonia Phippard: Local authorities also spend from their formula grant, so the £36 million, and £12 million this year, is only the additional money to deliver the additional responsibilities. The calculation this year is that they will have spent about £100 million of formula grant on flood activity. I think the Pitt recommendations differentiate between what you might call national risk and systems, and the local, and we are looking for the right division of both money and responsibilities. The national strategy, which the Environment Agency is required to provide under the Act, will set that out and we shall be consulting on a draft of that very shortly.

Q193 Tom Blenkinsop: What if there is another large-scale flooding event such as the one in Cumbria? What have you done since becoming a Minister within the Department to ensure that there is a contingency fund to deal with such an epic event as that which occurred in Cumbria?

Richard Benyon: I have familiarised myself with the issues that have arisen not just in Cumbria, but also in Boscastle and other constituencies, represented by those I see round the table, who I know have experienced the same thing. But I have also fought like a scalded cat to protect that emergency funding, and we have. All the money that came out of the recommendations of Sir Michael Pitt—that was so fundamental in the Act—about preparedness, dealing with the emergency at the time and clearing up afterwards is absolutely secure. Exercise Watermark,

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which is to take place in the first three months of next year and about which we must inform you—the Chair or others might like to come along and see part of it—is absolutely crucial to delivering on Pitt’s recommendations about emergency services working together with local authorities, understanding who takes the lead on what issues and protecting areas of vital resource. We have to learn from the Cumbria issue relating to the bridges and roads, and the impact that that had—not just at the time, tragically, but also in the aftermath. We have to try to speed up getting communication through to communities that are cut off in the way that communities were.

We recognise in Defra, an emergency Department, that we shall be facing this problem in the future. New problems will be thrown up, problems that even Sir Michael Pitt in his very detailed, excellent report could not have foreseen. We have to make sure that we are able to learn from that and build on it. An enormous amount of work has been done by the previous Government; through the Act, in which the Chair was so involved; and through the work we have done afterwards in implementing it. I think that communities can be as assured as they possibly can be that Government at all levels are working in the right way.

Q194 Chair: The Chairman of the Environment Agency said that he would share with us at the flood summit—and the Committee would find it particularly helpful to understand—the difference between the cost of soft defences, like water being retained on farmland, and physical structures. If we could request that again through you, that would be very helpful. I think that the general figure given is that £1 spent on flood defences saves £8 in flood damage. Would it not be worthwhile looking at this anew, if £1 spent now can save £8 later?

Richard Benyon: That is why, as I say, it is the best return on investment that any Government spending can make. You referred in your previous point to agricultural land.

Chair: What I saw—as did you, in your earlier shadow role—was the damage caused by a river like the Derwent in Workington on farmland. Because it is private land, that has to be removed at the farmer’s expense. Obviously, if we are to invite farmers and landowners to give up their land and to be compensated, normally in a very small way, I think this could be looked at. I do not understand the cost. It would be very helpful to understand the comparative costs of different forms of flood protection schemes, such as water retained on land and managed retreat. I know that at the moment some EU rural development funds can go to retaining water on farmland for a specific period of time. What are the relative costs of that, as opposed to physical structures such as walls?

Q195 Neil Parish: If farmers were paid to take the water, in certain places, to stop a local town flooding or whatever, rather than just being compensated for loss of earnings, sometimes that could be a lot cheaper than trying to stop the flood happening at all. At the moment, they are just compensated for possible loss

of earnings on that land, but if there was a more positive aspect I think you would have a greater take-up in some places, especially, I suspect, in parts of Somerset.

Richard Benyon: I entirely concede that to be true. The other day I saw a farm where the farmer had agreed to construct a swale about as wide as this room around a village so that that village, which had flooded 10 times in the past 12 years, would be protected in perpetuity. He said he was being compensated with a modest sum for the land, which could continue to be grazed for most of the time, but 40 acres below the village were effectively created as floodplain that were not floodplain before, if you excuse my tortured syntax. He said he did not mind because he wanted to do the right thing by the village, but future generations of his family could possibly lose out on development of land, which was an asset of his business. He just wanted me to understand that farmers all around the country were happy to take water to keep it out of homes, but we need to understand that they need proper compensation where it is relevant. Of course, we cannot compensate a farmer for the possibility of development in 100 years’ time.

To respond to the Chair’s point, the chief measure we use to see the worth of something is how many properties are protected from flooding. If you do that by wetting farmland, to a certain extent blighting its ability to be farmed in the way it always has been, you may get a good calculation in terms of the properties you protect but it imposes a lot on the farming community. We need to make sure we get this right. We are talking to industry representatives about it; they came to our flood summit. I cannot promise we will always satisfy them, but we want to work with them and you to ensure we are being fair on this.

Q196 Chair: You could, of course, amend the outcome measures; you could insert food security as an outcome measure. Would you be minded to do that?

Richard Benyon: This is not my brief, so I am treading on dangerous ground. In opposition we said that we would protect the best farmland from development. I think that found its way into the coalition agreement, but I will have to check.

Chair: It would be interesting to know.

Richard Benyon: It is an interesting philosophical point, because there is an equivalence in what you say, but I cannot say any more than that.

Q197 Chair: Perhaps you could write to us about what is in the coalition agreement.

Richard Benyon: Yes.

Q198 George Eustice: I want to move on to the planning system. Earlier you talked about the problem that we cannot really protect some of the existing coastal developments. Are you discussing any measures with DCLG (Department for Communities and Local Government) to change the legislation in this area? We have had some evidence that currently, PPS25 is applied a bit inconsistently around the country, and that perhaps things should be tightened

up to make sure we are not storing up problems for the future, in terms of new development.

Richard Benyon: I have had a meeting with Bob Neill on this very point to discuss the review of PPS25. The job of the Environment Agency as a statutory consultee is to tell the authority what the risks are, in terms of flooding. I believe that in 98% of cases, the Environment Agency's views are taken into account. Recently, there have been one or two highly publicised cases where they have gone against it. Of course, they have an absolute right to do that. For example, one case involved a heritage building in Gosport. If that development had not taken place, this apparently very beautiful building would have been unviable. What would you have done with it? I do not mind that being developed if it is in a floodplain as long as every occupant of that property, the developer and everybody else, knows the advice given by the Environment Agency. I think that is where the line has to be drawn. But we work closely with DCLG to make sure that the development of its policies reflects the fact that the Environment Agency has an important role to play here, and the fact that under the coalition agreement the Government still believe inappropriate development on floodplains should not take place, and we have to make sure that is followed through.

Q199 George Eustice: Does that require new legislation or just a change to the planning policy statement?

Richard Benyon: I do not think it requires new legislation, but Sonia may correct me. Ultimately, this is for the Department for Communities and Local Government. We are consulting with it on a range of different issues, and there is a major planning reform under way. Whether or not it is part of that I do not know, but we work closely together.

Q200 George Eustice: A final point: do you think there can be any conflict? You mentioned earlier the value of regeneration. If you sort out flood defences, quite often regeneration in some coastal areas could go ahead. If you tightened it up, do you think there might be a problem, in that projects like the one in Gosport that you mentioned would not be able to go forward?

Richard Benyon: I think flood and coastal erosion defences have great potential in certain areas to unlock huge regeneration and economic investment, as I said earlier. We have to be careful that we get the wording absolutely right. Something might still be, strictly speaking, in a floodplain but, because of measures taken around about, the chances of that happening are minimal, if not zero. That should still allow development to take place. Otherwise, you will say to communities—I hesitate to name them, but York is an example—"Where will York be in 25 years' time?" This is one of our great cities in an area that has been known to flood. We have to be careful that the perfect does not become the enemy of the good. But we are clear that inappropriate development in floodplains should not take place.

Q201 Dan Rogerson: The Pitt review highlighted the role of fire and rescue services in responding to flood events and to prepare for and be part of planning for it. The Fire Brigades Union has said it is concerned that there should be statutory recognition of this when fire and rescue authorities are planning and looking at where their resources go. As we have already discussed, we are in a period when everybody is looking at their budgets. Do you think there should be some form of statutory duty on fire and rescue authorities to allocate resource to deal with these sorts of issues?

Richard Benyon: The most important aspect of this is to get the right systems in place for when an emergency takes place. As I said earlier, not only is that a recommendation of Pitt that we are carrying forward, but we will test it next year in this major exercise. Whether or not it requires certain statutory changes to be made I am uncertain. I do not think Sir Michael Pitt felt there was a need for any strategic change; it was more about understanding the gold-silver-bronze command structure and how that interfaced with local authorities. There is a piece of working happening at the moment and Sonia will tell us all about it.

Sonia Phippard: I simply confirm that that is the case. We are looking at various responsibilities, including whether a statutory responsibility would or would not be beneficial. There are risks as well as certainties from putting a statutory responsibility on one set of players when the strength in flood responses is so often in the co-operation of a range of services. The most important priority is to maintain that co-operation.

Q202 Dan Rogerson: I think the question is not about an acknowledgement in principle that they will do things; it is about whether, as budgets come under threat, fire and rescue authorities, in looking at their budgets, will prioritise statutory concerns rather than those that they see as more discretionary, and therefore whether there needs to be protection of this sort of work.

Richard Benyon: I was going to use the word "policing" but that is not the right one, because we do not want to impose in areas where we should not, but we have to make sure Sir Michael Pitt's recommendations are followed through. If at any point we see areas where there is local failure in this respect, or the wrong priorities are taken, we have a national responsibility. In that difficult relationship, if you are a localist you believe you have to trust people, and trust them in certain circumstances to fail, but this is probably the most important issue that we deal with in Defra because it affects so many people's lives and we have to get it right. We will be constantly testing that relationship between Government and localism.

Chair: But at the moment there is a specific gap in the law. A coroner considered the case of the young man who died in Hull. All the emergency services turned up and I think it was deemed that it would have been most appropriate for the fire service to have the cutting equipment. My understanding—Pitt was very clear on this—is that we need to have emergency services with the right piece of equipment. The fire

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service has said to us on a number of occasions, both individually and in evidence to the Committee, that it needs that piece of law. I think Tom also wants to come in on that point.

Tom Blenkinsop: The Minister said he was not aware whether Pitt had made a specific recommendation. I remind the Committee that he referred to “a fully funded national capability for flood rescue, with fire and rescue authorities playing a leading role, underpinned as necessary by a statutory duty.” For me, that is definitive; it is fairly clear.

Q203 Chair: I am sure your own fire service will tell you that the key is that at the moment it has no flood duties and is not funded for flood duties; it is funded for fire and rescue. Perhaps you could drop us a line on this role. It may not be your Department; it may be the Department for Communities and Local Government, but there is a definite gap in the law, and this would be an opportunity to address it.

Richard Benyon: This is an issue that cuts across Departments. You will know how our emergency services are funded, but we have to make sure this works. I will certainly write to you with more detail, and we will test the fire services’ response to this very closely next year.

Chair: I think it is a matter for the Department for Communities and Local Government, but you have overriding responsibility. That would be most helpful.

Q204 Neil Parish: What plans do you have to improve the operations of internal drainage boards?

Richard Benyon: The first thing we did was say that we thought the internal drainage boards were a wonderful example of local community spirit and voluntary activity by very committed people who know about water levels and the advantage of managing them in the right way. We think they are great organisations. We did not want to impose amalgamations on them. We think some of them could operate better if they did; some could operate in a slightly federal way, if I dare I use that word, where they can continue to exist but share services. There is a problem in the North West, where pumps are currently managed by the Environment Agency, but we want to put that in the form of a new IDB and there is not one in that area, so we want to build expertise. I am working with the association on that. We think the changes that need to be made to the governance of IDBs can be put into the Public Bodies Bill that is currently going through Parliament. We are working closely with the Association of Drainage Authorities and we want to encourage them wherever we can to take on responsibility for a wider function of flood defences.

Q205 Neil Parish: That takes me neatly into the second part of the question, which is: should drainage boards take over responsibility for main rivers in their areas from the Environment Agency?

Richard Benyon: I think the Environment Agency has a very important role and should retain an important role. I am not saying that there aren’t areas where responsibilities could migrate, but in the main—I think particularly of the eastern part of the country

where there are large rivers and large areas of agricultural land that are completely dependent on the performance of IDBs—I do not want to fix something that is not broken. I would be wary of going into main river functions unless I can be persuaded.

Neil Parish: This is an old chestnut of mine. One of the problems I see very often with the Environment Agency is that it tries to do too many things with the rivers. It tries to keep up the level of water in the rivers in the summer so they can maintain greater wildlife. That is fine, except that you have to be able to get rid of that water in the winter when it starts to rain so you can drain. For instance, in Somerset the Tone and Parrett are virtually silted up at Burrowbridge and yet nobody seems to do anything about it—until, I suspect, Taunton and Bridgwater flood; then they will. Perhaps for internal drainage boards, main rivers is too big a role for them, but somehow we have to allow them to do more, and we have to get the remit of the Environment Agency to be maintaining not only the environment but drainage. That way, there could be sluices in the river to keep levels of water high when you want, and you could get rid of the water when you need to, rather than just let it silt up. My feeling is that over the years we have allowed a lot of these rivers to silt up, and that is why we get so much flooding.

Q206 Chair: To come back to what we said earlier—Lord Smith of the Environment Agency was very keen on this idea—the previous Government seemed to have a very clear policy of not maintaining main watercourses for reasons of biodiversity. For every pound spent on maintenance, £8 was spent on physical structures, so the first question is whether you review that. Looking at the IDBs in my own area, for example, three pay something like £60,000 a year to the Environment Agency on the assumption that it will maintain the main watercourse and stop it backing up into the areas on which they spend separate amounts of money to maintain. I know you have given this some thought. I thought you were creeping towards the suggestion positively that you would authorise IDBs to retain that money that would otherwise have been given to the Environment agency. I do not say I would go as far as to give them the main responsibility, because we worked for five years to ensure that the Environment Agency had responsibility for main watercourses, but a programme of work could be agreed between the Environment Agency and IDBs. The engineers and resources of the IDBs could be used to pursue those works.

Richard Benyon: This is the direction in which we want to go. Again, I am trying to talk generally about something that can have completely different application in one catchment than in another. There is also the wider issue of smaller rivers. A lot of communities were flooded, in 2007 and in other floods, by the effect of weed in smaller rivers. The Environment agency used to have teams of people who cut weed, and for probably perfectly understandable reasons it no longer has them, but what was lacking at that point was anything to fill the gap. What I have seen happening in certain areas is community work and work by riparian owners to

produce a protocol with Natural England. Yes, we must be conscious of our biodiversity responsibilities—some of these rivers are SSSIs and are very delicate environments—but we are also talking about people’s homes. I am not sure that in the past we got the balance entirely right and it is one we have to get right in future. I do not think I can do that entirely from my desk in Nobel House; it has to be delivered locally. We have to empower IDBs. The Environment Agency is very open to working out new protocols and it is something we have to get right for the future.

Q207 Chair: On sustainable urban drainage systems, do you think it is right that local authorities should continue to own them but expect water companies and their customers to pay for their maintenance?

Richard Benyon: SUDS?

Q208 Chair: Yes.

Richard Benyon: The Act provides that the authority that approves them can own them.

Q209 Chair: I am talking about existing SUDS.

Richard Benyon: Sorry. I am not sure it is fair. I think we have to work on where we are going to get to under new sustainable drainage systems. In the past it was much too easy just to connect to a sewer, and we paid the price for that in certain communities. The present technology on sustainable urban drainage systems is fantastic; we have so much more know-how. There is an issue about the resilience of some of the existing ones, and we have to sort out the ownership and responsibility of those.

Q210 Chair: Are you looking at incentives for home owners who take resilience and resistance measures, so that can be recognised somehow?

Richard Benyon: We hope it will be recognised in premiums, as I said earlier. I think that is the primary method; it has to be the great driver, and that is the kind of relationship we want to have with insurers in future.

Q211 Chair: One thing that Pitt was absolutely determined to rule out—you have just alluded to it—was the automatic right to connect. I do not think the Act has achieved that. How can we either stop mis-connections in future or prevent new developments from proceeding where surface water may spill out as a result of developments with inappropriate connections to sewage pipes?

Richard Benyon: I think mis-connections is the one area of Pitt that we have not followed through. It is a fantastic report and, quite rightly, the previous Government, you and this Government moved it forward, but on mis-connections, I want to test a non-regulatory route. There is a whole range of activities that can and should be carried out on mis-connections that can improve the situation. Have we talked enough to white good manufacturers, building standards and building research establishments? I do not think we have. In the better regulation world in which we live, we have to exhaust

those opportunities before we go down the legislative route that Sir Michael suggested.¹

Q212 Chair: Would you be minded to give water companies the right to be statutory consultees, on the basis that the Environment Agency is now a statutory consultee on planning applications?

Richard Benyon: I must confess I was surprised to discover they weren’t.

Q213 Chair: So will you give them that right?

Richard Benyon: It is an ongoing discussion.

Q214 Chair: I am pleased to hear it. There is ongoing consultation about private drains, national drains and sewers. Has the Department estimated the length of pipe and drains?

Richard Benyon: I have seen some figures and it is thousands of kilometres.

Q215 Chair: You could write to us with the actual figure, but as I am sure you are aware, there is a dispute. The Department is assuming that local authorities will earn money from the sale of these private drains and sewers, whereas in their submissions and evidence, they tell us they believe this is simply not the case. So there will be a mismatch of funding. Given the fact that local authorities will have their budgets cut as well, obviously it will put huge pressure on local authority budgets if (a) you do not know the value and (b) the value does not turn out to be anything like what the Department assumes it will be.

Richard Benyon: On the figures I have seen, my assumption is that they will save money.

Q216 Chair: On what basis?

Richard Benyon: At the moment it is thrown back to them and they deal with it on a regular basis.

Q217 Chair: If it is a private drain and sewer it falls to the householder to do the repair, so I do not see what the local authority input is at the moment that would mean that they saved any money from the sale. It is the private householder who will gain the benefit.

Richard Benyon: It is the laterals.

Q218 Chair: It is private drains and laterals.

Richard Benyon: At the moment there is a cost, which is being borne in great measure by local authorities. What is proposed is that they would be removed from the issue altogether.

Q219 Chair: This is a matter of debate between the Department and local authorities. It would be helpful to have in writing your estimate of the cost currently borne by local authorities and the estimate of the saving they will make.

Sonia Phippard: We can let you have that. Obviously, we are talking about the figures that underpinned the proposals in the first place.

Q220 Chair: But they were criticised.

¹ A full answer to Q211 is found in Defra’s supplementary written evidence, Ev 73

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Sonia Phippard: They were. We've got a working group with the local authorities to look at not only at what was said then and any alternative evidence there might be to challenge those figures but also what is really happening on the ground, including the costs of the new responsibilities as they come in train. We are trying to track it in real time as well and, frankly, at the moment that is the best evidence we have before us, but we can certainly let you have that.

Chair: That would be helpful. Let us move to the next part: water management and governance.

Q221 Amber Rudd: What parts of the vision set out in the previous Government's future water strategy are you thinking of keeping in your White Paper, which we hope will be published next year?

Richard Benyon: Our White Paper will be centred on three main areas of work: the recommendations of Martin Cave, Anna Walker and the Ofwat review. It will be running alongside and in tandem with the Natural Environment White Paper. You cannot talk about the natural environment without talking about water. The Water White Paper will deal with some very technical aspects, particularly in terms of the Cave report, so we want that to be seen as separate. We think that is a really important piece of work.

Q222 Neil Parish: The Water Framework Directive is challenging targets for improving water quality. Given the lack of progress so far, what will you be putting in the Water White Paper to make sure we meet these targets? This is a lovely one.

Richard Benyon: Thank you, Mr Parish. I hope we can achieve a situation that means that the current judicial review that we face—our dispute with the Angling Trust and the WWF—is resolved and we can move on. We all want the same thing. We want to comply not just because we must, but because we want to be the greenest Government ever; we want clean water and plenty of it. Whatever people's views about the Water Framework Directive and where it came from, or whatever, it is a good discipline and it is the right thing for our environment. One of our great challenges is that it is predicted that the summer levels of rivers will drop by 50% and average levels by 15% over the next 30 years. That presents massive challenges, not just in relation to the activities that take place in catchments, and abstraction, but also as regards the quality of the water.

There is plenty of good news on water quality, not least the fact that we now see kingfishers and otters in places where they have not been seen for a generation, but there is still a big problem. The quick win was point source pollution; the problem we have is diffuse pollution. Some of that is the product of activities that took place a couple of decades ago and we must be smarter in dealing with it. That puts burdens on all kinds of people, not least Government, but also the farming community. Farming is a vital activity that feeds us and protects the countryside, which provides so much income from tourism and the rest of it. You do not need me to tell you that. We do not want to be seen to be hitting an industry that has been through a very tough time, but we have to work with farmers, incentivise them in the right way and build on really

good schemes, such as the Sustainable Catchment Management Programme (SCaMP) in the North West and one down your way in Devon, where water companies work with farmers to get them to farm in a certain way so that water companies do not have to spend millions of pounds on concrete and steel to strip nitrates and pesticides out of water, or whatever it is. So there's lots of really good work is happening now and we have to make sure that we're pushing forward. I want to take a positive view about the Water Framework Directive, rather than see it as something that we just have to do or we face infraction charges. There is plenty of good reason to push forward with it.

Q223 Neil Parish: You make the interesting point that rivers could well drop by 50% during the summer in 30 years' time. Surely the Government cannot necessarily be held responsible for that under judicial review, or can they?

Richard Benyon: You would think so. That is a long-term climate change issue, and we've got to adapt. One of the most interesting aspects of my job at this particular time is not just looking at a reformed water industry and a reformed regulatory world but also seeing how it all fits in so we can adapt to climate change, make sure that the natural environment is at the heart of whatever the Government are up to and what they do right across the piece. That abstraction, which is a major issue, could be a driver for real benefits if we can get some form of pricing in—something that Cave looked at. I think this offers potential for the future. These are the areas of thinking we want to tease out in the White Paper, and I think it is an exciting time to be looking at that.

Q224 Neil Parish: A final question: what discussions are you having with the EU Commission on the implementation of the Water Framework Directive?

Richard Benyon: We have quite a few discussions. Letters wing their way across the channel, but we have given it assurances that we are addressing its concerns. We want to make sure it understands that we are complying, not just because we are told to but because we want to.

Q225 Neil Parish: A lot of countries do not.

Richard Benyon: We want to make sure there is an equality of stick as well as carrot, and that other countries are viewed in the same way as we are. If people have evidence, we are very happy to provide them with it, but we want to work in partnership with the Commission and make sure that it understands that we are on the side of the angels here.

Q226 Thomas Docherty: Following on in slightly less diplomatic terms, do you feel that you still face the possibility of legal action over the implementation of the Directive?

Richard Benyon: If you are referring to the judicial review, I should probably be careful what I say about it because it is not, as I think was said to you, suspended; we are in negotiations with the two parties that have brought this action. I hope we can satisfy them that we want to work with them. I have had really good meetings with both the Angling Trust and

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the WWF. I hope that that can be resolved. We may be referring to possible infraction charges. I am confident that we will avoid such a thing because we are implementing the Nitrates Directive. Certain parts of the United Kingdom, such as Northern Ireland, are totally nitrate-vulnerable zones. I suspect that in the great scheme of things that is the end view that some people will have for England, but at the moment we want to make sure that we are delivering on water quality and at the same time assisting farmers in achieving that. There are plenty of grant schemes that we have protected through the CSR process. RDPE money can go a long way to supporting farmers in remaining competitive through the above-ground storage of slurry and also through leader funding, which is another way to help farmers to help us achieve the targets we have been set. I am confident that we are moving in the right direction on this.

Q227 Thomas Docherty: When you were working through the budget cuts, did you make a specific assessment of the threat of legal action with regard to the decisions you were making in some of these areas?

Richard Benyon: To an extent that is the world in which we live. I do not budget through a four-year period to face fines and to pay them. Perhaps that is the way some countries operate; we don't. We want to be a Government who prove their green credentials by what they do and how they incentivise farmers and other land users in what they do. I am not in the business of predicting that we will face infraction charges. Another directive that could come our way—but I get the impression that the better regulation penny is dropping in the Commission a little bit—is the soils directive, which could be a huge burden on us here. I hope that we push back on that. The Secretary of State has been very clear in her determination in her discussions on this with the Commission. I do not predict that we will face fines; we certainly have not budgeted for them, and we are striving to avoid them.

Q228 Thomas Docherty: Have you built in a financial contingency to challenge any legal actions that may arise?

Richard Benyon: There is a contingency element in the budget, but it was not specifically directed towards that. I suspect that our legal department faces various challenges in certain ways, but I did not see any particular line in the budget that predicted that. I do not know whether my colleague has any information.

Sonia Phippard: No. There is an active case under the Urban Waste Water Treatment Directive that we are fighting and we have budgeted to continue to fight that. That will still be running as we go into the new spending review period. Legal costs are part of the Department's administration budget. Like all Departments, we face a 33% cut in that budget but within it obviously we need to make responsible allocations for legal costs.

Q229 Thomas Docherty: To clarify, you have taken a 33% cut in your administration budget. I am trying to tease out of you whether there has been a corresponding cut in either your legal defence budget

or your contingency funds in case it goes horribly wrong and you lose the case.

Sonia Phippard: The answer is that we are still working through precisely and in detail exactly how we manage, because all Departments face that 33% reduction.

Q230 Chair: To be fair, the previous Government ran up enormous fines in the way they introduced the Rural Payments Agency, so it is not necessarily a line of inquiry we need to pursue here.

Richard Benyon: If I may correct something, when I said a letter had been received, it was about the Urban Waste Water Directive. I confused that with the Water Framework Directive.

Q231 Chair: On the Urban Waste Water Directive, I had a briefing from the water unit last year. Are we being singled out for special attention by the Commission as regards urban waste water because our planning regulations are slightly different from the rest of Europe? Is that your impression?

Sonia Phippard: I do not think so. We know that others have had challenges under the Urban Waste Water Treatment Directive. I think capital cities tend to attract the attention of the Commission. London is a very large capital city, so the fact that that is one of the two grounds makes us look a bit singular, but on the other hand, we know that the solution in London is such a big one that we have taken a long time to get here.

Q232 Chair: I was thinking particularly of business parks. Are they singling out business parks and some farm treatments, or not?

Richard Benyon: Can I make inquiries on that?

Sonia Phippard: I think the answer is no.

Chair: We will ask for a briefing, if we manage to meet the whole team when we are in Brussels.

Q233 Richard Drax: Perhaps I may take us back to Mr Parish's point about river levels falling and lack of water. Wessex Water told me a while ago that we lose about 96% or 97% of all the water that falls on this country and hence we have hosepipe bans. What plans are there, bearing in mind we face climate change—if indeed that is true—and a shortage of water, to increase the building of dams in planning for the future, because (a) they are expensive and (b) highly controversial? These are big budget items.

Richard Benyon: What I hope we can achieve through reform of the industry is a system that would encourage, in areas where we are short of water—the South-East and East Anglia—the movement of water from one area to another down a pipe. We do not have a grid in this country, but we can get to something that approaches the start of a grid if we incentivise water companies to invest in the right way. That is where I hope we can get to over a period.

In terms of Thames Water, we have a major decision to take, not far from my constituency, about a big reservoir. We are looking at that. Thames Water is coming up with a proposal on that in the near future, but we have to recognise that there are parts of this country that face severe water shortages. I talked to

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Martin Cave about this yesterday. He is doing some work in Australia, which is obviously a very different place with very different circumstances. They get water rage there. Householders who break local byelaws are attacked by others. I think we are a long way from that in this country, but we have to recognise that in the South-East and in East Anglia, unless we take strategic decisions that facilitate solutions down the line, we will face severe problems in terms of the economic development of those areas at the very least, let alone the housing needs and the needs of the existing population. In the North-West, where we suffered severe drought this year, the water comes predominantly from reservoirs and dams, which are expensive to maintain. Many of them were constructed in Victorian times. In your area and mine and further east, it is groundwater that we need to preserve, but perhaps we need to look at different options in that approach as well.

Q234 Chair: Minister, in reply to an earlier question you mentioned the RDPE. Which UK body will deliver on that for its duration?

Richard Benyon: There is a lot of work going on at the moment. The local economic partnerships are one possibility, and there are others as well.

Q235 Chair: Do you accept there is a lacuna at the moment until such time as the Local Enterprise Partnerships (LEPs) are set up?

Richard Benyon: Absolutely. The LEADER funding, for example, is delivered quite effectively in certain areas by organisations such as AONBs (Areas of Outstanding Natural Beauty), but RDPE money is more specific. I think the LEPs offer the best alternative—

Chair: Order, order.

Richard Benyon: We need to not just say that; we need to provide some further detail of how we are structuring that.

Q236 Chair: In the interim, to whom would people apply?

Richard Benyon: We think that when the regional arrangement finishes there will be an interim period during which it will be delivered centrally, but the idea is that LEPs and other organisations will be the best vehicle forward after that.

Q237 George Eustice: I wonder whether you can say a little more about the efficient use of water. Water UK said it was our most precious resource but also one of the most undervalued. The Walker review concluded that we should perhaps put much greater value on the efficient use of water than we do at the moment. Do you think that the remit of Ofwat should be changed so there is greater emphasis on the efficient use of water?

Richard Benyon: This will be teased out in the Ofwat review and the Water White Paper and in consultations that are happening or will happen. I am really pleased that we have aspects of water use included in the green deal; this is really important. The element of people's water use that is connected to hot water in the home can now be included in the

green deal. It is £6,500 of investment per home, and I think it is really important. But at the upstream end as well we need to value water—I don't just mean value it, I mean really value it—and there are various vehicles for doing it. One is the Cave review, which looked at a market for abstraction, and we will look at that. Then there is the work of TEEB—The Economics of Ecosystems and Biodiversity—which was central to Nagoya last week. It says that once you know exactly what an ecosystem service really is worth, you can start to use it as an economic tool, in terms of conservation credits or a variety of other different mechanisms to improve the sustainability of a resource. This is a fascinating and really difficult area to get right and that is why it needs an intellectual and properly-resourced piece of work such as a White Paper can deliver. I hope that in about a year's time, or hopefully by June, as we develop it into a legislative framework you will see that the huge amount of thinking that has gone on through Cave, Walker and the White Paper develops into something that really works.

Q238 George Eustice: Are you looking at a price-setting mechanism?

Richard Benyon: Plenty of people have advised us that water is too cheap. If you come from the South-West you may well disagree. You and your colleagues have let me off lightly so far. The fact is that when we talk about use of water we refer not only to households but to businesses. I think we could put a bit of competition into the mix. At the moment, I believe the threshold is 50 megalitres. Only one or two businesses have managed to negotiate a price. If we drop the threshold to 5 megalitres, or even zero as Cave recommended, we could start to get real drivers of competition, which could start meaning, certainly for the business use of water, that we would provide a value and a response from companies, which will be a good thing for our economy.

Q239 George Eustice: Do you think that is a better way than water efficiency targets on companies? Waterwise has suggested a per capita target for water use.

Richard Benyon: We have a system where water companies are regulated on their water efficiency—leaks and other things—through Ofwat. In our review of Ofwat, I am quite open that we should create incentives so that water companies do not just say to Ofwat, "We think we can cut our leakage by so much," and Ofwat says, "No, we want a bit more," and then they settle for halfway between. It is an old-fashioned relationship. That will continue to an extent, but if we have a driver in there that means that the water company is incentivised commercially to deal with leaks, you can be much more successful. I am concerned with outcomes, and that is how you construct a modern water industry for the future.

Q240 Chair: How will we achieve that?

Richard Benyon: Through competition, and the recommendations of Cave. Do you mean the lowering of the threshold?

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Q241 Chair: How will we achieve the competition and the level of investment to which you have just referred?

Richard Benyon: One of the things most frequently said to me is: don't spook the investor. The investor really likes the water industry; it is a good investment for pension funds and the like because they know where it is; it deals with a product people understand and value; and it has a five-year pricing cycle. That investment has been hugely valuable; £80 billion has been invested in the past 20 years. I do not want to do anything that spooks that, but I think we can continue with that but also have a new relationship between the water companies and the regulator and between the water companies and the customer. I think competition can be a real driver here. That is not just me saying that, that's Cave. We really want to push on with this, but it needs a lot more thought and that is why we are producing a water White Paper.

Q242 Chair: Do you think there are lessons to be learnt from the Scottish model? Is the Scottish model of competition working?

Richard Benyon: Was it Tesco that saved £1 million on its water bills by being able to operate in that kind of commercial framework in Scotland? So yes, there are. Scotland is different in so many ways. It has just one water company.

Q243 Chair: But it is publicly owned as well.

Richard Benyon: Yes, it is publicly owned.

Q244 Dan Rogerson: Let me ask about efficiencies and incentives—perverse incentives, at times. If we are looking at efficiencies in energy, for example, and the gains that can be made there, do you think enough is being done to bring together what the energy industry has to do with what the water industry is having to do? Have you spoken to colleagues in the Department of Energy and Climate Change (DECC) about that?

Richard Benyon: Yes, in the process of getting the green deal sorted out, absolutely. We are conscious that it is not just about dealing with it on a macro level and a water company level. You also have to look at responsibility at the user end. Anna Walker's recommendations on metering are particularly interesting. We are looking at the Southern Water experience and what it is doing, in terms of not quite universal metering but something not far from it, and seeing its impact. Knowledge is power to a householder, and that is where smart metering comes in, which is perhaps the next stage. People, particularly those on lower incomes, can start saying, "Hang on; I can save a few quid here if I just change my behaviour in a small way." Where we do not have smart metering, or any metering, we can still drive efficiency at community level by making people more aware of water, not in a preachy or Big Brother way but perhaps in a Big Society way, which is just about encouraging people to be more responsible through tweaks in their behaviour, nudging them in the right direction. I think there is a lot of potential here to make people more conscious of the water they use.

Q245 Dan Rogerson: The Chartered Institution of Water and Environmental Management has said that at the moment, if both energy and water companies wanted to take the credit for having invested in a device, it would count as double-counting in terms of the credits, and so it is not allowed, but that disinclines them to work together on those sorts of projects. Do you think there is scope for change there?

Richard Benyon: Yes. It is crucial that we work closely with DECC on these kinds of issues, and we do. I do not know whether there are any specific areas about which we can inform the Committee.

Sonia Phippard: No, except to assure you that the work we are doing in the Ofwat review is being done very much in partnership with DECC, who are doing a similar exercise with Ofgem, to make sure we do not make recommendations that are incompatible. The Minister has referred to the work on green deal; we are talking to them about their thoughts on metering. Where specific issues are raised by groups such as the chartered institution, we certainly look at those.

Q246 Richard Drax: Given the Government's keenness for policy matters to be decided by Ministers, should the role of Ofwat be more narrowly prescribed?

Richard Benyon: Ofwat has been in existence for 20 years and it is the right time to review it. We had a lot of response to consultation on our Ofwat review. I am not hedging my answer, Mr Drax, because it is absolutely the right question to ask and it is one that we are asking. I do not come into this role with the arrogance of knowledge on everything—far from it. It is an extremely wide and, at times, technical issue in its totality. That is one of the reasons why we want to make sure that the large numbers of organisations that interface and interact with Ofwat have an opportunity to contribute to this process. We are carrying forward the Ofwat review to coincide with the White Paper. I hope that we will have a regulator that is able to cope with the difficulties over the next 20 years. That is a really important challenge, because the climate change adaptation issues we have to face and the sustainability role that we want water companies to have require a regulator that is attuned to those issues. Twenty years ago, climate change adaptation was not an issue particularly spoken about.

Q247 George Eustice: Pre-tax profits across the industry rose quite significantly last year to £2.8 billion. Do you think that means there might be scope for a tougher pricing regime so you can get those bills down, or would that jeopardise investment?

Richard Benyon: We are at the start of a new price review, so these factors will be more relevant as we come towards the end of that period. We have to be careful about the language we use. I know that water company profits sometimes excite headlines in certain places, but we have to remember that a water company that is profitable is one that invests. We have a good regulatory regime. They do not allow huge proportions of that to go into the pockets of their shareholders; it is going into investment. I cannot remember the exact ratio of investment to profit, but it is a hugely impressive figure when you look over

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the past 20 years. I do not think I can comment on one particular year's figures, but we in Government, through all these review processes, are conscious that we want water companies to be profitable because we want them to continue to invest in the infrastructure they need and also deal with the ancient infrastructure they have inherited. In all of our constituencies we have streetscapes of Edwardian or Victorian buildings with sewers of that period interspersed with modern developments, infill developments and all kinds of other things that have too easily forgotten the burden they place on that infrastructure. We managed to get the water companies to invest enormous amounts of money in this infrastructure at no cost to the taxpayer, albeit at a cost to the householder. It is really important that we allow the level of investment that they have been able to give to continue.

Q248 George Eustice: Following up on that, given the importance of having that stable regulatory framework, do you have in mind a rough date when you might want to publish a Bill that clarifies exactly what you mean?

Richard Benyon: I am not sure I made myself particularly clear, but I touched on this in reply to a question that the Chair asked right at the beginning. We want to be in a position to have legislation that comes out of the White Paper and the Ofwat review in November 2012. Perhaps my colleague can help me out.

Sonia Phippard: We published our draft structural reform plan, which did indeed talk about legislation between November 2011 and November 2012. That was on the understanding that that was the date of the second Session. Since then, the Government have brought forward the Fixed-term Parliaments Bill and the intention to move the start of the second Session to spring 2012. Our expectation is that legislation, as necessary—it may or may not be necessary in the case of Ofwat—would probably be part of legislation in the second Session. But as the Minister told the Chair earlier, if there is an urgent case or a need to look at the possibility of first-Session legislation, we would of course accept that.

Q249 Chair: To be clear, presumably the Government cannot implement the conclusions of the Cave and Walker reviews without primary legislation. The Government have said that consistently.

Richard Benyon: There are some elements we can do without primary legislation, but there are some that will require it.

Sonia Phippard: Most of Cave's recommendations do require primary legislation. The Walker review has a much wider range of issues, some of which can be brought in without primary legislation. Some—for example, if the Government wished to move towards a requirement for universal metering—would need primary legislation.

Q250 Thomas Docherty: To finish off the point about the Ofwat review that you announced in late August, can you indicate to us what you think is a reasonable estimate of the time that the review itself will take? Given that there is a knock-on for the price

review of 2014 and the publication of the White Paper, how will that fit in?

Sonia Phippard: The consultation period is just closing, so the review team is even now reading the copious inputs it has received. Our expectation is that the work of the review basically will be completed by Easter next year so that conclusions can feed into the White Paper in June.

Q251 Thomas Docherty: Finally, taking that into account, how do you ensure that the impact on customers' interests will be minimised as you prepare for the price review in 2014? How does that dovetail together?

Richard Benyon: We think we can do this without interfering with the price review period. We have to be open about it. If we think there is a problem we will say so, but we feel we can do that.

Sonia Phippard: One of the things that the review is looking at is the consumer angle, including the role of the Consumer Council for Water. We would not want it to interfere with the customer interest, but the review may well make recommendations that are designed to strengthen the customer role in the price review. Obviously, it is important that we have those recommendations in good time.

Q252 Richard Drax: To return to Wessex Water, on pricing, it told me that the money it has to spend to do the work underground is a huge investment, because it has inherited old pipes, or whatever it may be. The majority of its water loss is through leaks, which cost a huge amount to repair. Do you have any idea of where we are across the country, in terms of getting our water network to a point where this vast investment will reduce, or is that impossible to judge?

Richard Benyon: I do not know. I know where we are on leaks and issues like that. To an extent, it is like the Forth rail bridge. When you do a big piece of work to replace pipe, it has a knock-on effect down the line on another old piece of infrastructure. Will we ever get to the point when we have done all that? Of course, Ofwat could say to water companies, "You've got to do that to the exclusion of all other aspects; forget affordability and sustainability—drive forward on leaks," but I suspect that we have the balance just about right. Some areas have reduced leakage by 50% over the past 20 years; some have done it by about 30%. As you say, it depends on the area and the infrastructure they inherited. I think we have to face facts. Perhaps this is something that water companies do not make enough of. They inherited years of under-investment and have set about a process of patch and mend. What that leaves in financial terms is a figure that I would quite like to have, and I would like to know whether it has been calculated by economists. It would inform how we treat water companies over the next decade or two.

Q253 Chair: Ofwat has said—it has issued us with a briefing on this matter—that in relation to private sewers, the funding has fallen outside the price review period currently in place. It has said that companies could recover the costs if they proved to be material before Ofwat is next due to set price limits. Ofwat is

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not clear whether the costs would be materially higher or materially lower, and it is just a case of what the implications will be for customer bills of the sale and transfer of private sewers. There is just this regulatory issue about whether or not water companies will be able to absorb the costs in the price review period. Sonia, would you like to clarify that?

Sonia Phippard: There have been some slightly confusing statements around this. My understanding is that Ofwat anticipates that some water companies at least will face additional costs as a result of the transfer of private sewers. It is perfectly ready, and has issued guidance to the water companies, to accept and consider requests for interim determinations. It has said that it wants the water companies to collect clear evidence of those costs before they come in and make those requests, which we as consumers would all think was fair, but it anticipates that between now and the next price review it will get, from a number of water companies, requests for interim determinations to cover the costs as the evidence becomes clear.

Q254 Chair: As far as the Department is concerned, they will be able to raise the money to pay for the costs, outwith the price review, from the user.

Sonia Phippard: Yes.

Q255 Chair: But you are no more able than they are to say what the individual cost to water customers will be.

Sonia Phippard: No. We talked earlier about some of the uncertainties of the costs around private sewers. This is the other end of the equation, as it were. Until the water companies take on the responsibilities and have the opportunity really to understand what needs to be done, it is quite hard to estimate the cost that will fall to them and the timetable for that because, on a much smaller scale, it is rather similar to what they discovered at privatisation in the first place.

Q256 Neil Parish: Turning to charges and metering, one of Walker's findings was that currently there are very high levels of bad debt, which penalises those who pay their bills by about £12 a year. She went on to conclude that the current charging system "is creaking at the seams." Do you agree, Minister?

Richard Benyon: Yes, I do. I think she came up with a very important point. She identifies the "can't pay", those who are genuinely impoverished, and the "won't pay" and the "should pay". They are the people who are being subsidised by all our hard-working constituents. We do not have the ability to cut off supply in this country. At the moment I do not have a view on whether we can identify an accurate way of distinguishing between those two groups and of allowing water companies a greater ability to deal with them, but Walker did say that bad debt needed to be sorted out. That is another reason why we are including that as part of the remit of the White Paper. Are there any other aspects?

Sonia Phippard: That is the principal thing. She also recommended looking at the tenanted sector, which we are doing. We are working with the water sector on the most effective ways to take forward that set of

recommendations in a way that does not impose absurdly high, or disproportionately high, costs on landlords who have a very good record.

Richard Benyon: The recommendation about named individuals is also very important, because a large proportion of the bad debt comes from people who have moved. They just disappear and it is very expensive for water companies to track them down, but it would be easier to do that with a named individual rather than somebody who was just the householder.

Q257 Neil Parish: You have answered part of my next question. You talked about metering just now; under what circumstances should water companies be mandated to require all customers to move to metered supply, and should those meters be intelligent meters in all cases?

Richard Benyon: Anna Walker is very clear that we should not go towards universal metering. You can't go to universal metering because there are blocks of flats and it is incredibly complicated. I am really interested, as I have said, in what Southern Water is doing. It thinks that it will reach 88% in a few years' time, and it will be interesting to see how much further it can get. It is doing interesting work on transition charging and transitional tariffs, where people will end up paying more. It seemed to me, from outside this job, that metering was the obvious way forward, and that we should all be on meters. It is not as easy as that. As you get more and more people on meters, those who pay their water bills roughly speaking on the size of their property and the way it is rated become fewer and fewer, and it becomes much more expensive. That in itself is an incentive for them to be metered, but we are building up a huge cost burden for those who can't and that area of the pricing and affordability concerns that Anna Walker raised needs sorting out. Some will face rises of 20% for water in a fairly short space of time.

Q258 Neil Parish: And smart meters?

Richard Benyon: As I said, I really like smart meters as a concept because it empowers people to make decisions. Until it broke, I had a smart electricity meter at my house. You could see the impact on electricity usage of switching on a kettle. We are moving to a digital age where, from your laptop, you will be able to assess all your utilities almost in real time. Water is quite far behind in this; it is more complicated and difficult, but to provide households with the information to control the amount of water they use is a fantastic tool for any family, but particularly those families on low incomes, so they can use less of a commodity they pay for.

Q259 Thomas Docherty: My understanding is that Walker also urged Ofwat to be more proactive on behalf of customers. What is your response to that recommendation?

Richard Benyon: One of the things we are looking at is where Ofwat starts and finishes and where CCW starts and finishes and making sure that that relationship is right. I hope that through this whole process we can see a new relationship forming

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between the water companies and their customers. That is a rather sweeping statement. What do I mean by it? I am thinking more of Cave than Walker here. If you follow Cave's recommendations and change the whole structure of the water industry so you have a company that does nothing but interface with the customer, all of us as MPs have had experiences of water companies. My mail bag of complaints about the water company in my area is now very low, but it was not always like that. I think that from time to time some water companies have failed in that relationship with the customer. Cave's very clear recommendations are that he wants to see a separation between those who interface with the customer and deal with bill charging and those who build and maintain pipes and do large-scale engineering works. He says they are two very different disciplines and they should be separated, as in Scotland. I think this offers real potential for a completely new relationship where the customer is much more in the driving seat and is offered choice.

Q260 Thomas Docherty: Coming back to Richard's earlier point about the Government's desire to be much more responsible for policy, I imagine that the Government would not be particularly enamoured with Ofwat taking on the role of customer champion because that is the role of the Government. Is that fair?

Richard Benyon: I do not mind the Government being challenged by a customer champion. There are plenty of them. They come into meetings at Defra and tell me what is going wrong in various industries. I do not mind that at all and I do not want to lose it. I do not think that should be transferred into the building. The customer would lose out in accountability terms. I want to make sure that we keep that independence of organisations. I do not call that policy, Mr Docherty, but I may be missing something. I think Government and the industry should be challenged by a strong, independent customer protector and, through this process, I want to make sure we have an enhanced one.

Q261 Dan Rogerson: You acknowledged the problem in areas such as the South-West, just to pick one at random, where there is high penetration of metering and a lot of people have already made that shift because there is a big incentive to do so. There are people who cannot make that shift and you acknowledge that is a problem. Is there a response to that? As you said, those costs are being loaded on to those people. Is this something the Department are looking at, along with Ofwat, to find solutions to it?

Richard Benyon: Yes. I am not running away from the issue by saying that is a matter of major consideration in the White Paper, but it is. I do not have a silver bullet for that one, but it is something we have to address, because you will have two-tier water customers; we have them now. We have the disparity in regions, which Anna Walker identified and Ofwat is now looking at, and we need to find a solution. For these issues we do not have a silver bullet, but we hope that by thinking it through, consulting properly and coming forward with a

serious piece of work that asks these questions, we can find solutions to most of them.

Q262 Amber Rudd: Minister, CCWater told us that customers would take only a few pounds on top of their bills to help with a social tariff to try to make sure that everybody can pay. What is your view of social tariffs and what customers can take in order to provide for others?

Richard Benyon: There is a philosophical point here. We have to ask: how much do we expect a water company to act as an arm of a Government's welfare programme? I think there is a requirement on water companies to do that, but what I need to work out is the extent to which we require that to happen. Mechanisms exist, WaterSure for one; it is quite specific and maybe that can be extended through social tariffs. A lot of work is taking place in Anglia, Southern Water and many other water companies, who want this role because it helps them with Mr Parish's point about bad debt. I hope they want to do it because they are decent and corporately responsible bodies, but we have to make sure social tariffs, if that is what emerges, are fair and are able to reach the people they are supposed to, and that the mechanisms for delivering them are simple, because if it is a complicated system to deliver, it is less likely to work. It must be a simple pricing mechanism.

Q263 Amber Rudd: On the point about getting to the right people, should there be some sort of provision within local or central Government for the water companies to find those people?

Richard Benyon: There is now. It is not a particularly good one; it is that water bills are more than 3% of gross household income. That is a very blunt measurement that does not catch everyone in severe debt and catches some people who are not, but that is what we have and we shall look at amending it if we have to.

Q264 Amber Rudd: To return to the points we discussed earlier following Mr Parish's questions about bad debt provision, I understand there is provision coming forward for landlords to take responsibility for tenants who might have disappeared, as you put it. Do you think that will go forward, and is it a positive step?

Richard Benyon: I think that is another area we will work through in the White Paper.

Q265 Chair: It is now in the Act, so it is a matter of the extent to which it can be implemented.

Sonia Phippard: We are looking at the practicalities of implementation, in particular how we can implement it in a way so that the cost to the landlord is as light as it reasonably can be. We are doing some further work on that with the water companies.

Q266 Chair: I believe Thames Water in particular has said that water companies should have the power to pursue bad debt through the courts. Is that a step too far, or do you support that?

Richard Benyon: I would not be averse to them having that power. Anna Walker talked to Citizens

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Advice about this, and I do, too. I think it is really important. Organisations like Citizens Advice deal with debt problems by setting out the totality of debt and making arrangements with utilities and others about how to address it. We have to make sure that the water element of the debt is integral to that. Bad debt as a percentage of the total debt of individuals, whatever category they are in, is, I suspect, quite low, but that is not to say it is unimportant; it is still a massive figure, particularly for water companies and the rest of us, who have to bear the burden of bad debt. It is not a problem we are ducking and it is one for which we shall find a solution.

Q267 Chair: The evidence we received showed that bad debt was a sizeable chunk and caused real concern to water companies.

Richard Benyon: For water companies, yes. I was thinking in terms of a household in bad debt.

Q268 Chair: But it is the “can pay, won’t pay” category which exercises us particularly. For example, energy companies have a contract with the customer, whereas water companies have a contract to supply but no corresponding responsibility. Water companies cannot cut off water supply.

Richard Benyon: Energy companies can.

Q269 Chair: I do not know whether, at the moment, they have even the legal right to have a trickle flow. Is that something you will look at in the White Paper?

Richard Benyon: Yes.

Q270 Dan Rogerson: To turn to the South-West, as you have quite rightly foreshadowed, we are obviously interested in your response to those issues, in particular the case studies in the Walker review. Anna Walker set out a number of options and the previous Government instructed Ofwat to go away and look at them. Are you open to all the options that are in the report?

Richard Benyon: To an extent it would be wrong for me to prejudge Ofwat’s work, which is imminent, and how we take that forward. Let’s look at them. Anna Walker talked first about a one-off payment from Government, or an annual payment from Government, to the South-West. Realistically, in the current climate, without wanting to prejudge the report, I think we know where we stand on that, because we are all intelligent people. The other one is a transfer from water companies to the South-West and also some rebalancing arrangement within the region. I know MPs from the South-West have met with Regina Finn. I am very willing to meet MPs from the South-West at any stage as we develop our thinking following the work that Ofwat is doing. I do not want people to think that there is a date at which we in Government will make a single decision that will either satisfy or not satisfy people in the South-West. I see us bringing forward a range of possibilities. I suspect, but I am guessing, that I will not keep everybody happy, but I might be able to help people to some degree. I am particularly minded of the impact of bills in the South-West on those on lowest incomes. Mr Rogerson, your constituents in the South-West are paying on average

£100 more a year than people in the rest of the country. That is an issue, particularly for those on lower incomes.

Q271 Dan Rogerson: That is the average, and for some it is much higher.

Richard Benyon: On average, yes.

Q272 George Eustice: We had a presentation by Ofwat. One of the things that its analysis showed was that the annual corrective adjustment would cost water bill payers elsewhere in the country around £40 million a year, whereas changing to a whole new national social tariff would cost £100 million and so that would be a significantly more expensive option. Is the total cost of dealing with this issue something that will be weighed in the balance?

Richard Benyon: There are issues here above my pay grade that relate to the way the Treasury views transfers of money around the country. That is not to say I am shy of pushing in those directions and raising issues with the Treasury or anyone else, but everything has implications. What I want to hear from people who look at this and certainly colleagues from the South-West is: where are we on the possibility of a social tariff that would take money from somebody in Newcastle who may be on benefits to pay a water charge payer in the South-West who may be a millionaire? That is an issue that I need to sort out before we start to talk about single banded amounts being transferred around the country.

Q273 Neil Parish: But there is also the issue that in the South-West we have 3% of the population and 30% of the beaches, and that is why we have this much higher rate. There are some well-off people, but there are an awful lot of people who are just making ends meet. If I may play back one of your comments, you said that nationally water may be too cheap.

Richard Benyon: I did not say I said that; I said people say that to me.

Q274 Neil Parish: You have clarified that. But seriously, rather than talk about £40 million, I think about £1.70 per bill payer across the whole country would reduce bills in the South-West by about £65. We are interested not only in a social tariff but also in the fact that there are a lot of retired people in the South-West who do not have big incomes and who have to subsidise the beaches in the west country. We do not expect an answer today, but please do not close your mind to it.

Richard Benyon: Mr Parish, I can assure you that my mind is not closed to it, and it is an issue that is thrown up to me in one form or another not every day, but almost every day. As I said in an Adjournment debate in Parliament earlier this year, I recognise that there is a determination and urgency about this. We are looking at a number of options and I am very happy to discuss them with you. I think we had better wait until the Ofwat work on this comes out, which I hope will be in the next two weeks or so.

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Q275 Neil Parish: We talked to George Osborne a little bit about whether we could find a way round the Treasury's objections to it.

Richard Benyon: I am, too.

Q276 Dan Rogerson: In terms of the example of a person on benefits in Newcastle, which I appreciate was an extreme one, I would point out that average incomes in my constituency are lower than in Newcastle; they are probably the lowest in the country. I just leave that with you. It is a convergence area under the EU. I think that is an important point to make. I know you do not say it, but sometimes the argument outside is characterised as, "The South-West is a very wealthy area," but there are these poor urban areas.

Richard Benyon: I was straying into the realms of philosophy again, which is probably a great mistake to make in these circumstances.

Q277 Dan Rogerson: But do you accept that any solution that merely shunts who pays what bill around within the South West Water area, as it is at the moment, does not address the issues raised in the report?

Richard Benyon: I recognise that a solution that remains within the South-West certainly would not satisfy you and your colleagues in the South-West. Whether I can find something that would remain to be seen, but I understand that you want some kind of transfer across the country. Whether or not we can deliver that remains to be seen.

Q278 George Eustice: We took evidence from the Consumer Council for Water. It was quite clear that if there was a will to do this, it would be possible to set criteria that would ensure you did not set a precedent for Thames Water, for instance, and its infrastructure. Are you also involving the Consumer Council for Water in your discussions on this?

Richard Benyon: Very much so. Governments are wary about creating precedent and I can understand why. What has happened in the South-West over the past 20 years is a product of a mistake and also a product of geography, but other factors will come into it. We talked, seemingly hours ago, about the Urban Waste Water Directive and the impacts it will have on charge payers in London and the Thames region, and there will be other burdens in other parts of the country. I am nervous about funding zooming in all directions around the country because precedent is created, but I know exactly your point.

George Eustice: Its proposal was that, for instance, you could look at the variance of average water bills in one region against the national average, so that in the South-West, where they are substantially higher, there would be a case. In the case of Thames where those costs are absorbed among millions of people and the average increase in bills might be miniscule there would not be a case. Provided you got those parameters right it was doable.

Neil Parish: In terms of the South West Water area payers, if you look at the national average on income, Devon and Cornwall are lower.

Q279 Chair: The Minister will go away and think about it. Minister, have you considered what other European countries do? I know that normally that is anathema but, if we look at a lot of the new environmental principles we have to apply, Denmark and France impose an environmental tax or levy. Are there approaches like that? I know Anna Walker has considered this. Have the Government kept an open mind on that?

Richard Benyon: This is an area we are looking at through the Natural Environment White Paper. We are conscious of that. Even though that is relevant just to England, it has a UK and European context, and it would be wrong for us to go through that process without looking at how they manage the natural environment in other parts of Europe. We've got to fulfil our national responsibilities, particularly under the agreement achieved in Nagoya, so we are looking internationally as well as nationally.

Q280 Chair: Turning for a moment to the competition aspects, the previous Government identified three findings: legal separation of large water companies' retail operations, to which you referred earlier; the further package of reforms to the upstream water supply licensing regime; and further reform of the merger regime. Do you believe that Ofwat has done everything to make sure we are exploiting the current competition available to develop within the existing legislative framework?

Richard Benyon: I think it has been looked at fairly rigorously. That is not to say there cannot be improvements. I will ask Sonia to help me here.

Sonia Phippard: I think the area where we are most seriously still exploring that is probably the upstream and abstraction issues. Both the Environment Agency and Ofwat have regimes that maybe they could push a bit further. That does not rule out more radical reform, but we are certainly exploring with them whether there is more scope in the existing regimes.

Q281 Chair: Minister, you referred to the idea of putting some real value on abstraction. What are the next steps to introducing such an abstraction regime?

Richard Benyon: I hate to keep coming back to it, but the next steps are the Water White Paper, and also the Natural Environment White Paper, which seeks to put the value of nature and its resources at the heart of Government and how we account in our national accounts for the natural environment. So it is a two-pronged approach, but the specifics that Cave talked about in terms of the value of abstractions is a technical area. I talked about not wanting to spook the investor, and I think we have to be very careful here. I do not want to jump the gun by saying something on which we need to do a lot more work.

Q282 Chair: Obviously, you will be mindful of the competing needs of the various interested parties and those with existing abstraction rights. I presume that they are mostly water companies, but it is also of great concern to farmers and landowners.

Richard Benyon: Absolutely. I do not want to impose a cost where we need not have one, but at the same

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time this could be a huge driver towards better use of water as a resource.

Q283 Chair: Minister, on behalf of the Committee I thank you and Sonia for being with us this afternoon.

I thank the Committee for staying back and you for being so fulsome in your replies. I hope you'll look forward to the fruits of our hard work in the production of our report.

Richard Benyon: I certainly will. Thank you, Chair.

Written evidence submitted by OFWAT

INTRODUCTION

1. Ofwat (the Water Services Regulation Authority) is the economic regulator of the water and sewerage sectors in England and Wales. The industry comprises 22 regional and local monopoly companies and five new entrants (new appointments). Ofwat has been in existence since 1989. It became a corporate body with a Board structure on 1 April 2006.

2. Our main duties are to:

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

We are also required to contribute to the achievement of sustainable development.

3. Since privatisation, our regulation of the sectors has helped to deliver a number of successes. Leakage has been reduced by one-third, drinking and bathing water quality has been improved and £90 billion has been invested in infrastructure. We have challenged the companies we regulate to become more efficient, delivering bills that are £110 lower than they would otherwise have been.

4. However, the sectors now face a new set of challenges, including:

- climate change;
- population growth;
- increasing environmental regulation; and
- affordability concerns coupled with rising consumer expectations.

5. We welcome the work already undertaken by the Pitt, Cave and Walker reviews.

EXECUTIVE SUMMARY

6. Regulation of the water and sewerage sectors has been very successful over the past 21 years. But the sectors in England and Wales face new and significant challenges including climate change, population growth and affordability. So the time is right to review the regulatory framework and ask how it can contribute to meeting those challenges.

7. This submission explores briefly some of the issues that Ministers may wish to consider as they seek to address these challenges in the Water White Paper and any future legislation. We have structured our submission into the following broad themes.

- Environmental.
- Social.
- Economic.

8. At the heart of our submission is the need to value water. This will help drive better investment decisions, sustainable management of water resources and efficient use of water. For example where companies understand the value of water they will be incentivised to share or trade water where that is efficient, instead of unsustainably abstracting more water from the environment. They will also be able to make better decisions about managing demand and leakage compared to building new supplies such as reservoirs.

9. Decisions on environmental improvements need to be more transparent. Consumers should understand what they are being asked to pay for through their water bills. Sustainable outcomes will only be possible if accountability for environmental damage lies with those responsible for that damage. Tools like the “polluter pays” principle can help.

10. Customers are central to the success of the sectors. The sectors, including the regulator, must have legitimacy in their eyes. So we need to continue to improve customers' understanding of and engagement in how we set price limits on their behalf. Customers must also see that they are treated fairly and supported when they cannot pay their bills. Changes that directly affect customers—for example the roll out of metering—must have clear policy goals set out.

11. We also need to develop innovative ways of regulating that build on customer engagement. That includes targeting our regulation on those areas customers consider most important. We could also take a more risk based approach to data gathering to reduce the regulatory burden. This would include continuing to safeguard services to customers by effective action on their behalf where there are failures. Because we are already planning for the next price control period, any changes to regulation need to be made as soon as possible to allow them to become established.

ENVIRONMENTAL OUTCOMES

12. We need a holistic approach to environmental policy that emphasises water. It is a crucial part of the natural environment, our economic prosperity and way of life and we must value it properly.

13. This means considering the effect of removing water from the environment, the carbon impacts of providing clean supplies and disposing of used water and the impact on customers' bills.

14. Such an approach will help to, but will not on its own, reveal the true value of water to the environment and society. Revealing that true value would drive more sustainable investment choices by companies, more sustainable decisions on the location of water intensive industries, and more sustainable behaviour by consumers of water.

15. The recent drought in the north west highlighted problems that arise when water becomes scarce—either at a point in time as in this case, or over time as in the south east. While a national water grid would be unfeasible and very expensive, an understanding of the value of water would encourage companies to share resources in more effective ways. This might allow other investment to increase supply to be deferred—delivering both cost benefits and benefits to the environment

16. Water customers have, to date, borne most of the costs associated with the Water Framework Directive and other environmental regulation. It is important that environmental improvements are paid for fairly and all responsible parties bear their share of the costs. This is particularly important where customers are already struggling in the current economic climate to pay their bills. Costs must include the carbon impact of implementation.

17. A particular concern is how to encourage less pollution and damage to our water resource in the first place. Under the current arrangements there is no incentive on those responsible for causing pollution to consider alternative options. This is unfair on water customers who have to pay for expensive, carbon intensive treatment processes. The polluter pays principle, as promoted in the Water Framework Directive, has an important role in addressing this. It gives the right signals to stop polluters from polluting. But this must be backed by strong regulation to deter those willing to flout the rules.

18. Climate change means we will need to adapt to the increased risk of weather volatility, such as more frequent flooding. We are currently reviewing the regulation of drainage infrastructure to ensure that it is fit to meet the challenges of the future. We will be happy to share the findings of this review with the Committee.

19. There is an opportunity for the Natural Environment White Paper to set these issues in a wider context and to emphasise the value of water to the environment. We will share our response to the Government's current consultation with the Committee.

SOCIAL OUTCOMES

20. Consumers are at the heart of our regulatory regime. They are entitled to good quality services at a fair price. Therefore, it is essential that consumer representation is strong and effective within the price review process. We need to continue to improve that representation, engagement and understanding, which can only be beneficial for the consumer.

21. Effective engagement will ensure that customers, who have no choice in the supplier of their water service, are confident that they are getting a fair deal. This is essential if the sector, including its regulatory regime, is to have legitimacy in customers' eyes.

22. The Walker review made a number of important recommendations. It identified affordability as a growing problem, particularly in the south west whose customers face the highest bills. Bad debt is rising, adding £12 to each customer's bill. It is important that a clear framework is established to assist those unable to pay their bills.

23. Ministers asked us to look at a number of options to help customers in the south west to help inform their choices on social policy issues. We would be happy to share our initial findings with the Committee.

24. The Walker review also looked at metering. It concluded that metering is the fairest method of charging. But consideration needs to be given to the pace and impact of switching to metered charges. Failure to consider the impacts can lead to affordability concerns for vulnerable customers.

25. It is important that, while the review of the welfare system is under way, affordability concerns within the sectors are given due attention.

ECONOMIC OUTCOMES

26. The regulatory framework has worked well so far. We now have an opportunity to examine what parts of the system remain fit for purpose and which need to be changed. We are currently carrying out a review of how we regulate, and how the regulatory burden can be reduced by taking a more targeted, risk-based approach. We will share our preliminary findings with the Committee.

27. Greater customer engagement and closer integration of the customer voice in the regulatory process will greatly assist this move towards risk-based regulation.

28. Focusing more on risks within the sectors will allow us to collect less information. Instead, we can concentrate on the material issues of concern, and particularly how they impact on customers.

29. If the recommendations of the Cave review are followed and market forces are introduced into the sectors the regulatory framework will, necessarily, change. Overall, the impact of these changes will be deregulatory.

30. Although we have just begun a price control period (2010–15) any changes to regulation would need time to bed in. The companies would need time to adjust to any new reporting requirements and we would need time to put any new systems in place. As a result, any changes would need to be made well in advance of the beginning of the 2015 price review process in early 2012.

October 2010

Supplementary written evidence submitted by OFWAT

When I gave evidence to the committee on 13 October I promised to write to you on two issues:

- clarification on misconnections to the sewer system and who should pay; and
- the revenue outstanding (bad debt) caused by households in the water and sewerage sectors.

MISCONNECTIONS

No-one knows the actual number of misconnected properties, with estimates varying widely. The Environment Agency and Water UK estimate that as many as 300,000 households in England and Wales may have drains that are wrongly connected to the sewerage network.⁴ And the Environment Agency predicts that this number is likely to rise significantly over the next few years.⁵ Previous work has suggested the number of misconnected properties may be even higher. In 2007 Defra estimated that between 650,000 and 3 million properties could be misconnected. What is clear is that this is a significant problem that needs tackling.

Misconnections may involve surface water pipework plumbed into foul drains or sewers thereby using up spare capacity and increasing the risk of sewer flooding. Alternatively, foul pipes can be connected to surface water drainage, resulting in pollution of the receiving watercourse.

Misconnections typically arise when, in the of course maintaining or improving properties, new pipework is connected, either inadvertently or deliberately, to the wrong drain. It is a significant environmental problem that can be difficult and costly to investigate and resolve.

The existing legislation (copy attached) provides for the disconnection and/or rectification of misconnections. This sets out the powers of the local authorities and water companies when dealing with sewer misconnections, and the cost recovery mechanisms.

We would like to see the legislation amended to make the process of resolution more effective and more efficient.

While developing the Flood and Water Management Bill we worked with Defra on new clauses to enable sewerage companies to require a householder to rectify a misconnection. If, after a reasonable time, the householder had not acted, the company could redirect misconnected pipework (rather than simply disconnect it) and recover the reasonable costs of the work from the householder. This would avoid sewerage companies having to involve local authorities who, we are told, can be slow to act owing to resource constraints and would ensure that the polluter pays principle was observed.

REVENUE OUTSTANDING

In 2009–10 the total level of revenue outstanding (which also includes revenue due from previous years charges) for households was £1,586 million or 83% of the total amount outstanding. This compares with £327 million for non-households in 2009–10 or 17% of the total amount outstanding.

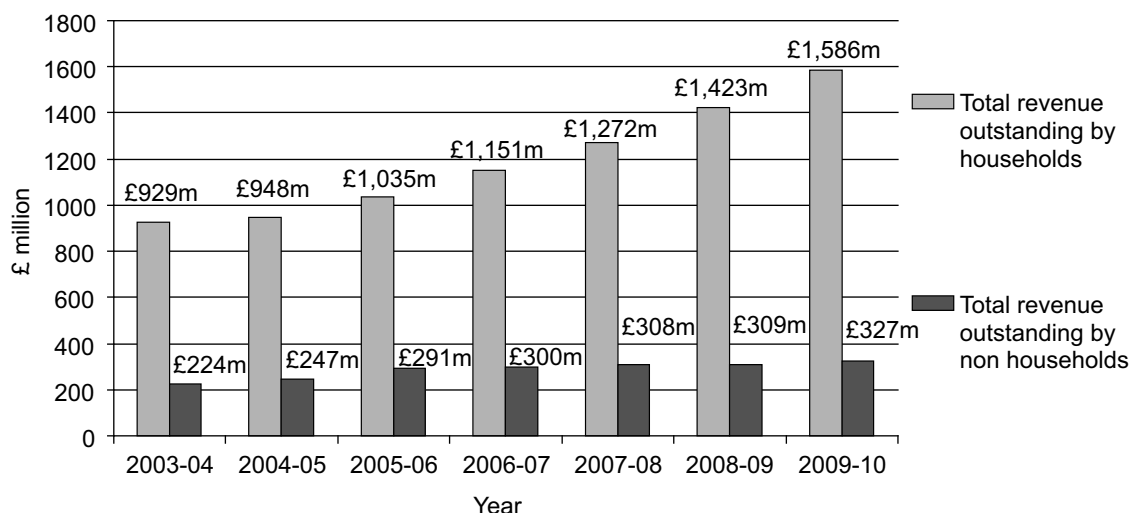
The graph below shows the level of revenue outstanding for each year since 2003–04 and shows the difference between household and non-household. It can be seen that non-household revenue outstanding is much lower in absolute terms and has been rising at a slower rate (in percentage terms) than households.

⁴ <http://www.water.org.uk/home/news/archive/water-environment/misconnections>

⁵ Environment Agency. Water for Life and Livelihoods—consultation response to the draft Dee River Basis Management Plan.

As I said in the evidence session, we believe companies can get better at collecting debt from customers and we look forward to the commencement of measures passed in the Flood and Water Management Act. The measures will allow, in circumstances where a property is rented, the water companies to request the tenants' details from the landlord. If the details are not provided in a timely way companies will have the right to pursue charges from the landlord. This gives companies an extra tool to collect debt from a group of their customers.

TOTAL REVENUE OUTSTANDING FOR HOUSEHOLDS AND NON HOUSEHOLDS (ALL COMPANIES)



We have published a focus report titled “A drain on society—what can be done about water debt?” which explores the issues around the household debt problem in the water and sewerage sector. This report is available on our website (www.ofwat.gov.uk).

Regina Finn
Chief Executive

22 October 2010

Annex

EXTRACT FROM “INVESTIGATION AND RECTIFICATION OF DRAINAGE MISCONNECTIONS—GOOD PRACTICE DOCUMENT”, WATER UK/ENVIRONMENT AGENCY, JANUARY 2009

RELEVANT AND AVAILABLE LEGISLATION

Section 171 Water Industry Act 1991—confers a right of entry to a sewerage undertaker for the purpose of carrying out its sewerage functions. This includes the power of entry in order to investigate whether there has been an offence and whether the Sewage Undertaker should take action. Sections 158, 159 and 168 confer a right of entry to lay pipes and carry out investigations where the WaSC is authorised to carry out such works.

Section 106(2)(b) Water Industry Act 1991—this states there is no right to discharge foul water into a surface water sewer where separate sewer systems exist.

Section 106(2)(c) of the Water Industry Act 1991—prohibition on connections to storm water overflow sewers.

Section 109 Water Industry Act 1991—this section makes it an offence to cause a drain or sewer to communicate with a public sewer in contravention of section 106.

Section 109(2) of the Water Industry Act 1991—disconnection of wrongly connected drains and sewers to the public sewer by sewerage undertakers, and the recovery by them of their costs.

Section 113 of the Water Industry Act 1991—allows the WaSC to carry out work on private drainage should the company believe that drainage to be objectionable. There are no powers for the WaSC to recover costs in altering the drainage in these circumstances.

Section 59 of the Building Act 1984—This is a power exercisable by the Local Authority dealing with the satisfactory provision of drainage for existing buildings. Where the private drainage is unsatisfactory or is a hazard to health or a nuisance, the Local Authority can serve notice requiring the owner to make satisfactory

provision for the drainage of the building. If the person on whom the notice is served fails to execute the works then the Local Authority has powers to carry out works in default and recover its costs in doing so under section 99.

Section 161A Water Resources Act 1991—The Environment Agency has anti-pollution works notice powers under Section 161A. This allows the Environment Agency to serve works notices requiring persons to carry out anti-pollution works where any noxious, poisonous or polluting matter has entered or seems likely to enter controlled waters.

Section 85 Water Resources Act 1991—sets out principal offences relating to pollution of watercourses. Foul water misconnections to surface water sewers may result in pollution of controlled waters at the point of discharge, which is a strict liability offence under section 85 Water Resources Act 1991.

Sewerage (Scotland) Act 1968 Part 1 S15—Owner or occupier to remedy defects in drains and other works. This gives both Scottish Water and the Local Authorities powers to issue notices to require owners or occupiers to remedy drainage defects, and undertake the work in default and recharge for the full cost of this work, if the owners do not comply with the terms of the notice. This legislation mirrors the powers within S59 of the Building Act in England and Wales, allowing Scottish Water to enforce work to rectify outstanding misconnections.

Further supplementary written evidence submitted by OFWAT PRIVATE SEWERS BRIEFING

KEY MESSAGES

- We have always been clear that costs associated with the adoption of private sewers were legitimate costs to be recovered through price limits.
- But, the impact of the adoption of private sewers is very uncertain and difficult to forecast in advance.
- We didn't allow funding for the adoption of private sewers when we set price limits for 2010–15. But, we were clear that companies could recover costs if they prove to be material before we are next due to set price limits.
- We understand that companies may wish certainty in this area and seek protection from having to spend money that was not funded in price limits.
- However, we must consider whether customers should be asked to provide funding (through bills) based on very uncertain forecast data. It is entirely possible that actual expenditure could be very different [much lower] than forecast. It is also important that companies face incentives to manage the costs efficiently.
- Our position is unchanged. Companies can recover material costs associated with the adoption of private sewers. Our latest guidance simply emphasises the importance of actual data given the uncertainty in forecasting.
- This is principally a short term issue. Relevant costs beyond 2015 will be picked up as part of the normal price setting process.

BACKGROUND

The ongoing Defra consultation on the adoption of private sewers by water and sewerage companies will lead the way for private sewers to be adopted on 1 October 2011. There are significant issues associated with the transfer. Companies will become responsible for infrastructure that they have little, to no, knowledge about.

The location, length and condition of the private sewers to be transferred are uncertain. Consequently, at this point in time it is difficult to forecast the likely short and long term cost of identifying, repairing and maintaining these assets with any great accuracy.

In the 2009 price review we did not make any allowance for costs associated with the adoption of private sewers. This reflected some uncertainty on the timetable for transfer but, principally it reflected the very significant uncertainty about the likely cost of the transfer.

Companies are naturally concerned about the impact on their business. But we must think carefully about the implication for customers. Given the uncertainty, there was a real chance that we might have funded substantial expenditure in 2010–15 which turned out not to be necessary either because the transfer was delayed, or because the costs turned out to be significantly lower than best estimates. We also want to maintain incentives on companies to properly understand the impact of this issue and manage costs efficiently.

However, we were clear from the beginning of the review process that we accepted that costs associated with the adoption of private sewers were legitimate costs. In our final determination we explained that companies could come back to us before 2015 once the timing and extent of the costs became clear.

We have always accepted that there would be legitimate costs associated with the transfer of private sewers. Where costs are properly calculated and accrued companies can ask us to adjust price limits to take them into account through the interim determination (IDoK) process.

We have recently published our guidance on the IDoK process between 2010–15 (RD 13/10), which included further comment on our expectations on private sewers.

In RD 13/10 we say:

“It was evident from the commentary provided in companies’ business plans that a significant degree of uncertainty surrounds the costs of the anticipated transfer and the timing of those costs.

In view of this unusual level of uncertainty, we would expect any IDoK application to be based, at least in part, on actual cost information gathered over a longer period than might otherwise be considered necessary. Consequently, on the Government’s current timetable for the transfer, it is unlikely that we would consider it appropriate to take account of estimated transfer-related costs before September 2013 at the earliest.”

It would not be beneficial to customers or the companies to apply for an interim determination without fully understanding the costs.

We have been working with stakeholders, including water companies, Water UK and the Consumer Council for Water on these issues. We believe that there is a broad understanding of our position but understand that some companies remain concerned and would prefer to be afforded greater certainty at an earlier stage. Though we understand the concerns of these companies it is imperative we ensure customers get a fair deal and that the costs of transferring private sewers are kept down.

Our current broad estimate is that average bills could rise by around £8 by 2019 with a range of £4–£14 across all water and sewerage companies.

The Government decided to implement this policy. We are ready and willing to help with its smooth transition. Making sure companies are able to continue to deliver a world class service and customers get value for money.

29 October 2010

Further supplementary written evidence submitted by OFWAT

THE WATER FRAMEWORK DIRECTIVE: ECONOMIC REGULATION PERSPECTIVE

Objectives

- Ensuring water customers pay a fair share, but no more, of the costs of implementing the WFD over the three river basin planning cycles to 2027.
- That European Legislation, including the WFD is sustainable. This means it being implemented in a way that reflects the costs and benefits to the environment and to society as a whole.

A balanced approach

As the economic regulator for water and sewerage services in England and Wales we are working closely with the Environment Agency and other stakeholders including Defra, water and sewerage companies and CCWater to achieve desirable environmental outcomes for customers at the best price.

In regulating the sector we have a duty to balance EU environmental legislation and objectives with what is economically acceptable to customers. It is our duty to ensure that the water and sewerage sectors have enough funding to meet all EU Environmental quality standards.

At the 2009 price review we allowed over £130 million towards meeting the WFD between 2010 and 2015.

Despite this level of investment, the UK is only likely to see 26% of rivers achieving Good Ecological status by the WFD target date of 2015.

The Environment Agency has suggested that current WFD costs up to 2027 could be between £30–£100 billion, depending on what approach is taken to achieving the Directive’s outcomes. We believe that it would be socially and economically unacceptable to domestic water customers if they are required to meet the majority of these costs. Without this investment however we are unlikely to reach a fully compliant status of 100% by 2027.

Going forward

We support the fairer allocation of costs towards the WFD between sectors following the polluter pays principle which is written into the Directive. By apportioning the costs of pollution to sectors other than the water and sewerage companies this principle is supported and costs for customers are kept down.

Currently 82% of the cost of the Directive will be met by water customers. The agricultural community is contributing 0.8% of the cost of the Directive even though, as the Environment Agency reports, agricultural diffuse pollution was responsible for 32% of WFD “failures”. Our concern is that water customers will continue to be levied with increased costs because of actions outside their control.

All organisations should be encouraged not to pollute, thus remove pollution at source and develop mechanisms for recovering costs. This would incentivise responsible behaviour and remove perverse incentives. Traditional end-of-pipe solutions are expensive and carbon intensive and control at source is usually the most cost effective solution.

Specifically, we support:

- allowing the development of proportionate and flexible catchment-scale approaches;
- taking climate change fully into account, while accepting that some change is inevitable;
- taking full advantage of the possibility of allowing exemptions on grounds of disproportionate cost;
- extending the disproportionate cost provision to other EU environmental legislation; and
- removing inconsistencies and barriers to optimum outcomes and efficient implementation, such as the “one-out all-out” rule⁶ in defining good ecological status.

We would also like UK government support for a change in the EU Good Ecological Status (GES) system to make WFD targets achievable at an acceptable economic cost. The system should address the distorting effect of the “one out all out” rule which gives the UK a low score on the GES system despite huge investment.

November 2010

Written evidence submitted by the Consumer Council for Water

The Consumer Council for Water (CCWater) is an independent non-departmental public body representing the interests of water and sewerage customers across England and Wales. We have four local committees in England and a committee for Wales.

We have worked with the water industry and its regulators since 2005 to get the best results for consumers. In that time we have:

- been central to achieving the customer focused outcome from the 2009 price review, which around 80% of customers found acceptable and was around £1 billion better for water customers than the 2004 review.
- convinced water companies to return over £135 million to consumers through either additional investment or keeping prices lower;
- dealt with over 78,000 complaints;
- returned over £10 million to customers in compensation; and
- cost only 23p on each water bill a year. This will reduce to 21p in 2011–12.

We welcome the opportunity to submit evidence to this Efra inquiry into outstanding legislative measures which may be required to implement effective flood and water management policies in England and Wales.

Our evidence is provided from the perspective of the water consumer, both domestic and business, and addresses the terms of reference accordingly.

1. EXECUTIVE SUMMARY

1.1 The Consumer Council for Water (CCWater) welcomes this inquiry into outstanding legislative measures. This will help to ensure there is a more comprehensive legislative framework in place to secure a sustainable water and wastewater sector, with affordable and effective flood and water management policies for England and Wales.

⁶ WFD monitoring, known as classification, is risk-based and focuses where there is likely to be a problem. It uses a principle of “one out, all out” which means that the poorest individual result drives the overall.

Floods and Water Management Act 2010

1.2 From our perspective, the Flood and Water Management Act 2010 (FWMA 2010) provided initial legislation that complemented the water strategies published by Defra and the Welsh Assembly Government. It included measures that promised consumers a more robust water and sewerage infrastructure.

1.3 The FWMA 2010 has provided the framework for addressing water consumers' priorities on flooding but requires speedy enactment and implementation.

Issues for Future Legislation

1.4 The issues of affordability and competition in the water markets still need to be addressed for water customers. The recent independent reviews by Walker and Cave have helped focus attention, but water customers will continue to suffer from the problems considered by these reviews until legislation—primary and secondary—is put in place to resolve them. Our evidence will consider solutions to the problems.

CCWater's role is critical to successful implementation

1.5 CCWater is available to work with EFRA and Government to find solutions to address the growing water affordability problem; promote fair charging and progress competition by lowering the eligibility threshold and by improving the opportunities to switch supplier for eligible business customers—issues that were not addressed by the FWMA 2010.

Affordability problems for water customers need to be fixed quickly

1.6 The recommendations of the Walker Review of Charging and Metering for Water and Sewerage Services need to be concluded and implemented to help those who are struggling to pay or facing unfairness in how they are being charged for water.

1.7 To tackle the high bills in the South West, research indicates that customers are likely to prefer adjustments, to bring charges in line with other regions, to be funded by taxation.⁷ The current financial climate makes this less likely to happen, so social tariffs may be needed to address affordability.

1.8 To help low income customers in the South East, who could see increases of up to £200 as a result of being compulsorily metered, protection is needed through social tariffs.

1.9 To help low incomes households who are struggling to pay their water bill from other water companies, assistance is required.

Government policy guidance is needed for social tariffs

1.10 The FWMA 2010 makes provision for the introduction of social tariffs. CCWater has asked consumers what they think of social tariffs and how much they would be prepared to pay to help other customers.⁷ This in-depth research can help the development of the policy guidance that will be required, to enable the water companies and regulator to implement the tariffs. All water companies could need suitable tariffs in place to protect low income families. Gaining customer acceptance for tariffs that create additional cross subsidies and increase water bills can be achieved by involving customers and taking their views into account.

Competition for business customers

1.11 CCWater are active in pressing for competition to satisfy the demand for choice by business customers. The eligibility threshold should be dropped and the pricing regime refined to encourage competition for business customers.

New customer focused indicator for Ofwat

1.12 Ofwat should be given a performance indicator based on customers' satisfaction with value for money and service as a key measure of a successful regulatory regime. Measuring Ofwat would motivate them to reduce the regulatory burden and create the right incentives for water companies to focus on their customers and involve them in key decisions that affect their bills.

Bigger say for customers in the price setting process

1.13 In the future, water bills are likely to increase to pay for the private sewers transfer, flooding and quality obligations. Customers are more likely to accept price increases if they have been involved in the decisions their local water company has made on investments. Motivating Ofwat to create the conditions for this to happen is crucial to the future of the water industry.

⁷ Customers would only be prepared to add, at most, a few extra pounds onto their bill to for a cross subsidy to help those on low incomes. Cross Subsidies and Social Tariffs: The Consumer Perspective, Creative Research, London, June 2010

1.14 Increases on water customers' bills need to be perceived as acceptable by customers. The FWMA 2010, and any future supplementary Bill, should not impose unfair additions onto customers' bills or see water customers paying for improvements that others require or will benefit from—unless they are subject to cost benefit analysis and there is customer input into the decision making to ensure the solutions are seen as legitimate by water customers.

1.15 As the regulations and guidance develops, CCWater will be looking for clarity on what water customers may be asked to pay for, whether those costs are fairly apportioned and what benefits water customers would receive for their money.

2. EFRA COMMITTEE QUESTIONS/CCWATER EVIDENCE

2.1 Which of the key issues covered by the consultation into the draft Flood and Water Management Bill and by the Walker and Cave reviews should be taken forward as legislative priorities?

The key issues for water consumers are:

2.1.1 Cave Review of Competition and Innovation

- (a) To get competition available and functioning for eligible business customers as quickly as practicable. 84%⁸ of large business customers and 69%⁹ of small businesses are supportive of competition in principle.
- (b) Reduce the threshold for business competition at a pace that will not damage the trust of eligible customers and change the pricing methodology (the costs principle) that constrains competition.
- (c) A step by step approach to opening up competition, with government and regulators establishing that:
 - benefits outweigh costs; and
 - ineligible customers are not disadvantaged.
- (d) A bigger role for consumers in setting water prices to give greater:
 - visibility of what customers get for their money;
 - choice; and
 - legitimacy for the regulatory system.

2.1.2 Walker Review of Charging and Metering

(a) To further deal with water affordability through legislation, including tackling high water bills in the South West. Customers are likely to prefer adjustments to bring charges in line with other regions to be funded by taxation.¹⁰ As this is unlikely to happen in the current financial climate, social tariffs may need to address affordability. Please see 2.3.1.

(b) Expansion of DWP's "Water Direct", which currently only helps those customers who are in debt. Government could help prevent water debt by allowing people on benefits to pay direct to water companies through this scheme.

(c) To get metering implemented without customer backlash. Customers¹¹ say metering is the fairest basis for charging for water services. However compulsory metering will be contentious as research indicates 27% of customers oppose it¹² and only 40% support it. There is also a need for protection for the least able to pay and a pace of implementation that customers will support and accept, with sound communication about the process. Relevant water companies should be required to have a structured compulsory meter installation process in their plans so they are clear on their responsibilities.

(d) Fair apportionment of environmental costs so that water customers do not subsidise schemes that are primarily aimed at the wider public good.

(e) Environmental improvements are paced so that the impact on customers' bills is seen by them as acceptable, but ensuring that legal obligations are met.

(f) Customers should have greater involvement in decisions which will affect their water bills. There should be a new requirement on Government and regulators to consult with customers and their representatives before agreeing water quality directives or legislation which water customers will have to pay for.

(g) Transfer of highways drainage costs from water customers to local and other public authorities to incentivise sustainable drainage.

⁸ "Setting Strategic Direction, Competition research with business customers"—MVA June 2007

⁹ http://www.cwater.org.uk/upload/pdf/SME_Competition_FINAL_11_June_2010_20100611143232.pdf

¹⁰ Customers would only be prepared to add, at most, a few extra pounds onto their bill to for a cross subsidy to help those on low incomes. Cross Subsidies and Social Tariffs: The Consumer Perspective, Creative Research, London, June 2010

¹¹ 57% The Consumer Council for Water Charging Research 2007 ORC International April 2008

¹² The Consumer Council for Water Charging Research 2007 ORC International April 2008

2.1.3 Extending Ofwat's powers

Legislation to extend Ofwat's powers:

- for imposing financial penalties on a water company after a contravention to five years; and
- to acquire information from water companies where it suspects a standards of performance breach.

2.2 *What are the further policies required to ensure flood and water management which delivers optimum social, economic and environmental outcomes?*

2.2.1 Economic Regulation

Ofwat should be given a key performance indicator based on customers' satisfaction with service and value for money. Better satisfaction with value for money for the water and sewerage service is crucial if customers are to accept future price increases. This is necessary for a sustainable water industry. This should motivate Ofwat to create the right incentives for water companies to focus on their customers and involve them in key decisions including:

- prices;
- metering;
- social tariffs;
- surface water concessions; and
- other major changes service.

2.2.2 Flooding

The FWMA 2010 was a positive step towards meeting consumers' needs for protection against flooding. CCWater is playing an active role to ensure consumers' requirements are built into national strategies and guidance.

The strategies' consultations need to value the public's contribution, so there is acceptance for the cost of flooding measures. Consumers views¹³ show the strategies should cover measures to:

- make water companies plan in more flooding resilience;
- raise customer awareness; and
- plan emergency and response mechanisms as well as investment priorities and funding matters.

Planning guidance and regulation could be strengthened to consider sewer capacity in development control or to ensure developers pay to expand sewer capacity satisfactorily.

2.3 *Are there remaining issues related to the Flood and Water Management Act 2010 (including sustainable drainage systems (SUDS) and the transfer of private sewers and lateral drains)?*

2.3.1 Guidance on social tariffs

High water bills in the South West, affordability problems elsewhere for some customer groups and compulsory metering in South East England mean measures to protect low income households are urgently needed. In the South East some customers are likely to see their yearly bills increase by up to £200. In the South West, average unmeasured bills will rise by £212 or 29% by 2015, demonstrating the growing disparity between measured and unmeasured bills. Consequently water companies need guidance now to create tariffs for customers struggling to pay. The guidance needs to be clear on who has the responsibility for deciding if a proposed social tariff is acceptable.

2.3.2 New regulations to help water companies tackle outstanding customer debt

Regulations need to clarify:

- occupier information requirements;
- timescale for providing information; and
- procedures for non compliance.

Delayed regulations means debt accrues causing all water bills to increase, which is especially hard for those struggling to pay.

¹³ Qualitative research for Yorkshire Water and the Consumer Council for Water by MRUK Research October 2008.

- Qualitative Responses to Loss of Water Supply by Accent Sep 2007
- Quantitative research on Domestic Customers' Views on the Loss of Water Supply and Compensation by Accent Nov 2007.

2.3.3 New regulations for managing discretionary use of water during droughts

Regulations are needed to introduce more consistency in the application of bans on non-essential water use. Consumers need to understand their water company's rationale for imposing restrictions, and what uses of water are banned. The need for clear information is paramount and we have consumer experiences to help identify good practice.

2.3.4 Sustainable Drainage Systems (SUDS)

(a) To prevent SUDS falling into disrepair the consultation on National Standards should be explicit on the local authorities' duty to maintain them.

(b) To remove the risk of foul flooding by overloading a combined sewer, new legislation should ensure that SUDS can only connect to a surface water sewer.

2.3.5 Transfer of private sewers and lateral drains

Regulations for new build standards are needed urgently to prevent substandard private sewers being constructed before the October 2011 transfer date. Ultimately all water customers will pay for repairing defective private sewers.

Regulations for the transfer of private sewers should include park homes or residential caravan sites where some of the most vulnerable consumers live. We have made detailed comments on the recent Defra and WAG consultation.¹⁴

October 2010

Written evidence submitted by the Environment Agency

EXECUTIVE SUMMARY

The Environment Agency welcomes the Committee's request to input to its inquiry to consider the need for future floods and water management legislation. The Environment Agency is ready to implement Government's decisions on the Flood and Water Management Act 2010. The Environment Agency supports consideration of the following issues in future water legislation:

- Improved allocation of water;
- Sustainable balance between supply and demand options;
- Further improvements to water quality;
- Improving sewerage system management; and
- A strategic overview for water resources.

1.0 INTRODUCTION

1.1 The Environment Agency is the leading public body for protecting and improving the environment in England and Wales. We provide independent technical advice, regulate, and deliver a number of services to ensure the sustainable use of natural resources, including water quality and water resources. We have a strategic overview of all forms of flooding and manage the risk of flooding from main rivers and the sea.

1.2 Water is under significant and increasing pressure. There are already challenges around providing secure supplies and many waters are affected by diffuse pollution. With a changing climate and a growing population, we are likely to see more catchments reaching sustainable limits.

1.3 This will put at risk the balance of water needs between people, the economy and the environment. Long term planning, flexible systems for water management and new approaches may be needed as a response.

2.0 IMPLEMENTATION OF THE FLOOD AND WATER MANAGEMENT ACT 2010

2.1 The Environment Agency recognises the Flood and Water Management Act 2010 as a positive step towards achieving Sir Michael Pitt's vision for all sources of flooding to be managed effectively. The Act provides clarity on the roles of the Environment Agency, Local Authorities, Internal Drainage Boards and others in managing flooding, and for the first time allocates responsibility for the management of surface water which was a major source of flooding in 2007. We welcome the measures in the Act to manage surface water flooding, including sustainable urban drainage systems (SuDS) which provide benefits to water amenity and the environment as well as flood risk.

2.2 The Environment Agency will work with Defra to develop a National Flood and Coastal Risk Management Strategy for England which reflects Government policy. The draft strategy will be subject to scrutiny by Parliament and approved by the Secretary of State. The Strategy, supported by guidance, will

¹⁴ www.ccwater.org.uk

help us deliver our strategic overview for all sources of flooding by setting the direction for flood and coastal risk management in England, and providing clarity on how the rest of the Act should be delivered at a local and national scale. In Wales, the Environment Agency has an enhanced oversight role for all sources of flooding and coastal erosion risk management. We will co-ordinate and monitor the implementation of Welsh Assembly Government's National Flood and Coastal Erosion Risk Management Strategy for Wales.

2.3 The importance of Local Authorities in delivering local flood risk management must not be underestimated. Local Authorities will clearly have a very important role in local flood risk management. We support the work by government to build technical capacity within Local Authorities, including their participation in the Foundation Degree course at the University of the West of England.

2.4 We welcome Government's indicative timetable for commencement of the Act and look forward to assisting Government in the delivery of these provisions.

3.0 FUTURE FLOOD LEGISLATION

3.1 Government was unable to legislate on all the flood provisions consulted on in the draft Bill. Whilst the Environment Agency does not view the issues not included in the final Act as essential to delivering integrated flood risk management, many would be beneficial so we would support Government bringing forward these provisions in legislation as soon as possible.

4.0 FUTURE WATER LEGISLATION

4.1 *Improved allocation of water*

Both the Cave and Walker Reviews highlighted that the current abstraction charging regime may not provide a sufficiently strong price signal to reflect water stress and the true value of the water environment. A revised approach could provide opportunities to reveal the value of water, and would complement many of the recommendations made in the Reviews. The use of market forces, particularly a more liberal trading regime (but not a free market), could be used to improve access to water today, and could more importantly provide a key tool for climate change adaptation.

4.2 *Further improvements to water quality*

As pressures grow, the need to find adequate measures to safeguard the quality and quantity of water resources will become more important. We are working with Defra to gather the evidence to confirm the main sources of pollution and now identify gaps in measures and mechanism that need to be addressed. As point source impacts have been reduced diffuse sources become more important. They are by their very nature more difficult to assess and reduce than point sources. Options ranging from incentives (such as agri-environment schemes) to water protection zones or general binding rules, could help to secure improvements. There may also be some benefit in reviewing authorisation regimes (eg REACH, Plant Protection Products Directive and the Biocidal Products Directive) for pesticides, biocides and other chemicals to ensure that environmental risk is considered sufficiently in the authorisation process. Initiatives based on local partnerships, such as recent work we and Defra have undertaken on bathing waters, will be increasingly important to reduce diffuse pollution of water.

4.3 *Improving sewerage system management*

Surface water drainage, sewerage systems and combined sewer overflows can pose significant risks to water quality and flooding, particularly if their performance deteriorates. There is a complex split of responsibilities between local authorities and sewerage undertakers for resolving misconnections of private sewage discharges into surface water sewers, and of surface water drains into separate foul sewers. Addressing this would help to deliver more integrated management of sewerage systems, alongside the planned transfer of private sewers. We are working with Defra, the water industry and central and local government to improve knowledge and awareness regarding: the interface of sewerage systems and Sustainable Drainage Systems (SuDS) for new developments and the re-development of existing areas, and possible future retrofit; current sewerage system and asset performance; effects of changes in climate and demand; and collaborative working on surface water management.

4.4 *A strategic overview for water resources*

Managing and planning the future supply/demand balance across all sectors of use could be improved. We have details for public water supply, but there is less information for other key sectors, including energy, agriculture, navigation, industry and commerce. We believe a voluntary approach could be adapted. We are working with Government to support those sectors and improve planning in this area.

October 2010

Supplementary written evidence submitted by the Environment Agency

Thank you for your email of 21 October 2010 requesting further information to assist with your inquiry into future flood and water management legislation. We undertook to provide you with additional information and we welcome this opportunity to respond to your questions.

(1A) Does opening the market to competition pose any risks to the ability of the Environment Agency and other agencies to promote the holistic management of water resources?

Any change to the way water is managed will introduce new risks, but also opportunities. We will work with Defra, WAG and Ofwat to ensure that competition improves water management, whilst protecting the environment and water users and to ensure that effective water resources planning and drought planning can still take place.

However, the potential options for future competition in water are still being developed, and will need to be assessed carefully for use and others to understand any potential risks and opportunities for mitigation.

(1B) Do you agree with the assumption that trading and competition, in more effectively assigning a value to water, will deliver the most sustainable option for water resources?

The wider use of market forces through trading and competition has the potential to reveal the value of water more effectively than the current system of management cost recovery.

29 October 2010

Written evidence submitted by Water UK

INTRODUCTION

1. Water UK represents all UK water and wastewater service suppliers at national and European level. We are pleased to give evidence to the Efra Committee's inquiry into future flood and water management legislation.

2. In particular, Water UK will discuss some outstanding issues from the Flood and Water Management Act 2010 (guidance to companies on introducing social tariffs and draft regulations on measures to combat bad debt) as well as five recommendations of the industry's policy document "Meeting Future Challenges" which show that there is much that could be done to benefit our customers, society as a whole, and the environment without a need for further primary legislation.

Which of the key issues covered by the consultation into the draft Flood and Water Management Bill and by the Walker and Cave reviews should be taken forward as legislative priorities

3. The real difficulty some customers face in paying their water bill (the can't pay) and the burden placed on other customers by those who do not pay their bill (the won't pay) are key issues for the industry. Amendments to the Flood and Water Management Bill towards the end of the last Parliamentary session began to address these concerns and they were also highlighted by Anna Walker's Review of Charging for Household Water and Sewerage Services.

AFFORDABILITY

4. Ensuring that water and sewerage services are affordable for all—especially those in genuine difficulty—is a pressing concern for companies. Section 44 of the Flood and Water Management Act 2010 allows companies to introduce social tariffs or schemes to reduce charges for individuals who would have trouble paying their bill and endorses cross-subsidisation.

5. However, companies cannot act until Ministers issue guidance on social tariffs. Water UK urges the Committee to recommend that this guidance on social tariffs is made available by government as soon as possible.

DEBT

6. Bad debt is a major and growing problem for the water industry. Those customers who do pay their bill pay an extra £12 a year to make up for those who don't pay. Part of the reason for this is that water companies cannot always get the information they need to bill their customers.

7. Section 45 of the Flood and Water Management Act 2010 introduces a requirement for owners of rented properties to supply information to a water company to identify who is the "liable person" for the bill at their property. This is a good first step in tackling the debt problem.

8. We are currently awaiting draft regulations from government to implement this new requirement and would urge the Committee to recommend that the Government brings these regulations forward at the earliest opportunity.

MISCONNECTIONS

9. A misconnection, in which a household drainage pipe is connected to the wrong sewer, can cause pollution and lead to sewer overloading. Sewer flooding is extremely unpleasant but—although this issue was raised in the consultation on the draft Flood and Water Management Bill—misconnections did not make it into the final Bill.

10. Water and sewerage companies do not currently have the power to redirect a misconnected pipe into the correct sewer. Instead they have to go through a time-consuming process involving the local authority. Water UK supports the proposal that gives water and sewerage companies the power to reconnect a misconnected drain themselves.

COMPETITION

11. There are potential gains from encouraging the trading of water upstream, as highlighted by the Cave Review. More water trading would result in the more efficient use of water resources, giving customers greater security of supply at lower financial and environmental cost.

12. Progress towards capturing these gains does not need to wait for primary legislation—there are things that could be done under the current legislative framework. At present, regulatory incentives discourage companies from developing the existing market for bulk supplies which might make better use of existing supplies and offer efficiency gains by reducing the need for investment in resources and assets.

The further policies which are required to ensure flood and water management which delivers optimum social, economic and environmental outcomes

13. In June 2010 Water UK published “Meeting Future Challenges: a blueprint for policy action” which highlights five policy areas in which the industry recommends a way forward to ensure a sustainable water industry for customers, society and the environment. There is much that could be done under the current legislative framework to deliver these key priorities, and it is important that this is done soon enough to have an impact at the next price review in 2014.

Giving customers more influence in investment and price decisions

14. Water UK believes that there is scope for customers to have more input into the price setting process. This would ensure that customers’ priorities are better reflected in the services they receive and the bills that they pay.

Ensuring that water and sewerage services are affordable for all

15. We have highlighted the urgent need for guidance from Ministers to allow companies to introduce social tariffs for vulnerable customers to address the pressing problem of affordability.

A measured pace to environmental improvements which ensures that overall prices are acceptable.

16. The water industry and its customers have contributed greatly to improving the water environment over recent years. Looking forward, we must ensure that overall sustainability is not threatened by customer resistance when small environmental gains are delivered at disproportionately high cost, and that an appropriate balance is struck between managing local environmental impacts and the global environmental impact of greater energy usage.

Renewing incentives for efficient and sustainable delivery

17. There is considerable scope for the current regulatory regime to be improved in order to deliver more for customers and the environment for less. Examples include removing the bias between capital and operating solutions, improving incentives for operating savings and incentivising exemplary environmental and sustainability performance. An innovative approach to regulation is needed to encourage sustainability and innovation.

Ensuring access to the capital markets

18. To deliver sustainable water supplies and sewerage services, as customers expect, the industry will need to continue to attract additional financing in the coming years. It is important that the regulatory regime continues to support investor confidence and to provide companies with scope to pay new and existing investors a reasonable rate of return on investment. Without that confidence, the rates of return required by investors would increase which would inevitably impact either on sustainability programmes or on customer bills.

Any issues related to the Flood and Water Management Act 2010 (including sustainable drainage systems (SUDS) and the transfer of private sewers and lateral drains)

19. As detailed above, Water UK urgently seeks guidance from Government on social tariffs (section 44 of the Act) and awaits regulations on measures to combat water debt (section 45 of the Act).

20. Water UK is responding to Defra's consultation on the transfer of private sewers to water and sewerage companies and has been working with Defra try and resolve the many complex issues involved in the transfer. These include technical, legal and financial matters.

21. One outstanding concern in connection with the Flood and Water Management Act relates to the automatic right of connection to the public sewerage system. The Pitt Review called for this to be ended—in order to reduce surcharging, flooding and pollution from sewers—but the industry is still concerned that this recommendation is not adequately reflected in the Flood and Water Management Act 2010. Water and sewerage companies need greater discretion to permit, or disallow, connections to the public sewerage system.

CONCLUSION

22. Water UK is delighted to submit evidence to the Efra Committee whose report will influence the development of the Water White Paper, to be published in the summer of 2011, and looks forward to examining the issues in more detail with members of the Committee in oral evidence.

SUMMARY

1. Water UK represents all UK water and wastewater service suppliers at national and European level.
2. Water UK highlights some outstanding issues from the Flood and Water Management Act 2010 as well as five recommendations of the industry's policy document "Meeting Future Challenges".
3. Section 44 of the Flood and Water Management Act 2010 allows companies to introduce social tariffs or schemes to reduce charges for individuals who would have trouble paying their bill. Water companies cannot act until Ministers issue guidance. Water UK urges the Committee to recommend that guidance on social tariffs is made available as soon as possible.
4. Section 45 of the Flood and Water Management Act 2010 introduces a requirement for owners of rented properties to supply information to a water company to identify who is the "liable person" for the bill at their property. This is a good first step in tackling the bad debt problem which costs those customers who do pay their water bill an extra £12 a year. Water UK urges the Committee to recommend that draft regulations to implement this new requirement are made available as soon as possible.
5. A misconnection, in which a household drainage pipe is connected to the wrong sewer, can lead to sewer flooding which is extremely unpleasant. This issue did not make it into the final Flood and Water Management Bill. Water and sewerage companies do not currently have the power to redirect a misconnected pipe into the correct sewer and have to go through a time-consuming process involving the local authority. Water UK supports the proposal to give water and sewerage companies the power to reconnect a misconnected drain.
6. The Pitt Review called for an end to the automatic right of connection to the public sewerage system. This recommendation is not adequately reflected in the Flood and Water Management Act 2010. Water and sewerage companies need greater discretion to permit, or disallow, connections to the public sewerage system.
7. "Meeting Future Challenges: a blueprint for policy action" highlights five policy areas in which the industry recommends a way forward to ensure a sustainable water industry for customers, society and the environment. Much could be done without a need for further primary legislation and it is important that this is done soon enough to have an impact at the next price review in 2014.
8. The industry's priorities are:
 - Giving customers more influence in investment and price decisions.
 - Ensuring that water and sewerage services are affordable for all.
 - A measured pace to environmental improvements which ensures that overall prices are acceptable.
 - Renewing incentives for efficient and sustainable delivery.
 - Ensuring access to the capital markets.

7 October 2010

Supplementary written evidence submitted by Water UK

IDENTIFYING AND ASSISTING CUSTOMERS WHO HAVE DIFFICULTY IN PAYING THEIR WATER AND SEWERAGE BILLS

1. IDENTIFYING “CAN’T PAY” CUSTOMERS

The water industry is acutely conscious of the difficulties that some customers have in paying their water bills, and the need to differentiate between these customers (“can’t pay” customers) and those who could pay but don’t (“won’t pay” customers).

Water companies do many things to help customers who are struggling to pay their bills—for example:

- Helplines—customers can discuss their payment problems with companies and agree appropriate payment plans.
- Flexible payment plans—customers can choose how frequently they pay.
- Referrals to charitable trusts and hardship funds.
- Free water meters—may reduce customer’s charges.
- Help in applying for direct payment from benefits—Water Direct.
- Advice on the “WaterSure” tariff—metered customers on benefits who qualify can receive a reduced bill.
- Promotion of debt advice agencies and support of local Citizens Advice bureaux.

However, in order to help customers who are struggling to pay their bills, companies first need to identify them. To do this, companies rely on information.

The best source of information is from customers themselves, so companies encourage customers who are having difficulties to contact them, for example by providing freephone numbers and by making it clear that customers with genuine difficulties will be treated sympathetically and given assistance in getting back on track.

Companies also use information they hold, for example payment records, to identify customers who may be having payment difficulties—and then use a variety of different methods to try to contact the customer.

An alternative source of information is through contacts from money advice agencies such as Citizens Advice or the Money Advice Trust.

Once contact has been made with a customer, by whatever route, companies will seek to understand the customer’s financial situation, for example through an income and expenditure survey.

This will identify whether it is the customers’ financial situation that is causing them to have difficulties in paying their water bill, and to understand whether the difficulties are temporary, which could be managed by reduced payments for a short period, or are likely to be ongoing.

If the difficulties are likely to be ongoing, companies will seek to understand whether a customer is claiming benefits. If the customer is, then the company may be able help the customer to apply for Water Direct, so that charges can be paid directly from benefits.

If appropriate, the company may suggest that the customer applies to an independent assistance fund for help in paying amounts owed, or contact a money advice agency for help in managing their finances.

Companies will also provide advice on whether switching to a meter would reduce the customer’s bill, and if the customer is already on a meter, whether they may be eligible for the WaterSure tariff.

2. CHALLENGES IN IDENTIFYING “CAN’T PAY” CUSTOMERS

The key first step is identifying and contacting customers who are finding it difficult to pay their bills. This is made more challenging for water companies by the limited rights they have to information about their customers.

Customers do not have to enter into a contract, or provide any information to their water company, to receive a water supply. Water companies do not have any rights to require information to be provided to them about who is liable for charges.

This is a particular problem for rented properties, where the occupancy changes more frequently, and it can be difficult for water companies to keep records of who is occupying a property up to date. This lack of information makes it difficult to identify and contact customers who may have difficulty in paying their bills.

Implementation of Section 45 of the Flood and Water Management Act would make this significantly easier, as for rented properties the landlord would be required to provide information to the water company on who is liable for charges. We are urging the Government to implement this provision as soon as possible.

As well as identifying who is liable for charges, and enabling companies to bill the right customer at the right time, having customers' details would also improve companies' ability to access other sources of information, such as data held by credit reference agencies, giving a fuller picture of who is likely to be a "can't pay" customer.

However, even with this information, companies would still be dependent to a considerable extent on customers voluntarily providing information about their circumstances, for example on whether they are receiving benefits or tax credits. This limits companies' ability to take a proactive approach, for example by helping customers to apply for Water Direct.

If companies had access to government data on which customers are in receipt of benefits or tax credits, this would greatly enhance their ability to identify customers who could be having difficulties in paying their bills (particularly customers who are reluctant to contact the company themselves), and to proactively offer to help them. This could also potentially identify customers who could be eligible for social tariffs.

3. SOCIAL TARIFFS

Although as discussed above, there are a number of ways in which water companies do help customers having difficulties in paying their bills, there is currently limited provision for direct financial assistance through social tariffs.

However Section 44 of the Flood and Water Management Act 2010 explicitly allows charges to be reduced for individuals who would have difficulty paying in full, to be paid by cross-subsidies from other customers.

While in principle we continue to believe that the fairest way to provide assistance to customers who are having difficulty in paying their water bills would be through the welfare system, we welcome this provision.

We also welcome that it requires Ministers to issue guidance on how eligibility for such social tariffs should be determined, as this is essentially a social policy question that is rightly a matter for government, not for individual private companies (or for the economic regulator). We are urging the Government to implement this provision, and to provide the required guidance, as soon as possible.

In determining eligibility and the scope of social tariffs, it will be important to take into account customers' views on the scale and scope of cross-subsidies. Recent research carried out for the Consumer Council of Water found support for targeted cross-subsidies, provided they were limited to a few pounds per year.

Whatever eligibility criteria are used, they will need to be clear and objective, practical to implement, and minimise the potential for error or fraud.

This may imply some linkage to receipt of specified benefits or the planned Universal Credit. If this is the case, to implement the tariff effectively companies would need to have access to information on who is in receipt of the appropriate benefits or credits.

This could be on a similar basis to the approaches already used in the energy and telecommunications sectors, where data from companies is matched with government data to identify customers who are eligible for social tariffs.

October 2010

Written evidence submitted by The Department for Environment, Food and Rural Affairs (Defra)

1. Defra's structural reform plan¹⁵ commits the Government to "*implement the findings of the Pitt Review to improve our flood defences and prevent unnecessary buildings in areas of high flood risk*"; and to "*reform the water industry to enhance competition and improve conservation*".

2. On the latter, the reform plan commits the Government to publish a White Paper in June 2011 on reform of the water industry to ensure more efficient use of water and to protect poorer households, and put the required legislation in place by November 2012. The Water White Paper will be developed closely alongside the Natural Environment White Paper. The Natural Environment White Paper will be broader in scope and will consider our wider water environment including the effects of pollution and water availability.

NATURAL ENVIRONMENT WHITE PAPER—TO BE PUBLISHED APRIL 2011

3. Major pressures on the environment are driving continued use of natural resources beyond their capacity for renewal and causing ongoing damage to our natural systems. In general, these pressures are now systemic, diffuse and cumulative in character, as opposed to the "point source" pollution which much existing environmental policy was designed to address. This suggests a need for future policy to focus on the ecosystem as a whole, rather than separate facets in isolation.

¹⁵ <http://ww2.defra.gov.uk/about/our-priorities/>

4. The Natural Environment White Paper will articulate a new, compelling and integrated vision about the value of our natural environment, capital and services. It will set out a programme of actions designed to put the value of the natural environment at the heart of Government accounting and decision-making. It will take in policy on marine, air quality, biodiversity, soil, landscape and recreation and water.

5. The White Paper will be a key part of the commitment to be “the Greenest Government ever”.

THE WATER WHITE PAPER—TO BE PUBLISHED JUNE 2011

6. The Water White Paper will cover the following themes:

- securing sustainable water supplies;
- increasing choice and delivering better value to customers;
- modernising the current regulatory system;
- ensuring fair and affordable water charges; and
- incentivising water conservation.

7. The intention is for the White Paper to set the high-level strategic framework for the next Ofwat Price Review, taking into account the various reviews to date, including:

- Anna Walker’s Review of charging for household water and sewerage services (we will be consulting on proposals on this later in the year, although many of Anna Walker’s recommendations do not require consultation or new legislation);
- Martin Cave’s Review of competition and innovation; and
- Our review of Ofwat, being led by David Gray—due to conclude in March 2011.

8. We will be considering the need for legislation to implement the policies outlined in the White Paper. Regulation will only be pursued once non-legislative options have been ruled out. However, some deregulatory measures under consideration would themselves require primary legislation.

REMAINING MEASURES FROM THE DRAFT FLOOD AND WATER MANAGEMENT BILL

9. Government is currently considering the case for bringing forward the other measures included within the draft Flood and Water Management Bill which were not included in the final Act. Whether and how quickly these measures come forward will be subject to our stringent tests on the need for new legislation, as well as the availability of Parliamentary time.

FLOOD AND WATER MANAGEMENT ACT 2010 IMPLEMENTATION

10. The first commencement order for the Act was laid in Parliament on 31 August; commencing powers to make orders under section 4(2) (f) and section 36 of the Act. These powers have been used by ministers to make two orders (Flood Risk Management Functions Order and the Water Use (Temporary Bans) Order) which came into force on 1 October.

11. Also commencing on the 1 October were definitions within the Act; statutory instrument making powers; and the provisions that require the Environment Agency and local authorities to develop strategies for risk management. The main responsibilities for local authorities are expected to start in the spring, coinciding with the start of the next spending period and the availability of funding released by the transfer of private sewers. The implementation timetable is subject to change as we re-examine the case for introducing further regulation.

SUSTAINABLE DRAINAGE SYSTEMS (SUDS)

12. We are currently scoping the regulations for aspects of approvals and appeals, adoption and enforcement. We are also preparing draft SuDS National Standards. The technical standards should provide a framework to guide decision-making, but be flexible enough to take account of local and site-specific circumstances. We intend to consult on the timescale of implementation of SuDS provisions, but do not anticipate these will be in place earlier than the common commencement date of October next year.

13. The Government is currently considering options including around the requirement for approval and whether a phased approach would give local authorities, developers and others time to familiarise themselves with the new requirements. Under this scenario new SuDS would be approved, built and adopted over time, which would see funding requirements grow progressively in a manageable way.

14. We are developing options for long-term funding for adoption. Initially, SuDS adoption will be funded from the transfer of private sewers.

TRANSFER OF EXISTING PRIVATE SEWERS AND DRAINS TO WATER AND SEWERAGE COMPANIES (WaSCs)

15. A joint consultation with the Welsh Assembly Government is currently underway on regulations that would implement the transfer to WaSCs from October 2011 of private sewers that drain to the public sewerage system. The transfer of pumping stations is proposed to take place by October 2016 to allow water and sewerage companies time to resolve technical and health and safety concerns.

16. The government proposes that new sewers intended to connect to the public system should automatically be adopted by WaSCs. A mandatory build standard for new drains and sewers will help to ensure that there is certainty and consistency in what gets built and what is required of developers. Discussion of the detailed standards with stakeholders is ongoing and a public consultation is proposed for later this year.

October 2010

Supplementary written evidence submitted by The Department for Environment, Food and Rural Affairs (Defra)

Thank you for your letter of 4 November in follow up to Richard Benyon's appearance before the Committee on Wednesday 3 November and including six further questions. Please find below the answers to your questions plus a few more responses where the Minister committed to write.

1. *Has Defra considered incorporating food security measures into the outcomes for gauging the cost-benefits of flood defences?*

Defra has considered creating a specific outcome measure in relation to agricultural benefits and food security to be used in the prioritisation of national funding for flood and coastal defence. A specific outcome has not been included to date as doing so would divert resources away from protecting people and property and other sectors of the economy that tend to suffer much greater damages than agriculture when flooding takes place. The agricultural sector suffered less than 2% of the damages from the 2007 floods in comparison with 38% borne by the housing sector and 23% by the business sector (Source: Costs of the summer 2007 floods, Environment Agency). This was despite the 2007 flooding being an extreme series of events occurring at the most damaging time of the year for the agricultural industry with many farms having crops in the ground close to harvest. While flooding undoubtedly does have an impact of agriculture, this is partly no coincidence as much of the most fertile land in the country has been created by a history of regular inundation. Despite this, overall, it appears that agricultural land is not at disproportionate risk, with around 2% of grade 1, 2 and 3 agricultural land at a significant risk of flooding (1.3% likelihood or greater each year) which is similar to the proportion of households at this level of risk.

There is also no evidence that flood events, such as those experienced in the summer of 2007 and autumn 2009, represent a threat to food security in the UK. The summer 2007 floods did not have a significant impact on food supply, although it may have made a very small contribution to price increases in some products during a year of general commodity deficit on a global scale. According to the UK Food Security Assessment, the UK enjoys a high level of food security as a developed, stable, economy integrated into Europe with a very diverse supply base.

Whilst there is no specific outcome measure relating to agriculture and food security, agricultural benefits are appropriately valued and reflected within the existing appraisal and prioritisation system. Defra's guidance on the appraisal of flood and coastal erosion risk management requires operating authorities to incorporate food security considerations into their economic assessments of investment options by placing values on the damages avoided to agricultural land, infrastructure and other assets which play a role in growing food and making food available to consumers.

The case for maintaining or improving the defences of agricultural land is assessed in a similar way to other assets. A Defra policy statement on the appraisal of flood and erosion risk management published last year reiterates the need to value agricultural land and the damages that can occur as a result of flooding and erosion. Specific guidance was provided by Defra in 2008 based on HM Treasury Green Book appraisal principles. This takes account of the decoupled Single Payment Scheme introduced in the UK from 2005. Agricultural land and produce are valued according to market values, excluding any up-lift due to transfer payments to avoid landowners receiving a double-benefit.

Defra will shortly be consulting on a revised set of outcome measures for the period 2011–12 to 2014–15, as well as proposals to reform the funding system more generally. Defra would welcome as part of the consultation any new evidence on the relationship between agriculture, food security and flood and coastal erosion that can help inform Ministers' decisions.

2. *The Minister referred during the session to the anticipated income from asset disposals. Will these amounts be assigned as savings to Defra as a whole or assigned to the individual bodies, such as the Environment Agency or Natural England?*

The Secretary of State will cover income from the sale of assets at her forthcoming appearance on “The Outcome of the Comprehensive Spending Review” on Tuesday 16 November.

3. *Members raised the issue of the need for a statutory duty on fire and rescue authorities to undertake work on flooding. Please could we have a note setting out Defra’s response to this, including on the specific Pitt Review recommendation that there be a “fully funded national capability for flood rescue with Fire and Rescue authorities playing a leading role, underpinned as necessary by a statutory duty”*

The Pitt Review is not categorical about the issue of statutory duty, and in Sir Ken Knight’s review of the Fire and Rescue Services (FRS) response to the summer 2007 floods “Facing the Challenge”, it was stated that a duty was not necessary. The FRS and other responders do turn out to flood events, as is evidenced from past flood incidents. It is therefore not clear what difference a statutory duty on the FRS would make. Introducing a statutory duty could also lead to the FRS being the only organisation carrying out flood rescue, because the other responders would withdraw from the response due to lack of statutory duty, which would lead to increased pressure on FRS funds.

The then Government accepted Sir Michael’s recommendation and our focus since then has been on the development of a national capability, through work we have been doing with all of the main players, including the FRS.

For this purpose, the Flood Rescue National Enhancement Project was initiated by Defra. A comprehensive multi-agency Flood Rescue Concept of Operations (FRCO) has been published which provides national standards for flood rescue assets, training and equipment, and clarity on command and coordination in a wide scale flooding event.

A national, multi-agency register of flood rescue assets and the operational arrangements that will govern how they are used is being finalised, and will be coordinated by the FRS National Coordination Centre. To complement this, Defra have recently launched a grant scheme for flood rescue operators, including the FRS, to apply for funding to help improve national capability and meet the standards for flood rescue assets as defined in the FRCO. So far a number of applications have been received and these will be considered on 12 November, with an announcement on the initial successful bids expected to take place soon after.

Defra has also committed funding to raising the standard of existing teams to the required level, as articulated in the FRCO. This is vital as the concern is not only numbers of assets, but the standards of assets allowing them to be successfully utilised in flooding emergencies. Defra has committed such funding to FRS as well as voluntary flood rescue organisations.

The introduction of a statutory duty is not however, ruled out. On completion, the Flood Rescue National Enhancement Project will provide us with the means of assessing what shortfalls exist in our national capability and also what statutory underpinning is needed, if any.

4. *The Chair raised concerns about the lack of detailed information on the likely infrastructure to be caught within the proposed private sewer and lateral drains transfer. Please could we have a note setting out the detailed information on the extent and physical condition on infrastructure which Defra has used to evaluate the likely costs to water company customers of this proposal*

As set out in the Impact Assessment accompanying Defra’s consultation paper on draft regulations to implement private sewers transfer, published on 26 August, a lack of detailed knowledge of the extent and, particularly, the condition of private sewers means that water and sewerage companies cannot provide Ofwat with full and accurate data from which to calculate levels of funding in future price determinations beyond providing best available estimates. To obtain greater accuracy, an extensive survey and mapping exercise would be required, the latest estimate of the cost of which is around £1 billion. The government does not consider the cost of such an exercise to be justifiable.

Water and sewerage companies already report to Ofwat on the costs of operating and maintaining different types of asset, and the cost of maintaining assets most closely related to those proposed to be the subject of transfer has been used as a basis for estimating the cost of maintaining the transferred assets. Ofwat’s current estimates of the financial costs to water and sewerage companies are based on these indicative assumptions. Full details are set out in the Technical Annex to the Impact Assessment that accompanies Defra’s consultation paper which is available at: <http://www.defra.gov.uk/corporate/consult/private-sewers/100826-private-sewers-condoc.pdf>

The precise expenditure associated with the ownership and maintenance of private sewers will become clear over time as companies respond to faults and build up pictures of transferred assets. The estimates contained in the latest Impact Assessment reflects the increasing number of pumping stations estimated and a decreasing proportion of the sewerage network assessed likely to require immediate replacement, based on data provided by water and sewerage companies to Ofwat, which has fallen from 7.5% to 2.5%.

5. *Please could you provide a note on the communication between Defra and the European Commission about the Urban Waste Water Directive, and outline Defra's view as to whether the commission's treatment of specific types of property, such as business parks, leads to specific problems for the UK*

The UK is currently subject to infraction proceedings for alleged breaches of the Urban Waste Water Treatment Directive in relation to the adequacy of collection systems in Whitburn in NE England and collection and treatment systems in London. In addition to updates from the UK to the Commission on progress in London and on progress with compliance stemming from a previous infraction case in relation to Brighton, we have recently submitted pleadings to the Court of Justice of the European Union in defence of the UK position in the infraction proceedings.

In addition to the standards set for sewage treatment, the Directive sets requirements for the treatment of biodegradable waste water from industries that discharge directly to the water environment, including for example milk processing and the production of alcohol and alcoholic beverages. In doing so, the Directive makes no distinction in relation to specific types of property such as business parks. We are not aware therefore of any specific problems for the UK in this regard or in relation to any Commission interest in planning issues relating to business parks or farms.

6. *Members referred to the issue of support for vulnerable water customers. What is Defra's view of the potential for improved communication between water companies and central/local government in order to help identify customers in need of support?*

In her final report, Anna Walker made a range of recommendations around tackling bad debt in the water industry, including the sharing of data between central and local government with water companies so they might better target customers with affordability issues. We are currently looking into the feasibility of this recommendation under existing data protection legislation and will set out our policy on tackling debt and affordability concerns in the forthcoming Water White Paper.

SUPPLEMENTARY

The Chair asked if people will be allowed access to the Environment Agency maps without charge

The Environment Agency's generic maps are available to everyone free of charge and they also offer, for a fee, a bespoke service.

The Chair asked if the Department has estimated the length of pipe and drains that will transfer

It is estimated that the transfer will mean water and sewerage companies taking on responsibility for some 184,000 kilometre of private sewers and 36,000 kilometre of private lateral drains.

The Chair expressed concerns raised by the Local Government Association in relation the department's assessment of the savings expected to accrue to local authorities as a result of the private sewers transfer going ahead

The transfer of private sewers to water companies is expected to relieve local authorities of activity they have historically undertaken in respect of their own estate and property, and on behalf of local householders. This has especially been the case when multiple households are involved, responsibilities unclear, disputes have arisen, or where people are not in a position to bear the sometimes considerable costs. Local authorities were therefore amongst those calling upon Government to intervene on the issue and find a way to avoid costs continuing to fall upon them and their communities.

Annual savings to local authorities as a result of the transfer are conservatively estimated to be in the region of £50 million per year. This is based on a survey conducted amongst local authorities in 2002. Whilst this survey was conducted some years ago, it remains the best evidence available. This is particularly as the survey was conducted before the options around transfer were widely discussed, and therefore before the knowledge of potential transfer could have influenced levels of local authority activity. A more recent survey or one conducted now would not provide a better picture of the potential savings, as the exercise may be prejudiced by knowledge of the transfer and the purpose for which the data would be collected. There is some evidence that authorities began cancelling contracts and minimising costs even before transfer was formally announced, in the knowledge that it was likely to go ahead.

Further evidence in support of Defra's assessment has come from OFWAT, who estimate that the transfer will cost water companies £172 million a year, plus almost £1 billion one-off capital costs to resolve legacy issues that they will inherit. Without the transfer, a considerable proportion of these costs might otherwise fall on local authorities.

Whilst accepting there will be some savings, LGA have not offered an alternative estimate, nor presented any evidence that is inconsistent with Defra's assessment. The department recognises that some local authorities will be and have been involved in private sewerage more than others, and that in some cases costs are partially or fully recovered. These issues have both been accounted for in arriving at the £50 million estimate. The 2002 survey also found that many local authorities did not know how much dealing with private sewerage was costing them, as expenditure was and is often spread between many service-level

budgets. This, taken with the conservative methodology applied to the 2002 data (which for example removed the highest cost estimates from local authorities), suggests the Defra assessment underestimates the true level of savings.

The savings to local authorities from the private sewers transfer have now been accounted for as part of the Spending Review. As a result, Defra has secured the funding it committed to provide to lead local flood authorities from 2011–12 onwards. Transferring the money to Defra has allowed the sums to be fully protected from both the reductions in Formula Grant and the reductions in Defra's other budgets. Up to £36 million a year in total will be distributed directly to lead local flood authorities through Area-Based Grants. Funds will be unringfenced to allow for local flexibility. On top of this, funding to support the maintenance of adopted SuDS will also be provided by Defra, whilst options for a longer-term funding mechanism are considered. Local authorities were consulted before the savings were accounted for, and their views sought on how the value of each area-based grant should be set. By basing allocations on levels of local flood risk, those lead local flood authorities managing the highest levels of local risk will be provided with funds several times higher than the average. In some areas this could reach £750,000 per year.

Defra fully understands the concerns raised by local authorities surrounding the funding of new burdens under the Flood and Water Management Act. The department is committed to achieve a fair outcome for both local authorities and the taxpayer. This is evidenced by the importance attached during the Spending Review to protecting the funding for lead local flood authorities. In addition, Defra and the LGA have established a joint review panel specifically for the purpose of monitoring actual local authority costs and burdens, and resolving any issues that arise. The panel meets monthly and has an independent chair; a former local authority executive officer.

Note on Q211 in the oral evidence transcript

As the Chair identified, Sir Michael Pitt recommended that “the automatic” right to connect surface water drainage of new developments should be removed. The right to connect both surface water and foul drainage to the public system are dealt with by the Flood and Water Management Act 2010. It addresses both issues by amending section 106 of the Water Industry Act 1991 to make new connections of both surface water and foul drainage to the public sewer conditional on the developer meeting certain requirements. These requirements, once implemented, will be quite different for the two types of drainage.

The Chair is also right to flag the issue of misconnections, the unlawful connection of a surface water sewer to a foul sewer or vice versa. This was not an element of the Pitt report recommendations but an unlawful connection which can result in sewer flooding, or cause pollution remains illegal. As I outlined at the hearing I would like to explore non-regulatory interventions to tackle future misconnections. This could be through engagement with constructors, occupiers, water companies, building research and training establishments along with white goods manufacturers, retailers and installers.

17 November 2010
