

## **WORSHIPFUL COMPANY OF WATER CONSERVATORS**

### **OVERVIEW OF THE RESPONSES TO THE DEPARTMENT OF BUSINESS AND TRADE ON:**

- **CONSULTATION ON EXTENDING THE GROWTH DUTY TO THE ECONOMIC REGULATORS OFGEM, OFWAT AND OFCOM AUGUST 2023**
- **CALL FOR EVIDENCE ON SMARTER REGULATION AND THE REGULATORY LANDSCAPE JANUARY 2024**
- **CONSULTATION ON THE GROWTH DUTY DRAFT STATUTORY GUIDANCE JANUARY 2024**
- **CONSULTATION ON SMARTER REGULATION: STRENGTHENING THE ECONOMIC REGULATION OF THE ENERGY, WATER AND TELECOMS SECTORS JANUARY 2024**

**11<sup>th</sup> JANUARY 2024**

1 The Worshipful Company of Water Conservators ('WCWC') is a City of London Livery Company focussed on the long-term health of our water resources and the broader environment. Our members include senior professionals from water, environmental and related industries and regulators, along with others who share our concern for water and the environment. Our experience and knowledge ranges from the complexities of environmental sciences, through the application of engineering to deliver the goals identified by those sciences, and the subsequent management of the assets created. The WCWC's purpose is *promoting a diverse and sustainable environment.*

#### **PROLOGUE**

2 During the later months of 2023, the Department of Business and Trade (DBT) consulted on the role of regulators, particularly economic regulators, in the resurgence of the UK economy. A key statement on driving growth through world class, smarter regulation, by the Chancellor of the Exchequer and Secretary of State for Business and Trade was set out in a letter on November 22<sup>nd</sup> 2023 following the Autumn Statement, to regulators within the scope of the Growth Duty (s108 Deregulation Act 2015) i.e., Ofgem, Ofwat and Ofcom. This is set out because of the importance of what it says for the water sector.

[https://assets.publishing.service.gov.uk/media/6568909c5936bb00133167cc/E02982473\\_Autumn\\_Statement\\_Nov\\_23\\_Accessible\\_Final.pdf](https://assets.publishing.service.gov.uk/media/6568909c5936bb00133167cc/E02982473_Autumn_Statement_Nov_23_Accessible_Final.pdf)

*"Institutional frameworks and regulation are important for economic growth. That is why the government set out its vision in Smarter regulation to grow the economy (May 2023) for an ambitious approach to regulation. As Chancellor of the Exchequer and the Secretary of State*

*for Business and Trade, we are committed to ensuring that regulators are contributing to this agenda as much as they can. We want to see our independent regulators take a more active role in creating a dynamic business environment which will result in the UK being seen as a great place for investment and innovation, whilst continuing to protect consumers and the environment.*

### *Growth Duty Guidance*

*We have published a consultation on measures to strengthen the regulators' Growth Duty. Central to this is consulting on new statutory guidance to which you, as regulators within scope of the Growth Duty would need to have regard. Our intention in updating the statutory guidance is to be clearer about how regulators can support sustainable economic growth alongside or as part of their other duties. Subject to consultation, regulators will be expected to consider seven Drivers of Economic Growth and seven Behaviours of Smarter Regulation. Your views are important, and we strongly welcome your input to this consultation before we issue final guidance to be effective in April 2024.*

### *Growth Duty Reporting*

*The Government believes that transparency and accountability for regulators is vital to show Parliament and the public the critical work that regulators do. Therefore, alongside consulting on statutory guidance, HM Government is consulting on whether regulators should publicly report on the Growth Duty, either using non-statutory reporting, which would allow for more flexibility and proportionality, or statutory reporting that would be more uniform, but could support greater consistency.*

*In this letter we want to set out further details to regulators of how a non-statutory approach could work, subject to consultation. Under this model, we would invite you as regulators to report on your actions as an opportunity to showcase the valuable work that you do. Regulators would be invited to publish a report every year that included a Growth Duty statement and Growth Duty performance metrics. Please see Annex below.*

*To support growth, the government will evaluate how regulators have considered the Growth Duty before taking decisions on taxpayers' grant-in-aid funding and assessing regulators' approach to fees.*

### *Strengthening Economic Regulation*

*Additionally, the government has confirmed its intention to extend the Growth Duty to Ofcom, Ofwat and Ofgem. Alongside this, the government has published a consultation on strengthening the regulation of the water, energy, and telecoms sectors.<sup>3</sup> We are rightly proud of the UK's system of independent economic regulation; it has attracted over £570 billion of investment between 2000 and 2020, helping to enhance infrastructure and deliver improvements to these essential industries. Ofcom, Ofwat and Ofgem have played a vital enabling role in encouraging this investment and, as set out in the economic regulation consultation published today, we expect these regulators to continue to focus their efforts on ensuring the sectors are able to attract the investment needed for the UK to deliver on its resilience and climate targets.*

### *A Competitive UK Business Environment*

*The purpose of this work is to ensure that the UK business environment is internationally competitive by preventing unnecessary burdens on business and ensuring that regulators operate in proportionate way, considering how they can support growth and investment in the sectors they regulate”.*

3 The following were then issued:

- The Call for Evidence

<https://www.gov.uk/government/calls-for-evidence/smarter-regulation-and-the-regulatory-landscape>

- Consultation on the revised statutory guidance to assist regulators in fulfilling their responsibilities under the growth duty

<https://assets.publishing.service.gov.uk/media/655e18c45395a900124635f1/consultation-on-the-growth-duty-draft-statutory-guidance.pdf>

- Consultation on strengthening the economic regulation of the utilities sector

<https://assets.publishing.service.gov.uk/media/655dee93d03a8d000d07fe75/strengthening-the-economic-regulation-of-the-energy-water-and-telecoms-sectors.pdf>

4 During July-August 2023 the DBT had consulted on the extension of the Growth Duty under the Deregulation Act 2015 to include Ofgem, Ofwat and Ofcom. The DBT Better Regulation Unit responded in November and announced that it will proceed with the extension.

<https://www.gov.uk/government/consultations/smarter-regulation-extending-the-growth-duty-to-ofgem-ofwat-and-ofcom>.

5 The WCWC has responded to all of the above invitations and these can be found on the consultations page on its website. It did so because of the professional roles of its members in water and climate change policy, mitigation and adaptation. It is a member of the City of London Livery Climate Action Group. Its principal interest is in contributing on the effectiveness of regulators in impacting on the water and environment sector. The WCWC decided to respond to the two consultations and the call for evidence issued in November, as a set but in a way which enables each response to stand alone.

6 The responses are focussed on the water sector and are informed by the experiences of members of WCWC who have worked in and with regulators, principally Ofwat, the Environment Agency (EA), Natural England (NE) and Natural Resources Wales (NRW), in the context of the thrust of the consultations. In the context of the regulatory landscape, experience of working with the Drinking Water Inspectorate is included and the insights provided on the broader landscape may be of some assistance in evaluating regulators in other sectors. The WCWC is pleased to have had the opportunity to respond to the call for evidence and looks forward to being able to make further inputs as requested in the future.

7 It appears that there are two interrelated processes. First, how can the water sector be an enabler to a resurgent economy, and second, applying the principles of smart regulation to the sector. These are related insofar that the best contribution to the economy will be made if the regulation is smart. But in seeking to prepare an effective set of submissions, the WCWC offers a comment that the whole initiative on smarter regulation is starting to create a complexity in its own right which can be difficult to interpret in the context of the water sector. At a time when there is so much scrutiny of the water sector, the approach to its management must be clear to all interested parties, but much of the language of the consultations and call for evidence is couched in terms only comprehensible to the people most involved with the processes. So, in examining the experiences of regulation in the call for evidence, the DBT might also include some self-examination of smart regulation.

Smarter regulation to grow the economy - GOV.UK ([www.gov.uk](http://www.gov.uk))  
Better Regulation Framework - GOV.UK ([www.gov.uk](http://www.gov.uk))

8 The current consultations and the call for evidence pose some complex questions which require detailed responses. WCWC suggests that consideration needs to be given to the weight of consultation processes in order to avoid consultation fatigue. At the moment the processes seem fragmented. The issues of economic regulation in the sectors of water, energy and telecoms will be different for each sector but will share some common principles. The role of Ofwat, is much more intimately involved with the role of the EA and NE within Defra than energy or telecoms. So, the WCWC is focussed on what all of this means for the water sector.

### **SOME HIGHLIGHTS OF THE RESPONSES**

9 In the simplest of descriptions: the guidance for an integrated Growth Duty for all water regulators (emerging from one consultation with Ofwat now being added) contributes in part to the strengthening of the role of Ofwat (the other consultation) which is part of a smarter regulatory landscape for all water regulators (emerging from the call for evidence).

#### **Some relevant economic principles**

##### **The two worlds of finance and operations**

10 The WCWC highlighted that the consultations by DBT sit between the worlds of finance and practical operations of the water sector. This was explored by the WCWC in its submissions.

11 One world has been the financial markets, populated by issues like:

- Dividend, equity, debt, gearing, and financial engineering.
- The best or most effective way of raising money to invest – in bonds, share issues, in group loans, in external loans etc.
- It is often impatient, with a short-term outlook.

The other world has been water services engineering and operations populated by matters like:

- Capital asset engineering or operating solutions to real environmental problems.

- Operational efficiency.
- Customer service.
- Compliance with regulations.
- The impact of decisions on customer charges.

12 The latter is a world which demands patience. Even with the best will, changes involving investment in capital plant, in particular, cannot be made overnight.

But do they communicate effectively with each other? Between them lies economic regulation, involving matters such as: the weighted cost of capital, Regulatory Asset Value (RAV), return on capital, and natural capital. In these worlds, even the term ‘capital’ can mean subtly different things to different people.

13 The problems lie in the communication between these two worlds and that creates myths. Ofwat seeks to make a connection between these worlds. But the demands on water services, and the consequent costs, clash with the acceptability and affordability of rising water charges, which is at the heart of current debates on water regulation. For example, there does not seem to be a direct ‘line of sight’ between projects like the reduction of storm sewage and overflows and the impact on decisions like how these should be funded. The generally accepted accounting practice rules should eliminate some of the debate.

14 There needs to be greater clarity about what has been suggested by environmental and quality regulators and what has been included by OFWAT in a Periodic Review which in turn will define water charges. One example: in 2023 Defra promised £50billion to tackle combined sewerage overflows (CSOs) between 2025 and 2050. The water companies need clarity on how much will be allowed in OFWAT determinations for 2025-30 and then a detailed definition of which schemes are funded for each company. Those decisions must be respected by other regulators.

15 There has been a focus on innovation in investment models to seek sources of finance. These were explored extensively particularly in the response on strengthening the role of economic regulators. This focus was highlighted in the November 2023 debate organised by the WCWC at Bakers Hall on the financeability of future water services.

16 But the WCWC expressed some concerns about some of the proposals for innovative investment models and expressed a view that the search for innovative investments must not compromise operational integrity. This was explored in some depth in the response to the consultations on growth and strengthening economic regulation. It appeared that the consultations were tilted towards the worlds of finance more than operations.

17 The WCWC has suggested for some time that there must be an effort to bring these two worlds into greater harmony. There is much debate about the effectiveness of economic regulation in the water sector and the WCWC has suggested that the time has come for a once in a life time review of the price setting process to make it more streamlined and benefit from over 30 years of practical experience. It is suggested that such a review could embrace the purpose of water companies. This should take account of the circumstances facing the water sector over the coming years.

18 The WCWC suggests that there has not been sufficient consensus on what the overall role of water is in this balance and this highlights the suggestion that it would be useful if water

management was separated out from the debates about all regulators or all utilities. The WCWC suggests that the uniqueness of such a high profile requires an integrated approach in the water sector articulating the harmonised responsibilities of the regulators, and what is envisaged for Ofwat in these consultations should be part of that. This is needed urgently and, for example, should provide joint guidance on growth from DBT and Defra, as advocated in the submission by the WCWC on the guidance on the growth duty of utility regulators. It is justified by the magnitude of the investments needed.

### **The two worlds of economics and environment.**

19 The WCWC is very much aware of the role of water in a successful economy. Indeed, the UK's industrial and commercial past was driven by access to water, be it inland for hydro power of many kinds, or seas and estuaries for international trade. But despite trade effluent controls and the regime of consented discharges to rivers it has come at a price for the environment, for which efforts are being made to address now.

[Making Water a Part of Economic Development: The Economic Benefits of Improved Water Management and Services | SIWI - Leading expert in water governance](#)

The WCWC pointed out that growth must not be seen as an end in its own right, it must be part of a strategy meeting objectives defined in wider goals, such as sustainable water services and environment.

20 The notion that there is a lack of communication between operations and finance is also repeated in the interface of the value placed on the environment in the widest sense and the economics of considering water as a commodity in a resurgent economy. Growth should be a goal which includes happiness, wellbeing, fulfilment, etc. rather than just financial measurements. The WCWC suggests that more attention should be given to the principle of 'natural capital'.

[Enabling a Natural Capital Approach guidance - GOV.UK \(www.gov.uk\)](#) .

21 The WCWC notes that whilst the consultations, particularly that on the Draft Guidance on the Duty of Growth, refer to Environmental Sustainability, they did not address how the economics of Natural Capital and the Triple Bottom Line would be factored in. Indeed, Natural Capital is within the purview of Defra and the WCWC suggests that the two government departments should cooperate in bringing these two dimensions of economics together.

22 Just as the three submissions were finalised in January 2024, extensive and severe flooding occurred in England and Wales. This provided a reminder that any national water strategy must embrace flooding, and this has been advocated by the WCWC. Not only does this demonstrate the impact of climate change on how water behaves naturally in the environment, but it also demonstrates the challenges of maintaining hydraulic integrity of sewerage systems. Mitigation of and adaptation to flooding must be accounted for in the environmental regulators Growth Duty and feature further in any revisions to the planning framework.

**How much does society value high quality water, how much does water cost and how much is society willing to pay?**

23 Society at large is placing more value on high quality water in the natural environment than it has for many decades, perhaps ever. The submissions of the WCWC highlight the fact that to meet this perceived need the costs of delivery will rise however they are financed. As a consequence, prices will rise and that creates a series of issues around affordability and public trust in companies and economic and environmental regulators for a service essential to health and wellbeing. The WCWC notes that there was no discussion about affordability in the concepts of smart regulation and tariff innovation should be addressed as a consequence of these consultations. The WCWC suggests that the DBT must be central in enabling society to accept this shift in cost and charges and they must prepare the strongest possible business case in partnership with OFWAT plus the companies, EA and NE to explain the reasons to the public and to Government.

### **The value and cost of regulators**

24 In a further example of the dilemmas outlined above, the WCWC responded to the question in the Call for Evidence on the Regulatory Landscape about funding of regulators. It is true that regulators in the water sector are valued, but the WCWC posed the question as to whether or not the costs of that value are satisfied by the price society is prepared to pay for their contributions and notes the diminishing budget for the E A. But increasing resources is more than just employing more people and the WCWC drew attention to the contribution of technical innovation, for example in the use of drones for inspections being more effective and cheaper than manual inspections.

25 The WCWC highlighted some of the tensions in the relationships of a Sponsoring Department and its Arms-Length Bodies (ALBs) and funding is part of that. Allied to that are the relationships between those parties in setting front line practice within national strategies and policies.

### **Shared responsibilities**

26 According to the DBT, there are 90 regulators across the UK, not including local authorities. They cover a wide range of areas and have a range of different powers and responsibilities; in some cases, they have been given a specific job to do by Parliament. Many regulators, though not all of them, are public bodies funded by the taxpayer. These include the EA and NE in the water sector, but not Ofwat - an omission being rectified. The delivery of a sustainable water environment supported by effective water services extends beyond the economic regulators.

27 There are others with influence on water management but they are not included in the Duty of Growth. Water companies have regulatory powers on such matters such as the physical criteria for sewer connections, water fittings and trade effluent discharges. Local authorities, excluded from the consultations and call for evidence, regulate planning and building construction and may ignore the advice of the water companies. Local authorities may not follow rules which work well with the water company responsibilities, for water fittings for example. They are regulators of private water supplies (all under the Water Industry Act 1991) and have powers regarding environmental nuisance. They could well play a role as Approving Bodies in the proposed framework for Sustainable Urban Drainage Systems (SUDS) and this is articulated by the WCWC in the submission to the consultation

of the strengthening of economic regulation). Other examples include local flood risk management authorities.

<https://www.gov.uk/government/collections/flood-and-coastal-erosion-risk-management-authorities>.

<https://www.gov.uk/government/collections/environmental-permitting-resources-for-local-authorities>

28 The contributions of the EA and NE to water management are very different to that of Ofwat. Water is unique in having environmental regulators and an economic regulator sharing the front line in a high-profile sector. The roles of the EA and NE could have as much impact as that of Ofwat in post Brexit onshoring, as the WCWC has pointed out.

29 The WCWC highlighted in its submissions on growth, examples of new industries drawing on water resources beyond any control by Ofwat but within the direct purview of EA regulation. The WCWC understands that there are drivers and behaviours in the Growth Duty common to the three utility sectors and that it is convenient for DBT, and makes common sense, to articulate these together in statutory guidance. In that sense the WCWC supports the revision of the guidance. These revisions will be applicable however the guidance on the Growth Duty is packaged. But it might well be more effective if the economic regulation of water is taken out of the ‘utility box’ and put in a ‘water box’ with the other regulators affecting the water sector.

30 The missing pieces of this mosaic of consultations are references to the impacts of planning and development control by local authorities and that the intervention of the Department of Levelling Up, Housing and Communities (DLUHC) is needed to issue variations to the planning framework. In spite of good intentions by water companies and by Ofwat, planning restrictions can hinder major projects as the controversies on major water supply and storage schemes demonstrate. The WCWC suggests that the DLUHC should also be involved in order to issue revisions to the planning framework. The WCWC has suggested that a closer working relationship between Water UK and the Local Government Association should be developed.

31 A feature highlighted by the WCWC is the constant theme throughout the submissions that the three government departments - Defra, DBT, DLUHC and the Defra ALBs - must work closer. A key feature of all the submissions, and indeed other papers produced by the WCWC, is cooperation and collaboration to produce a national water strategy and consensus on the way forward.

### **An evolution of Ofwat’s Appeal functions**

32 The WCWC has drawn attention to some specific opportunities which would be very good demonstrations of smart regulation. One such example is the very high-profile attention given to sewer connections.

33 New developments should have a legal requirement to deliver SUDS, with exemptions in prescribed conditions, now the subject of government plans to implement Schedule 3 of the Flood and Water Act 2010. The requirement should clarify that separated surface water can be discharged directly to water courses subject to complying with consents issued by the EA which will be the subject of the existing appeals procedure for all discharges. The WCWC



suggests an update of the automatic right to connect to the public sewer network under s106 of the Water Industry Act 1991 to accommodate the requirements for SUDS. Additionally, there is a need to update the process within that Section of the Act available to developers to appeal against any refusal to connect to a sewer to bring it into line with the procedure for appeals to Ofwat for refusal of consent to discharge to a sewer. Both of these points were discussed in the submissions as a very good example of integrated Duties for Growth of regulators in the water sector in addition to the extended Appeal role of Ofwat.

34 Whilst reference is being made to Ofwat Appeal functions the WCWC also pointed out in its August submission on extending the Growth Duty to Ofwat that even if the Growth Duty is extended to Ofwat then there is no obligation for water companies to provide water to non-domestic customers. The WCWC suggested that this obligation should be extended to water companies with the caveat that an applicant could Appeal to Ofwat if an application for supply is refused.

35 So in summary the WCWC is suggesting a major revision of the Appeal functions of Ofwat to cover both of these resolutions of current problems and these would be part of the systemic review suggested by the WCWC.

### **A couple of other points of high-profile interest before the WCWC sets out its suggestions for smart regulation of water in future**

#### **Innovation**

36 Innovation is referred to in the Duty of Growth consultation, but it must form part of all smart regulation; and in its submission the WCWC has pointed to many examples of specific innovation in new investment models, by expanding the appellant functions of Ofwat, by the use of drones for inspections, the evolution of catchment management and so on. The WCWC supports any development of tariff innovation, which is balanced fairly.

37 The WCWC is very supportive of innovation and has pointed out that any technical innovation must always be accompanied by caution in application so that no risks to health and the environment occur. It is co-operating in producing a think piece on innovation since 1974. It is, however, essential that operational and technical innovation must produce a tangible and measurable benefit if it is successful and the regulators should insist that the benefits should be clearly stated before the innovation is adopted.

#### **Customer care**

38 The WCWC also pointed out that the concept of customer care should be embedded in the way that regulators treat the organisations they regulate and to ensure that those regulated organisations are focussed on customer care for the end users, and in that sense is a good example of innovation.

### **SMART REGULATION OF WATER**

39 Smart economic regulation by Ofwat must not be seen as an end in its own right, it must be part of a strategy meeting objectives defined in wider goals for sustainable water services and environment.

40 In the submissions the WCWC outlined some principles of how smart regulation could be applied to the water sector. But in case the suggestions were couched within a longer summary and supporting texts these principles are set out below with some elaboration which enables this overview to be used as a standalone document. The WCWC suggests that these should:

- Develop a national water strategy, and do so urgently.
- Create a national consensus on water including how it can be an effective and safe enabler of a resurgent economy.
- Rebuild public trust by being clearer about the objectives and consequences of delivery plans; this would include a review of the resources available to the regulators and to ensure that the economic regulatory processes embed the principles of trust and customer care.
- Apply a simpler, clearer ‘line of sight’ between the source of investment and the practical application of that investment with optimum return to investors and fair charges to customers. This must form part of the economic regulatory process.
- Accept that innovation in investment must not compromise operational integrity.
- Integration of all the growth duties of all the regulators in the water sector, with separate guidance.
- Establish a closer working of all relevant government departments, particularly DBT, Defra and DLUPHC and Defra arms-length bodies.
- Reduce of the fragmentation of policy and practice.
- Apply a ‘once in a life time’ review of the Ofwat price review and determination processes rather than the current approach of ‘piece- meal’ changes. The WCWC suggests that this should be ready for 2029, implementing the lessons of almost 35 years of experience and acceptance of the economic and financial consequences of all the current demands for improvements to water services. This would embrace the principles of smart regulation as set out here, but preserve the principles of commercial viability. The WCWC suggests that any strengthening of the regulatory process must include extended powers for Ofwat to investigate and regulate the financial structures of the holding companies, all of their subsidiaries and their licenced subsidiary water companies. This will contribute to the rebuilding of public trust but must be done in ways which do not discourage investment.
- Attend to many specific issues which need resolution within this context.
- Recognise more explicitly that economic growth must be environmentally sustainable and incorporate the principles of Natural Capital.
- Plan for the future, learn from the past, act in the present.