



Time to Fix the Broken Water Sector

The case for increased investment in water and 'shadow' strategic priorities for OFWAT



Contents

Foreword	1
Introduction	3
The state of our rivers	6
The massive £10bn funding Gap	7
Response from OFWAT in PR19	7
Asset management failures	8
It's not as if we were not warned	8
Support building for infrastructure investment.....	9
A broken water sector	10
A way forward.....	11
'Shadow' strategic priorities and objectives for OFWAT	13
The environmental imperative, the 25 Year Plan and the Dasgupta Review	14
The 2024 Periodic Review – PR24	16
Making treatment works treat sewage, not rivers	17
Securing long-term resilience in water supply and demand management	19
Protecting customers while allowing for necessary investment – the safety net.....	20
Transparency over OFWAT decisions not to allow investment.....	21
In conclusion.....	23



“The time for yet more endless rounds of discussion and forests of policy papers is over. The time for action is upon us. Will the government, will OFWAT, rise to that challenge?”

Foreword

We are in a climate and biodiversity crisis. Every part of the government, business and civil society must play its part in responding to this new reality. Small, gradual, incremental changes are no longer adequate. More rounds of policy development, price reviews, business and environment plans will not be enough if they follow the same mindset, the same group think, as all the previous rounds.

The government's strategic policy statement for OFWAT may seem a minor, technical matter. But it is vital in showing a new approach is needed from both water companies and the economic regulator. An approach that will respond to the challenges we face, today, and does not, once more, try and put them off the solutions to tomorrow.

The long overdue Environment Bill will soon be on the statute books. This will create biodiversity targets and a commitment to increase the abundance of species that call England home. It will create a new framework for the protection and restoration of our environment. That restoration has to be delivered at the landscape and catchment scale.

In this joint report we have put forward a "shadow" strategic policy statement that sets out precisely the political leadership required from the government.

Water companies and OFWAT have to play their part. This strategic policy statement is the opportunity for government to step up and ensure they do. The time for yet more endless rounds of discussion and forests of policy papers is over. The time for action is upon us. Will the government, will OFWAT, rise to that challenge?



Nick Measham
CEO, Salmon &
Trout Conservation



Jamie Cook
CEO, Angling Trust

'For the first time since privatisation of the water industry, this strategic policy statement must put nature first.'



Introduction

Those interested in protecting the water environment from pollution, over-abstraction and other damage, and restoring English rivers to good ecological status, want a water industry that, as well as being resilient, efficient and innovative, does not over-abtract rivers, lakes and groundwater causing harm to the environment, nor discharge untreated or poorly treated sewage from its sewage treatment works or from sewage overflows.

Rivers, lakes and coastal waters should be free of sewage pollution and should not be used to 'treat' sewage because water companies have failed to invest – or have not been required or allowed to invest – in adequate sewerage systems and treatment works.

Similarly, rivers and streams must not be abstracted to the extent that they cannot support wildlife because water companies have failed to invest – or have not been required or allowed to invest – in alternative supplies of water, demand management measures, proper leakage control or water conservation.

None of this is new – a simple flick through National Rivers Authority reports from the period immediately following privatisation in 1989 shows that the problems the water companies' operations create for the environment have been well understood for decades.

Just before each five-year asset management planning cycle begins, the Secretary of State is tasked with setting out strategic priorities and objectives for OFWAT, the economic regulator of the water industry.

Section 2A of the Water Industry Act 1991 provides that a statement setting out strategic priorities and objectives for OFWAT and how it carries out its functions, having regard for OFWAT's legal duties, social and environmental matters, and such other matters as the Secretary of State thinks fit.

Specifically, Section 2(A) of the 1991 Act states:

1. *The Secretary of State may from time to time publish a statement setting out strategic priorities and objectives for the Authority in carrying out relevant functions relating wholly or mainly to England.*
2. *The Authority **must** carry out those functions in accordance with any statement published under this section.*



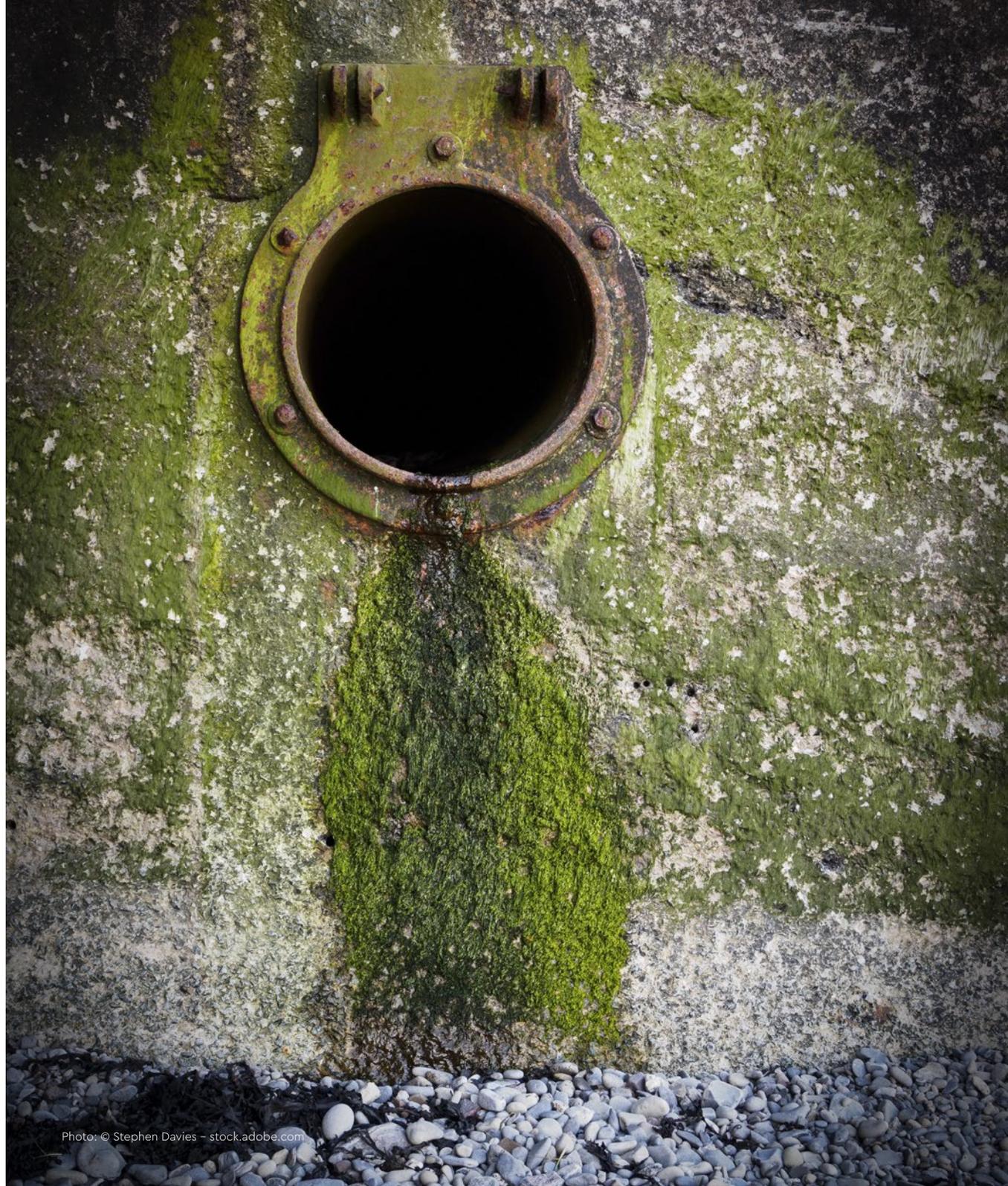
Photo: © Bernd Brueggemann – stock.adobe.com

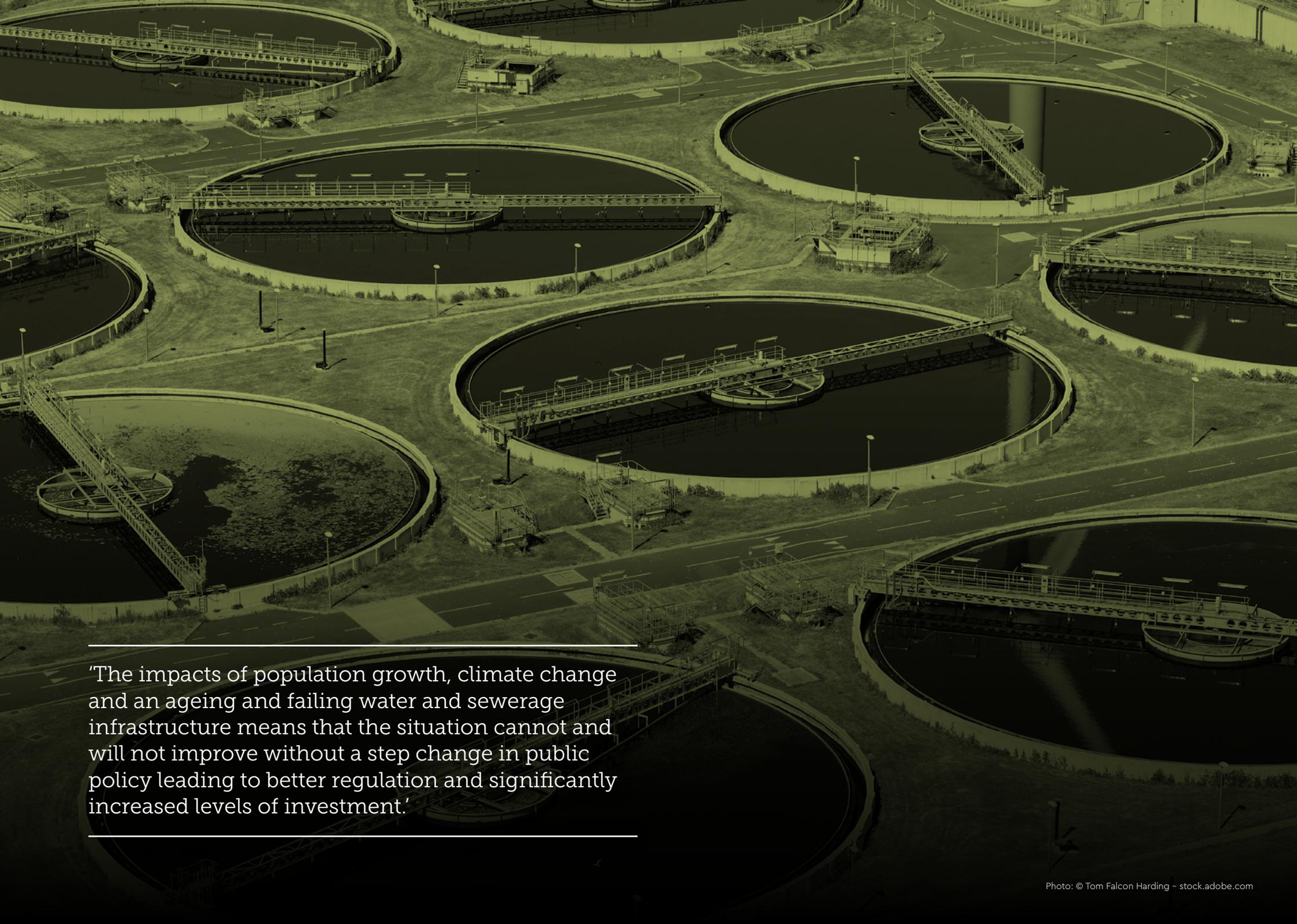
'...rivers and streams must not be abstracted to the extent that they cannot support wildlife because water companies have failed to invest...'

This strategic policy statement (SPS) enables the Secretary of State to deal with the damage being caused by the water industry to rivers, lakes, streams and groundwater by requiring OFWAT to encourage and require more environmental investment.

‘For the first time since privatisation of the water industry, this strategic policy statement must put nature first, indicating to OFWAT that the environmental imperative now needs to drive investment.’

For the first time since privatisation of the water industry, this strategic policy statement must put nature first, indicating to OFWAT that the environmental imperative now needs to drive investment. The Secretary of State should also give a formal direction to the Environment Agency under section 40 of the Environment Act 1995 to support the contents of this strategic policy statement, including requiring the Agency to increase its monitoring and enforcement activity and to assist OFWAT in bringing forward – and removing procedural obstacles to – water company investment in the environment and nature.





‘The impacts of population growth, climate change and an ageing and failing water and sewerage infrastructure means that the situation cannot and will not improve without a step change in public policy leading to better regulation and significantly increased levels of investment.’

The state of our rivers

Many of our rivers and watercourses are in crisis. The impacts of population growth, climate change and an ageing and failing water and sewerage infrastructure means that the situation cannot and will not improve without a step change in public policy leading to better regulation and significantly increased levels of investment. There can no longer be any hiding place for the water regulator, OFWAT, who must be given clear guidance in the SPS to facilitate the resources necessary to drive the environmental improvements needed to deliver broader policy objectives, such as those demanded by the Water Framework Directive and the Government's 25 Year Environment Plan.

As mentioned elsewhere in this paper, England has seen the proportion of water bodies achieving Good Ecological Status fall from a modest 22% in 2009 to a dreadful 14% in 2019. That figure is likely to be worse still next year, with the news that instances of sewage discharges into our rivers have increased by 27% to 400,000 in 2020, and that in once prime rivers, many monitored stretches are now failing to meet phosphate targets and a significant reason for this are poorly operated sewage treatment works.

Precious chalk streams now run dry for much of the year due to over abstraction by water companies who have failed to build reservoirs and other storage facilities to collect surplus water in times of plenty. This means that groundwater abstraction now occurs at the wrong time of year at the expense of wildlife and the environment. In many cases, the level of abstraction from the chalk aquifer is so high compared to the annual recharge of the aquifer that the ecological viability of the chalk stream is compromised.

England's record on the state of our rivers is shameful. Alongside the fact that only 14% of our rivers have been assessed as being of good ecological status and none when it comes to their chemical status, in England we only have one stretch of river, the Yorkshire Wharfe at Ilkley, which has been given designated bathing water status, compared to 32 in German rivers, 76 Polish rivers and 420 French rivers.

Meanwhile pressure from pollution growth and housing development will only make matters worse. The Housing White Paper (2017) set out a need for 225,000 to 275,000 new homes per year to keep up with population growth, adding greatly to both water abstraction and sewage treatment requirements.

Without a step change in investment, which can only occur with the support of OFWAT, the situation will only worsen with dire economic and environmental consequences.

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'England's record on the state of our rivers is shameful.'

The massive £10bn funding gap

Successive governments, and their agencies and regulators, have failed to take water issues seriously preferring instead to pursue cheap bills and to ignore the huge problems that have been mounting up as a result of an ageing and failing infrastructure and increased demand from population growth, coupled with uncertain future of water supply due to climate change.

Given the reluctance of water companies to bring forward investment proposals that will be rejected by the regulator, there has inevitably been considerable 'under bidding' in the process.

However, a look at capital investment figures for the industry for the last decade shows significant cutbacks, even on comparatively modest plans, in successive period reviews (PRs).

- PR09 (which set bills for 2010–15): OFWAT cut £2.1bn of capital investment from business plans
- PR14 (which set bills for 2015–20): OFWAT cut £1bn of capital investment from business plans (of which £100m was for WINEP schemes)

By the time PR19 came around with an increased focus on the environment and on preparing for climate change, one would have expected increased investment to be realised in the final determinations from OFWAT. Instead, we saw the most swingeing cuts of all.

'Successive governments, and their agencies and regulators, have failed to take water issues seriously preferring instead to pursue cheap bills and to ignore the huge problems that have been mounting...'

Response from OFWAT in PR19

Rather than taking note of the clear message from both Government and the Environment Agency that increased investment in water and sewerage infrastructure was long overdue, Ofwat used the next price review once again to reduce required resources and the capacity for improvement.

In PR19, companies' original business plans, submitted in September 2018, proposed £56.3bn of total investment, versus final determinations of £49.6bn agreed by OFWAT.

This represented an initial **cut of £6.7bn** which was later reduced following an appeal by four of the water companies to the Competitions & Markets Authority. The investment plans themselves were inevitably an underestimate of what was needed given the past history of the regulator throwing out infrastructure proposals in favour of keeping water bills low, at the expense of both resilience and the environment.

It is striking that OFWAT pays scant regard to the environmental consequences of their decisions. Up until fairly recently OFWAT didn't have a single employee with any environmental expertise preferring to consider itself to be, first and foremost, an economic regulator.



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Asset management failures

It is beyond argument that much of the English water and sewerage infrastructure is no longer fit for purpose. Burst pipes, sewage leaks and overflows are now an almost daily occurrence in many areas and temporary repairs only mask the need to undertake full network replacement programmes and increased capacity at sewage treatment works.

An examination of the data on water company pipe replacement rates reveals just how long the regulator is expecting us to keep using our existing sewers and associated assets.

Unbelievably the typical replacement/renewal rate is around 0.05% of the network per annum – which implies we are expecting sewers to last for 2,000 years!

By comparison, European averages show most countries have a replacement rate of around 0.5% each year, an expected life of 200 years¹ – which many would argue is still too long. For context, we know that modern PVC pipes can last between 50–100 years depending on various environmental factors such as ground conditions.

The result of this failure to plan resilient asset management programmes is to leave sewers to crumble, leading to floods and water flowing into sewers from the ground (which causes overflows to spill into rivers from overloading), sewage leaking through the ground into waterbodies as part of pollution incidents, and constant problems at sewage treatment works which simply cannot handle the flows.

If the government is serious about getting a grip on pollution from sewage overflows, we urgently need to invest in our assets to stop them falling apart and to make up for decades of underinvestment.

It is not as if we were not warned

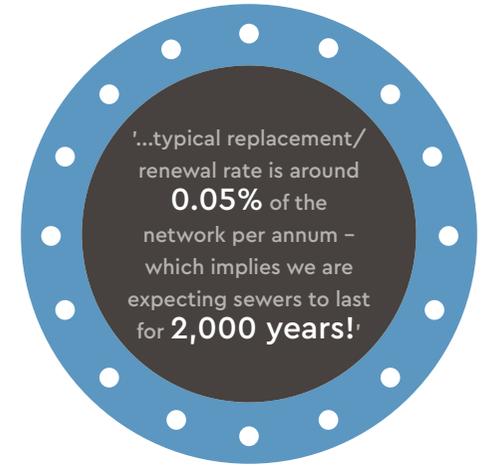
For many years, increasingly stark warnings of impending water shortages and environmental damage have been made in official reports and government policy announcements. However, none of these have been meaningfully reflected in the final water industry capital investment determinations made by OFWAT. As a result, sewage spills and leaks, infiltration into sewers and routine sewage overflows now endanger the health of our already over-abstracted rivers and water courses. This is an issue that has been repeatedly highlighted in reports both from and to government.

2011: the Government published its White Paper – 'Water for Life'²

The White Paper outlined the challenge that climate change and population growth present for future water resources, and the case for action to build resilience and ensure a healthy water environment.

It stated:

"Government will take a strategic overview of the quality and capacity of water and wastewater infrastructure, and the robustness of the sector's plans for future service delivery."



'If the government is serious about getting a grip on pollution from sewage overflows, we urgently need to invest in our assets to stop them falling apart and to make up for decades of underinvestment.'

¹ <https://www.eureau.org/resources/publications/eureau-publications/5824-europe-s-water-in-figures-2021/file>

² <https://www.gov.uk/government/publications/water-for-life>

2018: National Infrastructure Commission Report – Preparing for a drier future³

The report stated that:

"large numbers of households could have their water supplies cut off for extended periods if there is a severe drought. The response to this would cost tens of billions of pounds. In the event of a serious drought, the nation faces an unacceptable risk of severe supply limitations.

"Concerted action is needed to address these challenges, but conflicting incentives, limited cooperation between water companies, and a short-term focus mean that insufficient progress is being made."

2020: National Audit Office (NAO) Report⁴

The NAO report delivered a stark warning on the prospect of severe drought events saying:

"The government must take more concerted action now to prevent parts of southern England running out of water within 20 years."

The country's total water supply is forecast to drop by 7% by 2045 because of climate change and the limits of sustainable abstraction. **Almost all of the public water supply is obtained through abstraction from ground and surface water sources but abstracting too much water can lead to physical changes that reduce biodiversity.**

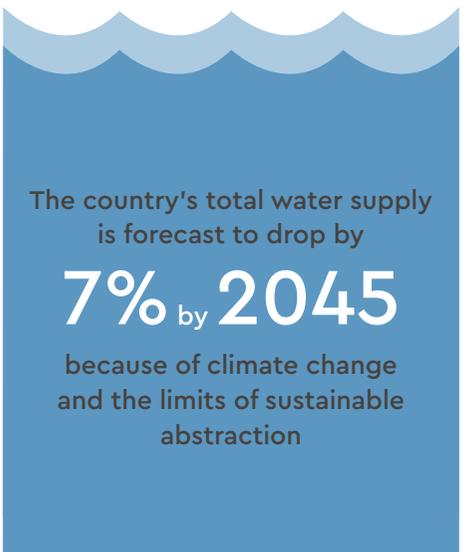
Support building for infrastructure investment

Whilst DEFRA and OFWAT seem reluctant to take the action necessary to avoid the impending economic and environmental crisis that will be triggered by drought events and declining water quality, there have been some encouraging signs of support for the changes needed.

In London, cross-party support from the London Mayors, Ken Livingstone and Boris Johnson, saw plans proceed for the Thames Tideway Tunnel. This £4bn super sewer will remove 36 million tonnes of Combined Sewage Overflows (CSO) sewage discharges into 25kms of the tidal Thames in London, at a cost of less than £25 on water bills. The project has widespread support across the capital and wider Thames Water (TW) region, although TW customers are wanting to see similar investment in their own local rivers such as the Thame and Windrush, that are blighted by sewage discharges.

Up and down the country, angling, boating, swimming and environmental groups are decrying the state of our rivers and calling for both effective regulation and greater investment to ensure their protection.

Last year, the **#EndSewagePollution** Coalition worked closely with **Phillip Dunne MP** – the chair of the House of Commons Environmental Audit Committee, to draft **The Sewage (Inland Waters) Bill**. The Bill sought to place



³ <https://nic.org.uk/app/uploads/NIC-Preparing-for-a-Drier-Future-26-April-2018.pdf>

⁴ <https://www.nao.org.uk/report/water-supply-and-demand-management/>

a duty on water companies to ensure untreated sewage is no longer discharged into England's rivers. This attracted widespread public approval, with over 130 MPs pledging to support the measure in Parliament. Although the Bill ran out of parliamentary time, on 29th March 2021 the government confirmed that it will legislate to bring in three proposed measures: placing a duty on government to publish a plan by September 2022 to reduce sewage discharges from storm overflows; a duty to report regularly to Parliament on progress on implementing the plan; and a duty on water companies to publish data annually on storm overflow operation.

Such a plan clearly cannot deliver the objective of 'reducing sewage discharges from storm overflows' without significant extra capital investment.

Phillip Dunne MP has now called for a doubling in infrastructure investment in the next price review. Speaking at the UK Environmental Law Association (UKELA) annual conference, he said OFWAT's role was key to solving the issue but would be reliant on guidance issued by DEFRA ahead of the next price review.

"Water companies need to double the level of annual investment in wastewater treatment for the next AMP cycle to tackle the contentious issue of managing combined sewer overflows (CSOs)," according to the chair of the Environmental Audit Committee.

On the other side of politics, **Meg Hillier MP**, chair of the Public Accounts Committee, was highly critical of both OFWAT and DEFRA with regard to water resilience⁵.

"It is very hard to imagine, in this country, turning the tap and not having enough clean, drinkable water come out – but that is exactly what we now face. Continued inaction by the water industry means we continue to lose one fifth of our daily supply to leaks.

"Empty words on climate commitments and unfunded public information campaigns will get us where we've got the last 20 years: nowhere. Defra has failed to lead and water companies have failed to act: we look now to the Department to step up, make up for lost time and see we get action before it's too late."

A broken water sector

The focus of this report is on the role and duty of OFWAT and the need for the DEFRA Secretary of State for Food, the Environment and Rural Affairs to require changes to the way the sector is regulated, enabling more investment to flow into measures to protect the environment. However, this must not be used as an excuse by water companies not to address the fundamental structural issues caused by a water supply and management sector that is, in effect, operated on a regional monopoly basis. This leads to inefficiencies and skewed priorities and stands in marked contrast to the situation and ownership structure in Scotland or Wales.

The 2018 report from the University of Greenwich, Public Service International Research Unit, *The Privatised Water Industry in the UK. An ATM for investors*,⁶ reported;

"...the public-owned sector in Scotland delivers the service just as efficiently, albeit at a lower cost to consumers.



Photo: © samopauser – stock.adobe.com

"Empty words on climate commitments and unfunded public information campaigns will get us where we've got the last 20 years: nowhere. Defra has failed to lead and water companies have failed to act: we look now to the Department to step up, make up for lost time and see we get action before it's too late." Meg Hillier MP

⁵ <https://committees.parliament.uk/work/317/water-supply-and-demand-management/news/115817/england-faces-serious-risk-of-running-out-of-water-within-20-years/>

⁶ <https://www.gre.ac.uk/news/articles/public-relations/2018/privatised-water-failure#>

Our econometric analysis suggests that the 40% increase in real household bills since privatisation was mainly driven by continuously growing interest payments on debt, contrary to the regulator attributing them to growing costs and investments. Finally, we show that the accelerating debt levels are primarily the result of disproportionate dividend pay-outs, which exceeded the privatised companies' cash balances in all but one year since 1989. We conclude that the way the industry operates may no longer be sustainable and seems to disadvantage consumers greatly without their knowledge, as there is a fog of misleading statements by the companies and the regulator."

This has contributed to underinvestment by English water companies. NGOs are exasperated Ofwat's failure to tackle this issue. Together with a lack of maintenance and operational improvements, English water companies have preferred to – or in effect been invited by OFWAT to—"sweat their assets" in order to maintain dividend payments and bonuses to shareholders and senior leaders.

A way forward

The Strategic Policy Statement (SPS) is issued by DEFRA to OFWAT ahead of each price review or Asset Management Period (AMP) period. It sets the policy framework for the next five years and is the only real pressure that can be applied to the otherwise 'independent' economic

regulator. The SPS is currently out for consultation and provides a unique opportunity to refocus OFWAT's priorities so that it can facilitate rather than impede public policy objectives, including the Government's own 25 Year Environment Plan (25YEP)

We strongly believe that the SPS must place a requirement on OFWAT to show how each set of its final determinations are consistent with delivering the targets in the Environment Bill and other public policy objectives, including ensuring reductions in over abstractions, an end to sewage storm overflows and security of water supply within clear timescales.

OFWAT would be able to challenge water company plans on efficiency but not scope and be accountable for showing directly how its ultimate decisions were consistent with the statutory goals set out in the Environment Bill, the 25 YEP and other national environmental objectives.

We can no longer accept a situation where decisions taken on something as vital as water resources are made with almost no regard for the environmental consequences.

To assist the Government with its forthcoming strategic policy statement to OFWAT, we have therefore produced the following "shadow" SPS. **We urge the Government to adopt this statement.**

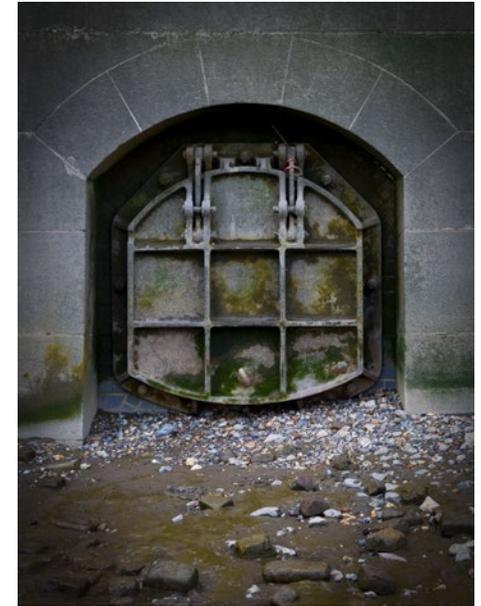


Photo: © London Time – stock.adobe.com

'We can no longer accept a situation where decisions taken on something as vital as water resources are made with almost no regard for the environmental consequences.'



Shadow strategic priorities and objectives for Ofwat

September 2021

Presented to the Secretary of State, in advance of his
statement to be issued to OFWAT under section 2A of
the Water Industry Act 1991

'Shadow' strategic priorities and objectives for OFWAT

Despite oft-repeated claims⁷ that water quality in rivers is better *"than at any time since the start of the Industrial Revolution"*, the Government is very concerned that only 14% of English rivers reach good or better ecological status.

That situation has not improved over the last decade and the Government wishes to make it clear in this statement that the position is unacceptable and should not have been allowed to develop.

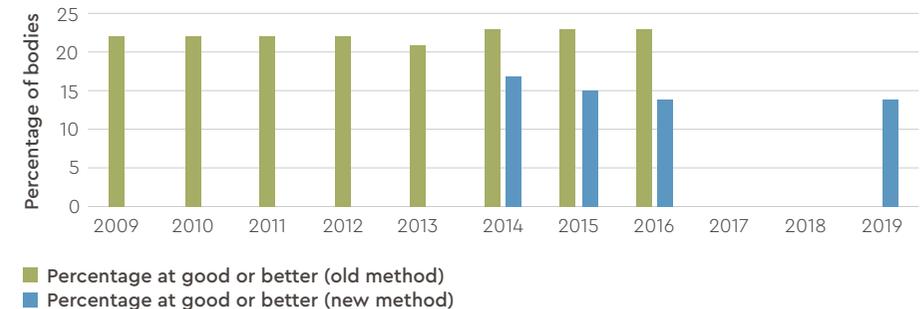
In 2009, 22% of rivers in England had achieved good ecological status⁸. The method of assessment changed in 2014, when, as the Environment Agency (EA) notes,

"the evidence base for status classifications was upgraded", but even allowing for the old method of assessment, there has been no progress since that time.

The graph to the right⁹, compiled using EA data, shows water bodies achieving good or better ecological status between 2009 and 2019¹⁰ and, reveals that there has been no progress for over a decade in this overarching measure of the health of our rivers, lakes and streams.

The Government acknowledges the water industry is responsible for about 1/3rd of those failures.

Percentage of water bodies in England at good ecological status or better 2008 to 2019



⁷ Letter to the Editor, The Times, 3rd August 2019 from the Environment Agency

⁸ Environment Agency (2009) National Statistics for River Water Quality – Forthcoming Changes briefing

⁹ From S&TC UK (2021) Doing Its Job

¹⁰ Environment Agency (2018) The State of the Environment; Water Quality

By any reasonable analysis, the Government can only conclude that regulation of the water industry by OFWAT and the Environment Agency over the last 25 years has failed on many levels to stop damage to English rivers caused by water company activities.

The Government also accepts its own role in this failure and regrets not having given a stronger directive to both OFWAT and the Environment Agency.

The environmental imperative, the 25 Year Plan and the Dasgupta Review

The Government has decided that this price review must be very different to previous ones.

There is now an **environmental imperative** to what happens next and that is supported at the highest levels of Government.

Following the Dasgupta Review ¹¹, the Government is clear that without a protected environment, there can be no sustainable economy and so requires OFWAT to adopt that position in all its decision-making.

The Foreword from the Prime Minister to "A Green Future: Our 25 Year Plan to Improve the Environment"¹², published in 2018, sets the agenda here. The Prime Minister set a goal of cleaner water and strengthening and enhancing the protections that rivers, coastline and wildlife habitats, including aquatic habitats, enjoy.

The Government wants "clean and plentiful water" – this is one of the ten goals set by the 25YEP.

Other goals are to have "thriving plants and wildlife", "a reduced risk of harm from environmental hazards such as flooding and drought", "using resources from nature more sustainably and efficiently", "enhanced beauty, heritage and engagement with the natural environment" and managing pressures on the environment by "mitigating and adapting to climate change".

No fewer than six of the ten goals have direct relevance to this strategic policy statement.

The Government recognises that if we want "clean and plentiful water", water companies have to ensure they provide for supplies of water that are not taken from the environment in a way that damages rivers, lakes and groundwater and the wildlife that depends upon those sources. If water is to be clean, then water companies need to treat sewage effluent to a high standard before it is returned to the wider environment. OFWAT has a central role in ensuring that both of those things happen.

The Government also wants thriving plants and wildlife and so requires OFWAT to ensure that sewage effluent and untreated sewage, when discharged to rivers and lakes, does not cause damage to plants and wildlife as it currently does on many rivers in England.

The Government wants "a reduced risk of harm from environmental hazards, such as drought" which required OFWAT to ensure that, when droughts occur, water companies already have alternative supplies of water that can be used to avoid harm to rivers and wildlife.

The Government wants to ensure that we are "using resources from nature more sustainably and efficiently" and so requires OFWAT to put a higher value on water – not just the water in rivers, lakes and groundwaters but also the water that comes through pipes to consumers' houses.

The Government has promised "enhanced beauty, heritage and engagement with the natural environment" and so requires OFWAT to exercise its functions to ensure that that beauty is maintained and is not damaged by water companies abstracting water or discharging sewage into rivers, lakes and coastal waters.

Simply put, the Government expects OFWAT and the Environment Agency, working together, to ensure that the public's engagement with the natural environment does not involve contact with sewage-polluted waters, whether they be bathing, canoeing, paddle boarding, angling or merely walking along the riverbank.

¹¹ HM Government (2019) Independent Review on the Economics of Biodiversity: Terms of Reference Published 14 August 2019

¹² HM Government (2018) A Green Future: Our 25 Year Plan to Improve the Environment

It is also a Government priority that we manage pressures on the environment by "mitigating and adapting to climate change". OFWAT must therefore ensure that the water supply and treatment systems in England are doing just that, mitigating and adapting to climate change in a way that the DEFRA statement of May 2021 shows that they are currently failing to do.

The 25YEP summarises the policies to be adopted to improve the environment in the whole UK – there is a long list – but the following are directly relevant to how we regulate the water industry in England and Wales.

Per Chapter 2 of the 25YEP – "Recovering nature and enhancing the beauty of landscapes", the Government now has policies of "protecting and recovering nature" and of "respecting nature in how we use water" to "reforming our approach to water abstraction" and "increasing water supply and incentivising greater water efficiency and less personal use".

Per Chapter 4, "Increasing resource efficiency and reducing pollution and waste", the Government is committed to "reducing the impact of wastewater", "minimising the risk of chemical contamination in our water" and "ensuring we continue to maintain clean recreational waters and warning about temporary pollution".

None of these 25YEP commitments and policies will mean anything if they do not now filter down, via this Strategic Policy Statement, into all decision-making processes within OFWAT, and the Government now expects and requires that to happen.

The Government is clear that its commitments cannot be delivered without a massive reduction in water company over-abstraction, and in pollution of rivers by untreated and under-treated sewage.

The Government is also committed to "ensuring interruptions to water supplies are minimised during prolonged dry weather and drought"¹³, but this will not be met without alternative and sustainable sources of water being

planned for and built now. As the 25YEP recognises, "our indicators suggest that as many as one-in-five of our surface waters are over-abstracted"¹⁴. The 25YEP also says that "water companies must develop and implement robust long-term plans that develop new water resources where needed. New supplies will include large infrastructure, such as reservoirs and water transfers, which are needed to make sure the water industry can provide sufficient water for homes and businesses and reduce abstraction from some sources to protect the environment"¹⁵. That is a priority upon which we now expect and require OFWAT to deliver.

The 25 YEP also requires "high environmental standards for all new builds" and that, "new homes will be built in a way that reduces demands for water"¹⁶. It also says that "two factors tend to affect demand on the public water supply: efficiency of use and leakage control. Water companies must take bold action to reduce water demands, both now and for the future". Therefore, OFWAT is directed to require water companies to implement universal water metering and deliver far more successful demand management measures than hitherto, for example through progressive water billing.

The 25YEP also notes that "if it is not properly collected and treated, wastewater (i.e., water from residential premises, industrial wastewater and contaminated rainwater) causes harm to the water environment".

In its previous Strategic Policy Statement to OFWAT in 2017, the Government made it clear that we expected OFWAT to challenge water and sewerage companies to improve the way they manage wastewater to meet the needs of customers while protecting the environment"¹⁷. However, as we can see, progress has not been effective enough since the last SPS, so for this periodic review, the Government must leave no room for doubt with in OFWAT' s mind that poorly managed sewage treatment works and sewage overflows need to be dealt with, **with the duty in section 94(1)(b) of the 1991 Act finally met by all water companies in all locations**. That is not optional.

¹³ 25YEP, at page 27

¹⁴ 25YEP, at page 68

¹⁵ 25YEP, at page 70

¹⁶ 25YEP, at page 35

¹⁷ 25YEP, at page 96

The conclusions of Dasgupta, were foreshadowed in the 25YEP with the Government clear that "the 25 Year Environment Plan will help boost the productivity by enhancing our natural capital – the air, water, soil and ecosystems that support all forms of life – since this is an essential basis for economic growth and productivity over the long term"¹⁸.

The Government has since said that it "agrees with the Dasgupta Review's fundamental conclusion: nature, and the biodiversity that underpins it, ultimately sustains our economies, livelihoods and well-being, and so our decisions must take into account the true value of the goods and services we derive from it"¹⁹ and has committed itself to "a nature positive future in which we leave our environment in a better state than we found it". The Government agrees with Dasgupta that this "requires protecting and enhancing our natural environment and its supply of goods and services on which we all rely" and "also requires ensuring that our collective demands on the natural environment are sustainable".

Overall, the Government has decided that "the Dasgupta Review will continue to shape a significant part of our ongoing efforts as we work with international partners, the private sector, NGOs and others to deliver a nature-positive future and ensure economic and financial decision-making supports that ambition".

Priority: OFWAT is expected and required to note and act upon the new **environmental imperative** as laid out in the 25YEP and in the Dasgupta Review.

The Secretary of State will also be issuing directions to the Environment Agency to exercise its functions accordingly, including to avoid narrow cost-benefit analyses, which are limited in scope in the context of Dasputa, preventing water company environmental investment from proceeding.

The 2024 Periodic Review – PR24

Therefore, in 2024, OFWAT is required to procure water company investment programmes and decide how much environmental investment a water company can deliver in the five years from 2025. These will be passed to the Secretary of State for final approval.

In the context of the current poor state of the aquatic environment – and the understanding that water companies are responsible for about 1/3rd of the problem – the Government believes that it is important to consider what OFWAT's decisions in 2024 will really mean and to communicate that clearly to the public.

Subject to the Secretary of State's final approval, OFWAT will, in effect, be deciding what environmental investments can go ahead and so, in consequence, it will also be deciding how much of the existing environmental damage being caused by water companies must continue unabated.

It is now 30 years since the water industry was privatised and therefore the Government wishes to make it very clear that rolling out the regular excuse that we "inherited a Victorian infrastructure" leading to over-abstraction and sewage pollution, is no longer tenable.

Priority: In the strongest possible terms, and in line with the environmental imperative, the Government now expects and requires OFWAT to deal urgently with the historic underinvestment in environmental protection by water companies since privatisation and to ensure that, going forward, both the sewerage and water supply systems deal with the combined pressures of increased population and climate change.

¹⁸ 25YEP, at page 18

¹⁹ HM Treasury (2021) *The Economics of Biodiversity: The Dasgupta Review Government response*

Making treatment works treat sewage, not rivers

In May 2021, when announcing amendments to the Environment Bill to require water company plans to deal with storm water overflows, the Government stated that sewerage infrastructure has not kept pace with population growth and is also under pressure due to climate change.

"During wet weather, storm overflows act to prevent sewers becoming overloaded with a combination of sewage and rain and release diluted wastewater into rivers. However, their use has increased in recent years as climate change has led to greater rainfall and water infrastructure has not kept pace with population growth".

The Government acknowledges that this failure to invest is the fault of previous Secretaries of State and OFWAT, going back to privatisation. They have presided over every 5-year asset management planning cycle and are directly responsible for the cumulative underinvestment by water companies.

For example, in 2019 OFWAT removed hundreds of millions of pounds of investment from water company business plans (with only marginal impacts on consumer bills) with inevitably damaging impacts on the environment. The Government is clear that this pattern must be broken.

Under the Water Industry Act 1991, OFWAT and the Secretary of State have had duties to protect the environment and to secure a sewerage system operated by water companies that takes into account the likely environmental pressures in the future. They have failed to do so.

This has occurred despite the Government's Social and Environmental Guidance to OFWAT in 2013²⁰ suggesting that "water and sewage companies should continue to actively plan for new development and increasing demands on both water and sewerage networks... to ensure that the system is resilient and capable of supporting sustainable growth".

That 2013 Guidance to OFWAT also said that "the Government expects OFWAT to work towards the targets of its adaptation report to ensure that its regulatory approach enables companies to adapt to climate change as efficiently as possible". OFWAT's adaptation report referred to identified risks of climate change relating to water supply and demand, asset resilience, discharge of wastewater to the environment and the coping capacity of sewer systems. OFWAT undertook to take action if water and sewerage companies failed to meet their obligations²¹

In respect of sewer capacity, the 2013 Guidance said "water and sewage companies should continue to actively plan for new development and increasing demands on the sewer system, and to ensure that the system is resilient and capable of supporting sustainable growth and meeting the challenges of increased rainfall from climate change"²².

The same exhortation was repeated in the Government's 2017 Strategic Priorities and Objectives to OFWAT²³ that "OFWAT should challenge water companies to make sure that they assess the resilience of their system and infrastructure against the full range of potential hazards and threats and take proportionate steps to improve resilience where required" and "OFWAT should challenge water companies to improve planning and investment to meet the wastewater needs of current and future customers".

However, the Environment Agency has acknowledged that only 14% of English rivers now meet good ecological status as defined by the Water Framework Directive and that sewage pollution continues to contribute significantly to that failure. Something more fundamental than merely 'continuing to plan' against increasing demands, or vaguely 'challenging the water companies to do better' is now clearly needed.

One area where systemic reform is necessary and, equally, where significant opportunities for improvement lie is in the quality of water company performance 'on the ground' rather than 'on the balance sheet'. In particular, the Government

²⁰ DEFRA (2013) Social and Environmental Guidance to OFWAT, at paragraph 3.8.2

²¹ 2013 Guidance paragraph 3.6.3.

²² 2013 Guidance paragraph 3.10.1

²³ DEFRA (2017) The government's Strategic Priorities and Objectives to OFWAT, at page 5, paragraph 19

must now remind OFWAT that there should be no policy in relation to sewerage treatment systems (as in fact there has been) of "sweating the assets" – deriving the highest financial output for the lowest resource input, often involving corner cutting – which obviously carries the risk that excessive quantities of sewage will be discharged to rivers untreated or undertreated. (This is borne out by the recent £130 million penalty and £90m fine issued to Southern Water, who had been engaging in just such 'asset sweating' rather than proper maintenance, monitoring and quality control.)

As recently brought to public attention by the work of Professor Peter Hammond, rigorous data collection and analysis – never before attempted by either industry or regulator – points to systemic maintenance and operation failures, with accompanying permit breaches likely on a widespread scale. The causes are often detailed maintenance/operational failures from lack of investment in this area – such as inadequate utilization of storm tanks, pump failures, and excessive infiltration to the sewer network, all of which contribute to unnecessary sewage spills and/or exceedance of works design capacity. Specifically, the Government therefore expects and requires OFWAT to work with the Environment Agency and the water companies to ensure that, over the next three years, all environmental permits for sewage works contain enforceable flow conditions, including against openly monitored inflow and flow-to-full-treatment (FFT) – the primary metrics against which the permits can be enforced – and to require water companies to report publicly in real time on whether or not the varying inflows have been treated as permitted, and whether the works are of sufficient capacity to deal with the inflows they typically receive from their sewer catchments in all but extreme weather events.

If any under-capacity is identified, OFWAT is expected and required to ensure that water companies bring forward the earliest possible plans to rectify that under-capacity. In fact, this may often be achievable by dealing with network infiltration, something which can and should be achieved in the relatively short-term, rather than necessarily by increasing works capacity, at a much higher cost and over a much longer time period.

Finally, the Government expects OFWAT to ensure that the water companies comply with their existing duties under the 1991 Act, including section 94(1)(b) that sewage is "effectually dealt with by means of sewage treatment works", which has not been met at so many locations across England for so many years, particularly in relation to the CSO spills that are increasingly prevalent, and will expect OFWAT, in collaboration with the Environment Agency, to pursue robust enforcement.

Priority: The Government expects and requires OFWAT to reverse the situation that has been allowed to develop where sewerage infrastructure, and particularly its maintenance, has not been required to conform to adequate engineering and operational standards, let alone kept pace with population growth and climate change. OFWAT is reminded of its statutory duty to enforce the requirements of the Water Industry Act 1991, including the duty per section 94(1)(b) on water companies, to effectually deal with the contents of sewers (in effect, to treat sewage so that discharges made to rivers and coastal water are not polluting) and the Government now directs OFWAT to ensure water companies comply with the 1991 Act.

Securing long-term resilience in water supply and demand management

On water supply, the Environment Agency has reported that over-abstraction causes the failure to meet good ecological status on many waterbodies. With a rapidly rising population and plans for significant increases in house building, demand for water will continue to grow. Yet there has been minimal investment in new storage solutions, resulting in further pressure on already depleted groundwater and surface water sources.

For example, in the Thames Water region, the most recent reservoirs built in their supply area were Queen Mother reservoir in West London and Farmoor 2 in Oxfordshire, both completed in 1976. No further significant reservoir provision has been made during a period of unprecedented population growth in the area.

The Thames Water supply area growth forecast is in the table below. Since the early 1990s, following privatisation and when the water companies started to report data, population growth in the TW area has increased by around 3 million (7.3m in 1993 to 10.1 m in 2020). TW has reviewed future growth forecasts ahead of WRMP24 and these are shown in the table below in red font. Over the next 50 years they forecast an increase in population in their supply area of around another 3 million. (2020: 10.1 m and 2070 13m)

Thames Water needs to plan a secure and sustainable water supply for the growing population alongside meeting the challenges of a changing climate and the need to protect and improve the environment. This cannot be achieved without constructing new storage facilities such as the long overdue Abingdon Reservoir, which would take pressure off some of the already over-abstracted Thames tributaries.

	TW Supply Area AR data					TW supply area – WRMP24 Forecast data				
	1993	2001	2010	2015	2020	2025	2040	2060	2070	2100
Pop (k)	7,286	7,852	8,667	9,554	10,112	10,631	11,650	12,709	12,997	13,720

The Environment Agency has reported that a large number of rivers are over-abstracted or at serious risk of being over-abstracted. Despite the Environment Agency's Restoring Sustainable Abstraction programme, which has prioritised those waterbodies also enjoying protected area status under conservation legislation, there has not been sufficient action to deal with over-abstraction and climate change is expected to exacerbate that problem.

The Government's Social and Environmental Guidance to OFWAT from 2013 had identified²⁴ that "it is essential that the water resources planning process and price review process are aligned to ensure water companies deliver the best outcomes for customers and the environment..." and that "the Government expects OFWAT to work closely with the Environment Agency and to use their regulatory tools and mechanisms to incentivise water companies to identify sustainable sources of water, avoid environmental damage and be able to finance plans for alternative ways of meeting their supply-demand balance"²⁵.

The Government's 2017 Strategic Policy Statement²⁶ made it an express objective of OFWAT that "OFWAT should further a reduction in the long-term risk to water supply resilience from drought and other factors, including through new supply solutions, demand management and increased water trading".

Concern over the resilience of national water supplies has again been raised in 2020 at the highest level, by both the Public Accounts Committee and the National Audit Office.

²⁴ 2013 Guidance, page 34, paragraph 3.2.2

²⁵ 2013 Guidance at 3.3.2

²⁶ 2017 Strategic priorities, at page 3, paragraph 11

Therefore, the Government now expects and requires OFWAT to deliver on the earlier objectives given to it in 2013 and 2017 to ensure that water companies identify and bring into full operation alternative sources of water where existing abstractions are known to, or suspected to, cause environmental damage and prevent rivers, lakes or groundwater achieving good ecological status. This matter has been trailed over many years and it should be no surprise to OFWAT or to the water companies it regulates that the Government now seeks urgent action – and will step in to force more urgent action here, if required.

Specifically in respect of demand management, OFWAT should now be directed to ensure that water and sewage companies bring forward plans for compulsory water metering and a strongly progressive charging system based on volumetric charging as is the norm for other utilities.

OFWAT should now require water companies to encourage and implement as far as possible the reuse of grey water by new builds, and by retrofitting of old properties, achieving a reduction overall in domestic and commercial use of water supplies.

The Government wishes to make it clear that OFWAT needs to do more to secure an overall reduction in water demand per capita and to use its functions as the economic regulator of the water industry to eliminate over-abstraction of English rivers, lakes and groundwaters as a priority.

Priority: the Government expects and requires OFWAT to exercise its functions to deliver water industry investment in alternative water supplies and in demand management, such that rivers are rapidly protected from being over-abstracted, in line with the environmental imperative, and that water supply for consumers is made resilient to the challenges of periodic droughts, climate change and population growth, without harming the environment.

Protecting customers while allowing for necessary investment – the safety net

In the 30 years since privatisation, OFWAT has considered its overarching priority to be controlling any rise in water bills, often with Government 's overall support and approval. What the 1991 Act terms as "the consumer objective"²⁷ has been over-riding when OFWAT has carried out its price review functions every five years. Overwhelmingly, OFWAT has taken that to mean that water bills must be kept down.

However, that consumer objective, by law, includes the interests of both current and future consumers, including in relation to the supply of water and the provision of sewerage services.

It is not just about keeping today's water bills down at all costs. Consumers of water are the same people that want cleaner and flowing rivers, unpolluted coastal waters and flourishing aquatic wildlife as the recent focus on pollution from water company combined sewer overflows (CSOs) has shown.

As the Chair of the Environment Audit Committee, Philip Dunne MP has said, the timing of momentum around CSOs is "near perfect" to align with this strategic policy statement.

The Government now expects OFWAT to take bold decisions in recognising that water companies need to increase investment significantly as part of overall 'green recovery' spending, post-Covid.

The Government is also clear that the consumer objective can only be served by pursuing the new **environmental imperative**.

Of course, the issue of water bills and ability to pay needs to be recognised, but the statutory system set up under the 1991 Act already allows for OFWAT and the Secretary of State expressly to have regard to the interests of individuals who are

²⁷ Section 2 of the Water Industry Act 1991 imposes general duties with respect to water industry on both the Secretary of State and on OFWAT. Section 2(2A) requires both to "exercise and perform the powers and duties mentioned in subsection (1) above in the manner which he or it considers is best calculated (a) to further the consumer objective"

disabled, chronically sick, of pensionable age or have low incomes – exactly those groups that might be penalised by rising water bills.

The Government is strongly of the view that, despite resistance, it cannot be beyond the abilities of OFWAT and the water companies to devise a system that provides a strong social safety net to those groups, while ensuring that for those of us able to pay a little more via a progressive billing system, so sufficient investment can be derived from water bills in order to protect the environment.

As Dasgupta reminds us, it is not only in the interest of the environment that environmental investment occurs rapidly. It is also in the best interests of the consumers that OFWAT is there to protect.

Further, the Government reminds OFWAT that the polluter pays principle is about to be enshrined in UK law through the Environment Bill.

In the context of water supply and sewage, all consumers are almost by definition polluters in that water used in both domestic and commercial situations is returned to the sewerage network in a polluted state and requires treatment.

The Government recognises, as it has done for many years, that an adequate social safety net is required to protect low income and other vulnerable water users from rising water bills. The Government's Social and Environmental Guidance to OFWAT of 2013 identified that "protecting and supporting vulnerable groups is a Government priority. Alongside its general duty to protect the interests of all consumers, OFWAT has particular responsibilities towards certain groups in society; the disabled or chronically sick, pensioners and individuals with low incomes".

The priority to be given to certain bill payers was repeated in the September 2017 Strategic Policy Statement in which Government noted that "OFWAT should challenge the water sector to go further to identify and meet the needs of customers who are struggling to afford their charges".

The Government is now clear that OFWAT must now, as a priority, impose a sufficient social safety net to protect all groups of vulnerable customers from rising water bills, but it must then recognise that for those sections of society and commercial operations that can pay, the polluter must pay, as that principle is now shortly to be enshrined in UK law.

To that end OFWAT should no longer seek to constrain water bills, except for those in vulnerable groups, where so constraining bills leads to the lack of investment in sewerage infrastructure that DEFRA has acknowledged this year, the failure to treat sewage before discharge to rivers, or the failure to develop alternative supplies of water and increase demand management, leading to over-abstraction of rivers, lakes and groundwater and damage to the environment.

Priority: The Government expects OFWAT to place great weight on the environment imperative. In order also to fulfil the consumer objective, the Government now expects and requires OFWAT to ensure, with water companies, a sufficient social safety net is put in place rapidly to protect all groups of vulnerable customers from rising water bills, while recognising that for the majority, water bills should no longer be constrained at the cost of environment and the capacity and resilience of both water supply and sewage treatment systems.

Transparency over OFWAT decisions not to allow investment

The Government reminds OFWAT that both it and all the water and sewerage companies are public authorities for the purposes of the Environmental Information Regulations 2004 and that they have a duty proactively to publish environmental information they hold. This is not optional. It is and has been a requirement on OFWAT and the water companies since 2004 and the Government expects OFWAT to ensure that the water companies now comply fully with the law on freedom of information.

OFWAT's decisions have a real impact on the wider environment and the public has a right to know and understand the effect of those decisions. The Government therefore expects OFWAT to publish in a format readily accessible to the general public, details of the proposed investments from water companies to deal with environmental problems, whether they be related to capacity to treat sewage prior to discharge to rivers or avoiding damage to rivers, lakes and groundwater from over-abstraction. The Government also requires OFWAT to

publish details and be clear where its decisions not to allow investment by water companies will lead to existing environmental damage persisting in rivers, lakes and groundwater, including how long OFWAT expects such damage to persist without being addressed.

For the avoidance of doubt, the Government will expect OFWAT to be able to justify as against the Government's 25 Year Environment Plan, the Dasgupta Review and the Government's plans to adapt to climate change, any decisions it makes to reject or reduce investments proposed by the water companies to deal with such matters or where investments are requested by the water companies or the Environment Agency to address any existing non-compliance with relevant permits or abstraction licences.

That will also apply to any proposed changes required by Natural England for the express protection of species or designated protected areas.

Priority: The Government expects OFWAT to ensure that the water companies perform their duties under the Environmental Information Regulations 2004 fully, including to publish proactively all environmental information they hold per those Regulations. The Government also expects and requires OFWAT to be clear on the environmental impacts of any decisions it makes to provide for, or not to provide for investment by the water companies in the next and all future periodic price reviews.

In conclusion

The 2017 Strategic Policy Statement required OFWAT to have regard to the Government's then forthcoming 25 Year Environment Plan. OFWAT was given the express objective that it "should challenge companies to further the resilience of ecosystems that underpin water and wastewater systems by encouraging the sustainable use of natural capital and by encouraging water companies to have appropriate regard to the wider costs and benefits to the economy, society and the environment".

In 2021 and going forwards, the Government now expects and requires OFWAT to ensure that the aims of the 25 Year Environment Plan, the fundamental findings of the Dasgupta Review and the need to meet existing legislation and no longer tolerate long-term failures to deal with sewage pollution or over-abstraction, are now met.

OFWAT must now require water companies to bring forward significant investment plans to deal rapidly with the long-term failure to deal with both the lack of sewerage capacity and treatment and the need to avoid over-abstraction causing damage to the environment and be clear and transparent about the effects on the environment – both positive and negative – of any decisions made.

Most importantly, when exercising its statutory functions, OFWAT is required and expected to consider the **environmental imperative** as its over-riding priority.



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