



Department
for Environment
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Sir Brian Bender
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31st January 2019

Dear Brian,

Thank you for your letter of 17 December, setting out the actions water companies are taking to mitigate against climate change, and to protect and enhance the environment. Today, Ofwat has published its initial assessment of their business plans and in light of this I would like to reiterate some of the government's priorities for the sector.

Business plans

I have been clear that the private water model can deliver the best outcomes for customers and environment at the best value price - when it is underpinned by strong regulation and companies working harder in the public interest, not just in the interest of shareholders. While Ofwat's initial assessment indicates that some companies are stepping up to this challenge, this is by no means the case for all. I am disappointed to see that the plans submitted by Thames Water, Southern Water and Affinity Water have been assessed as requiring 'significant scrutiny', not least as these operate in the most water-stressed regions. I fully expect the revised plans to be more ambitious in delivering for customers and the environment, and I continue to offer Ofwat my full support in holding companies to account.

At the same time, I would like to congratulate South West Water, Severn Trent and United Utilities for receiving a 'fast track' initial assessment for their draft business plans. This is a notable achievement as between them they supply nearly a third of all customers.

It is vital that we have a water industry that works for everyone, and for the environment as a whole. Over the past 12 months I have challenged the sector to become ever more efficient, more transparent in its financial structures and more focused on cutting costs for consumers. Because we have no substitute for water, and because these companies operate a natural monopoly – most of us cannot take our business elsewhere – they enjoy a particularly privileged commercial advantage. The onus is on them look after the needs of the natural world as well as customers

Across the industry, I am pleased to note that companies are planning a step-change in their support for vulnerable and less well-off customers. Although they are tackling unacceptable



levels of leakage I would nonetheless expect companies with the highest leakage rates, such as Thames, and those who have not committed to a 15% reduction, namely South East, to be aiming to go even further. It is a promising sign that a number of companies plan to reduce leakage by 50% by 2050.

Coming to the use by some companies of sophisticated financial engineering, I share Ofwat's view that all companies will need to ensure that incentives for owners (from dividend policies) and for executive teams deliver the best outcomes for customers. On the issue of gearing, I am disappointed to see that Thames Water and Yorkshire Water have not yet accepted Ofwat's default mechanism to share financial benefits of high gearing.

Environmental outcomes

It is crucial for *all* water companies to be responsible custodians of the environment. In line with our 25 Year Environment Plan goals, some companies are committing to do more to protect and enhance our natural environment. I want to see the industry go even further in developing catchment management plans, improving long-term water resources planning, and investing in new water supply infrastructure to make the network more resilient to extremes of weather and demand.

In this light, I look forward to forthcoming announcements from the sector on the further action they will take to protect the environment.

Our vulnerable peatlands are crucial habitats for wildlife, help with flood management, improve water quality and play a part in climate regulation. Understanding the water industry's long-term goals for peatland restoration will be helpful for our policy development in this area. Defra continues to support the development of the Peatland Code and would welcome thoughts from Water UK on potential funding mechanisms as we prepare to publish the England Peatland Strategy later this year.

I also look forward to hearing more about the role of the sector in planting trees. Woodland creation is a key part of the 25 Year Environment Plan. This government has a commitment to planting 11 million trees by 2022, and an additional one million in urban areas. Water companies could be a key partner in helping the government to achieve these ambitions and I encourage them to meet with the Defra Tree Champion, Sir William Worsley.

Resource management

Water companies have a key role to play in climate change adaptation. The challenge is considerable. Our refreshed UK Climate Projections show that up to 2100 our environment is likely to experience more extreme weather, with hotter, drier summers and wetter winters. In the UK, we tend to take for granted a plentiful supply of clean water. Yet our high population density means the available water per person is actually less than in many Mediterranean countries. The impact on soil quality and supply during summer 2018, and the evidence of projections that prolonged hot spells will become more frequent, underscore the need to make our water supplies more resilient.

It is for the water sector to rise to the challenge of managing and conserving this precious natural resource. I was pleased that companies managed to avoid disruptions to supply last summer, but I want them to go further to address pressures on water resources. They must prioritise flood reduction and drought mitigation, and also reduce demand, particularly by showing more ambition in reducing *per capita* consumption and continuing to act on the leaks which every day lose us three billion litres of water, over a fifth of our total supply.

As set out in the Water Conservation Report, Defra will launch a call for evidence and a consultation in spring this year into the different policies and levers available to bring down water use. This will deliver a recommended *per capita* consumption target in litres per person per day. It is important that water companies engage in this exercise and bring their experience and expertise in this area to bear.

Given the range of challenges ahead, I was particularly pleased that 19 water companies responded positively to my invitation to report under the third round of the Adaptation Reporting Power. Water UK members can be confident of Defra officials' support through the reporting process. I also look forward to Ofwat's plans to promote water transfers and other shared infrastructure through a special purpose unit. Together with investment in new water supply infrastructure and demand management schemes, this will be critical in securing longer-term resilience, as set out in our strategic policy statement.

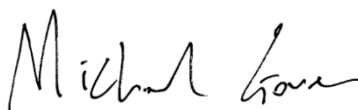
I recognise the continued support from water companies for the Environment Agency's National Framework for Water Resources. This will inform expectations and set clear challenges for water resources plans to address. As set out in a joint regulator letter of 9 August 2018, I expect water companies to take a genuinely regional approach to producing plans that transcend company boundaries and identify optimum solutions.

Financial resilience

Given the significant investment needed to improve longer term resilience and environmental and operational performance, it is vital that the sector continues to attract low cost finance. I am confident that Ofwat will meet its duty to ensure that efficiently-financed companies can continue to finance their regulated functions.

Our current consultation, 'Improving our management of water in the environment' is seeking views on a number of planning and regulatory measures to support further action on ensuring the resilience of water resources and wastewater and the mitigation of flooding. My officials are looking to arrange a roundtable discussion soon in order to go over these measures in more detail. This would also provide the opportunity to discuss the industry's commitments and wider strategies in relation to environmental improvement.

With every good wish



Michael Gove