

Department for Environment, Food and Rural Affairs

Water Bill

Organisations involved in the regulation of the water sector

February 2014

This is one of a series of briefing notes on the Water Bill. This note sets out the organisations involved in the regulation of the water sector in England and Wales. Further detail on the Water Bill can be found in other briefing notes.

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Regulation of the water sector

Following privatisation, regulation of the water industry has been effective in protecting consumers and the environment. The water industry is regulated by four independent bodies, each with a specific area of responsibility and expertise. These are: the Drinking Water Inspectorate, the Environment Agency, Natural Resources Wales and Ofwat.

It is for the regulators of the sector, in particular Ofwat, the Environment Agency, the Drinking Water Inspectorate and Natural England to work together to achieve a comprehensive and appropriate regulatory regime. All of these parties are required to put in place memoranda of understanding between one another in areas of mutual interest.

Drinking Water Inspectorate (DWI)

The DWI is the independent regulator of drinking water in England and Wales, responsible for ensuring that companies provide safe drinking water that is acceptable to consumers and meets the standards set down in law. In England and Wales, in 2012, 99.96% of water met national and European standards.

The Water Bill will enable the Secretary of State to make an order conferring a power on the DWI to set charges for the costs of carrying out its regulatory activities. There are equivalent powers for Welsh Ministers.

The DWI will be a statutory consultee when Ofwat proposes to issue an upstream water supply licence or make a new inset appointment. The DWI must also be consulted when codes are prepared for the reformed WSL and inset regimes.

Environment Agency and Natural Resources Wales

In England, the Environment Agency is responsible for protecting and improving the environment and promoting sustainable development. In Wales, since April 2013, these functions are performed by Natural Resources Wales (NRW). In the water and sewerage sector, both bodies regulate the abstraction of water from the environment as well as the treatment and discharge of wastewater, sewerage and sewage sludge back into the environment. The Environment Agency and NRW also provide guidance to help water companies with their longer term water resource management and drought planning functions.¹

¹ Each incumbent water company must publish a water resource management plan every five years, which sets out how they plan to maintain water supplies over the next twenty five years. They must also publish a drought plan every three years that sets out how they would intend on managing a drought. The Water Bill will change the frequency of the drought plans from three to five years as well as enabling the Secretary of State (in respect of customers that are supplied by licensees wholly or mainly in England) and Welsh Ministers (in respect of customers that are supplied by licensees wholly or mainly in Wales) to change the frequency.

These bodies will be statutory consultees when Ofwat proposes to issue an upstream water supply and sewerage licence or make a new inset appointment. They may also be consulted when codes are prepared for the reformed WSL and inset regimes.

Ofwat (the Water Services Regulation Authority)

The Water Services Regulation Authority (Ofwat) is a Non-ministerial Government Department. Ofwat's board takes decisions independently of Ministers and are directly accountable to Parliament.

Ofwat is the economic regulator for the water and sewerage sectors in England and Wales. It is responsible for regulating the water industry and ensuring that water companies provide consumers with a good quality service and value for money. This includes setting price limits to ensure that customers receive a fair deal while allowing water companies to raise sufficient revenue for investment; monitoring water companies' performance and taking action to protect consumers' interests (including investigating uncompetitive behaviour); setting efficiency targets for water companies; and making sure that companies deliver the best deal for consumers and the environment in the long term.

The five-yearly **price review** is Ofwat's main mechanism for setting price limits on incumbent water companies.² It incentivises efficiency by allowing shareholders to benefit from any performance that exceeds a target rate of improvement.

The next price review process will conclude in December 2014 ('PR14'), covering prices from 2015 to 2020. Ofwat have reformed their approach in PR14, putting customers at the heart of the process and allowing companies greater ownership of their business plans, setting their own outcomes (in line with their customers' priorities) and associated incentives and penalties. In previous price reviews Ofwat signed off all schemes proposed by water companies.

The PR14 methodology includes separate (targeted) retail price caps for household and non-household customers to ensure a greater focus on customers – and also ensure that household customers will not pay more as a result of competition in the non-household market. The approach in PR14 will also incentivise companies away from over-reliance on capital intensive solutions towards those which are most sustainable and cost-efficient.

The Water Bill will improve Ofwat's regulation of the industry by strengthening its powers to ensure that the new markets operate efficiently, fairly and effectively. It will also introduce a new overarching duty for Ofwat to take into account long term resilience when carrying out its duties.³

² The price cap takes account of factors including the overall rate of inflation, capital investment requirements, and the company's ability to make efficiencies.

³ NB: As with all the general duties with respect to the water industry this duty will also apply to the Secretary of State.

Water Industry Commissioner for Scotland (WICS)

WICS carries out similar functions to Ofwat in Scotland where new entrants can also be licensed to provide water and sewerage retail services. New entrants cannot be licensed to provide upstream services in Scotland. Under the Bill, an application for a licence made to WICS may be treated as if it has also been made to Ofwat (and vice versa).

Consumer Council for Water and Consumer Council for Water Wales (CCWater and CCWater Wales)

CCWater is not a regulator but also plays an important role in the industry by representing water and sewerage consumers in England and Wales. It also handles some customer complaints about incumbent water companies, inset appointees and licensees. Ofwat and CCWater have mutual duties of co-operation and information sharing, and CCWater will be a statutory consultee in the preparation of Ofwat's charging rules.

Market Operator

The market operator will be a company formed to hold a register of premises eligible to switch. It will also facilitate switching and financial settlement between incumbent water companies and licensees. It is common for such bodies to be established to simplify switching processes.

The market operator will act, effectively, as an agent for incumbent water companies and licensees once the market is established. The role of those market participants and how they will interact with the market operator will be set out in their licences and in market codes.

The market operator will not have any statutory roles, duties or responsibilities within the retail market. It will handle routine transactions and communications between incumbents and licensees to help them meet their statutory and regulatory obligations as prescribed by legislation, codes and their licences. The market operator will not take over any responsibilities that properly belong with incumbents, licensees or regulators.

The equivalent in Scotland is the Central Market Authority. This was similarly set up by the Scottish regulator and is now owned and managed by market participants operating in the Scottish retail market. The Central Market Authority in Scotland manages switching between retail licensees and calculates the wholesale charges the licensees have to make to Scottish Water.

Defra

It is the Government's responsibility to establish the strategic framework and policy priorities within which regulators such as Ofwat, the Environment Agency and DWI must operate. Defra sets out the policy priorities that the regulators have a particularly important role in delivering; and against which they will be held to account in respect of their independent regulatory decisions.

However, the Government does not constrain any of the bodies' regulatory independence or in any way limit their freedom to adopt what they consider to be the most appropriate regulatory approach to delivering outcomes in the light of the priorities set by Government.

How these bodies work together

All of these bodies work together closely and constructively to ensure the sector is regulated in a consistent and clear way. They work in partnership to streamline processes for companies and give clear signals as to which entity is responsible for what.

For example, Ofwat, the Environment Agency and the Drinking Water Inspectorate agreed to strengthen their working relationships to provide clear signals to the companies on delivering the outcomes of the Water White Paper. Defra works closely with the regulatory bodies to minimise the burdens on companies and simplify planning processes. This included bringing forward some of the work for River Basin Management Plans to enable their delivery through the 2014 price review. The Water Bill helps by aligning the timetable for drought plans and Water Resource Management Plans.

Similarly, the Environment Agency and the Drinking Water Inspectorate have a strong role through the price review process. Both regulatory bodies are involved through the Customer Challenge Groups in the shaping and testing of company business plans. They provide assurance to Ofwat that the business plans meet the relevant requirements.

These bodies all have shared duties, such as the protection of customers. They also have memoranda of understanding for mutual co-operation to facilitate their close working relationships.

The *Review of Ofwat and consumer representation in the water sector*⁴, carried out for Government by David Gray, recognised the complexity of having numerous regulators, but went on to say "we received a clear message that the system works".⁵ The review found that there were important strengths to the three-regulator system. In particular, the review argued that the diversity of bodies allows transparency over the trade-offs between economic regulation, drinking water quality and environmental regulation. It also maintains the crucial independence of the role of economic regulation, which is critical to the perception of the stability of the regime among investors and lenders to the sector.

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69442/ofwat-review-2011.pdf

⁵ At p.16

Regulation of the discharge of water

Local Government: SuDS Approving Bodies

In England, Schedule 3 of the Flood and Water Management Act 2010 (when commenced) will establish SuDS Approving Bodies (SABs) in unitary authorities (in single tier local government) and county councils (in two tier areas), and gives those bodies statutory responsibility for approving drainage applications and, where those drainage systems serve more than one property, the statutory duty to maintain approved SuDS.

SABs will:

- Evaluate and approve drainage applications for new development or redevelopment where construction work has drainage implications; and
- Adopt and maintain sustainable drainage systems in new developments that meet the evaluation criteria set out in the Ministerial National SuDS Standards that have been approved; where SuDS serve more than one property.

Role of the Environment Agency

The Environment Agency's principle aim is to discharge its functions so as to protect or enhance the environment and make a contribution towards achieving sustainable development.

The Environment Agency encourages the uptake of SuDS predominantly through the planning system as a means to reduce flood risk, improve coastal and inland waters as well as enhancing the environment for wildlife. Acting in its capacity as Strategic Overview for Flood Risk Management, the Environment Agency works with other organisations (such as water companies), promoting Sustainable Drainage when planning for future pressures, such as climate change and growth.

The Environment Agency will be a statutory consultee to the SAB if the drainage system directly or indirectly involves the discharge of water into a watercourse.

Statutory consultees of the SuDS Approving Bodies

Sewerage Undertaker

- With whose public sewer the drainage system is proposed to communicate

Environment Agency

- If the drainage system directly or indirectly involves the discharge of water into a watercourse

Relevant Local Highway Authority

- For a road which the approving body thinks may be affected

Canal and Rivers Trust

- If the drainage system may directly or indirectly involve the discharge of water into or under a waterway managed by them

Internal Drainage Board

- If the drainage system may directly or indirectly involve the discharge of water into an ordinary watercourse within the board's district

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