



Department  
for Environment  
Food & Rural Affairs



Llywodraeth Cymru  
Welsh Government

# Updating the general duties with respect to the water industry to reflect the UK Government's resilience priorities

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## 1. Background

1.1 During 2012 one in every five days saw flooding and one in four days were in drought. Over 6,000 flood warnings and alerts were issued last year; whilst hosepipe bans affected more than 20 million people. By the 2080s, without significant action to reduce demand for water and to increase supplies, almost the whole UK population may be living in areas affected by a supply-demand deficit.

1.2 All of the available evidence shows that our water supply and waste water services and networks; and our management of the water environment more generally will need to become increasingly resilient if we are to respond cost-effectively to future challenges. The Water White Paper set out clearly the UK Government's commitment to reform the aspects of the current system which can institutionalise short-term thinking and make it difficult to adopt the innovative solutions required to deliver the more joined-up, resilient water resources system that we will require to meet these challenges.

## 2. Proposal

2.1 [Section 2 of the Water Industry Act](#) 1991 sets out 'general duties with respect to the water industry'. These duties apply both to UK and Welsh Government Ministers and to Ofwat. This consultation document sets out our proposal to update these duties in order to reinforce the UK Government's policy emphasis on resilience set out in the [Water White Paper](#) and [Strategic Policy Statement](#) to Ofwat. The aim is to encourage an increasingly strategic approach to long-term investment in the sector, which recognises the need to allocate costs between current and future generations fairly.

2.2 The UK Government's [Principles for Economic Regulation](#) establish that independent regulation needs to take place within a framework of duties set by a democratically accountable Parliament; and that regulatory frameworks must be consistent with established policy priorities. In 2011 the UK Government set out the long-term priorities for the water industry in England in the Water White Paper. This articulated the evidence-based case for change to ensure that we plan now to protect the resilience of our future water supplies, taking account of climate change, population growth, patterns of demand; and the need for resilience in the face of hazards such as drought and floods.

**In order to support the required change in behaviours the UK Government propose to amend the general duties to clarify the key role of the regulatory framework in securing the long-term resilience of water and sewerage services; and of water and waste water networks.**

### **3. The case for change**

3.1 High quality drinking water, secure supplies to households and businesses, effective removal of wastewater; and a flourishing water environment are fundamental to a thriving society and economy. However, the UK Government Water White Paper made it clear that we will need to think differently about how we deliver these outcomes in future. We must make sure supplies and infrastructure are resilient both to the conditions we face today and to the changes in population and weather patterns that we can expect in future.

3.2 Pressure on water resources threatens growth by disrupting industrial processes, by affecting agricultural productivity and food security, by restricting the potential for new business start up and development, and by increasing the price we pay for water as we fund new sources of supply. If the power sector cannot rely on secure supplies of water, it could affect energy security and energy bills. Resilient water and sewerage networks are required to enable sustainable housing and economic development.

3.3 Weak resilience and network failure can have significant cost implications for householders and businesses. Improved levels of resilience will benefit households, individual businesses and the wider economy by reducing the significant costs which arise from increasing incidences of floods and drought. More resilient infrastructure networks will also reduce insurance costs and support additional inward investment.

3.4 An improved focus on long-term infrastructure resilience could also help to address the issue of supply chain cyclicalities. In 2010 the Infrastructure Cost Review reported that by addressing cyclicalities £2-3bn a year could be saved on the cost of investing across economic infrastructure. IUK has identified this as a particular issue in the UK water sector, whilst British Water estimates that the impact of the cycle leads to 3-5% lower productivity; resulting in the loss of 20,000-40,000 jobs within each five year period. Analysis by Ofwat shows that this lost productivity results in water customers paying an additional £5 to £6.50 on their bills.

### **4. What do we mean by resilience?**

4.1 Resilience refers to the ability of a system to withstand shocks and continue to function. We need our systems for water management, treatment and supply to be resilient in the face of environmental pressures and social change and to support economic growth. Water and sewerage companies have statutory duties to supply water and waste water services to their customers and to ensure effectual drainage within their appointment areas, so the resilience of their operations is essential to the performance of their functions. A range of hazards beyond the companies' control can have an adverse impact on the delivery of water and sewerage services. Work undertaken by Ofwat has identified that some of the most significant hazards are weather-related events such as droughts and floods:

- Drought is the most obvious hazard because water scarcity increases the risk of water restrictions and, in extreme circumstances, service failures.

- Water company assets are often at particular risk of flooding because they are likely to be located in vulnerable areas. Sewerage systems need to be resilient to surface water flooding.
- Heat waves are a less obvious risk, because they create additional demand pressures rather than affecting the availability of water resources<sup>1</sup>.

4.2 Water companies are already required to plan to secure the resilience of their operations; and this is a recognised regulatory priority. However, the increased frequency of the hazards described above, coupled with environmental pressures, population increases and the drive for growth, all underscore the requirement for an increased focus on the resilience of our essential infrastructure.

## 5. The general duties

5.1 The UK Government is committed to stable, independent and predictable regulatory frameworks to protect consumers, facilitate efficient investment and contribute to sustainable growth. It is the responsibility of Government to set the strategic framework and policy priorities within which Ministers take decisions and independent economic regulators such as Ofwat operate. These priorities are reflected in the general duties.

### **Summary of the General Duties set out in section 2 of the Water Industry Act 1991**

The overarching duties which currently apply to both the Secretary of State for Defra, Welsh Government Ministers and Ofwat are:

- to protect the interests of current and future consumers; having regard to the interests of vulnerable groups, and to do so wherever appropriate by promoting effective competition;
- to secure that the functions of water and sewerage companies are properly carried out;
- to secure that the companies are able to finance their functions by securing reasonable returns on their capital.

Subject to these, both parties also have common duties to:

- contribute to the achievement of sustainable development;
- promote economy and efficiency by companies in their work;
- secure that no undue preference or discrimination is shown by companies in fixing charges;
- secure that consumers' interests are protected where companies sell land;
- ensure that consumers' interests are protected in relation to any unregulated activities of companies; and
- have regard to the principles of best regulatory practice.

5.2 In performing their regulatory functions, Ofwat must balance all of these duties. The proposal is to update the duties to better reflect the policy emphasis on securing the long-term resilience of our water and waste water services which is set out in the Water White Paper, Water Bill and Strategic Policy Statement to Ofwat. This will act to reinforce all of

<sup>1</sup> [Resilient Supplies: how do we ensure secure water and sewerage services?](#), Ofwat, November 2010

the existing duties. It has particular read-across to the duties focused on protecting the interests of current and future consumers, securing that the companies properly carry out and can finance their functions, promoting economy and efficiency; and contributing to sustainable development.

## 6. Resilience and sustainable development

6.1 Some stakeholders have suggested that changing the order of Ofwat's statutory duties by elevating the duty to contribute to the achievement of sustainable development from a secondary to a primary duty could improve the delivery of longer-term priorities for the water industry. The Welsh Government is also supportive of this approach. This was considered by the review of Ofwat carried out by David Gray, which recognised that action was needed to embed Ofwat's commitment to delivering sustainable outcomes into regulatory policies and decisions but recommended against making changes to the sustainability duty.

6.2 The Water White Paper set out a commitment to provide a stronger steer to Ofwat on how it should interpret its sustainable development duty. This was provided by the UK Government's statutory guidance to Ofwat, the *Strategic Policy Statement* published in March 2012. This guidance provides an unambiguous statement that sustainable development is central to everything that Ofwat does and must be fully embedded throughout its regulatory decision making. In line with the UK Government's commitment to transparency, the *Strategic Policy Statement* requires Ofwat to report annually on how decisions have taken account of the three 'pillars' of sustainable development, using the UK Government Sustainable Development Indicators as a guide.

6.3 We have carefully considered the case for making changes to Ofwat's duties to support action to address the long-term challenges facing the sector and encourage better outcomes for customers and the environment. We are not persuaded that simply making changes to the order of Ofwat's existing statutory duties would be the most effective way of influencing future regulatory decision making and delivering the desired policy outcomes.

6.4 The commonly used language of 'primary' and 'secondary' duties is shorthand for the way in which the Water Industry Act is structured. It sets out specific overarching duties to protect consumers and secure that the companies can perform and finance their functions with all the other duties 'subject' to these requirements. However, it would be wrong to assume that those duties which are subject to the overarching duties are unimportant or in some way optional. All the duties have statutory force and there is a clear and unambiguous expectation that they must be reflected in regulatory decision making.

6.5 The UK Government has clarified that the sustainable development duty must underpin all the decisions made by the regulator. We now want to go further, by creating a new overarching duty specifically designed to prioritise an enhanced focus on long-term resilience to support delivery of the vision set out in the Water White Paper.

## 7. Impacts of increasing resilience

7.1 Resilience takes many forms and there is no single approach required to secure the long-term resilience of our water and waste water services and networks. Some resilience measures may require additional capital investment in infrastructure. Others will include innovative approaches such as catchment management, demand management and behaviour change. As an example, supply/demand deficits may be addressed in a variety of ways including:

- through low-cost demand-side water efficiency and behaviour change measures,
- through improved management of the water environment at a catchment level,
- by an increase in water trading and transfers between companies; or
- by capital investment in additional storage capacity or interconnections.

7.2 Government policy and regulatory practice are focused on incentivising uptake of the most appropriate and cost-effective solution in each circumstance. For example, Water Resources Management Planning Guidance requires water companies to demonstrate that cost-effective demand-management options have been exhausted before considering investment in new supply-side measures. In assessing whether measures are cost-beneficial, the focus must be on best overall value in terms of long-term resilience rather than a 'least cost' approach for the short-term.

7.3 The evidence suggests that proactive investment in long-term resilience may be economically more efficient than reactive responses to manage the effects of an ongoing drought or severe or repeated flooding. A more strategic approach to resilience may also deliver more innovative and cost-effective solutions for example through demand side measures, water efficiency and behaviour change. The purpose of clarifying the general duties to reflect resilience is to emphasise the role of the regulatory framework in maintaining an appropriate balance between ensuring that bills remain affordable in the short-term; and that companies are planning, investing and innovating to meet long-term pressures as efficiently as possible.

7.4 Both Government policy and regulatory practice already have a clear focus on resilience. For example: Ofwat's proposed methodology for the upcoming Price Review in 2014 already seeks to encourage a more long-term approach. In particular, the move to 'totex' (which combines capital and operational spending) gives companies greater flexibility to consider long-term investments and balance the affordability of those investments on current and future customer bills. Similarly, encouraging companies to engage with their customers and consider the 'outcomes' customers want, potentially spanning price review periods, will increase the sector's capacity to take a long-term view. The Abstraction Incentive Mechanism and Trading incentives are also designed to promote resilience by reducing abstraction pressures on vulnerable sites and promoting interconnection between company networks.

## 8. Context: the Water Bill

8.1 The proposed change to the 'general duties with respect to the water industry' is one of a number of changes we propose to make following pre-legislative scrutiny of the [draft Water Bill](#) to ensure that it helps drive us towards more resilient water resources. These include: incentivising the development of non-water company water storage; and clarifying the powers of Direction that exist within the water resources planning framework.

8.2 Incentivising the development of non-water company water storage has the potential to build in additional resilience to our supply system, as well as offering benefits for farmers and land managers in supplying their own water needs. The UK Government want to make it easier for owners of such storage who have excess capacity to sell water into the water supply market by slightly modifying the bulk supply regime. Both Governments will be discussing these measures with interested parties over the coming weeks.

8.3 The UK Government is also proposing to clarify the powers of Direction that exist within the water resources planning framework in order to be explicit that such Directions may include specifying a level of service that a water resources plan must address. Directions may apply generally to all water companies or to one or more specified companies. They could be used to reduce the planned-for frequency of restrictions on water use or to address company specific resilience issues. This measure aims to improve resilience in the face of a severe drought and reduce the risk of economic and public consequences.

## 9. Consultation

9.1 We would welcome your views on the proposal to amend the general duties to clarify the key role of the regulatory framework in securing the long-term resilience of water and sewerage services; and of water and waste water networks.

9.3 The Welsh Government is still considering this provision. If you have any comments which are specifically in relation to or have reference to Wales, please copy your response to the Welsh Government.

9.2 Please forward your comments to the address(es) overleaf by Friday 10th May.

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