

Water (Special Measures) Bill

Lead department	Department for Environment, Food and Rural Affairs
Summary of proposal	The Water (Special Measures) Bill makes provision for new measures to hold water companies accountable, to improve their operations and reduce the number of pollution incidents in the water sector.
Submission type	Impact Assessment – urgent measure (7 October 2024)
Legislation type	Primary
Implementation date	2025
RPC reference	RPC-DEFRA-24009-IA (1)
Date of issue	13 November 2024

RPC opinion

Rating	RPC opinion
Fit for purpose	The Department identified the problem of excessive pollution incidents in the water sector (2,174 in 2023, an increase of 148 from the previous year) and used recent evidence from Ofwat, the Environmental Agency as well as comparisons with the energy sector to support the rationale for intervention where relevant. The appraisal of options is limited, with only the preferred options having an associated NPV figures. The preferred options are monetised using relevant data and provide a satisfactory assessment of impacts on businesses, including costs for monitoring devices, familiarisation, pollution reduction plans, and imprisonment for obstruction. The IA commits to a collective post-implementation review but does not clarify if this will include unintended consequences.

Urgent measure statement

The Department has used the Better Regulation Framework's 'urgent measures' process for this provision. Where the Government decide that legislation is required urgently and there is insufficient time ahead of collective agreement of a preferred regulatory option for the necessary options assessment (OA) to be submitted to the RPC for independent scrutiny in accordance with the framework, departments are instead required to submit an impact assessment (IA) for scrutiny as early as possible after collective agreement. This IA should contain the evidence that should have been set out in the OA, on the rationale, identification of options and the justification for preferred way forward. The RPC then offers an opinion that includes an overall fitness-for-purpose (red/green) rating, informed by the individual red/green ratings for those three categories. Even though the decision to legislate has been taken without the benefit of independent scrutiny of an impact assessment, the RPC considers that the information will, nonetheless, be of value to the Government, Parliament and others at later stages in the passage of the proposed legislation.

RPC summary

Category	Quality	RPC comments
Rationale	Green	The IA covers ten measures to deliver the Government's manifesto commitments within the water sector. The Department has identified the problems under consideration and provided satisfactory arguments for intervention using recent evidence where appropriate to highlight the scale of the problem and support the rationale for government intervention. The proposed interventions set out in the IA are specific to the problems identified by the Department and aligned with one of four objectives.
Identification of options (including SaMBA)	Green	The IA covers several measures that were part of the Government's manifesto commitments within the water sector and provides a satisfactory level of assessment of the options. However, it could be strengthened by providing a fuller list of options under consideration as expected by the Green Book or use of the strategic options framework filter. The IA does however provides a short-list option assessment containing a business-as-usual option, and

		<p>two other options (inclusive of the preferred option) for each problem under consideration, and has engaged with regulators when developing the shortlist where appropriate.</p>
Justification for preferred way forward	Green	<p>The IA provides a satisfactory justification of their preferred way forward; though, it could be strengthened by providing an NPV or an assessment of potential cost and benefits for options other than the preferred one. The Department uses relevant data and sources to provide monetisation of the preferred options. The IA could, however, also benefit from the application of optimism bias adjustments for the monitoring of every outlet measure.</p>
Regulatory Scorecard	Weak	<p>The IA evaluates the impact on businesses, including costs for installing monitoring devices, familiarisation, creating annual Pollution Incident Reduction Plans, and imprisonment for obstruction. The NPV is based on proportionate evidence and the IA notes that some costs may be passed to households. Assuming all costs are transferred to consumers, the Department estimates an annual increase of less than £5 (1% of average water bills) compared to no intervention. However, the IA does not calculate an EANDCB figure or consider impacts on competition. The assessment must provide discussion on these areas of the scorecard.</p>
Monitoring and evaluation	Satisfactory	<p>The Department has committed to a post-implementation review (PIR) which will be carried out collectively across all measures. The PIR will take a practical approach and focus on establishing the extent to which the measures were implemented successfully. The Department also sets out its evaluation questions and metrics it will use to identify lessons learned and assess if the measures achieved the expected outcomes. However, the Department does not make it clear if the review of potential unintended consequences will be included in the PIR.</p>

Summary of proposal

The Water (Special Measures) Bill, introduced to Parliament on 4 September 2024, aims to address water industry performance issues, particularly pollution. The Bill IA was submitted to the RPC on 4 October 2024 for scrutiny and was subsequently published on 25 October following requests from the House of Lords. It introduces new provisions to hold water companies accountable and improve their operations. The Bill is anticipated to drive behavioural change in water companies, increase accountability, and improve environmental performance. It is expected to result in better regulatory enforcement and greater transparency. The Bill provides for implementation, with various measures coming into effect through secondary legislation following consultation with industry. Ofwat, the Environment Agency (EA), and the Drinking Water Inspectorate (DWI) will be responsible for ongoing enforcement and operation of the new measures.

The Department identified three regulatory provisions (RP) in the Bill, while the other seven are not. The RPC rating is based solely on the three RP measures, despite the Department's assessment of all measures.

The Department estimates an NPV of -£537,979m (discounted, 2023/24 prices) over a 10-year appraisal period for the measures in the Bill that are regulatory provisions. The cost impacts fall largely on water companies and include cost of familiarisation, regulator enforcement recovery, improved monitoring of emergency overflows and adjusted penalty systems.

Rationale

Problem under consideration and argument for intervention

The Department has clearly identified the problems under consideration, referencing the following issues:

1. Lagging environmental water industry performance (**Rules about remuneration and governance – RP**)
2. Unacceptably high pollution incidents (**Pollution incident reduction plans – RP**)
3. Discharges from emergency overflows are currently not fully monitored, which hinders the ability to prioritise action to reduce discharges and remediate their impact. (**Monitoring of every outlet - RP**)
4. Regulators have faced challenges with companies 'obstructing' investigations (**Obstruction sentencing power – not an RP**)

5. 98 per cent of pollution incidents in England in 2023 were classified as categories 3 and 4 harm (minor and moderate offences). To impose a monetary penalty, regulators must currently prove to a criminal standard (“beyond reasonable doubt”) that an offence has occurred, which is resource intensive in comparison to the level of offence being enforced and size of the penalty issued, meaning financial penalties are often not used. **(Lowering the standard of proof – not an RP)**
6. Regulators’ current powers render them unable to issue quickly, proportionate penalties for frequent minor to moderate offences with little or no environmental harm, which can escalate into more serious offences if not addressed promptly. **(Automatic penalties – not an RP)**
7. Current cost recovery powers are insufficient to enable the EA to recover the full costs related to water company enforcement. **(Cost recovery power – not an RP)**
8. The Security and Emergency Measures Direction (SEMD) is not covered by the current fees order. Therefore, DWI is not remunerated for its security and emergencies work, impeding the growth and development of its SEMD work. **(DWI cost recovery power – not an RP)**
9. The Secretary of State does not currently have powers to require water companies to repay any shortfall incurred following a **Special Administration Regime** (SAR), creating a risk that taxpayer’s money may not be fully recovered. **(Shortfall recovery mechanism- not an RP)**
10. There is no legal requirement for the Secretary of State or Ofwat to be notified in the event a water company, or its creditors, make a winding up petition to the court. This means there is a risk, in the event of a water company insolvency, that government and Ofwat could be unaware that a water company is about to enter a SAR or make their views and interests known to the court. **(Winding-up petitions – not an RP)**

The IA encompasses ten measures to deliver the Government’s manifesto commitments within the water sector and the Department has provided satisfactory arguments for intervention. The IA references recent evidence, such as Ofwat’s consumer satisfaction ratings and information on water company executive bonus payments, EA’s Environmental Performance Assessment and comparisons to regulation in the energy sector where appropriate to highlight the scale of the problem and support the rationale for intervention. The Department also discusses the issues that could arise without government action for each proposed measure. Whilst the market failure is not always explicitly identified, such as in page 44, the detailed discussions on the Department’s rationale appears sufficient for the presence of a market failure to be inferred. However, for the ease of the reader, the IA should provide a complete discussion on rationale, options and impacts for each measure in turn.

Objectives and theory of change

The proposed interventions set out in the IA, are specific to the problems identified with the water industry and are aligned with one of four objectives. The Department does well to apply the SMART objective framework when developing these four policy objectives and discuss how each proposed measure aligns with a specific objective, the intended outcome of the policy and indicators of success. However, the objectives lack an explicit time limit for achievement, despite the IA using the standard 10-year appraisal period. The IA should provide a more definite time limit for achievement of the objectives. The IA would also benefit from a theory of change diagram that links the policy objectives to the policy intervention, intermediate outcomes and longer-term benefits.

Identification of options (inc. SaMBA)

Identification of the ‘long-list’ of options

As stated previously, the IA covers several measures that were part of the Government’s manifesto commitments on the water sector. As such, the Department has not conducted the expected full long-list options assessment as required by the Green Book or used a strategic options framework filter. Instead, the IA provides a short-list option assessment containing a business-as-usual option, and two other options (inclusive of the preferred option) for each problem under consideration. The Department also engaged with regulators when developing the shortlist where appropriate.

Despite the limited options assessment, the policy options presented in the IA clearly link to the problem being addressed and the combination of the Pollution reduction plans, the stronger penalties for minor to moderate pollution incidents and monitoring of discharges could potentially address the problem under consideration.

Consideration of alternative options to regulation

The Department presents a do-nothing approach for each proposal and considers alternative options to enacting new legislation such as:

- Ofwat using existing powers to modify license conditions to issue strengthened requirements on bonuses (Use of existing powers).
- Government communicating its expectation to sewerage undertakers that they increase the frequency of pollution incident reduction plans (PIRPs) to produce them on an annual basis and provide additional (non-statutory) guidance on what the plans should contain (non-regulatory option)

However non-regulatory options were not considered for every provision in the Bill on the grounds of the Government’s manifesto commitments restricted policy options available and some commitments could only be achieved through regulation. Given that the ‘monitoring of all outlets’ measure contributes to the bulk of the costs in the IA, the Department could have looked more at alternatives to monitoring the outlets

to achieve a similar goal rather than focusing on different options of how much of the network to monitor.

Justification for the short-listed options

The Department provides sufficient justification for discarding options such as:

- **Rules about remuneration and governance:** The option for Ofwat to use its existing licence condition power to issue strengthened requirements was discarded because companies can challenge the requirements through the Competition and Markets Authority.
- **PIRPs:** The option to strengthen the expectations of PIRPs on a non-statutory basis was discarded because, without a statutory requirement, sewerage undertakers may not prioritise producing the plans and may effectively equate to a continuation of business as usual.

Despite not using the Green Book's critical success factor assessment framework, the Department's justification for discarding options appears rational and consider the effectiveness of the discarded options compared to the preferred options.

SaMBA and medium-sized business assessment

The IA acknowledges that some businesses affected by the measures in the Bill may qualify as small or medium-sized businesses by employee numbers. However, it argues that, regardless of size, all businesses within the water sector should be subject to the same requirements given the criticality of the services they provide and the public interest in reducing pollution incidents. Therefore, no exemptions for small or medium businesses were proposed. However, the Department intends to carry out further engagement and consultation to shape the guidance for the small, micro and medium-sized business.

Justification for preferred way forward

Appraisal of the shortlisted options

The IA's appraisal of short-listed options is limited as it does not provide an NPV figure or an assessment of potential cost and benefits for any option other than the preferred one. However, the Department does use relevant data and sources to provide monetisation of the preferred options and provide a qualitative assessment of the short-listed options. The NPV figures were calculated in accordance with the Green Book and RPC guidance (discounted with sensitivity ranges in 23/24 prices using a 10-year appraisal period). However, the IA should consider the application of optimism bias adjustments, in particular for the 'monitoring of every outlet' measure, to account for the fact that the Department could be underestimating the cost of deploying measuring devices at emergency overflow sites.

The Department uses data and publications from reliable sources such as Ofwat, Gov.UK, Office of National Statistics, Financial Conduct Authority, Bank of England and Consumer Council for Water in the appraisal of the preferred options. However, the analysis would benefit from the inclusion of international case studies that have enacted similar regulation in domestic water industries. The IA provides a risk assessment of the impacts and associated uncertainties of their short-listed options, such as the dependence of impacts on how Ofwat exercises the new powers provided by the Bill and uncertainties around assumptions used in the familiarisation cost calculations.

Selection of the preferred option

Options appraisal of the proposed measures appears appropriate to justify the selection of the preferred options. The assessment has discussed the potential options for each measure, setting out how each performs against the policy objectives and why this has led to the selection of the preferred option in each case.

Regulatory Scorecard

Part A

Impacts on business

The Department has identified 21 businesses in the water sector on which the suite of regulation in the Bill would have an impact and have discussed clearly the implications of the business-as-usual option (BAU). However, the IA does not refer explicitly to it as the counterfactual, except for on page 78. The IA should state this clearly throughout when discussing the BAU.

Moreover, the Department's cost analysis for the element covering the 'monitoring of every outlet' proposal does not consider cost to businesses for publication of discharge data, database management and maintenance of the monitoring devices which could be susceptible to damage from the elements and wildlife. The analysis also fails to isolate costs of the roll out plan for the price review 2024 (PR24) (BAU) from additional costs that would be brought about by the more ambitious deployment plan. However, since the Department provided combined costs (BAU and additional) for the more ambitious monitoring device rollout and costs for the roll out plans under PR24, it is possible to calculate independently the regulation's additional impact on businesses.

The IA presents a satisfactory assessment of the impacts faced by businesses, monetising capital costs for installation of monitoring devices at emergency discharge stations, familiarisation costs, costs of creating annual pollution incident reduction plans and imprisonment costs for the obstructing sentencing power proposal. The assumptions made during the monetisation of impacts are presented

within the IA and the Department employs sensitivity analysis to address uncertainties in the provided estimates.

Several proposals in the Bill are not regulatory provisions but, for transparency, the Department provides low, central and high NPV estimates for all measures in the bill (page 41) and separate figures for only regulatory provisions (Page 29 and 42). The included impacts sum to an estimated NPV of -£537,979m over the 10-year appraisal period for the measures that are classified as regulatory provisions.

To enhance transparency within the IA, the Department should present two NPVs in the Regulatory Scorecard section: one covering all measures in the Bill and another focusing solely on regulatory provisions. This distinction acknowledges the familiarisation costs linked to the non-regulatory provision measures in the Bill. Despite having estimates for business impacts, the Department fails to calculate an EANDCB figure.

Impacts on households

The IA acknowledges that some costs from the Bill's provisions could be passed onto households by businesses. However, the magnitude of the costs passed on to households will be determined by Ofwat during its price review process. Under the assumption that 100% of the costs in scope are passed on to consumers, the Department models a less than £5 increase per year (1% of average water bills) compared to a counterfactual of no intervention. The Department also supports the Bill's impact estimate with commentary on the costs that could be passed on to households and those that they expect to be borne by the water companies. The Department notes the limitations of their in-house model, stating that the Bill model used lacks the sensitivity to determine precise bill impacts for individual companies or amounts less than £5, explaining the imprecise presentation of the Bill's impact.

Distributional impacts

The IA highlights that there will be some regional variation to the Bill's estimated impact in areas with lower population and higher need for monitoring devices. However, the variation is not considered to be significant by the Department. Moreover, water companies pass on increased costs to all consumers, so the IA does not comment on equalities impact for protected groups. However, the IA should consider providing a discussion on disproportionate impact on household income groups and mitigation or support for low-income households.

Total impacts

The IA does not estimate an NPSV or an EANDCH on the grounds that the proposals do not mandate the costs to be passed on to households, rather the amount of costs passed on to households will depend on Ofwat's decision during its pricing review process.

Non-monetised impacts

The Department discusses non-monetised impacts, referencing protection of the water environment, improved environmental performance of water companies and fewer environment incidents.

Part B

Business environment

The Department acknowledges that the measures in the Bill would impose costs to the water industry, though this is not expected to have an impact on the wider existing market structure.

1. **Rules about remuneration and governance:** The restriction on performance-related payments where companies fail to meet required standards could reduce the attractiveness of executive roles in the water industry. This may be a contributing push factor in experienced executives leaving the industry and it could also make it more difficult to attract new candidates to fill roles.
2. **PIRPs:** Introducing a statutory duty to produce PIRPs is not expected to have any impact on the attractiveness of investment in the water sector as there is already an expectation for these plans to be produced. Moreover, the Department argues that the production of PIRPs could support innovation as the plans creates an opportunity for innovative thinking on approaches to reducing water pollution and sharing best practices across the industry
3. **Monitoring of every outlet:** The duty to monitor every emergency overflow will increase operation costs for the water industry. However, the Department expects these costs to be funded by Ofwat's price review process, reducing the likelihood of the measure having a significant impact on the attractiveness of the sector to investors.
4. **Lowering the standard of proofs and automatic penalties:** The introduction of new penalties may drive innovation from the sector to increase compliance rates and avoid penalties being issued. This has the potential to reduce investor confidence as it will have a direct impact on water company net incomes and may lead to uncertainty in the market. However, the Department has committed to a consultation before setting the level of fixed monetary penalties.
5. **Cost recovery power:** The introduction of the EA and National Resources Wales (NRW) cost recovery powers will mean that water companies will have additional costs through enforcement charges. Additionally, including SEMD work cost recovery will increase the regulatory costs water suppliers pay the DWI.

However, the Department fails to consider the impact that measures in the Bill could have on competition. The IA must provide a discussion of the impact of the proposed measures upon the competition within the water industry.

Trade and investment

The Department states that it does not expect any measures in the Bill to have a significant impact on international trade. However, the introduction of new penalties has the potential to alter investor confidence for non-compliant companies. Although, the impact on investor confidence is assumed to be balanced by the assumption that broader improvements to performance of water companies resulting from the Bill could create a more investable industry.

Natural capital and decarbonisation

The Department holds the opinion that the combined measures in the Bill will help to protect the water environment, improve the state of the UK's natural capital, and is not expected to have a significant impact on greenhouse gas emissions.

Monitoring and evaluation

The Department has committed to a post-implementation review (PIR), which will be carried out collectively across all measures. The PIR will take a practical approach and focus on establishing the extent to which the measures were implemented successfully. The success of the implementation will be assessed using interviews with Ofwat, EA, NRW, DWI and water companies, after one and five years, including questions on barriers and limitations to delivery. Value for money will be assessed through change in government funding required by the regulators for water company enforcement as well as cost of implementation compared to benefits from improved performance and environmental outcomes.

The Department also sets out its evaluation questions that seek to identify lessons learned and assess if the measures achieve the expected outcomes. The IA does well to present in detail the sources that will be used for the PIR, while linking the data sources to the objectives they will be used to assess. The expected PIR will use a mixture of quantitative and qualitative data from existing and new evidence sources such as interviews after one and five years of implementation and metrics collected by the Environmental Agency and Ofwat.

However, the Department does not make it clear if the review of potential unintended consequences will be included in the PIR, but that it intends to consult water companies and other interested stakeholders before implementing any of the measures in the Bill to minimise unintended consequences. As unintended consequences are a required consideration to be discussed within a PIR, the Department must ensure this is included. Moreover, the IA highlights the main external factor that could influence success of the measures in the Bill as water company behaviour, and the Department considers a possible review of the measures if water companies continue to offend at minor-to-moderate level to the same extent.

Regulatory Policy Committee

For further information, please contact regulatoryenquiries@rpc.gov.uk. Follow us on Twitter [@RPC_Gov_UK](https://twitter.com/RPC_Gov_UK), [LinkedIn](#) or consult our website www.gov.uk/rpc. To keep informed and hear our views on live regulatory issues, subscribe to our [blog](#).

1 Committee member did not participate in the scrutiny of this case to avoid a conflict of interest.