

Ofwat's consultation "Contributing to sustainable development"
Waterwise response
April 2006

Waterwise welcomes Ofwat's consultation on the practical measures it will take to deliver its new statutory duty to contribute to the achievement of sustainable development. We look forward to working with Ofwat to this end.

We welcome Ofwat's proposed adoption of the UK Government's five guiding principles of sustainable development.

We agree that securing value in the broadest sense, including to the economy, society and the environment, will be absolutely key to Ofwat's delivery, with stakeholders, of sustainable development. It is essential too that the outcomes of Ofwat's sustainable development work are tangible and measurable. In practice, this would mean, for example, that in PR09 applications from companies for funding for large-scale water efficiency projects will be treated on a level playing field with applications for large-scale supply-side measures, assuming that a robust evidence base for both is in place.

We see the formation of the Water Services Regulatory Authority, with its broad range of members, as a key opportunity to contribute to sustainable development.

We comment below on the specific questions posed in the consultation paper.

Ofwat questions

1. Do you agree with our interpretation, as an economic regulator, of the guiding principles of sustainable development?

_ What are your views on our interpretation of securing value in the broadest sense?

_ How should we contribute to achieving an appropriate balance between price or costs and the benefits of improving standards?

_ Where you do not agree with our interpretation, what needs to change?

Waterwise response

Securing value in the broadest sense is essential to the delivery of sustainable development. We absolutely agree that the costs and benefits of all approaches should be assessed: the challenge will be applying the costs and benefits and value tests equally to all measures, as well as across the long-term. For example, because in parts of England and Wales the water resource situation has worsened dramatically since PR04, and this will be compounded by climate change and new housebuilding programmes, it is inconceivable that a future

price review set firmly in the context of delivering sustainable development would not include applications, and funding, for large-scale water efficiency projects alongside large-scale supply-side measures such as new reservoirs.

It is essential that the cost effectiveness of such measures is assessed by both the water companies and Ofwat. For this to happen, we accept that there needs to be a robust evidence base which will enable companies and Ofwat to rely on the water savings they will provide, but building this evidence base should be the only barrier to water efficiency measures being routinely selected as supply-demand balance tools sooner rather than later, including in price reviews from PR09 onwards. At the same time, the need for a robust economic basis should not stifle innovation – Ofwat should encourage companies to seek novel approaches where there is potential for tangible public benefit, and should work proactively with them to identify areas for innovation. As we and Ofwat have said elsewhere, the sustainable approach is for risk to be managed (against benefit) and not eliminated. The rigour of the cost-benefit analysis should be proportionate to the scale of the project.

We recognise that Ofwat's approach to sustainable development will reflect its work well into the future. We agree with Ofwat that in ensuring long-term security of supply the environmental limits on water availability must be reflected, and that the overall impact of different interventions to this end must be considered. This is how value in the broadest sense can be secured.

Waterwise believes that a dedicated programme within Ofwat to encourage, assess and award large-scale water efficiency programmes alongside large-scale supply-side measures will enable it to contribute to achieving an appropriate balance between price or costs and the benefits of improving standards – this in itself will represent a key measure of success of sustainable development in the water context. For example, given the rising gap between supply and demand in some parts of England and Wales, as indicated by Ofwat's own Security of Supply index, the very delivery of large-scale water efficiency measures will help avoid the scenario where future customers see increased water prices due to increased infrastructure costs as water becomes ever scarcer. We support Ofwat's requirement for companies to take into account the costs and benefits arising in future price review cycles in their business plans. Whether water efficiency and supply-side measures are cost effective should include an assessment of the value to the customer and benefit to the environment.

Large-scale water efficiency measures need to be included and reflected in the review of incentives for the 2009 price review. This is essential if it is to follow sustainable development principles.

We welcome Ofwat's requirement for companies to carry out rigorous analysis of the evidence base for future plans (both costs and benefits), in their approach to

regulation and the use of sound science. We also welcome realistic risk assessment and management rather than risk removal where this is not practical: we agree with the example Ofwat uses in its consultation paper that it would be prohibitively expensive, on the supply-side, to attempt to remove all risk of hosepipe bans during dry years via substantial investment in capacity – the flip side of this, firmly in the context of sustainable development, is investment in large-scale water efficiency measures such as the refitting of a whole housing estate with water efficient bathrooms, which is much cheaper than, and will reduce (though not remove) the need for further infrastructure.

We agree that the application of the precautionary principle is mutually compatible with an emphasis on an empirical, evidence-based approach.

We wholeheartedly agree that there is a danger of collective understanding of the **benefits** – quantitative and qualitative – of measures being less certain than that relating to the costs of implementing them. Because of the difference in experience and evidence, there is a particular danger of this applying to a greater extent to demand-side than supply-side measures. Through sustainable development, we believe Ofwat must seek to correct this balance.

Finally, we agree that improvements made in the infrastructure today should still be in use 50 or 100 years from now, and that the way Ofwat sets price limits should support an appropriate long-term perspective, and not encourage short-termism or unjustified risks. We also welcome Ofwat's view of the new sustainable development duty as an opportunity to extend existing working arrangements – we consider Ofwat's deeper involvement in issues related to housing growth to be essential. We welcome Ofwat's statement that it will continue to advocate robust cost-benefit analysis to achieve a reasonable balance between competing priorities, and that well-founded cost benefit analysis, coupled with evidence about environmental impacts and customer preference, is essential in identifying the most sustainable outcomes.

Ofwat questions

2. What are the main sustainable development issues that we most need to address before the 2009 price review?

_ What should our priorities be?

_ Please tell us if you think our list in chapter 5 laves out any of the key challenges that we most need to address in the period leading up to the 2009 price review.

_ How can we improve incentives for long-term planning?

_ What are the main issues for water companies to address? Are there any areas where current activities are unsustainable?

_ If there are any areas where you think our approach has created barriers to sustainable development, please identify these.

Waterwise response

We believe that Ofwat's priorities in the run-up to the 2009 price review should include water efficiency – in its own right rather than as a sub-heading under metering. (We believe that increases in water metering and in water efficiency are mutually beneficial, but not mutually dependent, and there is more to what can be achieved through water efficiency than metering.)

We support the list of priorities outlined in chapter 5 – water efficiency fits directly into the first four (Securing value in the broadest sense, Promoting long-term planning, Climate change and the Water Framework Directive).

As the consultation paper recognises, many of the policy areas identified are overarching issues. A persistent challenge in the delivery of sustainable development in the public and private sector has been the translation of broad principles into specific actions which reflect them. For this reason, we would propose the explicit inclusion of specific, practical headings beneath the broad list of policy areas, which should include water efficiency. We expand on this below.

Given the current supply-demand balance in England and Wales, climate change, and demographic changes including new housebuilding programmes, we believe it is essential that Ofwat develop a strategic but targeted approach to water efficiency in the run-up to the next price review. Waterwise is supportive of the twin-track approach which includes applications for new reservoirs, but a continued over-emphasis on supply-side over demand-side measures in the 2009 price review will not deliver or reflect sustainable development.

For historical reasons and those relating to the lack of a robust evidence base for water efficiency measures and savings, the water companies currently focus vastly more company resource on the development of supply-side than demand-side measures. This is unsustainable. The companies are working with Waterwise, Ofwat and the Water Saving Group to build an evidence base for large-scale water efficiency measures. Applications – and funding awards - for the 2009 price review must build on this and reflect a new, sustainable balance of measures.

Ofwat questions

3. How can we contribute to sustainable development in our processes and governance?

_ How do you think our sustainable development duty should be reflected in our processes and governance?

_ Do we encourage good governance in water companies?

_ We seek your views on whether a set of criteria or questions for assessing our policies would add value to our decision-making process.

Could we make improvements to our approach to consultation? If you think we could, what do we need to do?

_ We seek to advise and use our influence in areas where we have expertise and can add value to the debate. What should our priorities be?

_ How can we improve our communication with the companies we regulate? Should we do more to promote the spread of good practice?

Waterwise response

Waterwise proposes a dedicated Ofwat water efficiency team alongside the broader supply and demand balance team – certainly in the run-up to the 2009 price review. This would enable the necessary step-change in applications for large-scale water efficiency measures from companies, based on robust evidence that is likely to satisfy Ofwat, in the next crucial few years. Without this step-change, such an opportunity will be lost for another five years, with companies reverting to small-scale, piecemeal programmes which compare poorly with the amount of company resource spent on supply-side measures. A dedicated Ofwat water efficiency team could actively promote the spread of good practice on water efficiency – working closely with Waterwise and other colleagues on the Water Saving Group to develop the robust evidence base for large-scale water efficiency required, it could then help to ensure that this is translated into applications for large-scale water efficiency measures, related to the robust evidence base, so that they have a strong chance of success.

The Office of the Deputy Prime Minister has recently pointed out that there are climate change reasons (namely, embedded energy) to increase water efficiency across England and Wales, beyond those areas which are already suffering or prone to drought. Water efficiency is not a regional issue – it is conceivable that drought could extend beyond the current afflicted areas, certainly within the long-term which Ofwat's sustainable development approach will cover.

Ofwat could also encourage good governance in companies by setting out that it expects them to take-up existing incentives such as the R and D tax breaks offered by government – these can provide over 100% tax relief and could therefore be applied by companies to the development of large-scale water efficiency programmes at no cost, but few water companies currently follow this route.

As we have stated above, an habitual pitfall encountered by organisations seeking to deliver sustainable development is the failure to translate overarching principles into actual practical policies that impact outcomes. We think it is essential to develop a series of criteria or questions against which Ofwat's policies can be assessed. We think Ofwat's approach to delivering sustainable development should therefore be specific and transparent, comprising

- a set of principles/broad policy areas of relevance, as reflected in chapter 5,

- a more specific set of policy outcomes/targets (such as water efficiency) which would reflect for example the next five years of working and are explicitly to be amended and to evolve, and
- a set of questions to inform the development of all policy
- Sustainable development reporting in Ofwat's annual report.

The framework outlined above will help Ofwat, with stakeholders, ensure that it is actually delivering sustainable development: avoiding the pitfalls some organisations suffer in merely paying it lip-service. It will be important for Ofwat not only to deliver sustainable development but to be seen to be doing so, so communication will be important alongside policy.

To support this framework, Waterwise welcomes Figure 2 in chapter 6, entitled "A balanced long-term view", including the reference to promoting development of the evidence base to support the regulated water industry's contribution to sustainable development. We would add a specific further criterion/question – "Ensuring the taps don't run dry".

Ofwat questions

4. How should we measure progress in contributing to sustainable development?

_ We propose that companies continue to measure their own progress via the Water UK sustainability indicators, and we will contribute to the development of these indicators as required. Do you agree?

_ We are considering options for reporting our progress in contributing to sustainable development. How can we best achieve this?

Waterwise response

We do think Ofwat should require information on sustainable development indicators from companies through the June return. One of the key measures of the success of Ofwat's sustainable development approach will be the sustainability of the behaviour of the companies it regulates. Requiring this information in the June returns - in addition to the voluntary reports the companies provide to Water UK - will help ensure this. In the context of the water resource challenge, we believe this increased information on requirements would be proportionate.

We think Ofwat should report annually on sustainable development in its annual report. We think it would be a mistake to produce a separate sustainable development report as this by definition separates sustainable development from the bulk of Ofwat's work programme.