



Waterwise Response to Ofwat's Consultation on its forward programme 2010-11 to 2012-13

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Waterwise is an independent, not for profit, non-governmental organisation focused on decreasing water consumption in the UK and building the evidence base for large-scale water efficiency. We are the leading authority on water efficiency in the UK. In England, we sat on the UK Environment Minister's Water Saving Group alongside the water industry, Ofwat, the Environment Agency, the Consumer Council for Water and (the department for) Communities and Local Government, for which we produced, in October 2008, the Evidence Base for Large-scale Water Efficiency in Homes. Ofwat is co-funding Phase II of the Evidence Base, which produced its first report in February 2010.

Overview

Waterwise very much welcomes the forward programme. Taken alongside Ofwat's recently-published long-term strategy "Delivering Sustainable Water", it sets out a series of comprehensive steps to ensure that water regulation going forward reflects, and is in a position to address, the current challenges. The existing system has delivered considerable achievements across England and Wales, including a significant uplift in water efficiency programmes being carried out by the water companies – both funded through the new water efficiency targets and self-funded. However, the challenges it was originally designed to meet, twenty years ago, are very different to the current long-term challenges, particularly of climate change and population, which the UK now faces.

Waterwise is delighted that Ofwat is taking such an early, strategic look at addressing these new challenges, and that working closely with stakeholders forms a key part of its strategy. We very much look forward to working with Ofwat to deliver a fit-for-purpose regulatory framework for water for the future. This will include Waterwise engagement in the wealth of specific projects and workstreams Ofwat is taking forward in this context.

Below, we set out some key themes which we would like to see addressed in this process.

Key themes to be addressed

Water efficiency

There are considerable opportunities for water efficiency to contribute to meeting the new challenges of climate change and population growth. Water efficiency is unique in that it is a key tool in both mitigation of and adaptation to climate change.

Water efficiency is essential for mitigation, because of the carbon costs of heating water in homes, buildings and offices for cooking, bathing and cleaning (in homes this accounts for 5% of the UK's total greenhouse gas emissions), and for industrial processes. Wasting less hot water reduces the carbon footprint at the user end, but it also does so at the supplier end, as the water company is required to pump and treat less water and wastewater.

So water efficiency can make significant, quantified contributions to the UK's carbon targets of 34% by 2020 and 80% by 2050.

Water efficiency is also essential to the UK's climate change adaptation plans – every sector of the economy is dependent on water, some areas of the UK are already suffering water stress (with some classified by the Environment Agency as suffering “serious water stress”), and it is known that in the near future there is going to be less water and more people in the UK: so less water will need to go further.

In this context, it is important that the regulatory framework does not act as a barrier to driving water efficiency into the mainstream. The UK water industry is carrying out some fantastic water efficiency work (Waterwise is shortly publishing a document detailing this work), and this is of a significantly larger scale than during the last price review. However, the investment in water efficiency remains absolutely minimal compared to that spent on capex, supply-side measures. This balance needs to be addressed through a change in incentives, so that one of the most effective tools to meet the future twin challenges of climate change, and those of population growth and demographic change such as an increase in single-person households (which generate higher per capita consumption), is fully exploited – water efficiency. There are examples in other developed countries of the water industry being incentivised across the board to sell less water, for example – building on the new revenue correction mechanism here, this would mean turning the regulatory framework on its head, and changes to the capex/opex balance, which Regina Finn has suggested should certainly be considered. The current cost-benefit analysis is also too narrowly-focused on short-term economic cost and does not reflect the new long-term challenges: this was identified by the Walker Report.

Other sectors

Unlike the challenges when the water industry was first privatised twenty years ago, the current long-term challenges identified in Ofwat's forward programme and long-term strategy – such as climate change and population growth – are cross-sectoral. They will need to be met by all sectors of the economy – including the energy and housing sectors. The forward programme states that Ofwat will work with other regulators – this needs to include the regulators of other sectors. For example, the regulatory framework for the energy industry for 2012 and beyond is currently being re-designed – this is the same timescale as the Ofwat process for water, and the wider government review of regulation for water. The water industry is now subject to the Carbon Reduction Commitment, and is starting to undertake joint retrofitting projects which include the use of incentives for hot water efficiency (and energy efficiency) such as the Carbon Emissions Reduction

Target. So water companies are beginning to use energy incentives such as the Carbon Emissions Reduction Target to help fund water efficiency retrofitting. As the low-carbon economy develops, it will be extremely important that the regulatory framework for water ties in with other sectors – this may even include some joint mechanisms.

The low-carbon economy

There are considerable opportunities for water efficiency to contribute to the low-carbon economy. These include further developing the UK manufacturing base for water-efficient products such as toilets and showers, as well as more green service jobs through joint retrofitting programmes. Bringing large-scale water efficiency programmes, including retrofitting, into the mainstream of water company activity, reflected in the regulatory framework and afforded equal incentives to the supply-side, would help drive this potential. Funding pots from the EU and the UK government to develop the low-carbon economy could also be brought into this process.

Regulation – risk, efficiency, innovation and incentives

Despite the welcome revenue correction mechanism introduced in PR09, the wider regulatory framework for the water industry incentivises capital expenditure on supply-side measures – the revenue correction mechanism will only kick in every five years, and the current wider imbalance is reflected in the difference in the amount of investment by the water industry in water efficiency, compared with supply-side measures. A first step to correcting this balance would be quantifying this difference. There is an argument for turning the regulatory framework on its head, as has happened elsewhere in the developed world, to reflect the long-term challenges of climate change, and incentivise water companies to sell less rather than more water. The development of a shadow cost of water might help in the move towards such a wider change.

Waterwise's Evidence Base for Large-scale Water Efficiency in Homes, supported by Ofwat, shows clearly that retrofitting partnerships are the most cost-effective way to save water (as well as carbon and energy). The water companies are already starting to work in partnerships of this kind, and this represents considerable innovation on behalf of the industry. Partnership retrofitting also spreads risk (and cost), and increases engagement and take-up rates. The draft forward programme reflects that innovation can be around processes as well as technology, and such innovation needs to be incentivised within the regulatory framework. This is also relevant to how risk is balanced.

Developments in the wider water sector

The cross-party agreement of the need to reflect the full, long-term value of water in the regulatory framework - not least as a result of the Cave and Walker Reports - will be important to Ofwat's own process. This reflects cross-sectoral agreement that metering is the fairest way to pay for water in the long-term – and work by many stakeholders to help develop a road-map, with full costs and benefits attached, to this end. The post-Cave and Walker environment has also helped spur an appetite to increase water efficiency (this has been driven in part by Waterwise's building, with Ofwat and other stakeholders, of the economic case for it). The Floods and Water Management Bill also includes (at the time of writing) a new power to impose social tariffs.

Waterwise involvement in Ofwat's forward programme and long-term strategy

Waterwise looks forward to being involved in the following specific projects and related workstreams:

As listed in the forward programme for 2010/-11 to 2012-13:

- Ensuring a fair deal for customers – including issues on water efficiency, metering, tariffs and cost-benefit analysis arising from the Walker Report and the Floods and Water Management Bill
- Making monopolies improve – including new mechanisms to promote innovative technology and approaches, and issues arising from the Cave Report
- Harnessing market forces – including designing and implementing new market arrangements
- Contributing to sustainable development – including work on adaptation, water efficiency targets, and wider climate change policies
- Delivering better regulation – including benchmarking, the review of incentives, accounting separation, future scenarios, impact assessments on major policy proposals, the development of market mechanisms, the review of PR09, the June returns process, and the resource efficiency project.

As listed in "Delivering Sustainable Water":

- Future scenarios
- Future price limits
- Regulatory compliance
- Metering and charging
- Europe and environmental policy
- Water markets

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