Dear Defra

New Strategic Policy Statement for Ofwat: Sustainability First consultation response

Sustainability First is an independent think tank and charity focused on promoting economic, social and environmental wellbeing in public utilities including the water sector. Please find below our response to Defra's consultation on the Strategic Policy Statement (SPS) for Ofwat, which sets out the Government's strategic priorities for Ofwat's regulation of the water sector in England.

Overview

We fully support the need for a Strategic Policy Statement, and also recognise that it needs to be nested under the strategic objectives which have been set for Ofwat in legislation. Work from Slaughter and May for Sustainability First last year stressed that the biggest limitation on Ofwat's actions in delivering sustainability was not legal constraints, but clear political steers[1]. The SPS admirably seeks to give these steers which are, welcomely, significantly more numerous and granular than in the 2017 SPS.

Below we outline our response to Defra's three key questions and in particular suggestions for improving the SPS. However, we would like also to suggest a more overarching suggestion: the SPS would be greatly improved if – either within the document or elsewhere, perhaps through a water strategy – ministers were to set out a **strategic vision for a future water industry**. We have included some suggestions of what this might look like in our response to question 1. However, this could also help give a steer on the Department's expectations for Ofwat and provide additional clarity on the SPS so it is also relevant to questions 2 and 3.

Question 1: Has the government identified the most relevant strategic priorities for Ofwat?

We consider that the SPS would be greatly improved if – either within the document or elsewhere, perhaps through a water strategy – ministers were to set out a **strategic vision for a future water industry.** This is not about prescribing outputs but giving a clear view on the 'basket' of outcomes that the sector needs to deliver. It could, for example, say something like:

"We see a successful water industry as one which:

- Recognises that as an essential service and part of critical national infrastructure, it plays a key role in ensuring social, environmental and economic well-being both for the short and long-term and needs to deliver for customers, society and the environment;
- Maximises public value, while securing fair returns for investors;
- Provides a safe, clean resilient water supply in a world already experiencing climate change and climate, biodiversity and habitat impacts;

[1] https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/Notes_on_Sustainability_Law_and_Regulation_in_the_Utilities_Sector.pdf

- Plays a full part in returning the aquatic environment to the State for Nature target for 2030 and such targets as may be set out under the Environment Bill;
- Delivers the day-to-day service which customers have the right to expect, responds to problems in a timely and efficient fashion and meets the changing expectations of customers, citizens and communities;
- Supports and empowers customers in vulnerable situations, including those in water poverty, ensuring water is affordable, services are accessible/inclusive and no one is left behind in any changes, and customers and communities are protected;
- Listens to its customers, citizens and wider stakeholders, and balances the needs of todays and tomorrows stakeholders;
- As a high energy user, plays its full part in achieving net zero for the nation;
- Works as a sector, and with other sectors, and addresses systemic issues, recognising that we live in an increasingly interconnected world; and
- Charges no more than is necessary to fund the above and innovates to deliver more and to become more efficient."

The language used in Sustainability First's recent 'Essential Services Utopia' may help the Department consider how best to frame the outcomes that need to be delivered by the sector to maximise public value.[2]

We do not see this approach as undermining Ofwat in any way, rather as giving appropriate strategic and political leadership – and statement of the outcomes the industry needs to focus on and what success looks like for AMP8. Put another way, it is for Government to define the what in terms of outcomes and for Ofwat to define the how. An obvious parallel would be with the balance between the Government's net zero strategy and Ofgem's role in decarbonisation.

Having given due consideration to the framing of the SPS, we would broadly support the strategic priorities set out for Ofwat in the draft SPS but with three exceptions.

First, the centrality of the public interest in water is only acknowledged in Para 40 in the context of governance whereas the importance of water companies acting as **public service organisations - maximising social and environmental value - should be an overarching theme**. Indeed, Ofwat have, of their own volition, stressed this and a number of companies have placed Purpose in their Articles of Association. The document as a whole seems some years behind current thinking around purposeful business and the future of the corporation.[3]

Second, we believe that a stronger statement is required to the effect that AMP8/PR24 should be predominantly about outcomes, rather than process. It could also give a stronger steer that environmental targets/outcomes should be at a catchment scale.

A stronger focus is needed on **cross-sector working and intersectoral challenges**. In particular in relation to resilience and affordability.[4] We have outlined below some examples of where this might apply.

We would also note that there are likely to be some major **trade-offs** in Defra's strategic priorities for Ofwat over the next thirty years: between protecting and enhancing the environment and bills;

[2] Sustainability First (July 2021) How engagement can maximise public value in the essential services of water and energy
[3] Sustainability First (March 2021) Regulation for the future: The implications of public purpose for policy and regulation in utilities
[4] Sustainability First (September 2021) Do water and energy mix?

between net zero and resilience; between environment and social outcomes; and between short and long-term interests. An economic regulator, however good, should not be the sole decision point on trade-offs (particularly when they may have significant distributional impacts). The SPS largely ducks this issue and does not give a clear sense of prioritisation or weighting to different outcomes.

In this area, we consider that the SPS could be strengthened by requiring that Ofwat:

a) Be explicit about the trade-offs that it is making;
b) Be transparent about the distributional and other impacts that significant trade-offs may have and any associated interdependencies or related knock-on sequencing issues; and
c) Explains what methods it will use to deal with these issues.

Question 2: Does the strategic policy statement effectively set out the government's expectations of Ofwat in supporting delivery of our priorities? If not please identify where these expectations could be made clearer.

Overarching comment

There seems little if any reference **to citizens, only to customers**. In our view, clearer support of Ofwat's strategy – for the sector to deliver public value for customers, society and the environment – would be beneficial.

Water production and the treatment of wastewater have far wider implications than simply as a customer product. This is implicitly referenced with regard to the environmental angles, but the term citizen is never used. We also know that when people are engaged as citizens as well as customers, they have different views on the environment, resilience and wider priorities, which may need to be traded off. Taking a wider perspective can help identify common interests and **co-benefits** and can create an enabling environment for the development of **local and place-based** solutions.

We recommend the SPS amends a number of references to 'customers' to 'customers, communities, citizens and wider stakeholders'

Environment

We very much welcome the greater **focus on the environment**, which in 2017 had been relegated to a subset of resilience. The 25 Year Environment Plan is clearly at the heart of the document, as is the need for catchment approaches: and we have seen this change also reflected in, for example, the new approach to the Water Industry National Environment Programme (WINEP). We make the following suggestions as to where expectations could be made clearer:

- We appreciate that with the **water targets** in the Environment Bill yet to be set, the Statement cannot really cover these, but that said we would suggest explicitly encouraging Ofwat to leave room to take these on board as the price review develops - and not simply referring to the need to take account of the Water Industry Strategic Environmental Requirements (WISER). Ofwat should be given a strong steer that abstraction reduction should complement moves to reduce leakage and per capita consumption (see below where we argue that PVC reduction also may be best achieved across companies, rather than for each company) – and that companies should be left some discretion as to how to best achieve balance of supply and demand.

- We welcome the initial focus in the SPS on actively **'enhancing' the environment** as opposed to simply not harming or protecting. But point 20 seems to undermine this as it is weaker. It states: 'We expect companies to support environmental protection and enhancement of priority habitats such as chalk streams'. We query why just priority habitats? We propose this is strengthened/clarified so it's about 'enhancing the environment, striving to be biodiversity net positive, in particular for priority habitats (but not only priority habitats).'
- There is a major nuance with regard to aspirations to 'improve at least three quarters of our **waters to be close to their natural state**. In the past this has led to an overfocus on achieving 'good ecological status' to the detriment of better value improvements to water bodies which do not formally change the status /class of the water body.
- The SPS ducks a major issue in **environmental water quality**: **the trade-off** between major **end of pipe investments** in reducing storm overflows and often more cost-effective work on **reducing diffuse pollution**.
- There is also a strong case for explicitly **linking the reduction of storm overflows to sustainable drainage** and the reduction of surface water flooding: encouraging Ofwat and water companies to look for these 'win-wins' would be invaluable – this is hinted at in the water resources and DWMP sections, but not in the environmental water quality section.
- There are a number of initiatives in different sectors to improve **environmental water quality**: water sector initiatives such as the WINEP; changes to the Environmental Land Management regime; and the promotion of natural flood management. It is critically important that these are joined up, and we would argue strongly for insertion into the SPS (alongside the good text on 'operating in partnerships across catchments') of text such as : 'we expect Ofwat to have regard to changes in ELM and to developments in natural flood management and to encourage companies to work with these schemes to maximise the net public good, not simply undertake narrow schemes within their own area of expertise.
- There is a potential win-win through **sustainable drainage and grey water reuse and potential ground water recharge**. The SPS could make more of this.
- Companies should have a more **explicit role in consumer awareness and behaviour change**. This includes building customer understanding of sustainability, and how they can contribute to sustainability (including working with partners in other sectors such as energy), and in doing so support resilience, the environment and affordability.
- There is no mention of the link between **environmental and social value** e.g., numerous recent research reports have focussed on the health benefits of public access to green and blue spaces[5] and how this can help in addressing inequality and supporting the Government's levelling up agenda. We would note that this issue has become increasingly important in the pandemic. Also, Ofwat is encouraging companies to maximise public value in their decision-making. We suggest therefore, a tweak to the expectations so that Ofwat is expected to: "Encourage companies, when supported by their stakeholders, to deliver wider environmental *and social* benefits in the course of carrying out their functions."
- The SPS states - "English water companies have made the commitment to achieve **net zero carbon emissions** for the sector by 2030." **This is inaccurate**. They have committed to delivering net zero in operational emissions by 2030. That is very different and is a small part of their actual emissions contribution. The industry has been picked up by Ofwat for misrepresenting this. Given water is one of the most cost-effective sectors to decarbonise and the industry has not committed to net zero by 2030 this needs addressing – we would caution against undermining sector and Ofwat ambitions here (who are actively considering

[5] For example: The Environment Agency's Social Benefits of Blue Space – a systematic review.

whether water companies should go faster but said they will be led by government). It would also be justified to add that customer views should be sought on the necessary investment to achieve full 2030 net zero. We would note that there are some areas where the sector's role in terms of net zero could helpfully be encouraged (for example, the decarbonisation of construction and the role of catchment management solutions as carbon sinks).

Cross-sector working and resilience

- **Cross-sector approaches**, whilst often difficult to achieve, can be important for resilience and the delivery of wider public value (eg joined up support and services for customers in vulnerable situations). We consider that there is greater scope for co-ordination between Ofwat and Ofgem on their respective SPSs. In our view, Defra's SPS should support Ofwat in continuing to play an empowering and enabling role on cross-sectoral work and should encourage it to take a more strategic approach in this area.
- The focus on **resilience seems very narrow** with the focus on assets and in-sector solutions e.g., catchment management. Greater focus is needed on **intersectional resilience issues.** A major risk to water supply is from discontinuities in energy and telecoms, and water availability is an issue for current and future energy.
- It would be worth the SPS referencing the **National Infrastructure Commission (NIC) and CCRA3[6] assessment** of for example water's dependency on electricity, how climate mitigation and adaptation strategies in other sectors will impact water, hydrogen's dependency on water etc.
- Linked to the above, the SPS needs to mention the importance of building **customer (domestic and small business), citizen and community resilience** alongside asset resilience. e.g., not just individual customers but helping small business customers prepare for interruptions - such as care homes, children's homes, small hospices, animal places. This was raised as a gap during the Beast from the East.

Managing water demand

- We welcome the focus that Ofwat should 'support and encourage water companies to develop a consistent approach to address leakage on **customers' own pipes'** though there should be scope for companies to go beyond any minimum approach in the interests of customers. In addition, the focus on reducing **demand from personal and business customers.**
- It would be good to encourage p**artnership working more generally on demand reduction** as delivering behaviour change will require better sector wide and cross-sector engagement activities. For example, there are clear advantages to **co-ordinating water efficiency and energy efficiency messaging** e.g. hot water has been estimated to account for up to 22% of annual household gas demand (but this will vary –potentially significantly –by household), and on average 10% of electricity bills. Clearly energy usage impacts the affordability of energy which in turn impacts customers' ability to pay their water bills (often the last bill paid as customers can't be disconnected and consequently are advised to pay it last by many debt advisors). Demand reduction in energy networks also has implications for the resilience of water networks. The current communications approach is piecemeal, with at times conflicting messaging. We'd encourage an amendment on expectations so that

[6] Independent Assessment of UK Climate Risk - Climate Change Committee (theccc.org.uk)

Ofwat should - ' Encourage and support the water industry in collaborating with others to manage and reduce demand'.

Greater resilience to flooding

- We welcome all the points put forward but query if there may be benefit from emphasising the opportunities that could come from sharing relevant data with the public and third parties including local authorities in particular households at risk of surface water flooding.

Security, corporate and financial resilience

- Sustainability First considers that a focus on public purpose at the front and centre of corporate decision making is vital to create public value and to move from a 'compliance only' mindset. Whilst the sector has done much good work in this area, there is still more to do amongst all actors – government, regulators, and companies - to get the transformational shift at the scale and pace needed for the water sector to become truly sustainable. In our view, it is important for the SPS to endorse the focus on purpose and this direction of travel.
- The SPS does not mention **pandemics**. Sustainability First's research has found that even in the scenario where Covid becomes significantly less harmful and shifts from a pandemic to endemic in the population and is managed much like flu, there are likely to be legacy impacts which will be felt for a number of years and there will continue to be a risk of future pandemics. Companies and Ofwat should do lessons learned exercises from Covid-19 and ensure future action plans are in place to prepare for future pandemics or other similar significant interruptions or exogenous shocks from outside the sector.
- The Department will be reviewing the SPS at the same time as the energy sector is experiencing acute issues with **corporate and financial resilience**. To better manage these types of risks, the SPS could make it clear that it expects Ofwat to consider how water companies understand the totality of risks that they face, how these risks interact and the assumptions on which their modelling and mitigations are based.[7]

Serving and protecting customers including those in vulnerable situations

- There is a welcome focus on vulnerable customers, or rather **customers in vulnerable situations** (as is good practice terminology, recognising that 'the vulnerable' are not a predefined group, but rather are made vulnerable by their personal characteristics, circumstances, situation, and the behaviour of companies).
- The SPS says that Ofwat should ensure that 'the impact of any increased investment *remains* affordable and has broad customer support'. The last SPS acknowledged that a substantial minority of customers currently do not find their bills affordable. It would seem appropriate for this SPS to do the same especially given the growing number of customers who are struggling to afford their bills as a result of Covid-19. Ofgem's PR24 document includes their own stats on this[8].
- Also, there will be **very real tensions between affordability** and the need for funding to tackle resilience, improve the environment and deliver net zero. We'd welcome some acknowledgement of this in the SPS **and a steer on 'who pays' issues and how to deal with related trade-offs**. A basic problem remains that utility bills are regressive. The balance between help from utilities and help from the welfare state is something only government

[7] See, for example, Sustainability First (April 2020), Risk and uncertainty during the corona emergency Checklist for boards and executive teams to support strategic thinking

[8] PR24-and-Beyond-Creating-tomorrow-together.pdf (ofwat.gov.uk)

can define. The document does not attempt to do this, nor do other government documents. But it should be central, and the Government's concern around 'the just transition' should apply to adaptation as well as net zero.

- We agree that more needs to be done on **consumer and community vulnerability,** in particular to ensure that financial help reaches those who need it. Companies will need to review the range of support available and their eligibility criteria for help to ensure that those hardest hit by the pandemic and in the most severe water poverty are able to access support. We especially welcome the onus on water companies to ***proactively*** **manage customer debt.** We would suggest the SPS explicitly stresses the benefits of **interagency** working, in particular on the design and delivery of services and common messaging.
- We'd also strongly encourage a focus **not just on protecting** customers in vulnerable situations, but also **empowering people** to help themselves e.g. providing flexible bill payment options helps those on variable incomes including zero hours contracts budget more easily and pay in instalments at a time when they have money. This helps them to avoid debt and continue to pay their bills. Providing accessible websites with translation or audio built in means non- English speaking customers or those with reading difficulties can easily access the information they need without having to contact the company and rely on help e.g. with a translator. Providing advice in advance on how to stay safe during hot weather or a supply interruption, for example, gives customers and carers supporting them the information and power to stay safe alongside the peace of mind of knowing what to do etc.
- Linked to the above, we'd encourage Defra to expect Ofwat to promote **accessible services** and **inclusive planning and design - this is a key part of fairness.** Simple low-cost changes to services and communications could improve the customer experience and reduce call centre and wider customer service costs yet progress in this area has been painfully slow. This will be increasingly important as the population ages and with the growth in single person households. For example, the incidences of most health conditions are likely to rise by approximately 20% over the next 10 years as the population ages.

<u>Effective and timely services for all</u>

- This might also say something about ensuring companies deliver **accessible and inclusively designed services.**

<u>Protecting small business customers</u>

- The focus on improving protections for small/micro business customers is especially welcome. As is the recognition of the problems in the business retail market more widely and the need to address those to deliver better outcomes for customers and society.

<u>Engagement</u>

- We welcome the focus on the importance of **engagement.** But engagement is not just about achieving 'more for customers and the environment' but about **achieving more for communities and society** more widely i.e. maximising public value e.g., through debt referral partnerships/housing partnerships/colleges training apprenticeships and consideration of a company's wider role in the levelling up agenda and social mobility etc.
- The **language around engagement is a bit dated** e.g., in the customer section it says 'Service improvements should reflect evidence of customers' expectations, and the affordability and acceptability of future bills.' There is no mention **of co-delivery of services (though catchment management is mentioned) /co-design/the need to transparently trade-off**

different views e.g. affordability and service performance. Generally, it feels a bit weak on the **behaviour change** needed to support sustainability, wider resilience, net zero etc (though it does say companies must act to reduce demand – it would be better to talk about working in collaboration to reduce demand).

Developer services

The SPS is right to stress that the water industry has an important role in enabling the government's objectives on housing. But it is also important that water companies make it clear where proposed new developments will have a seriously detrimental effect on the capacity of wastewater treatment and where such developments will be particularly difficult to serve with regard to water resources. Not to do this will only exacerbate problems such as sewer overflows and water supply outages. There may be some elements which require funding in price reviews: e.g. cumulative systems implications which cannot be funded by a series of bilateral industry/developer discussions.

Focus on the long-term

The focus on **the long term is very welcome**, and we strongly endorse references to **adaptive processes** with regard to climate change.[9] Perhaps more acknowledgements could be made to the fact that this planning needs to take place against the backdrop of other potential long-term changes – e.g., in technology, ways of working, supply chain practice and deprivation – and of increased uncertainty even with regard to things like population projections. Again, as mentioned under financial /corporate resilience, understanding total risks and risk dependencies is crucial here.

General additional comments

- The SPS could be **stronger on data and digitisation**. It highlights some specific examples e.g., timely data sharing on vulnerability, but the SPS could also expect Ofwat to challenge companies to use and open up data where it can deliver better customer and citizen outcomes and wider environmental and social value.
- We recognise that it is for Defra to steer Ofwat as to its priorities for delivery through the industry, not to tell it how to do its job and the draft seems to us to be well judged in this regard. That said, we feel it would not have been inappropriate to give a stronger steer with regard to **reduction in bureaucracy and increases in transparency**. The price review process has become more and more a technocratic exercise with little capacity for citizens and customers to really understand what is being decided and the rationale for this. We have argued in our Fair for the Future[10] work that greater use of third-party assurance and deliberative approaches could increase legitimacy and transparency of the process while reducing complexity.
- There is also within some very good assessment and steers**, a real lack of concrete objectives for 2030, and for PR24** – particularly given that this is supposed to be the 'decisive decade' of action on climate change and the environment. There would appear to us to be next to nothing in the SPS which could avoid 'pushing everything back': something which in our judgement has happened time and again in successive price reviews. If forming targets are deemed to beyond the remit of the SPS, statements such as the following would be welcome - 'we expect clear and demonstrable progress in PR24, and for all decisions by

[9] Sustainability First (September 2021) Adaptive regulation and adaptive planning: Issues for economic regulation in water and energy

[10] https://www.sustainabilityfirst.org.uk/projects-fair-for-the-future

Ofwat and the industry to delay investment to be clearly grounded in evidenced based analysis of the reasons for this.'

- We would encourage the SPS to note the importance of the **place-based agenda**: we would support for example Yorkshire Water's use of local authorities as part of its review / accountability process. In this context, the document is also silent on **issues around communities** – particularly important in the rural areas which Defra has a particular remit for. A number of companies are doing good things in this area, but really need government to set out that community-based approaches are to be encouraged and supported.
- There is also a wider question as to whether more encouragement needs to be given to regulators to collaborate further e.g., on the cost of capital, data access and vulnerability. In our view this is an important way of maximising wider public value.
- The previous SPS also mentioned **best value plan**s, but Ofwat arguably still put a greater focus on lowest cost plans/short-term solutions in the end in its decisions at PR19. This is perhaps as it didn't have consistent mechanisms to assess this. We would suggest therefore the SPS encourages the development of **cross sector common Social Return on Investment (SROI) metrics** to enable the regulator to assess and deliver this in practice, this time round.

Question 3: Do you consider that this statement to Ofwat is clear and easy to understand?

We welcome the clarity of structure of the draft SPS, which we feel is a significant improvement on the 2017 statement. The alignment of material under the strategic objectives is clear and transparent. There are however a few places (e.g., in para 41) where 'we expect Ofwat' statements are hidden in text rather than, as elsewhere, brought out clearly and separately. And as noted in our response to question 1, clarity could be further improved by setting out a strategic vision for the industry and what success for the sector might look like.

We would be happy to discuss any of these points in more detail. And we are happy for this submission to be put in the public domain.

Kind regards

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