

Engage Consulting Briefing Note:

December 9th 2011

Water White Paper: Water for Life

Introduction

This briefing note summarises the content of the Water White Paper "Water for Life" published on 8th December 2011 by Defra (Department for Environment, Food and Rural Affairs; the Government department with overall responsibility for water policy and legislation). The Water White Paper represents Government's response to three major reviews of the water sector:

- Martin Cave's "Review of Competition & Innovation in Water Markets" ([Cave-report](#));
- Anna Walker's "Review of Charging for Household Water & Sewerage Services"; ([Walker-report](#)) and
- David Gray's "Review of Ofwat & Consumer Representation in the water sector" ([Ofwat-review](#)).

We intend for this briefing note to be used to inform interested stakeholders and to summarise proposed Government policy in a short, easily accessed document. The full Water White Paper can be found at: [water-white-paper](#).

Headlines

- New Abstraction Regime to be developed;
- Water Bill to be drafted in early 2012;
- Interconnection encouraged between water companies;
- Government to fund £50 per customer to South West Water;
- Threshold for competition to be reduced from 50ML to 5megalitres and eventually to zero for non-domestic customers;
- Competition to be extended to sewerage;
- No competition for domestic customers;
- No overall Government policy towards water metering;
- Mergers limit without referral to Competition Commission to increase from £10m to £70m; and
- No business separation of water companies proposed.

Summary

Recognising water as a vital yet finite resource, "Water for Life" acts as a call to action, by placing customers at the heart of any change, with a vision for a more robust and sustainable water sector.

Government appreciates that it cannot wait until it is too late to tackle the issues facing the water industry and recognises that it must begin to incentivise companies and consumers immediately.

The main challenges facing the water industry are:

- Climate change: whilst the exact impact on water is difficult to ascertain, with warmer climates, extreme weather events, and an expected increase in droughts, this will undoubtedly

influence the country's water resources in various ways. Decreased water availability, poorer water quality and a threat in sustaining economically important wildlife and species, are just some of the adverse consequences that could arise.

- Changing demographics: with an expectation that the population of England will grow by almost 10 million by 2035, this will certainly increase demand for water.
- Demand: whilst overall demand is forecast to decrease (due to a decline in both leakage and individual household demand), climate change will impact overall demand as more water is utilised in hotter conditions and the push for a low carbon economy may increase water usage by industry.

The White Paper outlines the Government's suggestions to support growth and innovation in the water industry as well as to protect the environment. Putting water affordability at the heart of their proposals and protecting taxpayer interests in their policy decisions, the Government proposes the following:

- Encouraging and incentivising more water efficient consumer behaviour;
- Improving water quality by reducing pollution and a commitment to tackle over-abstraction;
- Increasing innovation and growth by ensuring the market is attractive to new entrants as well as expanding the services water companies offer to their customers;
- Government will set the agenda as well as outline the roles and responsibilities of industry and what is expected of regulators;
- Whilst recognising that everyone must collectively contribute to more efficient water usage, Government appreciates that water affordability is a key concern for customers. Thus, Government plans to:
 - Set guidelines (to be published early next year) for water companies to help customers struggling to pay their bills through "social tariffs", to be implemented from April 2013 by those wishing to do so;
 - In the south west, where households face the highest water bills, Government has committed to contributing a fund which will reduce the region's water bills by £50 per household per year;
 - Legally, companies are prohibited from disconnecting water from domestic customers who fail to pay their bills, which adds £15 (on average) to the bills of paying customers. As a result, Defra is currently consulting on processes that will help water companies recover their debts which will in turn benefit customers by reducing their bills.

It is evident that Government cannot achieve their vision for the water sector alone, and that there is a role for everyone to contribute towards the objectives outlined in the Paper.

Engage Consulting provides consulting and IS services to the energy & utilities and water sectors.

We provide independent expert advice to retail organisations, network companies, environmental bodies, regulators, metering companies and many others through the end to end supply chain for energy and water.

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Government Views

Secure, sustainable and resilient water resources

The Paper focuses on reforming the water abstraction regime and increasing interconnection and trading of treated water.

Water Abstraction

Government notes that the key issue with the current abstraction regime is that it was not designed to protect the environment or manage various (often competing) demands. Abstractors' licences generally allowed licence holders to abstract up to a fixed amount of water which can result in a water resource issue in some areas. Although the regime has evolved, there are still issues:

- too much water being abstracted from some areas;
- abstraction charges (including licence costs) do not give the right pricing signals and therefore could link to not having a recognised value of water;
- current process for changing licences is becoming increasingly untenable;
- there are no incentives on abstractors for managing risk; and
- barriers to sharing water efficiently.

To address these, Government aims to introduce a reformed regime; it will work closely with stakeholders in designing the new system with a new national advisory group guiding the design process (consultations on the proposals are planned for 2013) while legislation to enact reform is aimed for introduction early in the next Parliament. Key themes for the new regime are as follows:

- changing existing licences in a phased way in order to transition to the new regime;
- clearer signals and regulatory certainty;
- better reflection of the water value as well as fairer to all abstractors; and
- aiming to drive efficiency in water use and be responsive to supply and demand fluctuations.

The transition to the new regime is intended to be phased to reduce disruption and costs (including initial focus on water stressed areas) with agreed principles to be followed. Government aims for the new regime to be in place by mid to late 2020s.

Interconnection and Trading of Bulk Supplies of Treated Water

The Environment Agency's work in this area has highlighted the importance of increased interconnection in the water supply system; furthermore, Government has evidence that improved interconnection offsets the need for new water resources or infrastructure.

Government envisages bulk transfers of water at this stage to be over short distances due to the costs; however, it anticipates future strategic interconnection projects building to a more integrated water supply network.

The Environment Agency will be considering the various interconnection options across licensed water supplies including the barriers to it. Ofwat is expected to support this work and bulk water trading by using incentives for water companies in the next price review – these include regulatory incentives to make trading more attractive to importers and exporters; and optimise the use of water networks. Furthermore, Government welcomed Ofwat's proposals to facilitate trading by developing:

- an upstream market code; and
- a contract model for bulk supplies/trading.

Protecting our rivers

The key focus here is improving water quality and tackling unsustainable water abstraction.

Water Quality

Government is planning to take forward the new catchment-based approach to water quality and diffuse pollution (from sources such as roads, farms, industrial estates, detergents and other products washed down the drains); it will look to continue tackling pollution (from sources such as private wastewater facilities and abandoned metal mines) and will consult on a national strategy in 2012 for urban diffuse pollution.

It wants to look at ways of stopping pollution at source, as it is cheaper than water companies having to address it and also means that costs are better distributed among polluters rather than mainly falling on water customers. Linked to this is the work that the Environment Agency is undertaking around River Basin Management Plans where investigations are due for completion by the end of 2012 – this aims to increase the rate at which rivers and lakes achieve good status.

Government intends to intensively support 25 catchment pilots and draw out all the lessons learnt from them. Government noted that mandatory measures might be pursued in delivering environmental outcomes if there appears to be inaction or if catchment plans do not clearly set out actions upon which progress can be checked. In addition, Government plans to:

- work towards a common agricultural policy for pollution;
- consult on a national strategy on urban diffuse solution;
- introduce more stringent bathing water standards; and
- maintain delivery of microbial standards at designated shellfish waters.

Unsustainable Abstraction

The Environment Agency has been investigating unsustainable abstraction instances with water bodies. Government aims to tackle the legacy of unsustainable abstraction while also working on reforming the regime; it will work with Ofwat and the Environment Agency on restoring sustainable abstractions and addressing the barriers to trade in abstraction licences.

To deliver this, Defra aims to:

- develop an action plan for addressing unsustainable abstraction in the River Basin Management Plans up to 2027 and beyond; and
- work with Ofwat and the Environment Agency to deliver a framework for company solutions for restoring sustainable abstractions to be included in the price review process (this includes Ofwat's consultation on Abstraction Incentive Mechanisms as part of its Future Price Limits proposals and Environment Agency's planned consultation in 2012 on its charging scheme).

Addressing barriers to trade in abstraction licences is a key commitment from Government; it also noted the Environment Agency's work around trading and market information in addition to consideration of licence revocations in instances where there are large unused licences.

Planning and Building for the Future

Aligning Plans

An independent review identified the need for better co-ordination of the Water Resources Management Plans (WRMP) and the Ofwat price review (2009). The next Water Resources Management Planning cycle will build on the priorities set out within the Water White Paper, which include:

- Using the UK Climate Change Projections (UKCP09) to enable a long term perspective of resource vulnerability;
- Understanding water scarcity and abstraction environmental costs;
- Consideration of Catchment Management Approaches;
- Water Trading and interconnectivity; and
- Strengthening WRMP Demand Management guidelines

Infrastructure

The Paper discusses water and wastewater infrastructure from a strategic national overview and future perspective. The key topics include:

- identifying the responsibilities of water companies;
- ensuring that water and sewerage networks are able to cope with increased demand;
- the New Planning Policy Framework; and
- the National Policy Statement for Wastewater.

Wastewater and Drainage

Over 10 million tonnes of wastewater is collected and disposed of each day and the cost to replace the current sewerage network is estimated at over £200bn. At the current rate of replacement/maintenance it would take around 800 years to complete the whole system. The White Paper discusses a number of wastewater and drainage options, including:

- additional investment to maintain the sewage network;
- a reduced focus on sewer network planning than with water supply;
- drainage networks that cannot cope with extreme rainfall;
- removing the automatic right for connectivity from developers; and
- further use of anaerobic digestion methods.

Developing a Customer Focused water industry

Government identifies a number of key commitments to help companies focus on the customer needs within this section specifically pertaining to affordability; reducing high household bills in the south west; reforming the market for business customers and protecting customers.

Affordability

Although water and sewerage is relatively good value (estimated at £1 per day on average), a high number of customers cannot afford to pay. The White Paper discusses the immediate need and the longer term reforms to reduce problems surrounding affordability including:

- Government support of social tariffs;
- The benefits of metering; and
- Implications and limitations of customer bad debt.

Reducing high households bills in the south west

Household bills in the south west are the highest across the country, mainly due to the network being less developed at the time of privatisation. Therefore, Government has decided to fund South West Water to enable customer bills to be reduced by £50 per year until (at least) the next spending review.

Reforming the market for business customers

Competition for business customers was originally outlined in Martin Cave's report ("Competition and Innovation in Water Markets") and is discussed in the White Paper. Topics include:

- Fundamental structure changes to the industry will not be required (e.g. legal separation of companies' retail operations), but existing strengths will be built upon to increase competition through evolutionary reforms;
- Acknowledging that customers switching supplier (for very large companies only) has not worked well and the market is too small to develop effectively;
- Scotland's competitive market has been successful (over 42% have switched or negotiated better terms);
- Water consumption threshold for switching will reduce to 5 million litres per annum (from 50 million) increasing the customer switching pool to 26,000;
- It is the Government's intention to deregulate further in a future Water Bill by:
 - reducing the threshold to zero so that any non-household customers can seek a new supplier for their water needs;
 - removing the costs principle from legislation and instead introducing a transparent wholesale access pricing regime that will allow efficient entry by new entrants;
 - extending the Water Supply Licence market to include sewerage services as well as water; and
 - legislating to remove the in-area trading ban and put all market players on a level footing (to support supply water and sewerage service requirements of national businesses);
- No case in the foreseeable future for opening up the household market to competition;
- Introducing statutory market codes to support the competitive market;
- Licence code changes to allow for a wide range of new entrants;
- Special Merger regime reforms; and
- Water company licence reforms.

Protecting Customers

Customers currently have representation from a number of groups including Consumer Focus, Citizens Advice and the Consumer Council for Water (CCWater). The Government is suggesting that a single body would bring further benefits to customers and will be considering transforming CCWater into that body post the 2014 price review. Further support will be given to developers to ensure that the service standards they receive are increased.

Taking Action

The White Paper discusses the consumer approach to water usage and how it could be improved through a number of different methods including:

- using less water in the garden;
- managing water consumption in the home;
- understanding more about drainage;
- changing attitudes towards water;
- incentives to save water;
- seasonal tariffs;

- water efficiency; and
- the Green Deal.

Government's Next Steps

These are as follows:

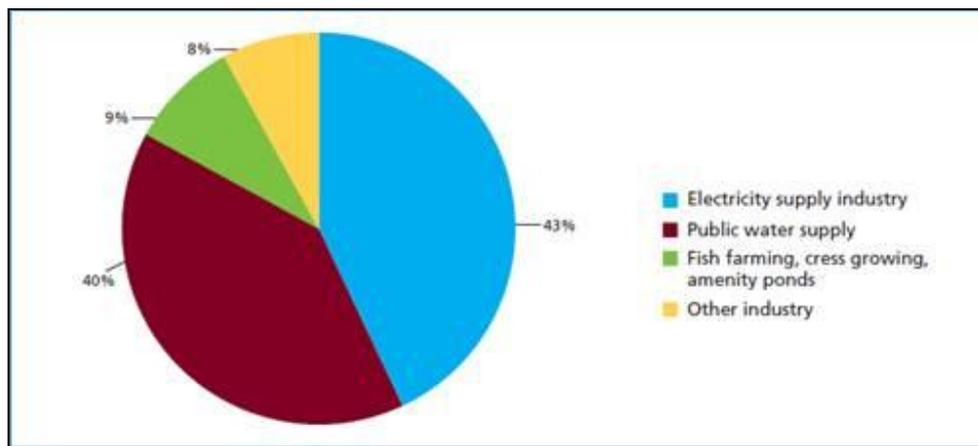
- Publish a draft Water Bill in early 2012 for pre-legislative analysis;
- Produce a strategic policy statement and social & environmental guidance for Ofwat during 2012;
- Publish final guidance on social tariffs for water companies early next year;
- Set out arrangements to work with stakeholders on designing a new abstraction regime for early 2012;
- Increase efforts to combat the issues surrounding unsustainable abstraction with information to be published on progress next year; and
- Producing guidance in 2012 for the next water resources management planning round.

Cross Sector Implications: An Engage View

The Water White Paper has a number of impacts on the energy sector and the energy costs of water companies. Whilst the Paper focuses on water, its objective of delivering a sustainable future that is resilient to climate change challenges and linking to the Low Carbon Economy drive, means that water is intrinsically linked to energy.

Defra noted that one of its key concerns is that if there are risks with the reliability of secure water supplies, this could adversely impact on both energy security and energy bills.

The following diagram from the White Paper highlights the connection between water and energy i.e. that 43% of abstracted water is used in generating electricity via various types of power stations:



At Engage Consulting we believe that, as well as setting the policy route map for the water sector, some of the White Paper implications could have a major impact on the energy sector. Energy market players will need to consider these as well as the Water White Paper as a whole – this can be summarised as follows:

- potential changes/reform to the abstraction regime (including licence modifications and charges) will impact energy market players especially electricity generation (power stations);
- current/future research and development on carbon capture and storage technology will need to consider any changes/reform to the abstraction regime due to water's use in that field;
- potential interconnection and bulk transfer of water will consume additional energy which will need to be considered in terms of electricity system balancing, and will also impact energy costs for water companies (which the customer ultimately usually pays for);
- addressing raw water quality at source will bring benefits as noted in the White Paper; it reduces the need for water companies to carry out costly and energy intensive treatment processes to deliver potable water;
- the White Paper mentions metering for the water sector and specifically discusses smart meters; it notes taking advantage of any synergies with the roll-out of smart meters for electricity and gas. Aligning the water and the energy industry in relation to smart meters and their communications infrastructure is an item for consideration by both industries. That said, the White Paper notes that it is ultimately the water companies' responsibility to demonstrate the business case for implementation (with the agreement of their customers); and
- addressing the issues of household bills' affordability, bad debt, consumer protection and social tariffs in the water industry has synergies with the work undertaken in energy. It is also worth noting that a number of the steps identified by the Water White Paper in its Taking Action section (in relation to consumer usage of water) have synergies with the approach in the energy industry.