

NON-VERBATIM MINUTE

DATE: Thursday 8 July 2021

TIME: 10:00 - 11:00

METHOD: Zoom Meeting

CHAIR: Baroness Anne McIntosh of Pickering, Co-Chair of the All-Party Parliamentary Water Group (Con)

MINUTES

The Chair, **Baroness Anne McIntosh**, welcomed the meeting attendees and speakers to the meeting.

The Chair said that in this meeting, the focus would be on identifying what the water sector was doing to prepare for the upcoming 2024 price review (PR24) and it would discuss how to encourage outcome-based regulation around the 25 Year Environment Plan.

She recapped that this meeting followed an AGM for the Group, where she was re-elected as Co-Chair. The Chair officially welcomed Liz Twist MP following her election as Co-Chair and thanked Alex Davies-Jones MP for her time as Co-Chair. She also informed the Group that Alex Davies-Jones would remain an officer for the group.

The Chair then said how delighted she was to be joined by a panel of excellent speakers and was looking forward to a great discussion aimed at exploring how government and water providers can work together to deliver the most value for customers sustainably. She stressed she was very conscious of the fact that the APPG was asking the water companies to do even more to make the infrastructure safe and sustainable, and how the focus has been very much on the prevention of floods. She also stressed how the UK was still living with a “Victorian infrastructure” while dealing with an increasing population and global warming and relying on automatic connections to new developments.

On this point, the Chair expanded on how keen she was to see a whole new infrastructure for sewage outflow combined sewer pipes, which could be a multi-million, if not billion, pound investment. Based on these challenges, she stressed the need not to “tie the hands behind the backs” of water companies but to invest in new ways to keep water affordable while investing in new sustainable drainage systems. She stressed how she thought government had to ensure that was also a developer’s responsibility in any new house built.

She then moved to introduce **Carl Pheasey** and hoped he would explain how we could wed this to nature-based and more natural flood defences such as sustainable drainage systems.

Carl Pheasey, Director - Strategy and Policy, Ofwat

Carl Pheasley introduced himself and thanked the Co-Chairs for the opportunity to speak at this event. He explained that he leads on a range of projects that require direct interface with cross-cutting government policy issues, which have meant him being heavily involved in several environmental projects, alongside regulating the non-household retail market as well.

He stated how timely it was to be discussing the link between PR24 and the environment, not least, because OFWAT is currently consulting on the high-level design of PR24 and how the environment runs through that document.

The first thing he said they are currently proposing are four core themes to PR24 and increasing long term focus adding greater environmental and social value through efficiency and innovation. What they are considering is how their approach to regulation should evolve to ensure that companies can make an appropriate contribution to environmental bills considering a whole range of other technical issues that are. What he said would be a great idea was to ensure that company have enough long term warning in terms of regulation direction. That could be alluding to companies, at the end of a review, what will be looked at the next one and what performance incentives might be included going forward.

While they asked companies to set out a relatively long-term view on what they will want to commit to and what longer-term goals, they're working to, the water industry hasn't always had long-term certainty on how it would approach and make decisions in the future.

The second example is the emphasis that they are putting on companies needing to innovate and to work in partnership both across the sector including by providing financial incentives to innovate, but also to work in partnership and innovate across catchment centres. He also stressed how they were also working actively with the Department for Environmental, Food and Rural Affairs (DEFRA) and the Environment Agency and others, including the industry, on how the sector could move to more outcomes-based approaches.

The Chair thanked Carl Pheasley and introduced the next two speakers **Guy Thomson**, and **Rob Francis**.

Guy Thomson, Group Director for Environmental Future, Wessex Water

Guy set the scene on why he and Rob would be presenting together, which is that Wessex Water has commissioned Frontier Economics to look at how it could accelerate its contribution to environmental leadership. He stressed how he was there as a representative of a water company, but also somebody who had been working on this agenda for a while in different incarnations as he has worked on successive price reviews in the NGO community as director of green Alliance and then subsequently as a founding executive director of Natural England. With that, he explained that colleagues were conflicted by having been on the other side of the debate. He said he felt that Carl had already introduced the collective challenge around getting a regulatory framework that would incentivise water companies to do more to deliver environmental improvement.

Guy also stressed he saw a huge potential for the industry in private companies with a core purpose to improve public health and the environment to be providing environmental leadership.

He also wanted to stress how he thought the real opportunity to accelerate nature recovery through nature-based solutions, was around how hard infrastructure could be more resilient in the face of environmental pressures. The question he believed needed to be addressed was how fast objectives could be reached.

Guy said that, based on his experience on the ground, prescriptive EU regulation currently incubates the sector and the ability to do what is needed to accelerate environmental improvement towards the government's commitment to restore the environment within a generation. He wanted to stress how this was not intended to be a political statement and it was nobody's fault, but that the regulatory framework that has been inherited from the EU has done some fantastic things for the environment, but it was not working to improve water quality and we were “flatlining” on our Water Framework Directive commitments.

For Guy, the choices were being driven by the current approach to determining our regulation and engagement to improve the environment. He noted how Carl had already touched on the way it works, which was the input/output based on the system currently in place and that it had been obliged to reduce nitrate pollution through investing in a carbon-intensive treatments. He said that with the use of trade market mechanisms, we could achieve the same outcome by delivering through nature-based solutions in partnership with farmers. He concluded by saying how through the green recovery process initiated by Defra, they needed to think about how they could evolve catchment approaches and innovating by trial to understand to deliver it. He continued by saying this could be done using MFA to design a market that would bring together the multiple sellers' nature-based solutions farmers and estate owners and landowners, with the buyers the environmental services they generate.

He continued saying Wessex Water saw an opportunity to incentivize water companies very differently and along the lines of what Carl had described around long-term societal outcomes, but that they were asking for more flexibility to deliver against those outcomes. He commented how in the Climate Change Act, a requirement to reduce carbon and build up the resilience of catchments in the face of climate change was needed to translate those national targets into drivers for local action that deliver better outcomes on the ground.

Guy concluded by saying that this was precisely why they commissioned the frontier economics report and handed over to Rob.

Rob Francis, Associate Director, Frontier Economics

Rob thanked Guy and shared what a pleasure it was for him to present to the Water APPG. He gave an overview of the report parameters and how they focused very much on the economics, and in light of the ambition in the 25 years environmental plan.

He said that firstly to adopt the terminology of the descriptor review and water body ecosystem, it could be characterized as a common pool resource. It had many users of that resource, and the supply of services from that resource was very much limited.

Secondly, there were feedback loops and externalities that could create either positive or negative impacts on the ability of that body to continue to supply those ecosystem services, and that could lead to virtuous circles or vicious circles of outputs. Thirdly, the impact of changes were not linear or constant. These systems can be pushed into tipping points and shift from one into another much worse equilibrium. Those characteristics were fundamental to understanding the effectiveness of any regulation or any market mechanism that one might apply to the services. Their review of the current regulation had highlighted inefficiencies that, in their view, would make it costly and difficult to achieve that plan and he thought this builds on what the existing previous speakers had already said.

First, the system is fragmented, the sectors that impact water bodies are subject to very different environmental regulations and based on very different incentives. Second, it is prescriptive and it's focused on outputs. And this restricts the ability of water companies to look for more efficient ways to deliver the right outcomes. Third, there's a focus on single issues which fail to recognize the interconnectedness of all the dimensions of an ecosystem. The result of these inefficiencies was that the status quo runs the risk of either not meeting the goals of the 25-year plan or meeting them at an inefficient cost, potentially running into billions of pounds of additional expenditure.

In terms of a way forward, he said there is the need to recognize that no system of regulation or any market mechanism will be perfect in the face of the characteristics that he referred to, but how it can be improved through a more pragmatic implementation. He explained that this high-level concept is what they call outcome-based environmental reform and it aims to facilitate efficient solutions to catchment targets and tradable permits and credits.

For Rob, this approach will be proportioned as targets to sectors companies will be able to deliver on the outcomes in partnership with each other, while using market instruments that could be established for the externalities, meaning the market forces can identify the most efficient solutions. He concluded that fundamental to that will be having clarity with the rules and market instruments, which can really catalyse the private involvement and private investment in this area.

He also said how they know that the use of tradable permits is also consistent with the polluter pays principle, a real challenge that reflects the complexities and the characteristics referred to above. They recognize that this would be much more complex than a car, for example, a carpet permit scheme, which is just a single environmental issue, and also an environmental issue that is global in scale and not local and catchment area. The numbers that Guy referred to highlight the potential for improvement and how we should let the realization that the sector can't be perfect, get in the way of being better. They went on to argue that the substantial benefits can be achieved by pioneering companies as they have been active in environmental improvement for many years. Moreover, they've also been active at working with partners in local catchments, and they also have experience of working with market to market mechanisms within an overall regulatory model.

The Chair thanked Guy Thomson and Rob Francis and said how the presentations slides will be uploaded on the APPG Water website. She then moved to introduced the final speaker, Kirstin Green.

**Please note the Wessex Water and Frontier Economic joint report is currently a work in progress and it will be released in due course. More information can be found [here](#).*

Kirstin Green, Deputy Director of Water Quality, DEFRA

Kirstin thanked the Chair for the kind words shared about DEFRA and their work and introduced herself and her role. She shared with the attendees that she is responsible for policy and legislation relating to improving the water environment, particularly focusing on our 25-year environment plan goals on clean and plentiful water and working very closely with regulators including Ofwat, but also Environment Agency Natural England and others.

She recognised the importance of water companies as an important stakeholder and briefly outlined DEFRA's Strategic Policy Statement (SPS) to explain what it is and how it fits within a wider suite of government policy and regulation. Moving onto her slides- she said how across the government, water industry and regulators are working to prepare for the 2024 price review, which is well underway.

She said how one of the important keys to this efforts is the strategic policy statement or SPS, through which the government sets priorities and objectives for 40 years that independent economic regulator, the SPS is a key tool for government, it says some course for longer-term national priorities, and clarifies government's expectation of the water industry's role in achieving those. She said how, at present, DEFRA has been working on developing the next steps alongside the sector regulators and other government departments including engaging publicly on a draft statement. They are planning to publish the consultation in July and for it to run over the summer. She outlined how the new SPS is going to set out the government's expectations on how off what can drive the water industry to be more ambitious in its environmental planning and delivery. As per the Wessex Water presentation, the level of ambition in the industry is very high which chimes extremely well with Government ambition and their commitment to drive performance. For one, environmental performance ministers have expressed a very strong interest around improving company's environmental performance with a strong emphasis on water quality reducing pollution, reducing unsustainable abstraction.

One of the things she wanted to clarify is how the strategic policy statement is one of a collection of tools really to influence improvements in water quality and deliver wider environmental value. And this graphic on the slide where it's trying to sort of set it in the wider context. So the SPS is one but not the only tool that we use to influence the sector to deliver against the government's ambitions. There is a range of other complementary tools, which are important now and for the future price control period. The SPS itself performs a very specific role in defining the sector's expectations of what will enter into the negotiations for PR24 and carry out their duties as the independent economic regulator. In other words, the government sets the strategic direction so often it can carry out its role independently and with confidence over the policies and duties.

When the SPS sits within the context of wider government policy and legislation and reflects those things. To that purpose, they had already referred in the session to the environment Bill, and it would all take into account and reflect all the measures that had been brought forward within that. That would include, for example in the environment Bill, the power to set new long term legally binding environmental targets for water- including considering current water targets on reducing pollution from agriculture from wastewater from abandoned metal mines and targeting to reduce water demand. Setting these targets would provide an additional strong mechanism to help deliver long-term environmental outcomes. DEFRA was doing this, as people will know through robust evidence-led process and through independent expert advice. A consultation on those targets was expected to come out early 2022.

There were also guidelines to help explain the relevant legislation and expectations so the water industry's strategic and environmental requirements, which were sometimes abbreviated to the wiser, were produced by an Environment Agency in Natural England together. It was a reference for water companies to use when developing their business plans. It expanded on the priorities set out in the strategic policy statement and the legislation and regulation that underpins those.

They also had the National Environment Program, as it had been referred to by earlier speakers, which sets out all the actions that water companies take to improve the environment over the whole price review period. She said it had a close relationship with the River Basin Management Plans of Defra the Environment Agency in Oxford which has been working together, along with water companies, on a project to review the Wynette framework for 24. This project would try and ensure greater environmental benefits could come out of that, taking into account many of the things that were six and frontier economics have been talking about. We were also going to be consulting on the changes to that when methodology in the next couple of weeks as well.

She concluded hoping that this summary would give the attendees the overall context and the thrust of the Department's ambitions for the SPS and the structures they have in place to improve the water environment.

Question and Answer

The Chair invited questions from participants.

The questions section opened with the **Co-Chair of the APPWG, Liz Twist MP (Lab, Blaydon)** complementing the presentations and commenting on how the various parts of the water industry sit together and focus on the environmental impact, which all are keen on improving. The Chair followed up and asked how could the water sector deliver the 25-year environment plan with the current regulations in place.

Carl Pheasey stressed how the focus on the price review process was a focal point for the industry and the fact that we were discussing a 2024 review in 2021 was a testament to that. He continued by stating how what the price review does was driving a lot of activity that goes on and around the issue. All the policy work Kirsten talked about was informing how the price review plays down, and all the activity that companies do, not just in trying to pull their plans together to do well in PR, but also to meet performance commitments

that will incentivize them on as part of the price review. He thought it was key to ensure that the targets and the incentives for companies get introduced, as they will inevitably make sustainability even more an imperative.

Guy Thomson continued on that point and said how as a sector, it should design a system that would enable and incentivize collaboration between parties that brings the costs of the interventions down which in this case was nature-based solutions and in turn, creates an opportunity for positive land-use change on the ground, and that's just what has been achieved under the current regulatory framework. Having consistent standards and more consistent rules in place that would enable internal innovation to take place on the ground.

Kirstin Green added that the priority going forward is to be as clear as we possibly can as a sector and that Government and the regulators should speak with one voice about what is expected from the water companies to increase transparency and efficiency. She continued saying how water companies have a massive role to play in delivering the water objectives in the 25-year environment plan and how she recognises how the water sector can't do it on its own and recognised the likes of Wessex Water who really thought through the next steps and worked innovatively through the current sets of regulations.

David Elliot asked how, since time was not on our side as regards environmental recovery, what needed to be done for other communities like farming within the water system and consider how their resources were included in PR 24 methodology.

Carl Pheasley agreed with the question and said how Ofwat had been very clear on the scope for more partnership working, led by or with the active participation of water companies and that they wanted to see more of that in PR24 for farmers or landowners.

He concluded by saying that while he couldn't speak to flooding issues in any detail, he could recognize the role that water companies had in his flood management authorities and the important role they've got to work with other stakeholders on the study front.

Barbara Young, Baroness Young of Old Scone (Lab) asked about affordability and whether it was something we could get that matches this ambition on environmental delivery while committing to affordable delivery for customers to make it a less arid terrain.

Kirsten Green acknowledged the difficulty of the issue with affordability and how we needed to ensure there isn't tension between investing a lot more at peace in the water environment through water bills and making sure that we don't take away from water quality or the ability to afford the water in the first place. She said she thought the key to this is about doing things efficiently and more cost-effectively. This with enabling and promoting those more cost-effective solutions while looking at a plan that goes beyond the five years must be part of the equation as well.

Guy Thomson observed how we should not underestimate the scale of change the industry had in front of them and what it will need to wrestle with. He also thought it was not sufficient to get us to where we needed to be and how science-based national targets were needed. He continued on the point on affordability that Baroness Young raised, stating how ultimately this was why we had an independent economic regulator to address those challenges.

Carl Pheasey said that the culture at some level between wanting what you want to achieve in terms of your level of ambition and the cost of it was something Ofwat will continue to focus on. He defined it as a set of trade-offs. We know that in many cases, market-based mechanisms and catchment approaches nature-based solutions are more efficient and are less expensive than the traditional end of pipe solutions. He continued saying that sometimes there was a perception that keeping bills down has been the focus since PR19. He continued saying that over that period, most customers saved on average 50 pounds over the period. He continued saying how the vast majority of those savings were generated by the regulators though investors in companies who took advantage of it. To conclude, he said that while we needed to make sure that we were getting the most efficient result, we needed a more effective intervention.

Steve asked whether utility regulators should look at closer collaboration between themselves to better address the joined-up environmental approaches needed around the energy and water nexus.

Carl replied that there was a strong case for more collaboration between utility regulators. He stressed how absolutely, the sector could work closely with all the other sorts of economic regulators as there was scope to do more. He continued saying he recognised that nexus between energy and water use, and how there was a lot of talk around how hot water demand drives energy bills.

Guy Thomson said how the model present in the water sector of an independent economic regulator being, which was given long term strategic direction by Defra, was a really powerful one to the point it should be replicated with other regulated utilities like energy and telecoms. In his opinion, it could set the scene for a more long-term policy still to address big challenges that regulated utilities could address.

Kirstin Green's thoughts on utilities and collaboration were very much what had been said until now, and that she was aware there was work going on within the government and with the National Infrastructure Commission looking at all those issues across different utility regulators. In terms of regulatory deficiencies, she commented that she would say that DEFRA was tackling several issues through the environment bill.

She finished by saying that if there were more they were always happy to listen to those. There was an understanding that things could yes be further improved, but that the system was not broken.

Conclusion

After the question-and-answer session, the Chair concluded the meeting by thanking the speakers for their contributions. She said there had been a lot of agreement on the urgency to invest in the sector to deliver sustainably in the future with the increase in demand and that due to the challenges of the sector, more questions were raised rather than answered. She also recognised that the Water sector was ambitious, as ever, and looked forward to a final discussion for the year, which would be announced imminently.