

Social and Environmental Guidance to Ofwat

**Consultation on the scope and content of guidance to Ofwat from the Welsh
Assembly Government**

**Social and Environmental Guidance to Ofwat issued under section 2A of the
Water Industry Act 1991(as amended by section 40 of the Water Act 2003)**

Guidance to Ofwat on social and environmental matters

1. Welsh Ministers give the Water Services Regulation Authority (Ofwat) the following guidance, under section 2A of the Water Industry Act 1991 (inserted by section 40 of the Water Act 2003). This guidance draws together relevant aspects of the Welsh Assembly Government's sustainable development agenda, so that Ofwat can carry out its functions in a way that is alert to the wider policy picture and, where possible, supportive of it.

Longevity

2. The Welsh Assembly Government intends the guidance to remain in place for some time – years rather than months - partly to reduce the regulatory uncertainty that frequent changes could produce, but also because of the broad nature of the guidance which reduces the need for change. This is without prejudice to the Welsh Ministers right to update this guidance at any time.

Scope

3. The guidance applies to Ofwat as it exercises its functions as economic regulator of those water and sewerage undertakers whose appointment areas are wholly or mainly in Wales and licences operating within those areas. (Guidance relating to water and sewerage undertakers wholly or mainly in England is a matter for the Secretary of State).
4. The guidance is not intended to provide a comprehensive picture of what Ofwat may wish to do over the next 5 years (or what other guidance the Welsh Assembly Government may provide).
5. Ofwat is required to have regard to this guidance when discharging its statutory functions mentioned in section 2 (1) of the Water Industry Act 1991 (WIA91) (subject to section 2 (6)) as amended by sections 36 and 39 of the Water Act 2003. The Welsh Assembly Government expects Ofwat to take account of this Guidance in its Forward Work Programme and corporate planning process. In this way, Ofwat can make a contribution, appropriate to its functions, principal objectives and duties, towards the wider social and environmental objectives of the Welsh Assembly Government, including assisting in meeting its duty under section 2(3) of the Water Industry Act 1991 to contribute towards achievement of sustainable development.
6. Where the Welsh Assembly Government wishes to implement specific social or environmental measures which would have significant financial implications for customers or for the regulated companies, these will be implemented by Ministers rather than Ofwat, by means of specific primary or secondary legislation. The Welsh Assembly Government does not seek to do this through this guidance.

Reporting

7. The Welsh Assembly Government expects Ofwat to report progress against this guidance annually.

Background

8. Dŵr Cymru Welsh Water, a water and sewerage undertaker, and Dee Valley Water, a water supply only company, operate within the area covered by this guidance. Both supply goods and services which are essential to health and wellbeing and occupy natural monopolies. Albion Water is a licensed water company supplying one large customer.

Ofwat's statutory objectives and duties

9. The duties for most of Ofwat's work as an economic regulator are set out in section 2 of the WIA91 as amended by section 36 and 39 of the Water Act 2003.
10. Section 2 of WIA 91 (as amended) sets out the general duties that Ofwat and the Welsh Assembly Government must meet with respect to the water industry.
11. This guidance amplifies and explains the Welsh Assembly Government's view on how Ofwat should carry out these statutory duties in respect of the companies concerned.

THE GUIDANCE

OFWAT'S ROLES IN CONTRIBUTING TO THE ACHIEVEMENT OF THE WELSH ASSEMBLY GOVERNMENT'S OBJECTIVES AND PRIORITIES

12. Ofwat's work can have major social and environmental as well as economic consequences. The following sections of this guidance provide greater information about the role the Welsh Assembly Government expects Ofwat to play in taking forward the objectives for water set out in the policies and strategies outlined below.

13. This Guidance encourages Ofwat, consistent with its statutory duties, to do a number of things including:

- have a renewed focus on affordability for all customers and fairness of charging for water;
- maximise its contribution to sustainable development;
- have regard to the Welsh Assembly Government's plans for addressing climate change;
- focus on development of long term, sustainable solutions to challenges, including encouraging innovative approaches to seek new ways of tackling issues;
- recognise the key role of water industry in the new approach to flood risk management; and
- have regard to the goals set out in the Environment Strategy for Wales and to facilitate the delivery of outcomes identified in this strategy and the Action Plan.

The Welsh Assembly Government Objectives and Priorities

14. The paragraphs that follow identify objectives of Welsh Assembly Government social and environmental policy. All these objectives are ones whose attainment may to a greater or lesser extent be affected by the way in which regulation of the water industry is conducted. It is therefore appropriate that Ofwat should have regard to these objectives in carrying out its functions.

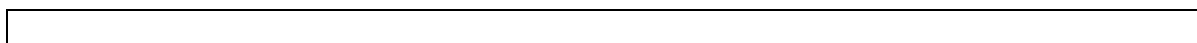
15. In undertaking its statutory duties Ofwat should have regard to this guidance and the Welsh Assembly Government's priorities and objectives for Wales.

One Wales

16. The One Wales document sets out goals and aspirations for the people of Wales and a progressive agenda for the government of Wales for improving the quality of life of people in all of Wales's communities and especially the most vulnerable and disadvantaged. It sets out joint commitment to the principles of social justice, sustainability and inclusivity.

Sustainable Development

17. The Welsh Ministers' Sustainable Development Scheme (produced pursuant to the duty contained in section 79 of the Government of Wales Act 2006) provides the over-arching framework for the Welsh Assembly Government's work in this area. As such, the scheme is the Welsh Assembly Government's overarching strategic framework and sets out the vision of a sustainable future for all of Wales where action, by the Welsh Assembly Government's and other organisations, for social, economic and environmental improvement work together to create positive change. The Scheme works in conjunction with other key documents of the Welsh Assembly Government to deliver change: our Sustainable Development Action Plan 2004-07 spells out how the commitments in the Scheme were to be met. The Scheme is currently under review, and consideration is being given to the development of a new Action Plan, which will be consulted upon widely.
18. The Welsh Assembly Government also supports the objectives that were set out in the 1999 UK Sustainable Development Strategy *A Better Quality of Life* and the principles set out in the UK's shared framework for sustainable development, *One future, Different paths*. It will work with the UK Government to ensure that Wales contributes to sustainable development at a UK level.
19. The Welsh Assembly Government's vision of sustainable development remains a broad one, embracing commitments to improving quality of life, promoting equality, tackling disadvantage and poverty, and reducing Wales' ecological footprint. Sustainable development in one place may require different solutions to those in another although the principles remain the same wherever. The Wales Spatial Plan recognises that the vision will need to translate differently in different areas of Wales.
20. The changes under the WIA91 (made by the Water Act 2003) place a duty on Ofwat to contribute to the achievement of sustainable development.
21. Sustainable development within government requires the integration of actions we are taking to promote a sustainable and innovative economy that minimises resource use and responds to sustainable development opportunities; to promote healthy living and a sustainable use of environmental resources; to tackle inequality for reasons of race, gender and disability and to address poverty and lack of opportunity through our Social Justice agenda. Sustainable development also requires actions by all sections of society.
22. The Welsh Assembly Government considers that sustainable development will require extending public participation in decision-making, ensuring that the views of all sections of society are able to and can participate.



23. Ofwat is expected to draw on a wide range of expertise in its decision making and to work in partnership with all stakeholders– including the Environment Agency, Countryside Council for Wales, the Drinking Water Inspectorate, Water Companies and the Consumer Council for Water Wales. This guidance has been developed in consultation with these bodies.

24. The Welsh Assembly Government measures its progress towards sustainable development through its confirmed suite of Sustainable Development Indicators. These provide the high level framework to set the context for the provision by water companies of information to measure their own Sustainable Development performance¹. Ofwat should facilitate provision of this information by companies.

25. The implementation of sustainable development practices requires a major change in culture and working practices for many organisations. Translating the Welsh Assembly Government's vision into action will mean that sustainable development underpins and drives everything the water industry does and advocates others to do.

26. Ofwat should take policy decisions that are firmly underpinned by sustainable development principles, taking account, where possible, of the long and short term effects on society and the costs and benefits of action and inaction.

27. In framing its advice and views Ofwat should bring to bear its knowledge of the interactions between economic practice and social and environmental factors, within the context of sustainable development.

28. As part of its sustainable development duty Ofwat should encourage good practice examples of sustainable development projects, and review the information it collects to inform Ofwat's guidance in order to promote and support the development of appropriate initiatives to achieve its social and environmental objectives.

29. The Welsh Assembly Government considers that wherever possible pollution issues are addressed at source. Ofwat should seek and use scientific knowledge to aid decision making and to take account of the full range of costs and benefits when making plans and decisions, including those costs and benefits which cannot easily be valued in money terms, and including cost/benefit analyses of the social as well as the environmental impacts of their decisions. Ofwat should also encourage companies to identify solutions to issues arising which deliver a package of benefits.

Long Term Viewpoint

¹ Sustainable Development indicators used to measure progress:
<http://new.wales.gov.uk/topics/statistics/headlines/sustain2008/?lang=en>

30. In its approach to setting price limits Ofwat has placed greater emphasis on strategic and long term planning within the water industry by requiring companies to produce Strategic Direction Statements setting out their strategies and plans for the next 25 years.
31. The Welsh Assembly Government also looks to companies to provide cost-effective and efficient solutions that link different policies and approaches. This includes the integration of the operation, maintenance and renewal of assets with new provisions to meet new requirements. It also requires the integration of water resources, drinking water quality and environmental considerations.

32. We support and further encourage Ofwat's approach to longer term planning horizons and to require that Water company programmes are designed in an integrated way.

33. Ofwat has a role in encouraging a closely integrated and comprehensive approach to forward planning and robust options appraisal. In so far as statutory timetables allow, in some cases it may be that the most long-term effective solution involves the deferral or the acceleration of action or the combining of two measures that might otherwise be taken at different dates. Nevertheless, the Welsh Assembly Government acknowledges that in other cases there may be sound arguments on occasions for an incremental approach, on grounds of cost-effectiveness or of uncertainty.

34. In all cases we expect Ofwat to monitor emerging information and Ofwat to take account of new evidence.

Corporate Social Responsibility

35. Ofwat should encourage the companies covered by this guidance to adopt corporate social responsibility with the objective of securing a full commitment to environmental and social responsibility and behaviour and to high standards of corporate governance.

36. As part of its approach to sustainable development, Ofwat should encourage companies to look at their own operations and performance. As set out in 'Securing the Future', sustainable organisations can be powerful drivers for more sustainable patterns of consumption and production. The government's vision for Corporate Social Responsibility is 'to see UK businesses taking account of their economic, social and environmental impacts, and acting to address the key sustainable development challenges based on their core competences wherever they operate'. Ofwat is expected to encourage actions by companies which help achieve this vision.

Company Reporting (Better Regulation) - Reducing administrative burden on water companies

37. The Welsh Assembly Government is not formally party to the cross-Whitehall policy on reducing administrative burdens, but it is supportive of its principles. It is keen that all regulators work in a more effective way to reduce unnecessary burdens, without compromising regulatory outcomes.

38. In consultation with others, Ofwat should continue to consider ways to reduce or streamline its information requirements of the industry while justifying any new burdens on compelling cost-benefit grounds.

SOCIAL OBJECTIVES AND SOCIAL POLICY

39. Pursuing the Welsh Assembly Government's vision of a sustainable future for Wales will involve action that contribute to many of the global and European commitments, as well as to issues specific to Wales and to Welsh circumstances.
40. The Welsh Assembly Government is committed to putting people, and their quality of life now and in the future, at the centre of its concern. The Welsh Assembly Government is also subject to an equality of opportunity duty.
41. As it exercises its functions and duties Ofwat should consider how it can promote equality of opportunity and prevent discrimination or disadvantage for the customers of the companies covered by this guidance.

Regenerating Communities and economic development

Community Engagement and Consultation

42. 'One Wales' sets out our vision for a fair and just Wales, in which all citizens are empowered to determine their own lives and to shape the communities in which they live. We are also committed to widening participation of communities.
43. The Welsh Assembly Government is strongly resolved to regenerate diverse communities across Wales. The Welsh Assembly Government want to see people empowered to rebuild the social, economic, cultural and environmental fabric of their communities.

44. Ofwat should encourage companies' decisions to reflect the needs and priorities of local communities and the Welsh economy, which may go beyond provision of essential services, through for example engagement in local flood forums.

45. In carrying out its functions, Ofwat should consider the desirability of consulting, even when not required to do so, on proposals relating to the exercise of its powers. When consulting, Ofwat's proposals should reflect the specific circumstances of Wales and should analyse responses to consultations separately for Wales and, where necessary and justifiable, should draw separate conclusions applicable to Wales and make recommendations to government accordingly. For this purpose, Ofwat should prepare a timetable for direct consultations with the stakeholders.

46. Whilst recognising that some essential actions may not fit with public opinion, the Welsh Assembly Government is keen to ensure that the wishes of water bill payers should be given a high priority within the price review process. Ofwat should continue its efforts to find out customers' views and priorities and consider how best any customer research should be planned to establish

meaningful views of those customers of companies wholly or mainly in Wales and how findings could be acted upon.

47. Ofwat, in exercising its duties or powers, is expected to engage positively and purposefully with the Consumer Council for Water Wales and others. It should have regard to such information collected by them on issues such as adequacy and affordability of the services provided by water companies and relating to water needs of the vulnerable groups of consumers. Its work should reflect the principles of equality of opportunity.

48. Decisions must take account of costs as well as benefits, but those costs and benefits should consider the wider social and environmental costs and benefits.

Economic development

49. The Welsh Assembly Government want to see that Ofwat have given consideration to making a positive contribution to the economy in Wales in making their decisions.

50. Ofwat should take a positive approach to the development of truly sustainable communities showcasing new approaches such as sustainable urban drainage systems, delivered in partnership between the water company and developers and consider developing incentives to promote such initiatives.

Wider social responsibilities

51. In carrying out its functions Ofwat should have regard to the fact that water undertakers carry out activities that provide wider social benefits, such as the promotion or protection of biodiversity, recreation benefits, local environmental quality, energy generation, landscape benefits, regulation of flood risks or the provision of environmental information and education to promote behaviour change around water use or to encourage appropriate use of the drainage system.

Water Affordability

52. Our ambition is a Wales where everyone achieves their full potential and everyone can live free from poverty. We have concerns over the escalating level of water affordability in Wales, alongside rising utility and other household bills.

53. The Welsh Assembly Government is particularly concerned about the impact of water charges, and the impact of rises in water bills, on those customers who

are least able to pay. This is especially so, when considered alongside other utility bill increases.

54. More generally the Welsh Assembly Government is concerned about affordability for all customers and the comparatively high level of water bills in large parts of Wales, even though the gap in prices between England and Wales has narrowed over recent years.

55. The Welsh Assembly Government believes that lower bills and a better environment are very much to the benefit of consumers whose interest it is Ofwat's primary duty to protect.

56. The Welsh Assembly Government looks to Ofwat to do all that is possible to minimise the potential financial burden on water customers in Wales while maintaining services and enabling the Welsh Assembly Government and water industry to meet their statutory national and European obligations and other desired outcomes, whilst maximising benefits to the environment and society.

57. Following aspirations of the Welsh Assembly Government, Ofwat should take decisions affecting water companies which reflect the potential effects on affordability. Ofwat should continue to take all necessary steps to understand issues of affordability and that affordability concerns are reflected when Ofwat considers and agrees companies charging schemes, and when it sets price limits. Ofwat should expect companies to be as efficient as possible and encourage them to develop pilot schemes addressing affordability issues.

58. Ofwat should give due weight to the economic and social effects of its policies, especially the impact of water bills on vulnerable and low income customers.

59. Ofwat should be guided by customer's views on the balance to be struck between the detrimental social and economic effects of sudden large changes in customer bills and the implications for the long term bill increase.

60. Ofwat should consider whether it might be reasonable and justifiable to extend the dates of completion of investment, in those cases where there is flexibility in the pace of the investment programme and where flexibility in timing might allow some lessening of the price impact, seeking advice from regulators and Government on any benefit and risks

61. When it publishes decisions on future price limits, Ofwat should explain how it has taken account of any representations from stakeholders in Wales.

62. Ofwat is further encouraged to review the ways in which low income households might be helped to pay for their water and sewerage bills, where appropriate involving officials from the Welsh Assembly Government and the Consumer Council for Water Wales in this work. This may include consideration of innovative tariff structures (See Charging section).

Metering and Charging

63. The Welsh Assembly Government is aware that there is a growing body of evidence for introducing metering both as a means of charging for water, and for encouraging customers to reduce their demand for water.
64. Apart from in a few isolated areas Wales' water resources are not currently at serious risk and there are no areas of serious water stress in Wales. However, we are mindful of the need to consider the implications of climate change, which will place greater pressure on our water resources.
65. The Welsh Assembly Government also fully recognises the environmental benefits that result from more efficient and sustainable use of water and the associated benefits this may bring in terms of a reduced carbon footprint, as a result of having to treat and pump less water as well as reducing both the amount of water used and energy required to heat it. Reduced demand leads to reduced wastewater, which in turn results in reduced infrastructure requirements and energy costs and increased resilience to climate change.
66. However, the Welsh Assembly Government also has reservations about the costs associated with a full extension of metering, and the potential impacts, particularly for poorer households.
67. The Welsh Assembly Government has commissioned jointly with Defra, an independent review of charging for water and sewerage services in England and Wales, which amongst other things, will consider the effectiveness and fairness of methods of charging and the role of metering. The Welsh Assembly Government will take a view on whether the Guidance would need to be updated depending on the outcomes of that review.

68. Therefore, along side any natural expansion of metering in their areas (that is, where customers opt for meters or meters are installed in new properties); Ofwat should encourage companies to introduce water efficiency measures to help reduce water use. More on water efficiency is set out below.
69. We are aware that technology is moving forward and would welcome further exploration of opportunities to make metering an affordable option and to develop tariffs which encourage and reward a sustainable use of water.

Charging

70. Initiatives such as Water Direct and Water Collect currently being piloted provide a welcome service to customers as well as delivering strong business benefits that will ultimately benefit all customers. In seeking initiatives to

support disadvantaged customers, we would look for progress towards development of other such “win: win initiatives”.

71. The Welsh Assembly Government expects Ofwat to approve charging schemes which are both fair and protect vulnerable and low income groups. The Welsh Assembly Government is keen to see suggestions for innovative tariffs and structures that could help address affordability issues and debt collection.
72. We encourage Ofwat to consider alternative tariffs or mechanisms to protect vulnerable customers.
73. The Welsh Assembly Government supports Ofwat’s recent signals to strongly encourage innovative tariffs and urges Ofwat to work with companies (who will be in a position to know how additional protection could be targeted at customer groups in their own areas) and with the Welsh Assembly Government to facilitate effective trials of suggested tariffs to understand the effect of the tariffs on customers' choices and the impact they might have on all groups of customers. These tariffs should not solely rely on increased metering uptake, but could include metering as an option, and should help to address affordability concerns and remain fair for all customers.
74. The Welsh Assembly Government continues to support maintenance of the existing ban on household water and sewerage disconnection. Ofwat should continue to provide incentives to water companies to minimise any additional costs being borne by those customers who pay their bills on time.

Competition

75. One of Ofwat’s objectives is to protect the interests of consumers of regulated water and sewerage services, wherever appropriate through promoting effective competition.
76. The approach to competition is ultimately a decision for government. Subject to any review and any legislative changes that may arise as a result, the Welsh Assembly Government currently takes a cautious approach to competition, focussing on the benefits to the generality of customers.

77. In pursuing its statutory duty to protect customers, by promoting effective competition and innovation and by acting against anti-competitive behaviours, the Welsh Assembly Government expects Ofwat to demonstrate the benefits for customers. In assessing such benefits, the Welsh Assembly Government expects Ofwat to demonstrate that these outweigh the drawbacks of increasing competition, including that there are no detrimental consequences for the generality of customers across Wales and that the long term interests of

consumers are safeguarded. In the meantime however Ofwat should be introducing more innovative regulation, including new proposals on differing tariffs especially for the low income and vulnerable sectors.

78. Ofwat should not introduce competition where it is incompatible with maintaining adequate protection to public health, the environment and the quality and security of public supplies.

ENVIRONMENTAL POLICIES

79. The Welsh Assembly Government recognises that our environment has an intrinsic value of its own, is our life support system, is a finite source of vital resources and is central to our quality of life, sense of place, health and wellbeing and underpins our economic development.

80. 'One Wales' states that the Welsh Assembly Government are keen to ensure that pollution is prevented, as far as possible, and making the polluter pay for the damage done by pollution, and more generally trying to ensure that costs are met by those whose actions incur them.

81. Ofwat should also use its influence with water undertakers to encourage them to respect environmental limits, so that resources are not irrecoverably depleted or the environment irreversibly damaged: this implies, for instance, contributing to the protection of the planet's climate by minimising emissions of greenhouse gases; protecting and enhancing biodiversity; minimising harmful emissions; and promoting sustainable use of natural resources.

82. Much of Ofwat's work will mean taking account of timing, risks and uncertainties; in some circumstances it will be justifiable to support measures to prevent possibly serious environmental damage where there is scientific uncertainty about the risks and solutions. Where the risk of environmental damage is less certain, or where there is uncertainty over the sectors causing or contributing to a particular issue, or the solutions are less obvious, the Welsh Assembly Government supports further investigation by companies. The Welsh Assembly Government also supports the implementation of innovative solutions, both to known challenges and in areas of uncertainty, particularly where those innovative solutions can bring additional benefits.

Environment Strategy

83. The Welsh Assembly Government's commitments for water are outlined in the Environment Strategy for Wales, May 2006. It highlights our aims for achieving sustainable water management, maintaining good water quality and reducing water pollution whilst meeting the needs of society and considering the issues of affordability.

84. The commitments in the Strategy are set out in a number of specific outcomes, each of which has an associated timeline for achievement and a number of indicators to measure success. These include outcomes for the sustainable management of water resources; more efficient use of water across all sectors; goals for drinking water and water quality; climate change; flood risk management and for the condition of sites of international, Welsh and local importance. These are repeated below.

85. Ofwat is expected to have regard to the Welsh Assembly Government's priorities set out in the Environment Strategy for Wales.

Climate change

86. The Welsh Assembly Government considers that climate change is one of the greatest challenges we face. Everyone in Wales has a contribution to make in tackling it – individuals, households, businesses, public services and community groups.

87. One Wales includes an aim to achieve annual carbon reduction - equivalent emissions reductions of 3% per year by 2011 in areas of devolved competence. We will set out specific sectoral targets in relation to residential, public and transport areas. It is not the Welsh Assembly Government's intention to set sector target for the water sector. That said, the water industry is a significant energy user and therefore a significant contributor to greenhouse gas emissions and it has a role to play in reducing its own emissions.

88. As well as the drive to reduce emissions, the impacts of climate change will also have a profound effect on the industry. In the future, Wales is expected to experience rising temperatures, wetter winters, drier summers, more intense rainfall events and greater climate variability. Without action, based on the UK Climate Change Impact Programme scenarios, it is likely that there will be discrepancies between peak water demand and availability, more widespread water stress for humans and ecosystems, more ecological water quality problems and increased flood events from rivers and urban drainage systems.

89. Climate change and other pressures on water resources present the water sector with two challenges. Like all sectors, the water sector is expected to play its part in reducing emissions. In addition, the water industry needs to adapt to the unavoidable impacts of climate change. Ofwat has an important role in encouraging and enabling companies to achieve this.

90. Ofwat should support water companies in developing long term, sustainable solutions to these new challenges. This will include encouraging innovative approaches and new ways of tackling issues.

Emission reduction and preserving carbon stores

91. The Welsh Assembly Government expects water companies to continue to reduce their energy usage and to find new ways of minimising demand in the future.

92. The Welsh Assembly Government would like to see continued reductions in the industry's carbon footprint. This could include maximising efficient energy production from the industry's own processes and resources, including anaerobic digestion and the capture of greenhouse gases, and through sourcing alternative renewable energy supplies.

93. Improvements have been made, but, Ofwat should be supportive of attempts by water companies to reduce energy demand.

94. We encourage Ofwat to support the projects that explore the potential of using renewable energy solutions and minimising energy use to achievement of our policies and statutory obligations.

95. The Welsh Assembly Government expects Ofwat to consider the environmental and social benefits of such proposals and to support companies in participating in schemes or voluntary action to increase their uptake of renewable energy sources or reduce non-CO₂ greenhouse gas emissions.

96. A key regulatory tool for reducing carbon emissions within the water industry will be the Carbon Reduction Commitment (CRC) scheme announced in the Energy White Paper 2007.

97. The Welsh Assembly Government expects companies to meet fully their obligations under the CRC. Ofwat should not put in place barriers to achieving the scheme's objectives and requirements. This includes an expectation that the industry is fully exposed to the CRC financial incentives.

98. When considering the costs associated with greenhouse gas emissions, Ofwat is expected to use the Shadow Price of Carbon as set out in Government guidance². The Welsh Assembly Government expects companies to use the Shadow Price by companies when they prepare business plans or consider solutions to future regulatory requirements.

99. As a public sector body, Ofwat will be expected to take action to reduce emissions from its own operations. The main regulatory instrument in this area is Article 5 of the Energy End Use Efficiency and Energy Services Directive. The Directive requires public sector organisations to fulfil an exemplary role in the context of energy efficiency.

² www.defra.gov.uk/Environment/climatechange/research/carboncost/index.htm

Adapting to the impacts of climate change

100. The Assembly Government expects water companies to take steps to adapt to future climate change.

101. Ofwat is expected to have regard to the Welsh Assembly Government's priorities on adapting to the impacts of climate change. These priorities will be developed in the Assembly Government's overarching policy on climate change in Wales. Ofwat should also help in the development of relevant actions under that policy as it develops.

102. Working within this context, the Welsh Assembly Government needs to ensure that the best evidence available on climate change is fully integrated into its water policies. It will also involve ensuring that water companies take a risk based approach to adaptation measures, informed by the best evidence available, including climate change projections for example, those provided through UKCIP08.

Supply-demand balance

103. Water undertakers have a statutory duty, under section 3(2) (a) of the WIA 91 (as amended) to further water conservation in the exercise of its functions. Ofwat also has a statutory duty, as a public authority, under section 83 of the Water Act 2003, in the exercise of its functions to take into account the desirability of conserving water supplied or to be supplied to premises.

104. The Welsh Assembly Government expects Ofwat to have regard to these duties when making decisions on proposals for demand management measures within the measures to balance supply and demand in the price review. Meeting the balance between supply and demand will contribute towards the environmental objectives of the Water Framework Directive.

105. Water companies have statutory duties relating to the supply of sufficient water to meet demand. Water companies should submit business plans to Ofwat which reflect the Welsh Assembly Government's projections of population and housing growth as well as risks to supply resulting from climate change. In addition, Welsh Assembly Government wants to encourage a greater focus on demand management measures in water company plans.

106. As part of this, Ofwat should consider water company proposals for achieving a supply-demand balance on the basis of the twin track approach to water resources management. As such, when considering the need for new resources, water companies would be expected to examine demand management and provide sufficient analysis of the appraisal ahead of new supply measures. This approach will help to offset the need for increasing

supplies and associated costs to customers and environmental damage.

Water Efficiency

107. The Environment Strategy places considerable emphasis on water resource management, including sustainable management of water resources, meeting the needs of society without causing damage to the environment and seeking to ensure that water is used more efficiently across all sectors.
108. There are currently no areas in Wales suffering from prolonged periods of water stress; therefore we do not anticipate Company Water Resource Management Plans with programmes of compulsory metering. However there are areas of water deficit, where forecast demand exceeds available supply. In these deficit areas and where there are valuable sites of nature conservation, action to reduce demand is particularly important. In addition, we recognise the significant amount of energy used in the treatment and pumping of water and climate change implications and therefore the overarching need to manage demand and reduce wastage.

109. We support action by Ofwat to change company and customer behaviours to value water, to use it wisely and to reduce demand.
110. The Welsh Assembly Government also supports meaningful water efficiency targets for water companies to be set by Ofwat, to be developed on the basis of evidence of the water resources situation in Wales, involving relevant parties. When setting these targets, or establishing other means by which Ofwat consider encouraging companies to introduce water efficiency measures, Ofwat should take into account the wider social and environmental benefits (including environmental externalities such as the reduction in the need for abstraction and greenhouse gases) of such targets, and subject to the appropriate cost benefit analysis. Targets should be discussed with the Welsh Assembly Government in advance of their imposition.
111. Improving water efficiency and across all sectors, in both new and existing homes, is an important way of reducing future demands on water supply. Ofwat should facilitate where possible, sharing of best practice on the cost effectiveness of water efficiency programmes between companies, and that any wider social or environmental benefits of demand management schemes are fully considered.
112. Ofwat should identify opportunities, within the Water Resources management planning process, to encourage more economical and efficient use of water resources by water companies.

Leakage

113. There have been substantial reductions in leakage since the introduction of targets in 1997.

114. The Welsh Assembly Government would expect Ofwat to continue to drive improvements in respect of leakages, building on improvements already achieved since targets were introduced.

115. To help maintain this trend, Ofwat should take a long term view of water company plans for leakage management including proposals for maintenance of distribution systems.

116. Ofwat is expected to keep leakage targets under review. This should be informed by the review of the Economic Level of Leakage and consideration of any wider social and environmental externalities. As new technology and management techniques develop, and as the value of water as a finite resource increases, the Welsh Assembly Government expects the economic level of leakage to reduce.

117. When considering proposals for demand management options, Ofwat should take account of the need to maintain sustainable abstraction to reduce the risk of environmental damage. The Welsh Assembly Government believes that the environmental impact of water company abstractions should be reduced, where these impact upon sites within the scope of the Environment Agency's Restoring Sustainable Abstraction programme (in particular on designated national and international nature conservation sites) and where there is a need to reduce flows to meet the environmental objectives of the Water Framework Directive. The Welsh Assembly Government believes that water companies should undertake investigations into the impacts of their abstractions, to inform the need for changes to abstraction licences. It therefore expects Ofwat to allow for such investigations in price limits.

118. Should investigations reveal the need for major supply side solutions, including the development of major new infrastructure, in Wales any decisions on such infrastructure would be a matter for the Welsh Assembly Government as water infrastructure projects in Wales are not a matter for the Infrastructure Planning Commission.

Floods and resilience

119. Flood risk management, particularly surface water flooding, is a high priority and has increasing significance in the light of climate change.

Surface Water Flooding and the New Approaches programme for flood and coastal risk management in Wales

120. The Environment Strategy launched in May 2006 highlighted both the vulnerability of Wales to flood and coastal erosion risk and the need for change in our approach to enable adaptation to climate change impacts.
121. During the summer 2007 large parts of England were severely affected by flooding. Wales was fortunate to escape the worst of this weather but suffered localised flooding. In July 2007, the Minister launched the New Approaches Programme to manage flood and coastal risk. Its aim is to facilitate change by adopting an alternative approach and establish programmes of work aimed at managing the consequences of flooding to tolerable levels.
122. The New Approaches programme will facilitate changes in the way Wales manages flood and coastal risk by moving away from a defence dominated to a more holistic risk management approach. It will address all sources of flooding, including surface water, sewer flooding, and coastal risk. It will encourage the development of actions complimentary to built defences.
123. The New Approach includes the need to work with nature rather than against it, the need for close partnership working between operating authorities, robust public engagement and a clear focus on consequence management. The Welsh Assembly Government plans to issue a refreshed framework for flood and coastal risk management in Wales in 2009. The Welsh Assembly Government is currently reviewing the findings of Sir Michael Pitt's review published in June 2008 and will shortly be consulting on the clarification of flood policy. The results will be available in Spring 2009. The refreshed New Approaches Programme will take forward the proposed findings and be the key mechanism for facilitating change.

124. Climate change, housing and other development are likely to place greater pressure on drainage networks, increasing the risk of surface water and sewer flooding. Ofwat should play a significant role by encouraging more sustainable management of surface water.

125. Central to this is the development of plans to manage surface water and Ofwat should encourage water companies to engage proactively with local authorities and other stakeholders in effective planning for surface water management making use of Sustainable Drainage Systems where appropriate. This should include considering the potential benefits that surface water management planning could bring to drainage investment planning – for example, making it more risk-based and informed by wider surface water considerations.

126. Subject to the impact on prices to customers, the Welsh Assembly Government wants Ofwat to support its aim for water undertakers in Wales to reduce the impact of sewer flooding in Wales as quickly as is possible.

127. The ability of the sewerage system to accommodate additional flows from new development should be a significant influence in reaching decisions on location and design for new development.

128. Ofwat should encourage water companies to engage with and exchange knowledge and information with local authorities and other stakeholders at an early stage to contribute to the timely and adequate provision of infrastructure.

Resilience to natural hazards

129. Regulatory requirements are placed on water companies by the Security and Emergency Measures Direction (SEMD) 1998 and SEMD 2006. This, amongst other things, requires companies to carry out security work on vital installations, and protect other installations and facilities according to guidance issued by Government to water companies.

130. Ofwat is expected to set price limits which enable water companies to carry out these essential works, ensuring resilience against natural hazards as defined in the Government's National Risk Assessment. This assessment for identifying hazards that impact infrastructure will increasingly include the predicted effects of climate change.

Water Quality

Maintaining and improving standards of Water Quality

131. With regard to the quality of water supplies, the Drinking Water Inspectorate's reports for Wales confirms that water companies' overall compliance of drinking water supplies in Wales with relevant quality standards is 99.96%.

132. The continuing safety of drinking water is paramount and it is important that these high standards of drinking water quality are maintained, as the Environment Strategy refers. The Welsh Assembly Government understands the need to maintain consumer levels of service to maintain public confidence in water supplies and to meet consumer high expectations of drinking water quality. It considers that a risk based approach to water supply based on water safety planning as current good practice and supports the benefits of a long-term approach to the stewardship of assets, the need for active provision for a proactive, preventative approach to discharge the primary duty of public health protection.

133. Turning to the water environment, Environment Agency monitoring shows that the quality of our rivers and coastal waters in Wales is generally very high.

It is important to the Welsh Assembly Government that these high standards of environmental water quality are maintained. This includes compliance with the 'no deterioration' requirements of the Water Framework Directive and consistency with the Environment Strategy's objectives of maintaining the quality of our coastal waters and the biological and chemical standards of our rivers in Wales.

134. Companies must maintain capital assets and safeguard the continuity of supply to customers. Without adequate maintenance, the substantial progress made in the last decades in delivering quality improvements might well be compromised.

135. Ofwat should work with water companies to identify a level of capital maintenance that protects assets against deterioration or enhances their performance in the most cost effective way.

136. Nevertheless, enhancements may also be required to secure the safety of drinking water quality and to meet statutory obligations, including for the Water industry's contribution to deliver the more challenging requirements of the Water Framework Directive (WFD).

137. The measures which water companies will need to take to meet WFD objectives will be determined through the river basin planning process, and so the links need to be made between the river basin planning process and the development of the environment programme which is part of the periodic review of water prices.

138. The Environment Strategy also includes objectives to enhance the quality of our coastal waters, and ensuring that our seas will be clean and support healthy ecosystems that are biologically diverse, productive and managed sustainably. The outcomes also include the need to enhance the biological and chemical standards of our rivers and that sites of international, Welsh and local importance are in a favourable condition to support the species and habitats for which they have been identified.

139. Ofwat should continue to play an active part in preparations for the Water Framework Directive, in particular by contributing to the debate on the proportionality of the responsibilities given to the water industry for the delivery of the Directive's objectives.

140. Any further enhancements beyond statutory obligations should generally only be made where they can deliver real and noticeable improvements, but at a level where impacts on prices are kept to the minimum necessary.

Water company partnerships working with Land Managers

141. The Environment Strategy recognises the differences in land use and the impact this has on water quality. One of the outcomes the strategy identifies is to ensure that diffuse pollution is better understood and action is being taken to reduce and manage diffuse pollution.

142. Water Companies are well placed to contribute to and develop innovative, integrated solutions to achieve multiple benefits, including environmental outcomes at river basin and catchment scale. In particular, the Welsh Assembly Government favours a partnership approach to addressing diffuse water pollution from agricultural and other sources. There is a growing body of evidence and knowledge about the range and effectiveness of these approaches and how they can complement other Government policy instruments such as agri-environment schemes in generating environmental benefits for society as a whole.

143. For example, where the benefits to water customers from measures which reduce raw water treatment costs exceed the costs over the whole life of a scheme these should be considered by Ofwat.

144. The Welsh Assembly Government expects water companies to play their part in this river basin planning process contributing to the work of the Environment Agency led river basin district liaison panels, and working in partnership with a range of public and private organisations.

145. As part of this it expects Ofwat to support water companies who wish to adopt innovative approaches to improving water quality, including working with land managers to control diffuse water pollution at source, where this is to benefit of water customers.

146. Ofwat should support actions by the companies to discharge their primary duty of public health protection, together with the maintenance of consumer levels of service to maintain public confidence in water supplies, and the meeting of consumer expectations of drinking water quality, by facilitating a risk based approach to water supply based on water safety planning from source to tap.

Jane Davidson

**Minister for Environment, Sustainable and Housing
06 December 2008**