National Audit Office

Ofwat – Meeting the demand for water

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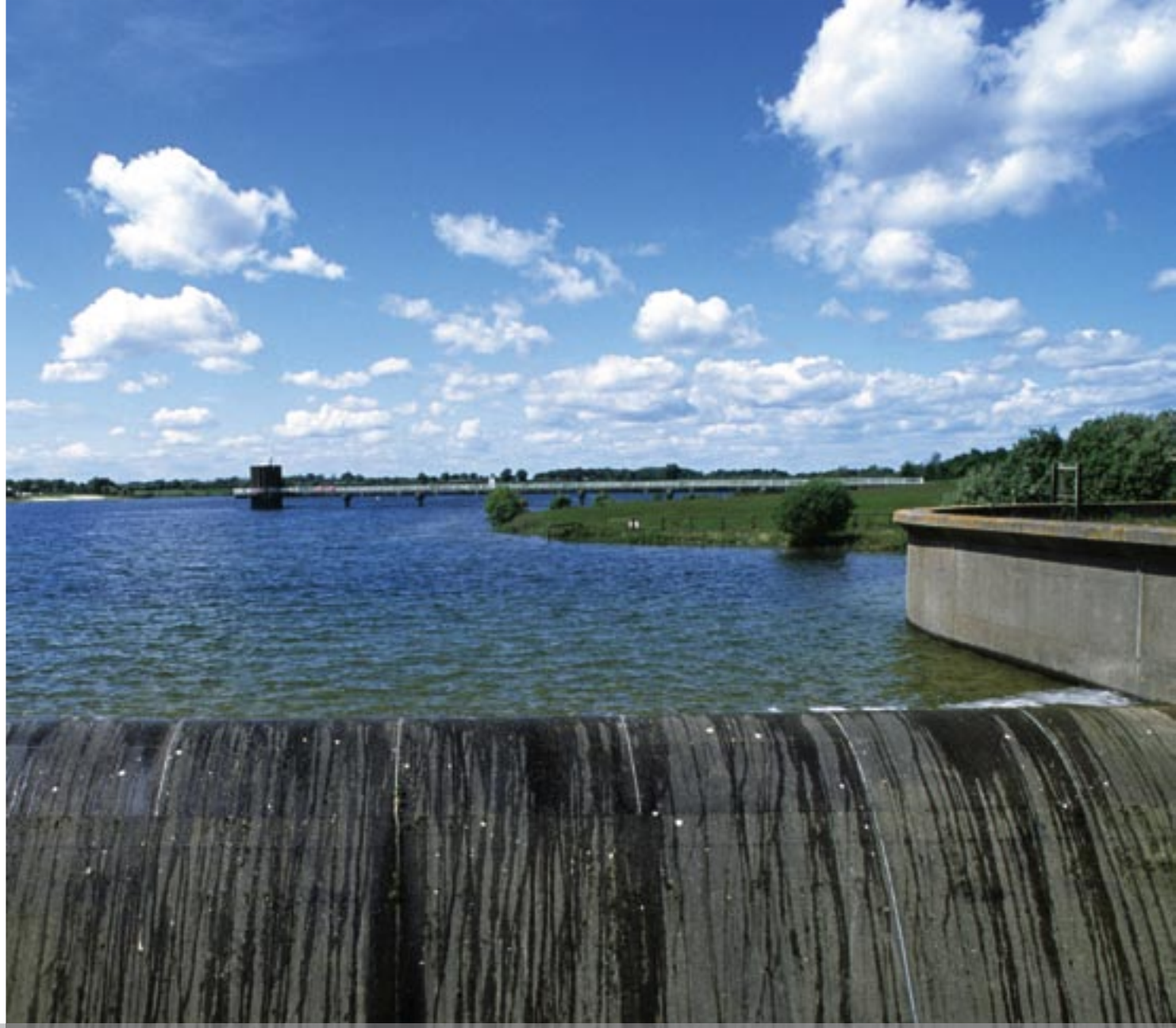


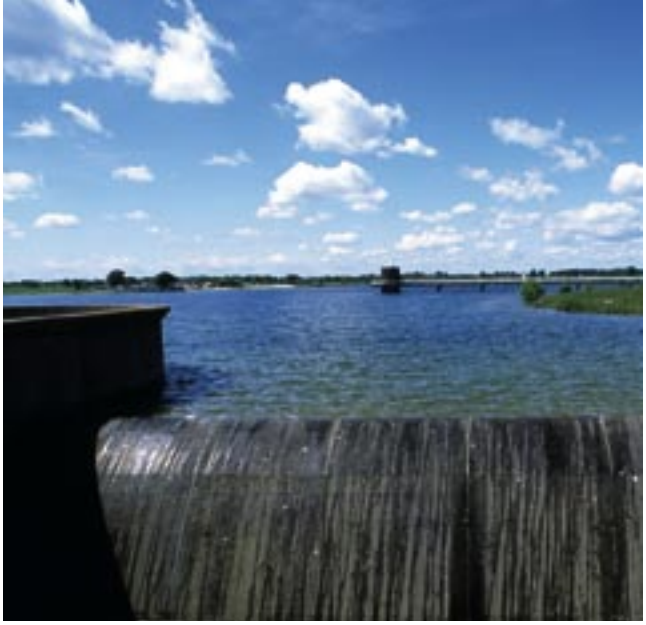
SUMMARY

1 The Water Services Regulation Authority (Ofwat) is the economic regulator of the supply and demand for water in England and Wales. Its broad purpose in this area is to regulate in a way that enables companies to secure sustainable supplies at the lowest cost to the consumer. To achieve this it needs to:

- collect relevant and reliable information to underpin its regulatory decisions (findings a, b and c);
- have a regulatory framework that provides incentives for water companies to meet future demands (findings d, e and f); and
- take appropriate enforcement action if companies do not respond to Ofwat's incentives (finding g).

2 We found that:

a There are inherent weaknesses in information on demand for water and leakage. Ofwat has secured better data on leakages. But calculations of leakage still depend on estimates of actual consumption. Consumption figures, even within the same region, range between 124 and 177 litres per person per day. It is not currently clear how much of this difference is due to socio-economic or other factors affecting water use as opposed to inconsistencies in consumption estimations, nor the impact that these differences may have on the aggregate projections of demand (paragraphs 2.3–2.9).



b The evidence on the results of water efficiency projects is growing. Ofwat has co-funded research which it hopes will produce more reliable evidence and has published a good practice register. However, the evidence does not yet enable Ofwat to say which projects are most effective in helping consumers waste less water, despite a specific Committee of Public Accounts recommendation in 2002. Given the lack of evidence, Ofwat's public reporting of water companies' water efficiency measures focuses mainly on the number of consumers reached by a project rather than the water savings generated. (Paragraphs 2.20–2.26 and 4.3–4.4).

c Metering can provide better quality data on actual consumption and therefore leakage. Available research suggests installation of meters also reduces household consumption. But there is a cost in installing meters and there is a risk that poorer families may not be able to afford the water they need for health and hygiene (paragraphs 2.17–2.19 and 3.17).

d Existing water supplies may be shared regionally by transferring water from areas with a surplus to areas with a deficit. Water companies have a strong incentive to make their own water networks as joined up as possible and can also agree to supply water to neighbouring water companies. A transfer of water from the North to the South East of England is however estimated to cost up to £15 billion to construct and cause significant environmental damage (Paragraphs 3.5–3.10).

e Ofwat's approach to setting leakage targets is sensible and supported by 62 per cent of consumers surveyed. Companies have to bring down leakage to the level where the cost of saving another unit of water through fixing a leak is the same as the cost of providing a unit of water through a new supply. Allowing a level of leakage which is economic rather than reducing leakage levels to zero prevents charges to customers from rising unnecessarily. All companies included social and environmental costs in their leakage calculations in 2004, but because some water companies found this a challenging exercise, Ofwat is updating its guidance (paragraphs 3.11–3.14).

f Evidence from the 2006 drought demonstrates that companies and consumers respond to non-financial incentives during a drought. For example, Anglian Water adopted a policy of prioritising all visible leaks, and consumer demand in the Thames region was 8 per cent less than the norm for the middle of summer. In the *Using Water Wisely* research[1], 62 per cent of consumers in water-stretched areas stated they would be more likely to conserve water if water companies conserved water (Paragraphs 3.18–3.19).

g The legally binding undertaking given by Thames Water to Ofwat to increase investment in response to the company's poor performance on leakage benefited the consumer. But, given Thames' persistent failures on leakage since 2000, customers would have benefited if Ofwat had been able to obtain such an undertaking earlier (paragraphs 4.8–4.10).

Recommendations

3 Ofwat needs to take a proactive and long term approach to respond to future challenges in the water industry and to ensure that it contributes to sustainable development.

A) Ofwat should continue to press companies for improved data on leakage and consumption by:

- working with key stakeholders, in particular the Environment Agency, to ensure any regional differences in water usage and leakage figures reported by companies are investigated, understood and explained. It should also consider the impact of the unreliability of demographic data which quickly become out of date as people move and new homes are built. Water companies must also manage an ongoing uncertainty about the location and number of new-build homes, particularly in the South East; and
- continuing to co-ordinate the work of the independent reporters, who verify the regulatory information provided to Ofwat, to ensure consistency in their reporting.

B) Ofwat should take the lead in ensuring that there is reliable evidence for the results of water efficiency projects. It should:

- encourage companies to propose appropriate water efficiency projects at the next price review through promotion of its good practice register and publication of guidance. Ofwat should provide clearer criteria by which it will judge whether to incorporate assumptions of additional expenditure for water efficiency projects in price limits; and
- regularly review and update its good practice register, to include more robust evidence as it becomes available. Ofwat should also try to include information on cost effectiveness as well as potential savings.

C) Ofwat should assess companies' progress on water efficiency on the basis of the quality of the project, its costs, and the water it saves, as well as the number of consumers reached. Ofwat could set out criteria for an effective water efficiency project and assess activity against it. Projects should be: based on a comprehensive understanding of consumer needs and priorities; targeted at the areas where most value can be added; aimed towards achievable, measurable goals; and demonstrably cost effective. Projects should also be evaluated for water saved and the effect on the consumer experience, with their outcomes disseminated to all stakeholders. The findings from the Consumer Council for Water's research into consumer attitudes and perceptions to water may help provide a useful basis for undertaking water efficiency projects.

D) Ofwat should build on its current approach and press for a long term and sustainable approach to leakage management. This will require companies to improve how environmental and social benefits and costs are included in the economic level of leakage calculation and to base costings on new guidance currently being produced by Ofwat. The impact of public perceptions of leakage, particularly in a drought, should also be considered.

E) Ofwat should improve its system of incentives by:

- exploring the introduction of a cap on the revenues a company may earn, as well as a cap on the prices it may charge, to discourage companies from promoting higher use of water to metered customers as more meters are installed; and
- investigating ways in which companies can be incentivised further to share water on a regional basis where this makes economic sense (including competition law concerns) and is environmentally sound.

F) Ofwat should build on its consumer focused approach to enforcement and ensure its interventions are timely and effective. To do so it should continue to keep its approach under review to identify any lessons that can be learned and applied to future enforcement activities. This is particularly important as it gains more experience of its new powers to fine companies, and should include examining its approach to leakage problems at Thames. Ofwat will need to act quickly and firmly against any breach of the undertaking as it monitors Thames' compliance.