

Water

Policies for Affordable, Available and Clean Water in England and Wales

Policy Paper 24

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Summary

Liberal Democrats want to protect the water needs of future generations, fairly share the costs of investment in achieving environmental standards, provide high standards of customer service and make companies more accountable to all their stakeholders.

Stronger Regulation

To establish a more effective structure to regulate the water industry (and other privatised utilities) Liberal Democrats would replace Ofwat with a single Office of Utility Regulation. A regulatory board for the water industry will form one subdivision of the new office.

Environmental Sustainability

The water industry must operate according to the principles of environmental sustainability.

These require that society neither squanders the resources needed by future generations nor leaves its children with pollution beyond the regenerative capacity of the environment.

Liberal Democrats would *integrate environmental considerations into water regulation*, obliging the new Office of Utility Regulation to take sustainability indicators into account when calculating price caps for water companies.

To improve water standards and control pollution we would:

- Work to end within ten years pollution from industrial discharges that damages our sea, inland waters, surface and groundwaters.
- Improve the management and protection of coastal zones.
- Penalise companies that fail to comply with key national and EU anti-pollution laws.

We would *reduce the need for new water developments and promote water efficiency* with a comprehensive demand management strategy, including:

- Clear and realistic targets for water companies to reduce leakage rates.
- Supporting the targeted use of metering to reduce demand amongst heavy water uses (e.g., sprinklers, swimming pools) and in areas where water is scarce, while reforming the tariff system to protect vulnerable members of society when they change to metering.

- Establishing a new, independent Water Services Trust (funded by a 2 per cent levy on water companies' profits) to provide grants and interest-free loans for installing water efficient appliances. The latter would also be promoted through regulations and labelling schemes.
- Making local authorities responsible for advising households and SMEs on water efficiency.

Sharing the Costs Fairly

Liberal Democrats seek to *share the cost of new investment in water quality more fairly* between companies, shareholders and consumers and *reduce the burdens on water charge payers in the most affected areas*. Through the regulator, we would:

- Require each company to finance a higher proportion of investment through borrowing or equity raising. This level would be set for each company individually, taking into account the circumstances of the company, including the economic life of the assets being financed.
- Encourage companies to achieve efficiencies over and above those negotiated with the regulator and ensure that local communities share in companies' success (including through customer rebates or funding local water projects of environmental importance).
- Establish a fairer system to finance water projects of national environmental importance.

Protecting Consumers

To create a fairer charging system for those who do not use meters, Liberal Democrats will replace water rates with a banded system of charging based on the Council Tax. *We will ensure that any new system does not impact unfairly on those least able to afford it.*

We will ban disconnections in situations where a household is on a low income and bring in new measures to protect those threatened with disconnection.

Our other proposals to promote consumers' interests include:

- Deterring mergers that are not well justified and ensure that the interests of consumers are fully protected by strengthening the competition authorities and passing a Restrictive Practices Act.
- Making companies more accountable and responsive to consumers, by strengthening the customer service committees and expanding their role.

The Liberal Democrat Approach

1.0.1 Liberal Democrat policy on water seeks to: provide more effective regulation; protect the needs of future generations; share the costs of future investment more fairly; provide a fairer system of paying for water and to build stronger partnerships between water companies, their directors, shareholders, employees and consumers.

1.0.2 The privatisation of water supply, a natural monopoly, has inevitably brought new problems for both water users and the environment. In particular, Liberal Democrats have criticised:

- Massive increases in water charges, with the consumer forced to pay a large proportion of the costs of investment in infrastructure and environmental measures. New investment has and will be needed to maintain quality standards. However, company profits and dividends have increased.
- Substantial regional variations in price increases. Those living in some regions have paid an unfair share for maintaining what is, in many cases, a national resource.
- The impact of increased charges on particular groups in the community.

We have noted that many single pensioners who use little water are discriminated against by the standing order for fixed charge elements of water bills. A person living alone in the South West, surviving on the state pension, may spend, on average, nearly one-tenth of his or her income on water.

- The industry's failure, despite increased charges, to secure sustainable future water resources and invest in water conservation and distribution. The unsustainable economic policies of successive Governments have degraded Britain's rivers, lakes, reservoirs and

underground aquifers. In some parts of the country, existing water supplies cannot cope with demand throughout the year. The abstraction of water from rivers and underground supplies is already causing major environmental problems. Increasing water demand will surely lead to demands for further development. However, it is estimated that one third of the water produced by water companies never reaches the consumer!

1.0.3 Renationalisation of the "big ten" water and sewage companies is neither realistic nor sensible. It would involve massive costs to the taxpayer without providing convincing solutions to the many complex issues facing the industry. As we stated in Federal Green Paper 26, *After Privatisation* (1992):
"Nationalisation has reached the end of its useful road. There is no practical way forward in simply setting one's face against the times . . . Privatisation is an irreversible fact of life. The question now is how the performance of the sectors in which privatised utilities operate can best be improved in the public interest."

1.0.4 Our proposals for reforming the water industry aim to achieve four core objectives:

- **Environmental Sustainability**

Water provision must operate according to the principle of environmental sustainability - requiring that society neither squanders the resources needed by future generations nor leaves its children with pollution beyond the regenerative capacity of the environment.

Liberal Democrats would integrate environmental considerations into water regulation; ensuring that the regulatory system facilitates sufficient investment to meet the needs of future generations; tackling pollution and promoting water efficiency and conservation.

- **Sharing the Costs Fairly**

Liberal Democrats seek to share the cost of investment in water quality more fairly between companies, shareholders and consumers. While water services should be provided in an environmentally sustainable way, unreasonable costs should not be imposed on regions with high infrastructure costs and major environmental challenges.

- **Fairer Prices**

Water is a basic human need. Liberal Democrats want to introduce a system of charging that is fair

to those on low incomes and with special water needs. (At the same time, we wish to encourage the conservation of water, as part of a comprehensive demand management strategy.) In addition to stopping consumers paying an unfair share of the cost of new investment, we will deter unjustified mergers and take-overs and make water companies more accountable to their consumers.

- **The Stakeholder Economy**

Liberal Democrats seek stronger partnerships between water companies, their directors, shareholders, employees and consumers so that all have a stake in its success.

Stronger Regulation

2.0.1 The water industry is a privatised utility that in almost all cases enjoys a ‘natural monopoly’, by virtue of controlling large networked distribution systems. Therefore, it should be subject to tough but realistic regulation to provide adequate protection for the consumer and facilitate sufficient investment to meet future generations’ needs. Liberal Democrats will establish a more effective structure for the regulation of the water industry and other privatised utilities.

2.1 Regulating the Water Industry

2.1.1 Responsibility for the economic regulation of water companies rests with the Office of Water Services (Ofwat). Its role is to ensure that the functions provided by water companies are carried out in all areas of England and Wales and to ensure that the water companies can finance their operations. Subject to these duties, it must also ensure that the interests of customers are protected and efficiency promoted by water companies.

2.1.2 Each year water companies are allowed to increase the tariff of a basket of services by a maximum amount of inflation (RPI) plus an additional increase to raise funds to finance the water industry’s investment programme (K), plus any underspend carried over from previous years (U) set by Ofwat. The K factor is set individually for each company so that companies can finance all the required capital expenditure and still make a reasonable return on their assets. K may be either positive or negative. It gives the companies some latitude in varying the individual charges in the basket, such as the standing charges and the amount related to the ratable value. The investment costs allowed for in the K factor originally related to environmental and water quality improvements required by UK and EU regulations. (It is important to note that the price limits set by Ofwat must take into account quality regulations set, monitored and

enforced by environmental regulators.) K factors vary widely between companies, reflecting their differing investment obligations (e.g., in principal and/or secondary treatment and long offshore outlets in the south west) and size and revenue raising capabilities.

2.1.3 In respect of water conservation, demand management and promotion of resource efficiency, the new Environment Agency also has a key regulatory role. Long advocated by Liberal Democrats, the Agency is the successor to the National Rivers Authority (NRA). It manages water resources by conserving, redistributing and increasing water resources, through abstraction licenses (including river flows and wetlands); discharge consents, including the release of contaminants; and strategic planning. It is also responsible for the proper use of water resources by abstractors and end users. Clearly, the Agency’s main source of influence on water company resource policy is the abstraction licensing process. It is important that the Agency and the economic regulator work together closely on all matters relating to efficiency and conservation.

2.1.4 The Department of the Environment (DOE) sets policy objectives and negotiates quality standards with the European Union’s Council of Ministers. The Drinking Water Inspectorate (DWI) audits the quality of drinking water supplied by the water companies.

2.2 A Single Regulator

2.2.1 The privatised utilities are subject to a varying mix of competition and regulation. Their regulators have extensive powers with little or no accountability. Considerable power is placed in the hands of one individual, the regulator, with inadequate provision for public accountability. As a result, utility regulators have become subject to intense pressure from various interest groups. Moreover, the regulator remains dependent on the regulated enterprises for information on the cost

structures of the industry, giving the enterprise a clear incentive to over-state costs and understate demand. There has also been considerable inconsistency in decisions both between the utilities subject to different regulators and, in some cases, between decisions of the same regulator.

2.2.2 In the water industry, this regime has two key deficiencies. First, as a result of the publicity that rising water costs have received, the single individual responsible for regulation is frequently placed under considerable political and media pressure. Second, the present legislation prohibits Ofwat, like other industry regulators, from giving a 'social weighting' in the tariff structure. In other words, Ofwat cannot balance tariffs to make water charging fairer to particular groups. This is despite the fact that water is an essential service and, for some, a very expensive one. Our proposals to address this are set out in Chapter 5.

2.2.3 To establish a more effective structure for the regulation of the water industry and other privatised utilities Liberal Democrats would:

- *Replace the separate regulators by a single Office of Utility Regulation.* A regulatory board for the water industry will form one subdivision of the combined Office. The full responsibility for decisions will be collective, rather than resting on one individual.
- *Require the regulators to publish more fully the reasons for their decisions* and making them subject to the scrutiny of a Parliamentary Select Committee.

2.3 Environmental Regulation

2.3.1 To Liberal Democrats, environmental and economic policy are inseparable. Our environmental policies are developed in the framework of sustainable development. Development is a conventional economic concept. Sustainability is a new concept in economic thinking, derived from the realities of local, national and global environment. Our economic policy reflects this new approach, which, in turn, requires new considerations in terms of regulating natural monopolies, such as water supply and treatment utilities. To this end, we have long advocated the development and adoption of broad indicators of sustainability.

2.3.2 Liberal Democrats would reform water regulation to marry environmental and economic objectives, using market mechanisms. Many aspects of environmental regulation - particularly pollution control for water - are most appropriately left with the Environment Agency. However, water prices are regulated only in terms of conventional economic concepts. The principles of environmental sustainability are excluded. In a natural monopoly like the water industry, sustainable financial and commercial decisions can only be promoted by the regulator. Therefore, under our proposals, the regulator would be obliged to take sustainability indicators into account when developing pricing formulae.

2.3.4 Suitable indicators are already available in the Government's publication *Indicators for Sustainable Development* (March 1996). The regulator could readily apply the relevant water quality or other sustainability indicators to each separate water company area. Guidelines or targets for further water indicators are already set by Ofwat, the Environment Agency or other regulators, for example, for emissions of particular pollutants. We would:

- Legislate to oblige the new Office of Utility Regulation to take into account the following sustainability indicators when calculating K factors for water companies: licensed abstractions and effective rainfall (updated to include the effects of global warming and climate change); low flow alleviation; leakage rates; the quantity of water supplied; pollution prevention and control; and the quality of estuarial, river, recreational and bathing waters. Develop the existing indicators for general use, working to ensure that important indicators, such as renewable water resources per capita, can be included.
- Penalise water companies that fail to reach 100 per cent compliance with discharge consents and introduce parallel legislation applicable to other trade and private interests.
- Penalise water companies who infringe the relevant national and European legislation on sewage discharges into coastal waters, sewage sludge disposal and urban waste water treatment.

Sharing Investment

3.0.1 Liberal Democrats seek to increase the industry's investment in increasing water quality and in conservation, by directing excess profits towards investment in a high quality water supply and funding water conservation measures. We seek to share the cost of new investment more fairly between companies, shareholders and consumers, across all regions of the UK.

3.0.2 Since privatisation, consumers have faced massive increases in the cost of water. New investment has and will be needed, amongst other reasons, to maintain water standards. However, company profits and dividends have increased. Those living in some regions have paid a disproportionate share for maintaining what is, in many cases, a national resource. Liberal Democrats would address these issues by:

- Requiring each company to finance a higher proportion investment through borrowing or increased share issues.
- Giving companies incentives to achieve efficiencies over and above those negotiated with the regulator and enabling local communities to share in companies' success.
- Using the reformed regulatory system to establish a fair system to finance water projects of national environmental importance.

3.1 Financing Investment

3.1.1 Since privatisation, average bills for unmeasured (i.e. unmetered) water and sewerage in England and Wales have risen by 78 per cent (39 per cent in real terms). At the same time, companies' profits have increased by 167 per cent. The principal reason for increased water charges has been the need to pay for two schedules of capital - yesterday's loans and tomorrow's new works. According to the Water Services Association, the industry has had to invest £15 billion since 1989 in order to improve water standards. Looking to the future, Ofwat has allowed

forward capital expenditure of £24 billion for the years 1995/96 to 2004/05.

3.1.2 It is not easy to make a simple, definitive statement as to the connection between increased charges, the investment programme and the cost of complying with EC Directives. However, the National Rivers Authority (NRA) concluded that about a quarter of CAPEX until 1994/95 went towards funding environmental improvements. Just under half of the £24 billion for the next ten years is for quality improvements. Similarly, it is difficult to calculate how CAPEX has affected water charges: Ofwat believes that two-thirds of the charge increases since privatisation are due to the cost of environmental improvements. This includes compliance programmes for drinking water quality, bathing water quality and sewage treatment works discharges (together accounting for about one quarter of CAPEX), on going maintenance costs, operating expenditure arising from compliance costs and environmental programmes such as river quality.

3.1.3 There is strong evidence, however, to support the argument that while customers have borne much of the cost of investment, company shareholders have received most of the financial benefits. For its part, the Consumers Association has concluded that more than 80 per cent of the companies' investment has been funded by increases in domestic consumers' bills. The Association has produced figures showing that between 1989 and 1993, average share prices on the FT-A All Share increased by 39 per cent. Over the same period, water and sewerage share prices rose almost 100 per cent and the dividends paid to water company shareholders increased by 110 per cent.

3.1.4 Proposals to redress this balance must be considered in light of their impact on future investment. A 1995 study by Dr Jean Shaoul of the Department of Accounting and Finance, Manchester University, compared the water industry's financial performance before privatisation and in the years immediately after. It concluded that company shareholders gained the most from the industry's new profits, at the

expense of customers and employees. Further, the form of regulation chosen by the government, price capping, played a crucial role. No limits were placed on the rate of return, water businesses' profits were not ringfenced and excess profits remained untouched.

3.1.5 The costs of some improvements have fallen disproportionately on particular regions. For example, the costs of cleaning up coastal waters, a national resource, have not fallen fairly across the country. Thirty per cent of the cost has fallen on Devon and Cornwall, which have just 3 per cent of the nation's population. The chair of the South West Water Consumers Committee believes their average bill will go up by a further £150 a year if this problem is not addressed. The issue is, however, broader than coastal clean-up. The cost of meeting the Urban Waste Water Directive will soon fall on the customers of North West Water, Wessex Water and Yorkshire Water. Similarly, lead will be a major concern in the north west and nitrates impact on agricultural regions such as that covered by Anglian Water.

3.2 Sharing the Burdens and the Benefits

3.2.1 We propose that the regulator would continue to ensure that individual water companies operated as efficiently as possible, by negotiating the 'K factor' in price regulation taking into account the need to fund works, improve water quality and other necessary purposes and provide sufficient incentives for investment.

3.2.2 Liberal Democrats also aim to share the costs and benefits of investment more fairly between companies and their shareholders and customers. The creation of long term capital assets should not be financed so heavily from current earnings. Through the regulator, we would require each company to finance a higher proportion of their investment through borrowing or increased share issues. This level would be set for each company individually, taking into the account the circumstances of the company, including the economic life of the assets being financed. In addition, each company would be required to break down for its customers the amount that the customer is paying towards current variable and fixed costs of providing water and the amount

the customer is contributing towards the formation of capital assets.

3.2.3 This proposal is not as radical as it may seem. A lower price cap, as implemented by Ofwat in 1994, will reduce both available capital investment funds and the level of dividends. Therefore, given that new investment is required by EC Directives (see above), a larger proportion of investment will need to be financed by borrowing.

3.2.4 In the past, some companies have made profits higher than expected by Ofwat. Companies may retain gains from any efficiencies achieved in excess of target until the next five year price review. The regulator may encourage individual companies to voluntarily share these efficiencies earlier. Some companies have chosen to share efficiency savings with their customers through customer rebates and discretionary investment. For example, in 1995, North West Water announced plans to repay £180 million to customers. Dwr Cymru (Welsh Water) has announced a rebate of £9 every year for the next five years. South West Water has just implemented a rebate of £10. To provide for a fairer distribution of profits between consumers and shareholders, we would require the regulator to develop means of doing this for each water company.

3.2.5 Liberal Democrats propose to formalise this process, to achieve two objectives. First, companies should be given incentives to achieve efficiencies over and above those negotiated with the regulator. Second, local communities should be able to share in companies' success. We propose that:

- Where companies generate profits in excess of the return expected from an average low risk enterprise, they would be required to distribute to shareholders no more than 50 percent of the excess generated by efficiency gains. The remaining 50 per cent of the excess would be offered to consumers either in the form of rebates or as local water projects of environmental importance. The decision could be made by Customer Service Committees, reconstituted as independent bodies, representative of local consumers. (see section 6.3) This way, shareholders and customers would both have a stake in increasing the company's efficiency.

3.2.6 To help reduce regional differentials in the cost of investing in water standards, we would subsidise water projects of national environmental performance, through the reformed regulatory system.

3.2.7 We continue to oppose Labour's "Windfall Tax" as a piecemeal, retrospective measure that would have negative implications for investment and

perhaps prices. It provides no guarantee that the environmental needs of particular regions would be sufficiently or fairly funded.

3.2.8 Companies may seek to maintain or raise profits by diversifying in other, non-regulated activities. We do not oppose this, but remain strongly opposed to monopolies and restrictive practices (see Section 6.4).

Cleaner Water

4.0.1 Cleaner seas, beaches, rivers and lakes are essential objectives of the Liberal Democrat plan for sustainable water use.

4.1.1 The water industry is dependent on a naturally renewable resource. It operates in a cyclical system that is highly vulnerable to erratic climatic events, which are becoming more unpredictable. Water companies dependence on the natural environment applies regardless of their ownership, market status or level of regulation.

4.1.2 The unsustainable economic policies of successive Governments have degraded Britain's ecosystems, as shown by the condition of our rivers, lakes, reservoirs and underground aquifers. Serious long-term contamination has jeopardised a large proportion of our naturally potable groundwater resources. The Government's recently published Indicators of Sustainability shows that one fifth of rivers in England and Wales are of poor or very poor chemical quality. In nearly one fifth of freshwater, mainly in sensitive upland areas of north and west Britain, estimated critical loads of acidity are exceeded. More than one-tenth of UK bathing waters still do not comply with minimum mandatory coliform standards. The culprits include agricultural, urban and industrial pollutants, for example nitrates, phosphates, heavy metal compounds and herbicides, pesticides, detergents, PCBs, radionuclides oestrogens and the discharge of raw sewage. The water environment and the geological and living elements of wetlands and forests that naturally regulate its flows have suffered additional stress through extreme weather events.

4.1.3 UK and EU environmental standards have not been adequately enforced by successive

Governments. River inspectors have often been overloaded and inadequately supported. In many areas, there are not enough inspectors to maintain standards, even if a few willful polluters have been caught and punished in the courts. Companies, farmers and households continue to pollute water courses, often unwittingly.

4.1.4 The above factors, and increased demands for water, have led to a serious and continuing depletion of water resources for the future, and a diminishing capacity of our island ecosystem, despite our reliable average annual rainfall, to repair and replenish itself. Reversing the mismanagement of successive Governments will require decisive action over a prolonged period. To control pollution, Liberal Democrats are committed to:

- Ensuring compliance with EU drinking water standards.
- Improving the management and protection of coastal zones and placing stricter controls on sewage discharge.
- Ending within ten years industrial pollution that damages our seas, inland waters, surface and groundwaters. Achieving these goals will involve continuing the substantial investment by both water companies and industry in environmental clean-up. Our 'market-based' economic policy instruments, particularly tradable emission licenses, would come into play. (See Policy Paper 9, *Agenda for Sustainability* (1994).)
- Playing a leading role in establishing measures protecting the marine environment.

Using Water Wisely

5.0.1 Liberal Democrats are determined to increase water conservation and promote the efficient use of this resource. This is the least environmentally damaging way of ensuring that the supply of available resources can cope with demand.

5.1 Rising Demand

5.1.1 Existing water supplies cannot cope with demand in all parts of the country, at all times of the year. Meeting the needs of water users while protecting the environment is becoming increasingly difficult. For example, the abstraction of water from rivers and underground supplies for industry and domestic use is causing marshes to dry out and reduce river flows, affecting birds, plants, insects and mammals.

5.1.2 In 1994, a study by the NRA concluded that, on present trends, the demand for public water supply could rise by as much as one fifth over the next twenty five years, depending on domestic and industrial demand, losses in supply and distribution systems and consumption patterns. Under such a “high demand scenario”, the demand for water should outstrip supply in all regions. Several large resource development schemes would be required, involving large financial and environmental costs. Under a low demand scenario (2 per cent increase), some regions would experience deficits. Overall, these could be met by smaller developments and transfer schemes, with fewer environmental impacts.

5.1.3 Climate change will also be a factor. Recent forecasts for the next twenty five years indicate that evaporation losses will increase. Further, groundwater recharge will be reduced by high evaporation and longer periods of soil moisture deficit are predicted.

5.2 Managing Demand

5.2.1 A long-term strategy for water resources is essential. We would require each company, with Ofwat and the Environment Agency, to undertake an open water resource planning process that considers all options to meet long-term water demands. This would assess: present water demands; the availability of water to meet those demands; future demands and the full range of demand management and development options to meet them; and a strategic environmental assessment of the options available to meet those demands.

5.2.2 In 1994, the NRA concluded that implementing a range of demand management measures could save 42 per cent of current distribution input. Even before environmental costs are considered, demand management schemes are more cost-effective than new developments. Individual elements of a demand management strategy are considered below.

“We will promote water conservation, without imposing unfair burdens on consumers.”

5.2.3 The NRA found that leakage control had the greatest water saving potential. Put simply, if less water was wasted through uneconomic leakage, demand could more easily be met from existing resources, reducing the amount of water companies need to abstract. Since privatisation, leakage has increased in six out of ten companies. Ofwat figures show that in 1994/95, the ten water and sewage companies lost nearly 4000 million litres (around 1000 million gallons) of water per day through leakage, equivalent to 30 per cent of distribution input. The ten smaller water only companies lost 820 million litres per day, representing 22 per cent of distribution input. According to the NRA, leakage by individual companies ranges from 4.6 to 18.4 litres per property per hour. In May 1996, the Director-General of Ofwat criticised the majority of water companies for failing to meet their own leakage targets and not demonstrating that they are running their systems efficiently and economically.

Although the water companies' charges were set at a level to finance this work, Ofwat figures show that capital investment on distribution fell between 1991/92 and 1994/95. Indeed, companies such as Yorkshire Water have admitted that they increased dividends to shareholders by using funds earmarked by the regulator for investing in leakage reduction.

5.3 Reducing Leakage

5.3.1 According to Ofwat, around one quarter of the water taken by the ten water and sewage companies leaks away before reaching customers' pipes. (For the smaller companies, the figure is 14 per cent) Given that the overall leakage rate is about 30 per cent, leakage from the "big ten's" distribution pipes represents four times that from customers' supply pipes. Further, individual companies' plans to reduce leakage use unclear timescales and are frequently arbitrary in nature.

5.3.2 To make water supply and distribution more efficient, Liberal Democrats would:

- Set, through the regulator, clear and realistic targets for each water company to reduce its leakage rates. The targets would be based on economic levels of leakage and take environmental factors into account. We would support the regulator setting economic incentives for their achievement, including refunds to customers and refusing any investment plans for additional resource or treatment capacity where leakage targets were exceeded.
- Reduce leakage on the consumer's side by obliging companies to provide help and advice on the renewal or replacement of pipes. In the longer term, we would consider extending companies' responsibility to the internal stop tap.

5.3.4 At the same time, rising consumption, diminishing returns and global warming mean that, on its own, leakage control will only be a short term solution. The NRA study showed that, of the demand management measures studied, leakage control had the greatest water saving potential but was the third most cost effective. In other words, leakage control will only be one component of a comprehensive demand management strategy.

5.4 Promoting Efficiency

5.4.1 Water efficiency must be promoted, without imposing massive, unfair burdens on water consumers. In 1994, the National Rivers Authority studied the efficacy of a number of demand management measures. These included: leakage control; domestic recycling; domestic metering; low flush WCs; shower installation; efficient washing machines; controllers on urinals; and low volume water heads. The NRA study found that the saving and cost effectiveness of individual measures varied. As noted above, leakage control had the greatest water saving potential. However, it was the third most cost effective, behind efficient washing machines and controllers of urinals. Domestic recycling was the most expensive.

5.4.2 Domestic metering has potential strengths as a demand management measure. It makes clear to the consumer the value of the resource being used and provides incentives to conserve water and prevent leaks. However, Liberal Democrats do not support the introduction of universal metering on a compulsory basis. This is for both economic and social reasons. For example, the NRA study rated universal domestic metering sixth out of the eight demand management measures surveyed in terms of cost effectiveness. Studies have suggested that metering, without compensatory measures or tariff reforms, would create hardship for some consumers. For example, poorer families with children may have to economise by reducing water consumption.

5.4.3 It is important to note, however, that no basis of charging currently in use or under consideration would be perfectly fair. A 1993 study by the Institute of Fiscal Studies (IFS) for Ofwat examined the impact of four charging methods on different types of household. The methods surveyed were: a "licence fee" (uniform charge); a charge based on the number of people in the household; a charge based on the type of property; and metering. It concluded that under all four systems, poorer households would continue to pay disproportionately higher costs for water. While the differences were small, the licence fee or house type options would impose higher burdens on poor households; charges based on household size and metering would increase the relative burden on middle income households compared to rich households.

5.4.4 The case for the immediate use of metering appears strongest in two circumstances: first, in areas where water supplies are under pressure and second, for non-essential uses. A pilot scheme operated between 1989 and 1993 produced a great deal of useful information. (However, the sample was not representative of the whole country.) On average, consumption dropped by 11 per cent, increasing to 30 per cent during hot, dry summers. This is useful in areas where there is a shortage of water. In areas where there is plenty of water this imposes extra costs as the costs of supplying water do not change relative to the volume supplied. Further, Ofwat has also found some evidence that in 1995, the use of water for garden sprinklers increased, contributing to higher and longer peak demands in periods of hot and dry weather. Where companies experienced this trend, the metering of household uses, particularly household sprinklers, significantly reduced peak demands. In some areas, on a hot day more water may be used by garden sprinklers than by industry. Therefore, we support the targeted use of metering to reduce demand amongst heavy water uses (e.g., sprinklers, swimming pools) and in areas where water is scarce.

5.4.5 The IFS study underlined the importance of compensatory measures to protect some groups. Most income groups would not be significantly worse off under universal metering than under the present charging system. However, larger households would tend to lose and smaller households would tend to gain. The highest proportion of losers was found amongst households consisting of unemployed families with children, whereas more than nine of out of ten single pensioner households would gain. Similarly, the IFS study showed the need for households to have sufficient incentives, in terms of lower water charges following reduced consumption, to justify a change to metering.

5.4.6 Therefore, where metering is introduced, the needs of vulnerable members of society must be protected by reforming the tariff system. The essential elements of such a reform are: a progressive tariff structure; meeting essential water needs at low cost; discouraging higher, non-essential water use such as garden sprinklers and swimming pools through higher costs and the use of meters; assisting with water conservation measures and introducing other demand management measures (so that the responsibility for achieved efficiency is shared).

5.4.7 Liberal Democrats propose to protect vulnerable members of the community by abolishing standing charges and introducing a minimum social tariff. We would establish a rising block tariff for metered water charges with a uniform social tariff. Under the minimum social tariff, the regulator could require every water company to provide each household with an adequate quantity of water needed for good health and hygiene at a basic price, uniform throughout the country. Given that water needs vary between household types, this would need to be defined by the regulator with guidelines provided to water companies. Indeed, some groups may pay nothing for their basic requirements. Beyond the minimum social tariff, water companies could increase the cost of water used by consumers so as to reflect the cost of providing it, subject to regulation (see Chapter 2).

“We have a fair strategy for managing water demand.”

5.4.8 Tariff charges as presently designed allow industrial users to pay less for each block of water as their use increases. Our new tariff structure would reverse this balancing and allow domestic consumers to pay less for the basic amounts of water needed by everybody and more for the extra water needed by those with large gardens and swimming pools. To this end, we support the compulsory application of meters for heavy, non-essential uses, such as sprinklers and swimming pools. The high costs of meeting those demands could be met by those users. This, and the tariff system, would provide incentives for conservation.

5.4.9 Our comprehensive strategy for managing water demand also includes:

Establishing an independent Water Services Trust.

There is currently no single body responsible for promoting water conservation. Our new Trust would provide grants and interest-free loans for installing water efficient devices. Over time, the latter would be integrated with our proposed assistance to energy efficient devices. The Trust would be funded by a 2 per cent levy on companies' profits.

- *Improving public education on water conservation* by making local authorities responsible for advising households and SMEs on water efficiency (with the Water Services Trust giving local authorities information and assistance) and by working with the regulator, water companies, the new Water Services Trust and the voluntary sector.
- *Using regulations and labelling schemes* to promote the use of more water-efficient toilets, washing machines, dishwashers and other household appliances.
- *Using labelling and public education schemes* to encourage the use of more water-efficient shower and bath design.
- *Funding research to examine the potential of “grey water” systems* for new properties and encouraging companies to research how to reuse waste water from treatment works.
- *Review building and product standards and the water bylaws.*

5.4.10 The present system of charging for water abstraction fails to reflect the environmental cost or water abstraction or encourage the wise use of water. Any demand management strategy must include a greater use of economic instruments to give water abstractors clear signals about the cost

of using water. Liberal Democrats would pursue a market based system for abstraction charging (probably incentive charging), complementing regulatory controls.

5.5 Water Transfer

5.5.1 From time to time, the construction of a national water grid is called for. Difficult technical, economic and environmental problems must be addressed before common carriage can become a reality. For example, the quality of drinking water could be reduced. There are limits on the extent to which different types of water can be mixed without causing corrosion problems. Further, a national grid is not necessary: it would be rarely used and, given that most boundaries between companies are on high ground, would require expensive investment in pumping. If rivers and canals were to be deployed, changes to temperature and chemical make-up could damage wildlife and prevent fish from spawning. The required pumping would consume a large amount of energy, with resulting environmental implications. A number of links between water company areas already exist - for example, water from the River Severn system can be carried between the North West, Severn Trent, Wessex and South West water companies. The further development of a national grid is a matter for commercial judgement rather than the committal of taxpayers' funds. In any case, it must be subject to a full, independent environmental appraisal within a government approval system.

Protecting Consumers

6.0.1 Liberal Democrats want to strengthen the position of consumers and, indeed, all stakeholders in the water industry. In particular, we seek a new basis of charging that is fairer than rateable values. We would ease the unfair burdens that the present system - and rising water charges - have placed on vulnerable sections of the community.

6.1 Fairer Charging

6.1.1 The impact of increased water prices on particular members of the community is a matter of great concern. Many single pensioners who use little water are discriminated against by the standing order for fixed charge elements of water bills. Since privatisation, regional differentials in water charges have grown. Increases in unmetered households' average water bills have ranged from 57 per cent (Yorkshire) to 106 per cent (Anglian). Across Britain, there is now a £122 difference, or 60 percent, between the highest and lowest average water bills. This has impacted harshly on vulnerable groups. A pensioner living alone in the South West, surviving on the state pension, may spend, on average, nearly one-tenth of his or her income on water. Under present charging arrangements, the costs of meeting peak demands, including for such non-essential uses as sprinklers and swimming pools, are averaged across all users.

6.1.2 Our proposals to share the costs of investment more fairly would ameliorate these problems (see section 3.2). Similarly, our proposals to redirect company profits towards investing in infrastructure development would help to reduce unfair regional differentials in water prices (see section 3.2) However, additional reforms are needed to make the charging system fairer. This would apply where metering (and our accompanying proposals for tariff reform) has not been introduced.

6.1.3 An alternative basis of charging to outdated rateable values is needed. Currently, the water bills

of more than nine out of every ten customers are based on rateable values. This method is unfair. It provides no assessment of usage and, therefore, does not encourage conservation. It bears little relationship to the consumer's ability to pay given that rateable values are based on information from the 1970s. It gives consumers no incentive to save water. As the law currently stands, it is to end by the year 2000. However, last year, the Government announced its intention to enable companies to continue charging for water on the basis of rateable values. After 1990, new properties were no longer charged for water according to that system. Companies must now develop "notional" rateable values! Liberal Democrats have strongly criticised this shift in Government policy as unworkable and unfair.

6.1.4 The Council Tax, though far from perfect as a means of raising local taxation, would at least be based on a recent assessment of property value and recognises situations in which one adult lives alone. In the short term, therefore, we propose to replace water rates with a banded system of charging based on the Council Tax (as in Scotland). This would allow the possibility of helping those living alone or on low incomes, similar to our proposals to assist vulnerable sections of the community (see section 5.4). For example, those on lower bands could be charged less.

6.1.5 The Government has argued that some low income groups may be adversely affected by such a measure. However, this could be tackled by phasing in any changes and by designing the charging structure to ensure that such a move did not impact unfairly on middle or low income groups. It would first need to be carefully researched, to assess the relationship between property values and income and set tariff levels accordingly. Moving to a new basis of charging may also require the further development of additional council tax bands, once this relationship has been assessed.

6.2 Disconnections

6.2.1 Since privatisation, an average of 12,000 households have had their water supplies disconnected each year. While the number of household disconnections has fallen by nearly three quarters over the past five years, water is essential to life and health. Therefore, we would ban disconnections in situations where the family is on a low income and unable to pay. Where a bill is not paid we will require the water companies to investigate the reasons for non-payment and to offer easy payment options and accept direct payment from benefits at a rate the family can afford. Further, we would require a summons to be issued and a judgment obtained enabling the customer to defend the case in court.

6.2.2 Ofwat has issued formal guidelines on disconnections, stating that companies should implement such steps in respect of payments and setting out the steps companies should take before disconnecting. However, in the past, Ofwat has complained that companies have proved resistant to such measures. We would fully support their adoption, if necessary making them mandatory for all companies carrying out disconnections. At the same time, any attempts by water companies to improve payment methods and assist clients who have financial difficulties should be supported.

6.2.3 Unfortunately, there will be always be a small minority of domestic and non-domestic consumers who can pay but still do not. Having proceeded to court, the consumer who refuses to pay could be further pursued to distraintment or prison, or to disconnection. In such circumstances, disconnection is fairer to the company and all its customers and should be permitted.

6.3 Accountability to Consumers

6.3.1 Liberal Democrats seek stronger partnerships between water companies, their directors, shareholders, employees and consumers so that all have a stake in its success.

6.3.2 The ten customer service committees (CSCs) perform a useful role in providing advice, receiving complaints and representing consumer interests. The

development of a code of practice for company disconnections is one example of their contribution. However the CSCs and the Ofwat National Customer Council are not sufficiently independent from Ofwat and are not perceived as such. They have insufficient rights of access for information from Ofwat and water companies. Given that nearly half the CSCs' members come from business or industry, they do not represent consumer interests adequately.

6.3.3 To make the industry more accountable and responsive to consumers, Liberal Democrats would strengthen the CSCs and expand their role. We would:

- Reconstitute the CSCs as bodies independent from the regulator and with rights of access to relevant information from both the regulator and water companies. The CSCs would carry out research, have access to expert advice and receive and pursue complaints.
- Make the committees' memberships more representative of consumers, by comprising them of representatives of elected local councils with the plc's area, and organisations with special interests in water.
- Require each company to have regular meetings with its CSC on its consumer, financial and environmental performance and the strategic plan (as most do now). Similar meetings with the public could also be required.
- Enable the CSCs to appoint consumers' representatives on the management board of our proposed Office of Utility Regulation.

“We would introduce a fairer system of charging for water.”

In section 3.2, we set out a mechanism by which companies could be given incentives to achieve efficiencies over and above those negotiated with the regulator, thereby enabling local communities to share in companies' success. Each CSC would be able to decide whether this should take the form of a rebate to consumers or investment in local environmental improvements.

6.3.4 Liberal Democrats seek new partnerships in business and in the economy as a whole. We are long-standing advocates of the stakeholder economy in which everyone, including consumers, is committed to success. This is discussed in Policy Paper 16, *Investment, Partnership, Sustainability* (1995). Specifically, we support the work of the Cadbury Committee on Corporate Governance, including its recommendations to improve disclosure and enhance the role of non-executive directors. Such proposals could give consumers a stronger voice in the way water companies are run - for example, CSCs could nominate non-executive directors.

Directors and Employees

6.3.5 Similarly, our proposals for providing employees with rights to participate in management and decisions could be developed, over time, to enhance the rights of consumers. Policy Paper 9, *Working for Change* (1994), sets out a non-prescriptive 'enabling' approach to developing employees' rights to information, consultation and participation in decision-making. The principal mechanism proposed is an Industrial Partnership Agency, which would devise schemes and structures most appropriate to particular employing organisations. As explained in Policy Paper 9, *Working for Change* (1994), Liberal Democrats would:

- Set clear guidelines for any rewards system applying to Directors and senior management.
- Require each company's remuneration committee to be directly elected by its shareholders.
- Impose penalties on companies awarding excessive and unusual benefits.

6.4 Mergers, Takeovers and Monopolies

6.4.1 Mergers and takeovers, particularly those between utilities, have become a cause for major concern. In November 1995, North West Water acquired the regional electricity company Norweb. Two months later, Welsh Water took over its regional electricity company. In June 1996, Scottish Power (having taken over the regional electricity

company Manweb in the previous Autumn) launched a hostile bid for Southern Water. Both Wessex Water and Severn Trent Water have made bids for South West Water and these have been referred to the Monopolies and Mergers Commission. At least two other water companies have been mentioned as possible bid targets.

"In monopoly or merger situations, we would ensure that the interests of consumers are fully protected."

6.4.2 As supporters of competition, Liberal Democrats view such developments with considerable alarm. Mergers and takeovers that simply build industrial conglomerates must be restrained. These make it more difficult for regulators to protect consumers' interests and concentrate power in one company to an unacceptable degree. Mergers that are not well justified should be deterred. Where monopoly utilities are involved in mergers or takeovers, we would ensure that the interests of consumers are fully protected. As explained in Policy Paper 16, *Investment, Partnership, Sustainability* (1994), Liberal Democrats would:

- Strengthen and give greater independence to the competition authorities.
- Pass a Restrictive Practices Act to merge the Monopolies and Mergers Commission and the Office of Fair Trading.
- Extend the right to initiate proceedings against monopolies or restrictive practices to those affected by them.
- Tighten takeover rules.

This Paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 5.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats and the Welsh Liberal Democrats determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. If approved by Conference, this paper will form the policy of the Party in England and Wales.

Many of the policy papers published by the Liberal Democrats imply modifications to existing government public expenditure priorities. We recognise that it may not be possible to achieve all these proposals in the lifetime of one Parliament. We intend to publish a costings programme, setting out our priorities across all policy areas, closer to the next general election.

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