

## **The Drinking Water Inspectorate's response to the Consultation on the Cave Review of competition and innovation in water markets**

This is Drinking Water Inspectorate's (DWI) response to the UK and Welsh Assembly Governments consultation on the Cave Review of competition and innovation in water markets. It deals primarily with the potential impact of competition on the role and duties of the Chief Inspector of Drinking Water in the provision of safe clean drinking water.

We note the proposals set out in the Cave Review for changes to the framework of the water industry to deliver benefits to consumers and the environment. We welcome the aspiration to improve services for consumers, and to improve environmental outcomes. However, of fundamental priority is the ongoing protection of the public health ensuring that there is sufficient water of high quality delivered to consumers at all times.

### **Background:**

The Chief Inspector of Drinking Water was appointed by the Secretary of State for England and Welsh Ministers under Section 86 of the Water Industry Act 1991 (WIA 91) as the regulator of the quality and sufficiency of public water supplies. In particular, to ensure there is adequate protection of public health associated with water supplies intended for drinking, cooking, washing and food production purposes. Current legislation places duties on water undertakers and combined water supply licensees to ensure that water is wholesome at the consumer's tap.

The requirement for water to be wholesome, and fit for human consumption, is set out in WIA 91. Further requirements and duties are set out in the Water Supply (Water Quality) Regulations 2000 (2001 in Wales) (the Principal Regulations) and the Water Supply (Water Quality) Regulations (Amendment) Regulations 2007 (Amendment Regulations). These cover wholesomeness at the consumer's tap by setting standards that must be met for a range of drinking water quality parameters. These statutory instruments transpose requirements set out in the EC Drinking Water Directive (98/83/EC) and are based on current acceptable levels permitted for public health and consumer acceptability. The Regulations also define:

- water quality monitoring requirements;
- investigations that have to be carried out should a standard be exceeded, and the penalties and sanctions that water companies or licensees may incur;
- the requirement to carry out a risk assessment of every supply system (specifically in relation to actual or potential risks to human health) and take action to address those risks,
- the approvals process for materials, substances and processes for use in treatment and distribution of water supplies, and
- notification requirements in relation to events, incidents and emergencies.

The Chief Inspector of Drinking Water has the power to prosecute a water undertaker or combined licensee for failure to carry out a number of duties in relation to the provision of

safe, clean drinking water. These include: supply of water unfit for human consumption, failure to adequately treat and disinfect water, and use of un-approved products and processes in contact with water that will be used for drinking water purposes.

The Chief Inspector of Drinking Water oversees the application of the Regulations by compliance assessment, technical audit and investigations into water quality incidents.

**Key Themes Associated with the Cave Review recommendations for DWI:**

The continuing wholesomeness of water is not automatically assured once attained and requires constant vigilance and maintenance to the point of delivery. The duty to ensure wholesomeness at the consumer's tap will need careful consideration if the recommendations made by the Cave Review are taken forward. Currently, a water undertaker's responsibility to carry out that duty applies to the whole of the supply chain from source through abstraction, treatment, and distribution to the tap. With future changes to the framework of the industry potentially resulting in a significant number of licensed organisations delivering different parts of the supply chain, it must be clear at all times who has the responsibility for ensuring that drinking water at the tap meets the statutory requirements in terms of wholesomeness.

To facilitate this, supplementary powers may be necessary to put in place legislation governing the provision of safe clean drinking water that is fit for purpose. Currently, the Water Act 2003, the Principal Regulations and the Amendment Regulations refer to duties of existing water undertakers and combined water supply licensees. The definitions in the Water Act 2003 would need to be expanded to ensure that the legislation applies to all potential market participants i.e. all retail licensees (including those for self supply) and upstream participants.

The Regulations should also be amended to prevent any market participant from being involved in the supply of water until after the Chief Inspector of Drinking Water has assessed the associated risks, and to enable the Chief Inspector of Drinking Water to prohibit the supply of water when a risk to public health is identified. Regulation 15 of the Amendment Regulations currently prevents water undertakers and combined licensees from supplying water from a new source until a risk assessment (under Regulation 27) has been carried out and three months has elapsed from receipt by the Chief Inspector of Drinking Water of the risk assessment report. In order to adequately control the potential impact on public health this requirement should be broadened to include a similar restriction to the introduction by any market participant of a new or revised water supply.

Regulation 27 requires a comprehensive risk assessment of each treatment works and connected supply system covering all hazards and hazardous events associated with a risk to human health. Under Regulation 28, water undertakers and combined licensees must submit a report on the risk assessment carried out for each treatment works and associated supply systems. Regulation 28(4) enables the Chief Inspector of Drinking Water to issue a Notice requiring a water undertaker or combined licensee to not supply water from a specified treatment works or supply system unless specified conditions are satisfied. Regulation 27 and 28 should be expanded to any market participant responsible for part or whole of the supply chain, thereby enabling the Chief Inspector of Drinking Water to issue a

Notice stopping a supply in the event that a potential danger to human health arises (or may arise) from that supply.

Regulation 35 requires any water supplier to provide information on request. This should be strengthened to ensure that relevant information and data on risk and other drinking water quality regulatory requirements are provided by, and shared between, all market participants in the supply chain.

The current regulatory unit of monitoring, as set out in Regulation 3 of the Regulations, is a defined and discrete water supply zone. However, moving to the proposed licensing regime will require a different unit of regulatory monitoring to facilitate individual specific sites/locations across a region rather than a defined discrete area of supply. This will need to be considered alongside the continuation of the water supply zone as the primary unit of monitoring and reporting under the European Directive on the quality of water intended for human consumption (Directive 98/83/EC).

Finally, the proposed changes to the framework of the water industry potentially resulting in a significant increase in the number of licensed organisations delivering different parts of the supply chain would have significant operational implications for DWI. Our resource requirements are related to the number of regulated entities; as these increase within an expanded competition regime, our resource capacity and funding arrangements will need to be reassessed.

#### **Response to specific areas outlined in the consultation document:**

The following paragraphs address only those questions presented in the consultation document which may have a potential impact on the Chief Inspector of Drinking Water and her role in the protection of public health through the supply of safe, clean water for drinking, cooking, washing and food production as the competition market develops.

#### Retail:

**Q1 – Do you agree with the UK Governments approach to implementing a framework of regulated access through introducing standard market and operational codes?**

**Q6 – Do you agree with the UK Government’s proposed approach to implementing the threshold reduction?**

DWI notes that a major reform is proposed to develop a framework that will allow effective competition in the water sector, and welcomes the opportunity to contribute to, and facilitate, the changes in the water supply regime .

One of the reforms proposed is the reduction of the threshold for the non-household retail market from 50 ML/day to 5ML/d as soon as practicable and subsequently to 0 ML/d. The reduction will significantly broaden the scope of the licensing regime by increasing the number of consumers with a choice of water supplier. A number of concerns for DWI in terms of its ability to carry out its duties as the independent regulator of drinking water quality are highlighted above.

DWI agrees that the case for extending competition to domestic households remains weak at this time and that further assessment should be carried out on the cost and benefits involved.

DWI notes that another proposal to facilitate competition for the non-household retail market is the introduction of a system of 'regulated' access with nationally agreed market and operational codes. However, additional to the codes, there should be a mechanism for ensuring market participants are bound by a responsibility to provide safe clean drinking water. The changes to current legislation set out earlier in this response would prevent a market participant from supplying water unless and until DWI is satisfied of the participant's competency to fulfil its duties as a participant in the public water supply chain.

**Q8 – What benefits do you believe the introduction of a self-supply licence would bring?**

**Q9 – Should there be any specific legislative exemptions for self-supply licensees to reduce their regulatory burdens?**

Currently, only statutory water undertakers or water supply licensees are permitted to deliver public water supplies under licensed conditions. DWI notes the proposals to introduce a new 'self supply permit'. We recommend that any legislative exemption to allow 'self supply permits' should only be allowed within a process that ensures the supplier has demonstrated the competency to undertake the role and fulfil its statutory duties to provide safe, clean drinking water. As previously mentioned, there should be a mechanism that prevents all types of licence holder i.e. for self supply or any upstream licence, from introducing a supply of water into a network without prior scrutiny by DWI.

Because of the importance of a self supplier having the competency to fulfil a public health duty, we do not believe that a 'lighter touch' should be applied to the self supply regime for consumer-facing obligations. The significance of public health consequences warrant contraventions of the supplier's duties to be considered offences. This would also ensure a "level playing field" for all supply chain participants.

**Q11, 12 and 13 – Legally separating the retail functions of incumbent undertakers**

DWI notes the recommendations and consultation questions on legally separating the retail functions of incumbent undertakers. Our current regulatory functions apply to existing "vertically integrated" water undertakers and combined licensees. Consequently, it is very clear who has responsibility for every aspect of the abstraction, treatment, transport and retail of water. The proposed vertical separation of retail activities, identifying and partitioning consumer-facing retail functions, will potentially result in a significant number of licensed organisations delivering different, fragmented parts of the supply chain. It is therefore, imperative that the new 'service providers' are properly constituted before the changes are made. For DWI, as previously indicated, it must be clear who has the statutory responsibility at each point in the supply chain for ensuring that water at the consumer's tap is safe and clean to drink and use, and that statutory accountability for mitigating risks is understood and "owned" by each participant in the supply chain (including retail participants).

New Appointments:

**Q14 – Do you agree that the larger user criterion should be removed from the inset process once the new WSL regime is in place and is shown to be effective?**

**Q15 – Do you agree with the approach to taking forward the Cave Review’s recommendations for the inset process?**

**Q16 – Is there sufficient certainty that customers will benefit over time from the existing process of new appointments?**

As with the WSL regime, DWI recognises that there have been some issues with the current inset appointment process mainly due to the complexity of the process resulting in delays to appointment confirmation.

DWI has worked closely with Ofwat to develop a process for assessing competency of inset appointment applications (mainly for un-served sites) with respect to their duties as water undertakers in relation to the provision of a safe, clean drinking water supply to consumers.

One of the concerns we have with the current appointment arrangements is the absence of a robust process that prevents a newly appointed licensee from providing a supply of water to consumers that could represent a potential danger to human health. The Cave Review indicated support for the proposal to eventually replace the inset appointment framework with a reformed system for the provision of upstream and infrastructure services. In the interim, the Cave Review recommended measures be introduced to ensure that the DWI has powers to check operational competency of alternative suppliers before appointment, as currently is the case with the combined water supply licensing regime. We welcome this recommendation and the consultation proposal to introduce a role for DWI in assessing applicants’ capability and capacity to act as undertakers. The proposed changes to current legislation set out earlier in this response would prevent a market participant from supplying water unless and until DWI is satisfied of the new entrant’s competency to fulfil its duty as a water supplier.

The Cave Review also recommended that market codes and guidance should be prepared by Ofwat in consultation with stakeholders that set out the processes, roles, terms and conditions for market participants. We comment on market and operational codes above in that there should be some mechanism for ensuring market participants are signed up to their statutory responsibilities for the provision of safe, clean drinking water. The changes to current legislation set out earlier in this response would prevent new appointees as well as new license holders from supplying water unless and until DWI is satisfied of their competency to fulfil their duty as water suppliers.

Additionally, the changes required to regulation 28 would ensure that DWI has a mechanism to stop a new appointee from supplying water for domestic and food production purposes in the event that an unacceptable risk to human health arises.

DWI has not had involvement in recent years with applications for alternative water supplies to large non-household users. Where this has occurred, most consumers have switched to existing water undertakers who report on these supplies to DWI within their routine

regulatory duties. The only exception is the supply of water to Shotton Paper Mill by Albion Water. Water quality data and other drinking water quality returns for non-household users need to be reported to DWI in the same way as other water undertakers report on their statutory duties.

The proposal to remove the larger user criterion when other WSL reforms are in place should not have any impact on DWI and its duties provided the points already raised on the proposed reforms are fully considered and appropriate action taken.

#### Abstraction and discharge:

**Q17 – In the light of the recommendations from both the Cave Review and from the Ofwat/Environment Agency joint project, are there measures that should be taken to help remove barriers to abstractions trading, ahead of any fundamental reform to the abstraction licensing regime?**

DWI notes the Cave Review's recommendations in relation to abstraction licensing and discharge consent regimes. It supports the need to recognise the true value of water, its regional scarcity, environmental impact of abstraction and distributional deficiencies. However, we are concerned that the focus of the Review and the consultation is solely on these areas with very little attention paid to the fundamental importance of ensuring that there is sufficiency of supplies for societal use, or to the legitimate and potentially competing demands of other resource users, possibly at the expense of protection of the environment under some circumstances. We understand that the recent review of abstraction licenses has caused some concerns to existing water undertakers, particularly regarding the availability and reasonable cost of abstractions for treatment and subsequent distribution to consumers for drinking water purposes. The public health implications of limiting abstraction rights should be a major consideration when reviewing abstraction regime trading, as should be the cost and affordability of providing alternative drinking water supplies.

For this reason, we welcome the consultation's proposal to further explore the Cave Review recommendations on abstraction licensing.

#### Unbundling of Combined Licences & Upstream

**Q18 – Do you agree with our proposal to unbundle the combined water supply licence?**

**Q19 – What are your views on how the “network” licence will operate in practice?**

DWI recognises that the proposals to unbundle combined licensing will widen the scope of the water supply licensing regime to allow many more participants to enter the market and specialise in different supply chain functions. We have already highlighted some of the concerns that could arise with this proposal, mainly in terms of ensuring that every participant in the supply chain, and particularly those who will be inputting water into a distribution system, has the responsibility for ensuring that the water supply meets the statutory requirements for wholesomeness. This is of particular relevance to the Cave Review recommendation that outlines the unbundling of the current combined licence to create a new upstream licence for companies wishing to introduce raw and treated water

into an incumbent's network. Although not clear from the Cave report/consultation paper, raw water should never be introduced in a water supply network without adequate treatment and prior disinfection to ensure drinking water quality standards are met (the design and continuous operation of an adequate treatment process and disinfection of water prior to supply to consumers are important regulatory requirements in the provision of safe, clean drinking water).

The same Cave Review recommendation on the reform of the current water supply licensing regime recognises that DWI will require "appropriate powers and resources to maintain the quality of, and confidence in, the wholesomeness of the water supply". The UK and Welsh Assembly Governments agree that we should be in a position to continue to ensure that safe, clean drinking water is provided as the market develops.

Therefore, as stated earlier, DWI considers it imperative that there is robust legislation in place to prevent all participants in the water supply market from introducing a supply of water until a full assessment of their competency to undertake the role and fulfil its duties to safeguard public health has been carried out and a Notice (or other such legal instrument) to that effect issued. Additionally, there must be a mechanism in place to stop a new appointee from supplying water for domestic or food production purposes in the event that an unacceptable risk to human health arises.

Regarding resources, our requirements are related to the number of regulated entities; as these increase within an expanded competition regime, our resource capacity and funding arrangements will need to be reassessed.

We note that the proposal for unbundling the combined licence includes the introduction of a network licence for those looking to provide infrastructure services. We consider that this area should be further explored particularly in respect to the responsibilities of the network licensee to ensure that the appropriate infrastructure is in place for the level of risk from potential contamination arising from previous usage of the site. Additionally, the infrastructure has to be adequately maintained to mitigate risk of contamination of the water supply from burst mains or other proactive mains activity.

### Innovation

**Q29 – What would be the benefits of giving Ofwat a statutory duty to support innovation? What would be the costs of such a duty?**

**Q31 – What would the benefits be of creating a new national water R & D body?**

**Q32 – Do you have any other comments on how the Government should take forward these recommendations?**

DWI supports the proposal of giving Ofwat a statutory duty to support innovation as this would be an effective way of stimulating economic drivers, especially in the early stages of the innovation cycle.

It is important to recognise the distinct but complementary nature of research that informs the scientific evidence base underpinning the activities of the industry and regulators, and

innovation that is targeted at improving the effectiveness or efficiency of industry's regulated activities and services.

DWI leads on the Government's national research programme for drinking water quality and health, encompassing associated public health and consumer acceptability issues. The programme provides the essential evidence base underpinning our regulatory activities and supports the role of the water industry in the protection of public health through the provision of safe clean drinking water.

The Cave review recommends the creation of a national water industry research and development body bringing together the English and Welsh Assembly Governments, industry, regulators, suppliers, research councils, the Technology Strategy Board and other stakeholders to agree national research and development vision for the industry. We note that the Governments agree that greater investment in innovation and take-up of new technologies and processes in the water industry is desirable.

DWI supports the Cave Review's principal proposal on innovation regarding the creation of a body to agree a national research and development strategy for the water industry. Due to the importance of ensuring the safety and cleanliness of drinking water supplies, research and development in this area should form a fundamental element of any future national strategy.

DWI recognises, as do the Governments, that there would need to be further exploration on the operation and funding mechanism for such a body. It is also important that the funding provision proposed by the Cave Review does not replace or compromise existing arrangements. This is especially important to ensure that organisations such as regulators, whose activities rely on a robust scientific evidence base, retain the capacity to invest in specific targeted research where appropriate.

**Summary:**

We anticipate further detailed discussions with the Governments on changes necessary to the current water supply and water quality legislation which would ensure that DWI can carry out its regulatory functions for the delivery of a safe, clean drinking water. We also welcome the opportunity to work with Ofwat and other stakeholders in the development of a robust process for assessing the competency and capability of new appointees and licence holders to discharge their duties as water undertakers.