
Third Special Report of Session 2012–13

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Environment, Food and Rural Affairs Committee

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The current staff of the Committee are Richard Cooke (Clerk), Lucy Petrie (Second Clerk), Sarah Coe (Committee Specialist—Environment), Phil Jones (Committee Specialist—Agriculture), Clare Genis (Senior Committee Assistant), Gabrielle Hill (Committee Assistant), Yago Zayed (Committee Support Assistant), and Hannah Pearce (Media Officer).

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Third Special Report


Government response

Introduction

The Government welcomes the Environment, Food and Rural Affairs Select Committee’s report on the Water White Paper. We thank the Committee for its efforts in producing this report and look forward to engaging further with the Committee through pre-legislative scrutiny on the draft Water Bill.

The Government has already made significant progress on the commitments set out in the White Paper. The Committee’s report is a helpful response, recognising the scale of the challenge we face to deliver sustainable and resilient water resources, the progress made and where we need to maintain momentum and meet the ambitious targets for water policy set out in the White Paper.

The following are the Government’s specific responses to the Committee’s recommendations and conclusions following their inquiry.

Abstraction

The Government is committed to tackling the unsustainable abstraction we see today, and to reforming the regime so that it is fit for the challenges for the future, placing this at the centre of its plans in the White Paper. This requires a twin track approach – taking action using the tools we have available now to address the over abstraction which is damaging ecosystems, while ensuring that a reformed regime is in place in good time to enable us to manage our water resources more effectively in the future. Reform of the regime is designed to build resilience and flexibility for meeting future challenges; it is not the route for tackling existing unsustainable abstraction.

1. The recent drought has underlined the importance of introducing a reformed abstraction regime able to provide sustainable and reliable supplies of water. The timescales set out in the White Paper lack ambition and unnecessarily risk further environmental damage. We believe that ten years is an adequate period in which to plan and implement reform of the abstraction regime and recommend that the reformed regime be in place no later than 2022. (Paragraph 10)

The Government agrees with the Committee on the importance of getting a reformed regime as soon as practicable. We also recognise the importance of getting this reform right. The abstraction regime is a complex system from an economic and environmental perspective, and we must ensure that our plans for reform are based on firm evidence and
take full account of the likely impact on abstractors’ businesses and the environment. The reformed regime will need to be in place for a long time and able to cope with the changing but unknown circumstances that climate change and population growth will present. We are therefore taking a measured, evidence-based and phased approach, working closely with stakeholders to understand the impact of reform proposals.

We are working to gather evidence to inform our impact assessment of reform options, before formally consulting at the end of 2013 and legislating early in the following Parliament. Far from lacking ambition, this is a challenging timescale, and we would expect implementation to start in the highest priority catchments in advance of the Committee’s proposed target date of 2022. Implementation would however be phased to reflect the number of licences that will need to be varied and to minimise disruption to major industries, such as manufacturing, food and drink production, and power generation. This phased approach also will allow the reforms to be tailored to the circumstances of over a hundred different catchments, where the effects of reform will be felt differently. Catchments where risks of over abstraction are lower would be brought into the new system later, with the aim being to have completed roll out by the mid to late 2020s.

2. Even with this shorter timescale, momentum may be lost. We recommend that the Government work with regulators, water companies and environmental groups to produce a workplan setting out key milestones for the duration of the reform period, and annually report on progress against them. (Paragraph 11)

We are committed to maintaining momentum on the reform agenda and shorter term action to reduce unsustainable abstraction. Defra, the Environment Agency and Ofwat are working together in a joint project team to deliver a challenging work plan which maps out the reform process. We have established the Abstraction Reform Advisory Group, comprising stakeholders representing major abstracting sectors, environmental NGOs and government representatives, which meets quarterly and is also involved in more technical work. We are reporting on progress to this group and the minutes of the meetings are publicly available.¹ To report formally on progress on an annual basis would add another reporting layer to the project and could detract from work on developing and implementing the reform.

We are working closely with the Environment Agency and Ofwat to implement short term measures to enable us to deal more efficiently with licences that are posing a risk to the environment. These include: Ofwat’s Abstraction Incentive Mechanism; moving funding of water company solutions for restoring sustainable abstractions into the price review process; a modified charging scheme which will allow the Environmental Improvement Unit Charge to be used to fund changes to river channels to protect water ecosystems; using a power in the Water Act 2003 to enable licences causing serious damage to our rivers to be removed or altered without compensation; and a reverse auction tool pilot to enable licensees whose abstraction is damaging the environment, to bid to sell back part or all of their licensed volume to the Environment Agency, reducing the cost of restoring sustainable abstraction.

¹ http://www.defra.gov.uk/abstraction-reform/working-with/advisory-group/
3. We are pleased that the Environment Agency and the Minister acknowledged the importance of ensuring that the agricultural sector retains access to a reliable water supply. As the reforms go through, we recommend that the Environment Agency maintains a constructive dialogue with farmers and food producers, recognising their key role in promoting self-sufficiency and food security. (Paragraph 13)

The agricultural and food production sectors are represented on the Abstraction Reform Advisory Group and we are working closely with them to ensure that food security is considered fully during the development of the reform options.

4. We urge Defra and the Environment Agency to work with the Institution of Civil Engineers to complete the reviews of both A guide to the Reservoirs Act 1975 and the Floods and Reservoir Safety guidance by December 2012. (Paragraph 14)

The reviews of both “A guide to the Reservoirs Act 1975” and “Floods and reservoir safety, 3rd edition” are in progress by the Institution of Civil Engineers, working with the Environment Agency. The review of “A guide to the Reservoirs Act 1975” is focused on changes to the legislation and will be completed once the amendments set out in Schedule 4 of the Flood and Water Management Act 2010 have been commenced. The review of “Floods and reservoir safety, 3rd edition” has a primary focus on technical matters with a remit to take into account current guidance and research and relevant changes to UK reservoirs legislation. It was commissioned in August 2011 with “Target timescale two years, subject to consideration of a detailed programme and budget”. We are working with the Institution’s working group to achieve publication as soon as possible.

5. The current mechanism for the removal of environmentally unsustainable abstraction licences is clearly unsatisfactory and is causing ongoing and severe damage to the environment. We recommend that the White Paper’s proposal that funding for the Restoring Sustainable Abstraction Programme be incorporated within the price review process be implemented as a matter of urgency. Defra should work with Ofwat and the Environment Agency to ensure that this change is made in time for the RSA programme to funded from the 2014 price review. (Paragraph 18)

We are working with the Environment Agency and Ofwat to put in place a range of measures to deal more efficiently with current licences that pose a risk to the environment. Government, the Environment Agency and Ofwat all believe that including water company solutions for restoring sustainable abstractions in the price review process has the potential to deliver better outcomes for both customers and the environment. As stated in the Water White Paper, we are working closely together to identify how this can best be achieved with a clear focus on having the new arrangements in place for the 2014 price review.

**Bulk trading and interconnections**

6. Defra’s decision to focus on maximising “strategic” interconnections allowing water to be transferred over relatively short distances is a sensible starting point and we look forward to the Environment Agency’s forthcoming overview of interconnection options. Defra should remain open to considering whether large-scale infrastructure may be an appropriate and cost-effective solution in some circumstances. Defra and
the Environment Agency should in particular look to exploit interconnection opportunities presented by other large infrastructure projects, thus minimising environmental impact and economic costs. (Paragraph 23)

We want to increase interconnection in our water supply system so that we can use our resources more flexibly and efficiently, and develop a more resilient water supply. Large scale infrastructure investment is costly, and water is heavy and expensive to move. Relatively local connections are likely to be the most attractive options, incrementally building a more integrated network. The Environment Agency is currently looking at the environmental barriers to large scale transfers via the existing rivers and canal network and we will be considering this as one of a range of options, including opportunities presented by other large infrastructure projects.

**Floods, drainage and the automatic right to connect**

7. Five years on from the devastating floods of 2007 we are not convinced that Defra’s work to improve the management of surface water has been carried out with sufficient urgency. Defra must ensure that implementation of the relevant provisions of the Flood and Water Management Act is not subject to any further unnecessary delay. The White Paper says disappointingly little about the retrofitting of Sustainable Drainage Systems and we recommend that Defra develop more concrete proposals to encourage this. (Paragraph 29)

The majority of provisions in the Flood and Water Management Act 2010 (the Act) affecting the management of surface water have been commenced. Although there is no legal timeframe set, Defra is encouraging Lead Local Flood Authorities (LLFAs) to prepare, publish and implement their local flood risk management strategies by spring 2013. The strategies which are a requirement of the Act, will help identify areas where retrofitting of sustainable drainage systems may be useful. Some local authorities are well advanced and close to publishing their local strategies and for the majority it is work in progress.

The recent flooding experienced in many parts of the country has yet again demonstrated the urgent need for better management of surface water flooding caused by heavy rain and local authorities working in partnership with sewerage companies are now well placed to undertake this work. A large programme of capacity building has been rolled out since 2010 helping local authorities build their skills and understanding of how to carry out their new role.

Following our consultation on Sustainable Drainage Systems in new and re-development, we are developing our policy proposals to ensure that implementation achieves effective outcomes and that there are no additional burdens on stakeholders which might impact wider, significant agendas such as the need to drive and sustain growth. We have committed to working through the areas where our consultation has told us that there may be remaining issues (such as the content of the National Standards, for example) with stakeholders throughout the summer and autumn and will look to implement the provisions as soon as the policy is right.

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The Water White Paper signals our intent to continue to encourage the uptake and retrofitting of sustainable drainage systems in existing properties. We are doing this at present by supporting Ciria’s Susdrain interactive web-based community site, which aims to highlight, share and disseminate good practice options for the uptake of sustainable drainage systems. We have also worked with Ciria to develop the comprehensive retrofit guidance for sustainable drainage systems published in April. We also actively encourage the uptake of sustainable drainage systems in our measures on water quality, for example, through the River Restoration Fund and Advice Notes on the Water Framework Directive.

In addition, The National Planning Policy Framework published in March 2012 sets out that when determining planning applications, local planning authorities should ensure flood risk is not increased elsewhere and only consider development appropriate in areas at risk of flooding where, informed by a site-specific flood risk assessment. This includes giving priority to the use of sustainable drainage systems.

**Flood Insurance**

8. It is deeply worrying that with only a year remaining until the current Statement of Principles on flood insurance is due to expire, and eighteen months on from this Committee’s call for urgency in establishing its replacement, Government has not yet been able to reach agreement with the industry. Defra must redouble its efforts to achieve a workable and affordable solution to this issue. (Paragraph 32)

The Government is working hard with the industry to deliver widely available and affordable household insurance in flood risk areas long beyond next summer when the current Statement of Principles expires. However, this is a difficult issue with no easy answers, and so it may take a little more time to find the right solution. The insurance industry recognises that.

We are working closely with industry and are considering an internal industry levy which would formalise the existing cross-subsidy in place between policyholders. This would allow policyholders in high flood risk areas to continue to secure affordable insurance without having an impact on bills more generally. We are looking for a deliverable, value for money approach that balances the needs of those living with the risk of flooding, other policyholders, and the taxpayer. Urgent, constructive discussions with the insurance industry continue.

**Metering**

9. It is extremely disappointing that a White Paper that places such an emphasis on valuing water says so little about metering. With water set to become an increasingly scarce resource, we believe that the Government must use water meters as a means to encourage responsible use of water. We recommend that the Government set a clear and ambitious objective to increase levels of metering, taking account of Anna Walker’s recommendation that metering penetration reach 80% by 2020. (Paragraph 41)

The Water White Paper recognised that metering is a useful tool for managing demand and that it is a fair way of charging for water. However, it also recognised that the costs and benefits of increasing levels of metering vary from region to region depending on the
level of water stress. This reflects the findings of the Walker Review which concluded that there is a strong case for metering where water is scarce and the benefits outweigh the costs. It stated that the case is less compelling in areas where water resources are not seriously stressed.

Water companies in areas of serious water stress are able to roll out programmes of universal metering if they include plans to do so in their Water Resources Management Plans. The Government therefore remains convinced that water companies are best placed to take decisions about the role metering should play alongside other tools in managing the supply-demand balance in their areas. A centrally dictated Government objective on metering uptake would be a blunt instrument and risk driving solutions that were inappropriate to the circumstances of particular areas. We have, however, committed in the Water White Paper to reviewing the methodology for the designation of areas of serious water stress to ensure that it takes account of the latest evidence and inform water company decision making. The Environment Agency has developed an updated version of the methodology and will be consulting on this shortly.

**Rainwater Harvesting and Recycling Water**

10. We recommend that Defra take more active steps to promote rainwater harvesting and water recycling and seek to incorporate incentives or requirements for their inclusion in the design of new developments. (Paragraph 44)

Under an Enhanced Capital Allowance scheme for water, businesses can claim 100 per cent first-year allowances, i.e. tax relief, on investments in designated water saving technologies, including rainwater harvesting equipment. For new housing, both the Building Regulations 2010 and the Code for Sustainable Homes encourage water efficiency and recognise that rainwater harvesting and water recycling can be used where appropriate.

The Local Housing Delivery Group, chaired by Sir John Harman, recently published a dual review of Local Plan viability testing and local standards in new housing development. Their report observed, amongst other things, that it would be inappropriate to set very demanding water efficiency standards that could only be reached with the use of rainwater harvesting and/or grey water recycling systems. The Harman review recognised that rainwater harvesting and grey water recycling were still not generally welcomed by social landlords or by private owners because of the associated running and maintenance costs, and that some systems could have a negative effect on embodied and operational carbon emissions as identified through research by the Environment Agency, the Energy Savings Trust and the NHBC Foundation.

It is important that in line with the National Planning Policy Framework, new housing is built to sustainable standards for water and that simplification does not mean lower standards in this respect. We will continue to work with DCLG to encourage Local Authorities and water companies to engage with each other and with the industry to achieve sustainable development, in a way that makes sense for the local area. We want to start to see large developments coming forward that are highly efficient in their use of water, both through simple water efficiency measures but also, where appropriate, properly designed, installed and maintained water reuse systems. There is scope for improvements
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in carbon efficiency and maintenance requirements, improvements which should in future make water reuse technology a more viable proposition.

The package of market reforms set out in the draft Water Bill include proposals to allow new entrants to apply for discounts where customers do something to reduce pressure on public water and sewerage networks. This could incentivise customers to introduce rainwater harvesting and water recycling systems to reduce pressure on water supply networks and to reduce the amount of wastewater put into the public sewer system.

**Leakage**

11. We recognise the progress that water companies have made in reducing leakage levels but urge companies and the regulator to do more to reduce the amount of water that is wasted through leakage. We recommend that in reviewing guidance to companies on the Sustainable Economic Level of Leakage, the Government and regulators should take account of the impact that leakage levels have on customers’ willingness to engage with efficiency measures, if necessary carrying out further research to seek to quantify this impact. (Paragraph 47)

Ofwat currently set annual leakage targets for water companies based on a Sustainable Economic Level of Leakage and a cost/benefit analysis. Defra, the Environment Agency and Ofwat are currently reviewing the assumptions water companies used in their calculations of the Sustainable Economic Level of Leakage and its integration with water resource planning at the last price review with a view to ensuring that the methodology used by companies is robust and applied consistently. Ofwat is also considering its approach to regulating leakage in the next price review. It is important that any new approach fully takes account of the short and longer term benefits and balances these against the impact on customer bills. Water company consultation with its customer challenge group will be key to ensuring the priorities identified in customer research are fully reflected in company business plans.

**Affordability**

12. It is simply unacceptable that, at a time when so many are struggling to afford their water bills, customers face the additional burden of subsidising those who refuse to pay what they owe. Legislation already exists that would make it easier for water companies to recover bad debt and the Minister acknowledged that money recovered from debtors would be “money in the pocket” for those who do pay their bills. We urge the Department to implement the relevant provisions of the Flood and Water Management Act without further delay. (Paragraph 55)

13. Take-up levels of WaterSure suggest that many of those who currently qualify for help with their bills do not receive it, and we are concerned that company social tariffs will face similar barriers to take-up. We recommend that the Government take a more proactive approach to publicising the help that is available to poorer customers. Defra should work with the Department for Work and Pensions to ensure that all means-tested benefit claimants are given the option to consent to the sharing of their data with their water company for the purposes of help with affordability issues, and should also
use the opportunity to inform claimants of existing support, such as the WaterSure tariff. (Paragraph 59)

14. We recommend that the Government make clear that the design and promotion of company social tariffs should not focus exclusively on customers in receipt of benefits to the detriment of others who may struggle to afford their bills. (Paragraph 60)

Government has consulted on the provisions of the Flood and Water Management Act to tackle bad debt and an alternative voluntary scheme. We are committed to tackling bad debt, but are also mindful of the burden that imposing liability for bills could place on landlords, many of which are small and micro businesses. We are considering our approach in the light of consultation responses, especially in light of the Government’s commitment to reducing regulation and the moratorium on regulation for micro businesses, and will make an announcement during the autumn. We also believe that no one measure or one source of information for water companies can fully tackle the issue of bad debt. We want to encourage water companies to tackle bad debt including by investigating alternative sources of data sharing where this is legal and feasible.

Water companies are encouraged to advertise the WaterSure scheme to their customers. We have made it clear in the Company Social Tariffs Guidance, published 22 June, that companies should engage with their customers and consider a holistic approach to supporting them. We suggested they may work with partners to ensure that a range of different kinds of appropriate support is available. We are working with DWP to discuss what kinds of data sharing, including by consent, could be available. Our guidance made it clear that water companies should design social tariffs most suited to their customers’ needs and that customers who are not in receipt of benefits may also struggle to afford their bills.

Market Reforms: Timescales

15. Increased competition in the water sector will bring clear benefits to customers. The Government should not delay reforms because of an overcautious approach to investor confidence. We recommend that Defra open the retail market three years from Royal Assent to a Water Act. Reforms to the upstream market may necessarily follow a different timescale to the retail reforms, but they should not be unduly delayed. (Paragraph 68)

The Government agrees that the market reforms that we have set out in the Water White Paper will bring benefits to customers. We want to set an ambitious but realistic timetable for the opening of the reformed retail market. High level analysis of the work required suggests that market opening in April 2017 is likely to be a realistic target date if the Water Bill achieves Royal Assent by the end of the Third Session. However, we want to work with key players in the market to develop a detailed roadmap before confirming this target date. The Government also agrees that upstream reforms may follow a different timescale particularly in the case of upstream sewerage on which there is limited experience to draw. The work to develop a roadmap will also cover the upstream package.
The Scottish experience

16. The experience of introducing a competitive water market in Scotland and the lessons learned from it must be fully exploited as the White Paper’s proposals for market reform are implemented. (Paragraph 71)

The Government agrees that it will be important to capture the lessons learnt in Scotland as we introduce our retail reforms. It is also important to bring in expertise from other sectors where retail competition has also been developed. In doing this we must recognise the differences in the respective English and Scottish markets and the scale and diversity of the English water sector.

The Government has set up a high level steering group drawing on experience and expertise from across the sector to help us to set the right direction for delivering this challenging programme. This will include members from the Scottish Government, WICS and Business Stream as well as from the English water industry and representatives of customers.

A joint Anglo–Scottish market

17. We welcome the proposed joint Anglo-Scottish water market but would be concerned should this lead to any duplication or conflict between regulators, or any additional bureaucracy for water companies and their customers. We recommend that Defra work with the Scottish Government to ensure that the most effective regulatory model is adopted, including an assessment of whether a single regulator for the joint market may be appropriate. The Government should ensure that protocols setting out the relationship between, and respective duties of, the English and Scottish regulators are in place before the joint market opens. (Paragraph 73)

The Government is grateful for the Committee’s support for the setting up of a cross-border market for retail water services. We will work with the Scottish Government to ensure that customers gain maximum benefits from the joining of the two markets. The Water Bill will include provisions that will mean that a new entrant would only need to make an application to one rather than two regulators in order to enter the Anglo-Scottish market.

We do not think that a single regulator is necessary to make the cross-border market work properly. The example of the single market for natural gas and electricity for the island of Ireland provides us with an example of a joint market with more than one regulator from which we can learn. In the meantime, Ofwat and WICS have confirmed that they will put in place a memorandum of understanding ahead of market opening to reduce the risk of duplicated effort and to put in place mechanisms to resolve disputes and handle complaints etc.

Future structure of the water sector

18. Defra should consider setting out a requirement for functional separation in the draft Water Bill. Defra should also consider setting out in legislation a lighter-touch
regulatory regime for companies which have legally separated their retail and wholesale functions. (Paragraph 78)

19. We are not persuaded by the Minister’s arguments against allowing a mechanism for companies to voluntarily exit the retail market and we agree with the English and Scottish regulators that providing an exit route should enhance competition and efficiency in the sector. We note in particular Ofwat’s view of the importance of an exit mechanism in achieving a well-functioning and dynamic market. We recommend that Defra include such a mechanism in the legislation implementing the market reforms. (Paragraph 80)

The Government is not minded to set out a requirement in the Water Bill for incumbent water companies to functionally separate their retail and wholesale arms. We agree with Ofwat that it should be able to decide how best to police the competitive market using existing tools, codes of conduct etc. Ofwat does not need any additional powers to do this. However, the Government does agree that there could be benefits for customers and incumbent water companies if they take additional steps to voluntarily separate their businesses such as we have seen with the joint retail venture set up by Wessex Water and Bristol Water.

However, we do not agree that the Water Bill should provide an exit route for those incumbents that no longer wish to provide retail services either to business customers or to business and household customers (e.g. through a separate retail appointment). The Water White Paper set out our rationale for avoiding the risks and disruption that structural change to the industry could create, whether mandated or voluntary. We want to maintain the strengths of the existing regime, and also to ensure that all customers – households as well as businesses - benefit from the retail arm of water companies becoming more customer focused. Ensuring this sharing of benefit is essential given we do not think there is a case for opening up the household market to competition in the foreseeable future. Water companies have other routes they could take if they no longer wish to concentrate on providing retail services, for example outsourcing or entering into partnerships with other water companies. However, the Government’s position remains that as the statutory water and sewerage undertakers they should retain ultimate responsibility for the service delivered to all the customers in their areas who have not actively taken a decision to switch to an alternative supplier.

**Consumer representation**

20. It is essential that there is a strong voice to represent the interests of consumers through the far-reaching reforms to the water sector to be implemented over the coming years. We recommend that Defra commit to retain the Consumer Council for Water in its current form for a period of three years after the White Paper’s market reforms are implemented. Any new arrangements for consumer representation which are introduced subsequently must take account of the unique needs of business customers. (Paragraph 84)

As we said in the Water White Paper, the Government believes in principle that there would be benefits for water consumers in having their interests represented by a single body that is also responsible for other regulated sectors. We also agree with the Committee
that business customers will need effective representation as the competitive market develops. However, we agree with the Committee that the timing of any change is critical, not least because of the change the sector is facing both through the next price review period and the implementation of the market reform programme. We have therefore committed to maintaining the role of the Consumer Council for Water until 2014, and will ensure that the review of next steps in advance of that takes account of the Committee’s recommendation.

21. We expect the conclusions and recommendations in this report to be taken fully into account as Government draws up the draft Water Bill. We look forward to the timely publication of the draft Bill for Parliamentary scrutiny. (Paragraph 87)

The Committee wrote in the summary to its report that “Legislation should be brought forward swiftly and we look forward to publication of a draft Water Bill before the summer recess.” We published the draft Bill on the 10 July. Given that the Committee’s report was published on 5 July there was unfortunately no time to reflect its contents in the draft Bill.

We are committed to full scrutiny and consultation of the draft Bill and have therefore published the Bill for pre-legislative scrutiny by the Committee. We look forward to receiving any further comments on how the legislation should be framed for introduction.