Title: Drinking Water Inspectorate Charging Scheme for England **IA No:** Defra 1382 **Lead department or agency:** Defra **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 23/02/2012 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Tracy Westell Milo Purcell

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
-£1.021m	-£12.834m	£1.407m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Defra currently funds the Drinking Water Inspectorate (DWI) for both its regulatory and policy functions; it now proposes to enable DWI to recover the costs of its existing regulatory functions from the water industry. This proposal brings the funding arrangements for the DWI in line with general government policy on charging, which states that businesses which benefit from regulation should bear the cost of regulation, not the taxpayer. Also, the Hampton Review 2005 included a specific recommendation that regulators should be more accountable to those who benefit from their delivery functions.

What are the policy objectives and the intended effects?

The proposal will:
- make DWI more accountable to those who benefit from its regulatory functions;
- make DWI funding more transparent;
- contribute around £2.0m per annum saving in the current spending review and reduce future pressures.

The proposal will also bring DWI in line with the cost recovery mechanisms for other water regulators (Ofwat, Consumer Council for Water and the Environment Agency).

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 0: Do nothing
Option 1: Enable cost recovery for existing services using basic methodology.
Option 2: Provide the regulatory service through the private sector.

Defra's preferred option is Option 1 which will enable DWI to recover the cost of its existing regulatory functions from water companies. It is also consistent with the views of water companies that the scheme should be as simple as possible. Although the option involves a modest net cost of around £1m, this is judged to be more than outweighed by the non-monetised benefits of aligning the charging of DWI services to those who benefit.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 06/2015

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: Richard Benyon Date: 9 June 2013

Summary: Analysis & Evidence

Policy Option 1

Description: Option 1: Introduce a charging scheme using basic methodology

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: n/a	**High:** n/a	**Best Estimate:** -1.02

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	n/a		n/a	**n/a**
High	n/a		n/a	**n/a**
Best Estimate	0		1.7	**13.86**

Description and scale of key monetised costs by 'main affected groups'

Average annual costs are £1.7m. This is made up of additional administrative costs of £200K in the first two years, then £100K thereafter, as well as £2.0m in charges raised from the water industry (from year 3 onwards). Over 10 years, the total cost has a net present value of £13.9m. The majority of this is the cost of the charges raised on industry (a cost to business with a net present value of £12.8m or £1.5m as an annualised cost (£1.4m as an EANCB at 2009 prices).

Other key non-monetised costs by 'main affected groups'

The cost to water companies and licensed water suppliers of reviewing and processing a bi-annual invoice from the DWI are negligible and not monetised. No additional data/administrative costs are incurred.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	n/a		n/a	**n/a**
High	n/a		n/a	**n/a**
Best Estimate	0		1.5	**12.83**

Description and scale of key monetised benefits by 'main affected groups'

Benefits are the reduced cost to government arising from transferring the annual funding of DWI operations to the industry. This exactly offsets the increased cost to the industry (£12.8m in total PV terms, or £1.5m as an annualised cost).

Other key non-monetised benefits by 'main affected groups'

The DWI will be able to inform the public on how well water companies have progressed with their drinking water safety management. Improved independence of DWI in relation to its regulatory budget & improved accountability of DWI in relation to the water industry and consumers – through approval mechanism on proposed charges. The proposed system will encourage water companies to help deliver lighter touch regulation as charges will reflect their respective regulatory burden.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

- changes to DWI governance and support arrangements might affect the charging regime but none are planned presently
- uncertainties regarding future market reform – plans unknown, but the proposal is sufficiently flexible to adapt to expansion of competition in the sector
- DWI future efficiency [see evidence base for safeguards]

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 1.41	**Benefits:** 0	**Net:** 1.41	No	NA

Summary: Analysis & Evidence

Policy Option 2

Description: Option 2: Provision of the regulatory service through the private sector

FULL ECONOMIC ASSESSMENT

Price Base Year n/a	PV Base Year n/a	Time Period Years n/a	Net Benefit (Present Value (PV)) (£m)		
			Low: n/a	**High:** n/a	**Best Estimate:** n/a

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	n/a		n/a	**n/a**
High	n/a		n/a	**n/a**
Best Estimate	n/a		n/a	**n/a**

Description and scale of key monetised costs by 'main affected groups'

The costs of this option have not been monetised (see below).

Other key non-monetised costs by 'main affected groups'

Much water monitoring activity is already delivered in conjunction with water and other private sector companies and the elements of the regulatory process which remain with DWI are judged to be too specialised to be economically viable for the private sector. Even if viable, the delivery of these functions privately would compromise the residual DWI's ability to deliver policy advice and may impact on public confidence (see risks). Monopoly providers may still need some regulation.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	n/a		n/a	**n/a**
High	n/a		n/a	**n/a**
Best Estimate	n/a		n/a	**n/a**

Description and scale of key monetised benefits by 'main affected groups'

The benefits of this option have not been monetised.

Other key non-monetised benefits by 'main affected groups'

This option might, if viable, deliver small further efficiency benefits and savings compared with Option 1 - but overall is not felt to viable for the reasons given above.

Key assumptions/sensitivities/risks — **Discount rate (%)** n/a

See Option 1. In addition, a key risk of this option is that the transfer of remaining public responsibilities within the drinking water regulatory regime to the private sector would compromise the independence of operations and impact on public confidence and health.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: n/a	**Benefits:** n/a	**Net:** n/a	No	NA

Evidence Base (for summary sheets)

Background

The DWI was established in 1990 as the drinking water quality regulator for the privatised water industry. All inspectors, including the Chief Inspector of Drinking Water, are appointed under section 86 of the Water Industry Act 1991 (“the WIA”).

The DWI differs from ordinary divisions in Defra in that the role of inspectors and the Chief Inspector is recognised in statute, and they exercise powers delegated directly to them by the Secretary of State. The Chief Inspector exercises the powers of the Secretary of State and Welsh ministers as set out in the WIA (as amended by the Water Act 2003) in relation to the safety and quality of drinking water. The DWI does this by means of technical audit of water company assets and operational procedures, taking enforcement action where appropriate including prosecution for offences as set out in the WIA and Water Supply (Water Quality) Regulations 2000 (as amended).

The Chief Inspector also acts for the Secretary of State in relation to enforcing that local authorities take action as set out in the Private Water Supply Regulations 2009 in relation to private water supplies. The Chief Inspector is responsible for publishing drinking water reports and providing the European Commission with data demonstrating compliance by the UK with the EC Drinking Water Directive 98/83/EC. Similar arrangements exist in Scotland and Northern Ireland and the Chief Inspector discharges Secretary of State duties as member state through a Memorandum of Understanding with her equivalents in Scotland and Northern Ireland. The Chief Inspector (and Inspectors) exercises these powers independently of Ministers.

DWI undertakes a range of statutory and non-statutory roles. The work of DWI can be divided into activities that stem from its statutory role in ensuring water companies meet their statutory requirements, and in the discharge of the statutory duties of the Secretary of State and Welsh Government, as set out in the WIA, and those that support policy functions.

Regulatory functions:

- Technical audits involving the inspection and assessment of water companies‟ water supply arrangements.
- Investigation of water quality events and incidents.
- Checking compliance with statutory requirements, and legal instruments.
- Technical evaluation of water companies‟ water quality data.
- Investigations of consumer complaints relating to drinking water quality as notified by members of the public, local authorities or businesses.
- Statutory public reporting on drinking water quality.

Policy functions:

- Commissioning and management of research programme on drinking water quality and health as evidence base for technical advice roles listed below
- Providing scientific and technical advice to Ministers and officials in Defra and Welsh Government on drinking water issues, policies and standards
- Assisting with Parliamentary questions on drinking water quality issues
- Involvement with national, European and international issues and organisations in the development of guidelines and standards for drinking water quality, and measures to improve drinking water safety

Although DWI‟s budget falls within the Water, Floods, Environmental Risk and Regulation Directorate‟s total programme allocation, the Secretary of State is ultimately responsible for allocating resources to DWI, and is accountable to Parliament for that expenditure. Therefore, currently, tax payers fund both DWI‟s regulatory functions and policy functions.

Problem under consideration

When DWI was set up it was funded by the taxpayer. Although administratively simple, it is not the solution that most appropriately reflects the principles of a market for drinking water quality. It does not reflect the polluter or risk owner or beneficiary pays principle, and creates moral hazard in the industry to the extent that water companies do not have as full a stake as they might in the costs of regulating drinking water quality.

Also, the Hampton Review of 2005 included a specific recommendation that regulators should be more accountable to those who benefit from their delivery functions. Defra considers that providing a mechanism for the DWI to recover the costs of its existing regulatory functions from the water industry will assist in achieving this recommendation by linking directly the costs incurred by the regulator to the activities associated with individual water companies. This will improve transparency on funding arrangements. DWI has a good record in respect of other Hampton recommendations and demonstrates very good compliance with the expectations of the Regulators" Compliance Code, as recorded by the BIS/BRE report of its review of DWI dated March 2010. This review focussed on an assessment of regulatory performance against Hampton principles and Macrory characteristics of effective inspection and enforcement.

Furthermore, the Cave Review into competition in the water industry is expected to lead, over time, to an increase in the number of water suppliers, and therefore an increase in the work faced by DWI. It is anticipated that this, along with increased numbers of inset appointees throughout England and Wales, will increase the extent of DWI regulation in these sectors. Enabling DWI to recover the cost of their regulatory activities directly from water undertakers (including inset appointees) and licensed water suppliers will provide a fair system that ensures that regulatory costs are recovered in proportion to their individual relative regulatory burden.

Rationale for intervention

Water customers suffer from the problem of asymmetric information. They cannot obtain information themselves on the quality of drinking water supplied to them as many aspects of drinking water quality are unobservable at the point of use. Health effects may take hours, weeks or even decades to have an impact and may be difficult to attribute to water consumption. This is compounded by the fact that (with the exception of some business customers) they receive supplies from monopoly providers and they are therefore unable to signal their preferences regarding drinking water quality by switching suppliers. Government intervention is required to police drinking water quality and this is effectively the rationale for DWI itself and the rationale for extensive statutory monitoring.

However, a significant proportion of the DWI"s activities relates to monitoring the way water companies meet their regulatory requirements through technical audit and associated activities. As it is the water industry and their customers that benefit from these regulatory services, they should bear the cost of the service they receive.

Enabling DWI to change the way its regulatory functions are funded [from water companies rather than the Exchequer] will add to the increased independence of DWI within government which is important for industry and consumer confidence. DWI already has its own budget; it has separate accommodation from the Defra policy division; produces an independent annual report; and the Chief Inspector of Drinking Water, appointed by the Secretary of State and Welsh Ministers, has specific independent powers on enforcement and prosecution.

By introducing a charging system, DWI"s position will be consistent with that of other water industry regulators, Ofwat and the Environment Agency, and with the Consumer Council for Water.

Policy objective

The Defra Charging Handbook 2005 provides guidance to facilitate consistent, coherent, transparent and predictable charging for regulatory services across Defra. The overall rationale for charging is that if an industry undertakes an activity that causes (or could potentially cause) an adverse effect on others (such as pollution or risk to public health) which requires regulation, it should face the regulatory cost. The role of the water supply industry in supplying safe water supplies is regarded as a fundamental part of public health management.

In addition, the proposed scheme to recover actual costs incurred will assist in meeting three of the Handbooks strategic principles:

The polluter, risk owner or beneficiary pays - The polluter or risk owner or beneficiary should bear the costs of any measures to prevent harm that they might otherwise cause by their actions or non-actions, including the cost of monitoring regimes. For drinking water supplies, the actions necessary to mitigate pollution and protect consumers are undertaken by water companies, and regulated by DWI. The risks are owned and managed by water companies, who are required by legislation to act proactively to mitigate risks to public health and levels of service relating to the quality of water supplies. It is also in the interests of water companies to engage in the process to minimise the impact of significant failures on their reputations and on consumer confidence. The effectiveness of active management of residual risks that impact on water quality as introduced by DWI are well established within the water industry and are known to be cost effective. Furthermore, water companies benefit from the regulatory activities of DWI [examples set out below]. Transparent allocation to individual water companies, rather than to the taxpayer, of DWI's costs for regulating these functions better aligns funding arrangements with this principle.

Aim for full cost recovery - This is the Government's broad policy for services. If policymakers do not plan to recover the full cost of the service they provide, and hence the service is being intentionally subsidised, they will need to justify this decision. This proposal enables DWI to fully recover the costs for its existing regulatory functions, as listed above.

Charges paid by the individual or firm should broadly reflect the cost incurred by the regulator in regulating that firm or individual - The charging system should be designed to be broadly cost reflective at the level of the individual, site or firm. A business that requires only light regulation (and therefore gives rise to few costs for the regulator) should generally pay lower charges than a business that needs frequent or more detailed interventions by the regulator.

This proposal brings the arrangements for the DWI in line with Defra general policy on charging, which is that businesses that benefit from regulation, not the taxpayer, should bear the cost of regulation.

In practice, the costs borne by water companies may be passed on to consumers as ultimate beneficiaries, subject to water companies decisions and approval by the economic regulator Ofwat. Consumers will continue to derive benefit from the independent validation and verification by DWI of the drinking water quality they receive from water companies. Ultimately therefore there will be a transfer of funding from taxpayers to water bill payers. Whilst this involves a switch from a progressive fundraising system (i.e. one which is scaled by ability to pay) to one which is more regressive, because the aggregate costs to be recovered are relatively small compared with other chargeable costs, the impact on individual consumers" bills will be considerably less than a 0.1% increase. Given this, and the fact that water companies will soon be able to consider social tariff schemes to assist those with the most significant affordability issues, we judge the equity impacts arising from the proposal to be negligible.

As the proposal comprises charges for existing regulatory activities, and does not entail a change in regulatory functions, it does not come within the scope of policy on one-in, one-out. This has been confirmed by BRE.

Description of options considered

Option 0 - Do nothing and continue to subsidise the full costs of DWI. This is not compliant with the Hampton Review recommendations, or with the Defra Charging Handbook strategic aims, nor is it consistent with other charging mechanisms of related water regulators. (Note however that under any option, Defra will continue to fund the "policy service" part of DWI which provides advice to Ministers and officials).

'Option 1 - Introduce a charging scheme using basic methodology – this is Defra's preferred option. This option will enable DWI to recover the cost of its regulatory functions from water companies. It is also consistent with the views of water companies that the scheme should be as simple as possible, whilst still retaining some basic incentives to reduce the regulatory burden by maintaining performance with statutory obligations.

Consideration was also given to introduce a charging scheme using more detailed methodology. However, when consulted, the clear view of water companies was that the sums to be raised through this charging process were very small (at around £2m over the whole industry per annum) in relation to wider industry costs, and that the charging regime burden should reflect this. Thus, minimising data submissions and administrative costs would be of greater benefit for both them and customers than the potential financial incentives to be gained from a more complex incentivisation mechanism. Some companies noted that the reputational impact of regulatory underperformance would be of far greater significance than the direct financial costs involved.

In summary, whilst a very complex charging method could be designed, the preference is for a simpler one, with some incentives but which gives water companies and DWI necessary certainty. It is also noted that other water industry regulatory charging options (e.g. for Ofwat and CC Water) are simply defined.

Cost recovery will recover costs incurred based on a two part charge: a charge using the number of tests for compliance purposes reported by each water company, which directly relates to DWI workload for each company on routine checking and monitoring; and a charge based on water company performance – reflecting directly the allocation of DWI"s resources to deal with underperformance using a risked based approach, principally in investigating and reporting on compliance failure, incident management and technical audit.

<u>Option 2</u> - Provision of the regulatory service through the private sector. This option was considered, but was not assessed quantitatively for the following reasons. The current regulatory model for drinking water quality has in place substantial private sector involvement. For example, delivery of the statutory monitoring (water sampling and analysis) that is required by the Water Supply (Water Quality) Regulations 2000 (as amended) has already been vested in water companies as a recoverable cost that is passed on to consumers through their water bills. It is integrated with process control and operational management requirements, and the estimated cost of these combined functions across all water companies in England and Wales is £500m pa.

Also, the quality assurance arrangements necessary to ensure the integrity of this substantial monitoring and control programme are conducted by co-regulation, involving bodies such as the United Kingdom Accreditation Service [the sole national accreditation service recognised by Government]; the analytical service industry; and water companies, using an agreed specification put in place by DWI. The remaining elements of regulation retained by DWI provide the minimal oversight necessary to deal with non-compliance by independent enforcement [or prosecution, where necessary], and with public reporting to maintain public confidence. These elements of the regulatory process are so specialised and of low margin that it is not likely to be economically viable for the private sector to deliver.

Finally, the service is critically important for public accountability in the provision of safe clean drinking water, and is fundamental to the protection of public health and maintenance of public confidence in public water supplies. This means that delivery of remaining regulatory functions through the private sector is still likely to need to include at least some oversight, especially if the provider has a high degree of monopoly power. This would impose costs and therefore reduce the already modest financial savings possible from this option. The provision of the regulatory service through the private sector would also inhibit DWI policy support functions as it would not benefit from the wider knowledge and information obtained in the course of regulatory activities undertaken by a separate private organisation. Industry satisfaction with these arrangements appears high, as reported by a recent BRE Hampton Implementation audit of DWI.

<u>Monetised and non-monetised costs and benefits of each option (including administrative burden)</u>

<u>Option 1</u> - The monetised cost of the regulatory functions undertaken by the DWI on behalf of the water industry is estimated to be £2.0m per annum [Source: DWI; see list of function above]. This would

represent a cost transfer to the industry [net economic impact=0] and in practice would be implemented from the third year onwards.

However, net costs arise from provision for transitional set-up costs, estimated by DWI at £200k in FY 11/12 and FY12/13 [to provide administrative and IT arrangements to support charging], and for ongoing management costs of £100k per annum [for data collation; administrative support; and financial management].

The cost to water companies and licensed water suppliers of reviewing and processing a bi-annual invoice from the DWI are negligible and are therefore not monetised. There are no additional costs relating to data gathering or submissions. The profile of the monetised costs is summarised in the table below.

Summary of monetised costs (undiscounted £,000s)

Year	***1***	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***	***Total***
Admin costs	200	200	100	100	100	100	100	100	100	100	1200
Industry charges*			2000	2000	2000	2000	2000	2000	2000	2000	16000
Total	200	200	2100	2100	2100	2100	2100	2100	2100	2100	17200

* = A transfer and fully offset by savings to government (which comprise the monetised benefits of Option 1)

In line with best practice the monetised impacts have been discounted at an annual rate of 3.5%. This calculation is intended to convert all impacts into a consistent basis on which they can be compared according to social time preference. More information on discounting is available from www.hm-treasury.gov.uk/d/green_book_complete.pdf.

The charging scheme will place proportionate costs on water companies and licensed water suppliers based on the level of regulatory activity involved. Water companies may pass the charges onto water customers, which could result in an increase to the average annual water bill of up to 15 pence.

Offset against the net costs above are the unmonetised benefits arising from the proposed arrangements, which:

- will assist the DWI in achieving one of the Hampton Review's recommendation that regulators should be more accountable to those who benefit from their delivery functions.
- will encourage water companies to improve their drinking water safety management and therefore help to deliver lighter touch regulation as they will be charged in proportion to their own regulatory burden on DWI.
- brings the arrangements for the DWI in line with general policy on charging, and consistent with similar regulatory arrangements within the water industry.
- Contributes to the improved operational efficiency of DWI itself, arising from the greater transparency and public accountability inherent in the scheme.

The DWI operates a risk based approach to technical audits of water companies and their drinking water supply arrangements. The regulatory activity applicable to each water company and each licensed water supplier is governed by the potential risk of its activities to public health. Regulatory monitoring for compliance with EU law is already risk based with the number of tests required varying according to the volume of water supplied/population served. The activity levels applicable to each company/licensed supplier will therefore vary, and will also change over time relative to the risks, and by the outcome of regulatory monitoring. The number and type of licensed water suppliers may also change according to competitive market forces and Government policy.

Risks and assumptions

Risks include:

- changes to DWI governance and support arrangements may impact on the charging regime – but none are planned presently
- uncertainties regarding future market reform – plans are currently unknown, but the proposal is sufficiently flexible to adapt to expansion of competition in the sector
- potential inefficiency in DWI operations leading to increased costs. Safeguards to ensure DWI"s on-going efficiency include
    - Public reporting of water company and DWI performance in the annual Chief Inspector's report
    - Defra governance oversight, as per existing arrangements
    - Defra internal audit, as per existing arrangements
    - BRE audit and the Regulators Compliance Code, regular assessment and public reporting arrangements
    - Stakeholder audit by invitation, continuing current practice of inviting water companies to carry out their own audit of DWI activities and performance

Assumptions include:

- That DWI remains within Defra for accommodation and administration/services support.
- Although a sunset clause does not apply to this scheme, it is proposed that the effectiveness of the arrangements will be reviewed in June 2015.

Wider impacts

Economic/Financial

The proposed charging scheme will apply to all water companies and licensed suppliers (none of these are classified as micro businesses). Each company/supplier will pay the costs incurred for the checking and monitoring, and technical audit services and inspections they receive, therefore not imposing a discriminatory burden on small firms/businesses.

Water companies and licensed water suppliers may pass the charges onto their water customers, who are the main beneficiaries of the regulatory work (wholesome drinking water). It is estimated that if water companies did pass this cost on to customers, the average annual water bill could increase by around 15 pence.

Social

There are no social impacts or additional impacts on rural areas.

Environmental

The overall rationale for charging is that if an industry undertakes an activity that causes an adverse effect on others (such as pollution or risk to public health) which requires regulation, it should face the regulatory cost. The role of the water supply industry in supplying safe water supplies is regarded as a fundamental part of public health management.

The water industry meets the cost of the statutory direct monitoring (water sampling and analysis) that is required by the Water Supply (Water Quality) Regulations 2000 (as amended). A significant proportion of the DWI"s activities relates to monitoring the way water companies meet their regulatory requirements through technical audits and associated activities. As it is the water industry and its customers that benefit from these regulatory services, they should bear the cost of the regulatory services provided.

The regulatory service is fundamental to the protection of public health in the provision of safe clean drinking water and to the maintenance of public confidence in public water supplies.

Water companies benefit from:

- Consistent, authoritative interpretation of regulatory requirements that facilitates a level playing field for all participants;
- Provision of guidance on matters of good practice; and
- Public confidence in an industry vital to social and economic wellbeing that accrues from independent scrutiny of functions that are substantially self-regulated and co-regulated by private sector organisations.

Consumers benefit from:

- The contribution of regulation to the consistent delivery of statutory obligations that brings focus on outcomes;
- Timely and proportionate independent investigation and public accountability when failure occurs;
- Regular, transparent and efficient provision of information verified by an independent source; and
- Assurance that there is an independent advocate for their interests in drinking water quality matters.

This proposal is consistent with the principle of a sustainable economy.

Consultation

The DWI charging scheme proposal was originally included in the formal consultation on the Floods and Water Management Bill in 2009. Stakeholders such as water companies, local authorities, NGOs, the agriculture sector, trade associations, private individuals and community groups were the main respondents. A majority of responses agreed with the proposal (only 9% disagreed with the proposal) and there were no significant issues requiring revision in the proposed policy. The main issues identified by the consultation were:

1) The charging scheme should be based on the five principles of better regulation; proportionate, transparent, consistent, targeted and accountable
2) DWI should ensure it operates in the most efficient and cost effective manner to limit the regulatory burden on companies and customers.
3) Look for formal confirmation that these proposed incentives for lighter touch regulations would not result in perverse outcomes by encouraging water companies to hide their potential problems and failures in any effort to reduce costs.

These issues have been taken into account in the final proposal. In particular, regarding issue 3 above, DWI will continue to be vigilant through its audit and inspection processes to ensure water suppliers meet their statutory responsibilities, and it has the powers to take enforcement action to deal with underperformance, if needed.

An informal consultation, in the form of meetings and stakeholder workshops for water companies and licensed suppliers, Ofwat, CCWater and Water UK, who represents the water industry, began on 24th October and ran for 6 weeks, closing on 5th December 2011. As industry were already aware and supportive of this proposal, no specific issues were raised.

Summary and preferred option with description of implementation plan

Currently Defra funds both the regulatory functions and the policy and technical advice functions undertaken by the DWI. However, a significant proportion of the DWI‟s activities relate to scrutinising the way water companies (including licensed water suppliers and inset appointees) meet their regulatory requirements through technical audits and inspections. As it is the water industry that benefits from these regulatory services, option 1, introducing a charging scheme, is the preferred option as it would bring the arrangements for the DWI in line with general policy on charging, which is that businesses that benefit from regulation, not the taxpayer, should bear the cost of regulation. Ofwat, who are aware of the proposed charging scheme, have confirmed to the Chief Inspector that the cost recovery arrangements for the DWI would have little consequence for their price setting processes.

By introducing a charging scheme, DWI will come into line with other related water regulators such as Ofwat and the Environment Agency and also the Consumer Council for Water which is a consumer body, who all charge for their regulatory activities. All three regulators recover their costs through the licensing regime (which is statutory). DWI will identify the costs of its regulatory services in relation to the costs incurred by each of the individual water companies.

The Public Bodies Bill includes the required primary legislation to provide powers for DWI to introduce a charging scheme. The scheme itself would be introduced by way of an Order made under this general charging power (schedule 4, amendment 79A - „Inspectors appointed by the Secretary of State under section 86 of the Water Industry Act 1991‟). Although the bodies listed within the schedules of the Bill are subject to sunsetting, Orders made, for example in respect of charging powers, will survive the removal of the body from the Act and will remain in force.

The operation of the charging scheme will be assessed in June 2015, to ensure that it is achieving its desired outcomes that it was designed to achieve and if necessary make any required adjustments.

The proposed scheme will provide the Secretary of State and Welsh Ministers (and therefore the Chief Inspector appointed to act on their behalf) with the power to recover costs of the DWI‟s existing regulatory activities by way of a charging scheme. It is proposed that the Welsh Order will enable Welsh Ministers to make Regulations to allow charging in relation to water companies whose supply area is wholly or mainly in Wales and the English Order will provide the same power for the Secretary of State in respect of water companies whose supply area is wholly or mainly in England. Following the informal consultation, it is proposed that the Order will come into force 1st January 2013.

Charges will be introduced from January 1st 2013. Costs will be invoiced directly bi-annually.