

Amgylchedd a Datblygu Cynaliadwy
Environment and Sustainable Development



Llywodraeth Cymru
Welsh Government

Keith Mason
Finance and Networks Division
Ofwat
Centre City Tower
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23rd November 2012

Dear Keith

The Welsh Government welcomes the chance to respond to Ofwat's consultation on its proposals to modify the conditions of appointment (licences) of all appointed water and sewerage and water only companies in England and Wales.

The Welsh Government understands an alteration to the licence condition is needed to implement the draft FPL framework. However, we have a number of concerns with the changes proposed. These concerns were raised by the Minister for Environment and Sustainable Development in a conversation with Jonson Cox, Chair of Ofwat on 22nd November and are summarised below.

Evidence Base

The Welsh Government is concerned about the strength of evidence presented to support the case for licence modification as set out by Ofwat. In particular we are concerned that the licence modification may have a negative impact on consumers in Wales and the wider public interest. This is based on concerns we have about the impact of the changes on investor certainty and the cost of capital for affected companies. A rise in the cost of capital risks driving customer bills higher. This may then have negative impacts on affordability and poverty issues in Wales.

Lack of consideration for the policies of the Welsh Government

The proposed licence modifications reference and support proposed changes in the UK Government's Water Bill, which risk pre-empting Government policy contrary to Defra's recent Strategic Policy Statement. There is little evidence in the licence modification consultation that Ofwat have considered either the Welsh Government's policy position, as set out in its Strategic Policy Statement (February 2011) or the more general impact of the licence modification on Welsh consumers.

Impact on the Cost of Capital and Investor confidence

The proposed changes would give Ofwat the authority to move activities from the wholesale price control. The Welsh Government is concerned that this adds considerable uncertainty to the regulatory process and adds risk to investors. This is important because it is expected risk, not actual risk, which shapes the behaviour of capital markets and hence determines the cost of capital.

We do not believe that Ofwat have sufficiently evidenced the impact of increased flexibility to move activities generating up to 20% of wholesale revenues outside of the wholesale price limit in any given price review, and up to 40% cumulative. We believe the consultation would have benefited from a cost-benefit analysis that looked at the impacts on the cost of capital.

Removing reference to the number of price limits and impact on direction of Welsh Government policy

The proposal to remove reference to the number of price limits altogether suggests that Ofwat is minded to split them further in the future. Ofwat state that the licence change will allow incentives to be developed and targeted on different services and activities. The Welsh Government is concerned that this could run contrary to its policy aim of adopting a more integrated, eco-system approach to Natural Resource Management as set out in Sustaining a Living Wales Green Paper (2012).

Engagement

There has been limited engagement with the Welsh Government on the development of the licence modification consultation as well as during the consultation period itself.

We hope that serious consideration will be given to these concerns as Ofwat assesses the responses to the consultation process. In particular I would like to discuss the next steps and your responses to these concerns within the coming week.

Yours Sincerely

Prys Davies
Deputy Director: Energy, Water and Flood Division