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ICE Response - Setting price controls for 2015-20 – framework and approach consultation

The Institution of Civil Engineers

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ICE would like to thank the Environment Agency for the invitation to take part in this consultation exercise and submits the response to questions below.

Yours sincerely,

Andrew Wescott
Policy Manager



ICE Response to Ofwat's consultation on setting price controls for 2015-20.

Introduction

ICE welcomes the opportunity to respond to this consultation and thanks Ofwat for providing the opportunity to do so. The consultation contains significant changes to the way the 2015-20 Price Review period will be structured. The document pre-emptively contains much of the proposed legislation contained in the draft Water Bill. This bill is currently going through Parliamentary scrutiny and certain aspects were criticised by the Environment, Food and Rural Affairs Select Committee following their oral evidence hearings. This consultation proposes a restructure of the regulatory regime with the assumption that the bill will pass through Parliament in its current form, or indeed at all, which is inherently risky. The changes to the retail and wholesale markets contained in this document may create an altered water sector without the comprehensive legislation required. Additionally, if the draft Water Bill is enacted, it will not be implemented until 2017. It would be prudent to delay some of the proposed changes in the consultation document, particularly those dealing with competition, until the full extent and details of the draft Water Bill are known.

There appears to be uncertainty regarding the impacts of competition on the water sector. This is captured in this document; however, there is a tension between the need to allow market forces to develop and using regulation to manage risks. In some cases, the market will be left to its own devices with little regulatory scrutiny, whilst in other areas regulation will be intrusive. This suggests a lack of certainty and confidence regarding the impacts of competition. These will be highlighted further in specific responses below.

The proposed changes to the water sector focus on supply side solutions. ICE supports increased interconnectivity between adjacent water companies and river basins and welcomes the incentives to improve this type of water trading. There are other solutions, such as storage, which are not covered in this consultation. There is also a lack of acknowledgement of the importance of demand management. Resolving our current and future water security issues will not be resolved by supply side solutions alone. Ofwat should review this consultation and include incentives to drive demand management and behavioural change to improve the way water is valued by society.

Finally, the consultation is limited in its view of water users. It focuses on the importance of utility customers only. While ICE acknowledges that Ofwat is the economic regulator with a remit to control prices, it makes no mention of other users of water. There is far too much emphasis on the willingness to pay, which comes at the potential cost to the environment, agriculture, industry and business. ICE recommends that Ofwat and the government engage with a wider range of stakeholder to address this issue.

Q1

This process appears appropriate; however, there is a significant emphasis on the needs of the customer in the process. The customer is very important, but other stakeholders and users of water should be considered, particularly in light of the non-financial incentives that comprise a significant aspect of this process. There is also a reliance of the willingness to pay principle enshrined in this process. This focuses on price, which is only one aspect that should be considered when a water company is setting its outcomes.

ICE welcomes Ofwat's approach to wider stakeholder engagement. The customer challenge groups bring together a number of stakeholders, including local authorities, EA, DWI and local business representatives, which provides a broader understanding of the pressure on water resources.

Q2

Considering the uncertainty of the impacts of competition it is sensible to limit this to the next 5 years. ICE supports the proposed pilot schemes for Options 2 & 3.

There is no specific mention of the ongoing stop/start funding caused by the five year regulatory cycle. ICE has highlighted this as an issue in its State of the Nation Water report (2012) and IUK has also raised concerns over this in its report titled *Smoothing Investment Cycles in the Water Sector*. ICE welcomes the establishment of a working group to deliver the recommendation of IUK's report; however, there should be also be measures to manage this funding issue in Ofwat's consultation.

Q3

There are two areas that lend themselves to long term performance commitments and incentives. Sustainable abstraction incentives and demand management incentives are both medium to long term in nature. The current abstraction licence regime is under review and the EA plans to implement changes over the next decade. Demand management and behaviour change require an increased awareness of the value of water to society. This cannot be achieved quickly and must be embedded within current and future generations.

Q4

The definition of retail provided is satisfactory; however, it should also include a Corporate Social Responsibility aspect. In order to increase the awareness of the value of water to society water companies, particularly the retail arms, must provide education to enable consumers to use water sustainably.

It is unclear from the consultation if leakage targets will be consistent across the wholesale and retail arms of the water companies. It will be somewhat pointless if wholesale water providers reduce leakage in their networks if retail providers are held to a lesser standard.

Clarity is required with regard to the tensions that may exist between wholesale and retail water providers concerning new developments. A retail provider may be willing to offer a connection to a new development; however, there may be restrictions or limitations regarding the wholesale supply and treatment of waste water. Ofwat must make it clear which aspect takes precedence. Scotland established the Central Market Agency to oversee and administer the market for water and wastewater retail services in Scotland. This group exists alongside the Water Industry Commission for Scotland, which regulates the utility sector. Are there plans for the establishment of a similar group in England and Wales? This is not discussed in the consultation document.

Q15

There is a misplaced view that market forces will protect customers when it comes to ACTS. Market anomalies occur in all free markets; therefore, the regulator must remain vigilant and act appropriately if such instances occur.

With regard to the calculation of ACTS, both historical cost data and forecast cost data should be utilised. There may be new activities undertaken by water and sewerage companies where historical cost data is not available. Estimations will also benefit from the use of a wider data range.

Q16 & 17

ICE welcomes Ofwat's proposal to exclude the cost of implementing meters from the ACTS; however, ICE would like to see further incentives introduced for water companies to roll out metering on a wider scale. This should occur immediately in areas classed as water scarce. ICE has called for the introduction of universal metering with complementary tariff structures and social tariffs.

Q21

Yes, this appears to be an appropriate mechanism.

Q22

ICE would like Ofwat to clarify an issue around the following please. In Table 3 the consultation states clearly that demand side efficiency services and customer side leaks (an important aspect of leakage control) will be the responsibility of retail; however, it admits that ACTS may not provide an incentive to increase this work (existing work presumably being covered by historical ACTS). In Table 8 it gives pros and cons and in Q22 (para 5.5) states that additional services will be recovered through wholesale controls. This indicates transfer payments between the two sides of the business. This may be manageable with the vertically integrated companies, but possibly an issue when new entrants enter the market for retail services.

Q23

ICE would like further information regarding the existing tariff structures. If they are a company-specific mechanism then it would be complex to establish comparability for customers wishing to switch retail provider.

Q24

This is an area where uncertainty appears to cause Ofwat to interfere in the market. The introduction of competition will, inevitably, lead to winners and losers. Ofwat appear to be managing this closely, which may distort the market. As was pointed out at the EFRA Select Committee hearings, the draft Water Bill should include a provision to enable water companies to leave the retail market if they are not able to compete.

Q25

Both historic and forward-looking costs should be utilised.

Q28

If costs are to be used as the primary incentive there is a risk of a 'race to the bottom' if and when competition is introduced into the water sector. Focussing everything on cost will result in important



water resource management issues, such as sustainability, becoming second rate incentives. There will also be an impact further up the supply chain as wholesale providers are forced to reduce their costs to enable retail providers to meet their bottom line.

Q32

Yes.

Q33

As a broad approach it appears appropriate. It may be beneficial to include a sustainability/environment incentive as this would disincentivise long distance bulk transfer.

Q34

ICE recognises the importance of incentivising the importer; however, it would be prudent to move towards a mechanism that allows water companies to develop and finance shared water resources in partnership. The shared-equity approach would improve the way those companies using the resource to manage it, rather than viewing it as a traded commodity.

Q35

In the earlier section regarding the retail controls for non-household customers there is an emphasis on reducing retail costs. As wholesale companies will provide water resources and waste water treatment services they may be forced to reduce their costs as well. This may endanger efficient trades as it may not be the low cost option for water companies. There is also the risk that water companies operating in already water scarce areas will be further impacted by having to drive down costs.

Qs 36, 37 & 38

These options appear appropriate; however, there is no mention of the Catchment Management pilots currently being undertaken by the EA. These pilots may provide important and valuable data which could be utilised by Ofwat when limiting the scope of AIM. There is also no mention of how the AIM relates to the ongoing changes to the abstraction licence regime.

Q39

This may require revision in light of the response to Qs 36, 37 & 38