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From the Chief Executive

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Our ref :

Your ref

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Dear Cathryn

Consultation on Ofwat Forward Programme 2014-15

We read with interest Ofwat's draft Forward Programme for 2014-15 and are pleased to be able to share our thoughts on its proposals.

We agree that it is timely for Ofwat to review its strategy five years on from the publication of *Delivering Sustainable Water*. During this time the UK government has published a number of important documents relating to the sector, including its *Strategic Policy Statement* (March 2013), *Social and Environmental Guidance* (March 2013), *Water Bill* (June 2013) and *Water for Life*¹ (December 2011). We agree that it is appropriate for Ofwat to review how it should regulate in order to deliver the policy objectives which the government has described in these documents.

Collectively the documents highlighted above set out the UK Government's vision for the sector, the legislative changes it considers necessary to promote that vision and the priorities for regulation of the water industry that the Government expects Ofwat to reflect in its decision making.

¹ This document is omitted from the list of relevant documents on page 6 of the draft Forward Programme

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Some of the wording in the consultation paper is slightly confusing in that it might imply that Ofwat believes that the Government's vision needs to be looked at again: "*Given the changes and challenges highlighted...now is the right time to develop a new long term strategy for regulating the water sector in England and Wales. **A vision is required for the sector, which encompasses service providers and customers.** And a vision is required for Ofwat, which will set out how [Ofwat] will regulate the sector from 2015-20 and beyond*". Given that the Government's vision for the sector has only recently been clearly articulated it would be worth clarifying that Ofwat is not seeking to develop an alternative vision.

Ofwat's strategy review should be conducted within the framework of priorities which the Government has laid out. It should also be firmly grounded in the statutory duties which Parliament has set out for Ofwat in section 2 of the Water Industry Act and, when confirmed, the additional duties that are envisaged in the current Water Bill. We are pleased that the draft Forward Programme acknowledges the central position of Ofwat's duties in defining the strategy. Finally the review should also be framed within the context of *Principles for Economic Regulation* published by the Government in 2011.

Ofwat's duties will most likely include, on passage of the Water Bill later this year, a primary duty to further the Government's resilience objective (*Strategic Policy Statement* (Priority VII)). The draft Forward Programme seems to imply that this policy objective will be met primarily through upstream trading, casework and a review of special administration arrangements.

Market reform will have an important part to play in achieving the resilience objective but other policy areas, including PR14 and future investment, will also be essential in meeting the Government's objectives. We do not believe resilience will be delivered through water trading alone. Our experience, as set out in *A Right to Water* and in recently failing to get the approval of environmental quality regulators' approval to a trade agreed between ourselves and Cambridge Water, is that there are a number of material environmental barriers to upstream trading in our region.

The Government's *Strategic Policy Statement* also sets out a number of specific expectations of Ofwat in relation to achieving the resilience objective, including amongst others:

- i. Ofwat to work with Government and the EA to consider the standards of service water companies provide in relation to droughts and water supply;
- ii. Ofwat has a statutory duty to further water conservation and should consider this in agreeing outcomes for demand management;

- iii. the Government expects Ofwat to incentivise a new and sustained approach to reducing leakage;
- iv. greater connectivity between different parts of the water network is an area of particular priority and the Government is looking to Ofwat to actively support the drive for greater connectivity; and
- v. using regulatory powers to enable effective investment in the long-term resilience of water and wastewater networks.

Given the expected promotion of resilience to a primary duty for Ofwat we would expect this to be reflected as one of the threads that runs through Ofwat's strategy review.

Moving away from the strategy review, we have brief comments on some of the other core projects proposed in the draft Forward Programme:

Choice and trading arrangements

Hopefully we have shown our support for the development of arrangements for the non-household retail market which will open in 2017.

We are also supportive of the work on upstream reform, as demonstrated by the work we have published in *A Right to Water, Trading Theory for Practice and Research into water allocation and effective water trading*.

There is much to be done to establish effective upstream reform and, based on our experiences, a key focus needs to be on the removal of barriers that inhibit water trading (e.g. abstraction licence reform is essential) and also greater competition in the sludge treatment market (e.g. the ban on co-digestion).

2014 price review

While the process has not always been comfortable either for the industry or Ofwat, we acknowledge that the changes that Ofwat has introduced for the current price review have been successful in changing attitudes and thinking for the benefit of customers.

A key development has been the views of customers taking centre stage. We sought to demonstrate in our business plan the 'golden thread' between customers' views and our proposals. All parties must take great care to preserve this thread as we negotiate the remaining stages of the process and not allow the customers' voice to fade.

Licence review

The proposal to resume simplification of companies' licence is positive. A review focussed on simplification, building on the success of the latter part of the licence review at the end of 2012 and the more recent Condition N changes, should establish a mature environment for further changes in the future. The involvement of companies in the work of simplifying the Licence, which was carried out prior to PR14, was beneficial and future company involvement will be an important part of the roadmap for conducting further licence review work.

Casework

We support the targeting of resources on cases that are strategically significant. The interaction with other policy areas, such as developing Charging Principles is also important. Our experience has been that Ofwat has been unable to reach timely decisions on a number of cases because of the policy implications. As more markets are developed, it will be important to establish the principles that avoid cases arising as far as possible. Where cases do emerge, timely decisions are essential as the uncertainty that exists while a case is being determined is unhelpful to all stakeholders and inhibits progress.

We look forward to working closely with Ofwat over the coming weeks and months to help develop your strategy for regulating the sector.

Yours sincerely

**Peter Simpson**

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