

Ofwat's draft Water2020 framework: What does it mean for water companies?

Water and wastewater services are vital for public health, for our economy and society. Across England and Wales, we all rely on them every day. Increasing pressures on these services mean that, if we are to continue to have trust and confidence that they will be delivered reliably, the way they are delivered needs to evolve. Ofwat's Water 2020 consultation paper sets out proposals to promote wholesale markets and begin to provide a framework for the 2019 price review (PR19). Our proposals are designed to protect current and future generations' interests beyond 2020. We welcome your views.

Key proposals

Building on our approach to the 2014 price review (PR14), we have worked collaboratively with the sector to develop our proposals for wholesale markets and PR19. This included using contributions that companies made in the market place of ideas. Key elements of change in our proposed regulatory framework for markets and PR19 are as follows.

We will encourage companies to treat their customers as partners in their decision making and make sure conversations with their customers are two way.

We will expect companies to have a longer term focus than the five-year price review cycle in their business

plans. We also expect them to get their customers' views on long-term issues and ask their customer challenge group (CCG) to report on the quality of engagement by the company with their customers. We will use the CCG reports, along with the longer term context of companies' business plans, to inform our risk-based assessment of those plans at PR19.

We will smooth the impact of our periodic reviews by introducing more 'in-period adjustments' to revenue. We also propose to migrate from the retail price index (RPI) to index both prices and regulatory returns by the increasingly prevalent consumer price index (CPI). We plan to phase in the introduction of CPI to help customers, companies and investors to make this change.

We will promote markets for water resources and sludge. Markets will help optimise the delivery of services across company boundaries and other sectors. To help promote them we will: get companies to establish information platforms to inform market participants about opportunities to enter the market;

- split companies' wholesale water price control into two separate controls: water resources and water network plus (covering raw water transport, water treatment and distribution); and
- split companies' wholesale wastewater price control into two separate price controls: sludge and wastewater network plus (covering wastewater collection and sewage treatment).

We propose that about 11% of the industry regulatory capital value (RCV) is allocated to sludge and water resources. Investment made up to 31 March 2020 will be protected (see diagram).

Why sludge?

A market will provide companies with more choices in terms of service provision that could include other water companies and firms operating in wider waste markets. The scope for interplay with wider waste markets could deliver material benefits, as innovative technologies are utilised to unlock new ways of generating value from waste.

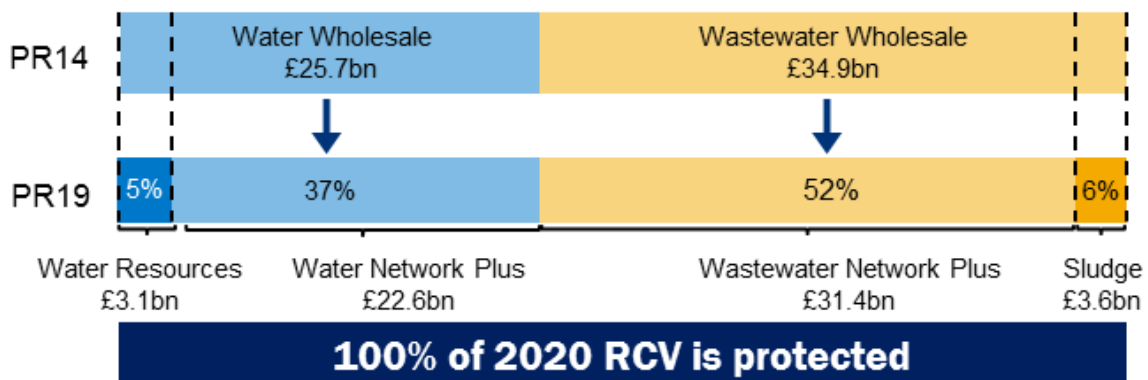
We see scope for third parties to provide sludge processing and transport services for both new and existing volumes – although the 'make or buy' decision would remain with companies.

Why water resources?

The evidence shows that there remain significant unrealised gains from water trading, which we estimate to be up to £1 billion over the lifetime of assets.

We only anticipate the market facilitating new investment.

What are the implications for the RCV?



Note: 2015/16 opening RCV in 2012/13 prices with the split based on 2013/14 MEAV

Why change the method of indexation?

RPI is no longer an official statistic and a recent [review](#), led by Paul Johnson, stated that: "RPI is a flawed statistical measure of inflation", and that "taxes, benefits and regulated prices should not be linked to the RPI". Ofcom, Ofgem and the Civil Aviation Authority have also either moved towards CPI or sought views on this issue.

We consider that continuing with RPI until 2025 would undermine trust and

confidence in this vital public service and are proposing a change to CPI. Any change would be **neutral to both company (nominal) revenues and customer bills in net present value terms** and require a transition to limit the impact on customers, investors and companies. We are proposing to phase in the introduction of CPI, by continuing to apply RPI to 50% of the RCV and CPI to the remainder. This will help existing debt that is index linked on an RPI basis, to unwind.

If you want to find out more and contribute your voice on this vital public service, please read and respond to our consultation by 10 February 2016.

More information

[Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#)

[Towards resilience: how we will embed resilience in our work](#)

[UK Consumer Price Statistics: A Review](#), Paul Johnson, January 2015

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a leading economic regulator, trusted and respected, challenging ourselves and others to build trust and confidence in water.

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