citizens advice

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Dear Sir/Madam

Thank you for providing us with the opportunity to comment on 'Water 2020: Regulatory framework for wholesale markets and the 2019 price review.' This submission is non-confidential and may be published on your website.

In broad terms, we are supportive of the approach you set out. The areas of suggested focus appear to be largely appropriate and form the basis of a credible roadmap to the 2019 price review.

We particularly welcome a number of the initiatives proposed that should drive down costs.

Firstly, we think that your focus on finding ways to introduce competitive procurement processes for major discrete projects is entirely correct. The successful Thames Tideway Tunnel project award had a notably low weighted average cost of capital (WACC), significantly below the wholesale WACC in the PR14 price control, which should result in significant consumer savings. Elsewhere, Ofgem's experience in offshore transmission tendering has also suggested that savings can be made through competitive procurement of major discrete projects. The suggested direction of travel to make such procurements the norm above a certain financial threshold appears sensible to us. It is possible that you may be able to set the bar for this lower than the £100m proposed, though we recognise the difficult balancing act you face between accessing the benefits of competition and the costs of tendering.

Secondly, we think that the proposal to develop means of in period adjustments in order to remove the problem of networks being subject to 'stop-start' incentives and large adjustments at the point of transition from one price control to the next, appears a logical one. It will be important that this is handled in an even handed way to ensure that both rewards and penalties are adjusted. We would expect it to be a relatively mechanical process with clearly defined, known in advance, triggers to avoid the risk of it either creating regulatory uncertainty, or being used as a lobbying tool by the networks to try and change the balance of rewards and penalties in their favour mid review. But we think those challenges are surmountable, they have been tackled in other sectors.

We welcome the proposal to move from RPI to CPI indexation in principle, though we are disappointed that you do not propose to enact this more quickly. As you highlight, RPI is a largely discredited measure that lacks public legitimacy. It also costs consumers money, as RPI tends to suggest a higher headline inflation rate than CPI does. CPI has been the basis of Government inflation targeting since 2003 and the water sector will have had the windfall benefit of the RPI measure for some 16 years by the time of the 2019 settlement. We would therefore like to see a more rapid move from RPI to CPI than that proposed, which appears to be an initial 50/50 RPI/CPI split on the RCV, with subsequent new debt CPI linked. We note that the justification for this appears to be that networks have some legacy RPI linked debt, but do not find this a wholly persuasive argument for a delayed transition. We think that a reasonable and prudent operator would have anticipated the movement to CPI indexation given that it has been the commonly accepted inflation measure for more than a decade now. Partially deferring the move to CPI would reduce incentives on operators to efficiently finance their debt. Additionally, given that Ofwat is signalling this move to CPI, we would expect a reasonable and prudent operator refinancing its debts both within the remainder of the PR14 price control, and during the PR19 price control itself, would not be entering into any new RPI linked debt - including when it is refinancing its existing RCV. This would suggest that, if any RPI/CPI split should exist in the PR19 settlement at all, it should be tapered so that the tranche of RCV that is initially RPI linked progressively reduces to zero rather being 'banked' as RPI linked in perpetuity. We note that some water companies have suggested that there is not currently a market for CPI linked debt as a reason for delay, but we think this is essentially a chicken-and-egg argument - that if demand for such products appears, so will the products.

We continue to commend your focus on encouraging water companies to refocus their management's attention from engaging with the regulator, to engaging with their customers - this must be the right approach. But this reframing does present challenges, particularly around information asymmetries, and we will expect you to continue working to address them in the PR19 framework. Our experience of consumer challenge groups (CCG), both in water and in energy, is broadly positive but uneven. Many utilities are engaging effectively with their stakeholders but some remain less able to show how feedback is affecting their thinking. A broader problem is that members of CCGs may not have the technical expertise to adequately scrutinise financial and engineering parts of business plans, and may lack context to understand how challenging (or not) a water company's proposed business plan is when compared to its peers (for example, whether other water companies are able to deliver more for less in the same areas). Ofwat should look to understand, and build, CCG capability in the coming years as it works towards PR19. Part of this may be education, but it is also likely to involve the provision of comparative information in order to help these groups contextualise the information they are receiving. Separately, while we welcome the move to encourage water companies to deliver bespoke incentives to reflect the desires and needs of the communities they serve, with 522 different performance outcomes put forward in PR14, we remain anxious that excessive proliferation may make it difficult to scrutinise how robustly the targets and rewards for each individual outcome has been set. As a stakeholder, we would welcome more assurance that there are robust processes in place to ensure that targets are always stretching, and rewards are always proportionate.

We note that in section 4.2.2 you suggest that a key barrier to delivering consumer value that you cannot address is that 'renewable subsidies are targeted in ways that reduce the benefits of co-digestion.' We would welcome more detail on this point, in order to understand whether we should pick it up in our energy work. We also encourage you to share your evidence base on this matter with DECC. While the UK appears to be on track to meet its renewable electricity targets, renewable heat is proving more difficult and it may be receptive to ideas that remove barriers to biogas projects.

Although not the focus of this consultation, we note that Ofwat has been tasked by government to provide an assessment, by summer 2016, of the costs and benefits of opening up the household water market to retail competition. As the statutory consumer watchdog in the energy sector, we have experience of the successes and pitfalls of the introduction of household competition and would be happy to share learnings with you.

I trust that this response is clear, but would be happy to discuss any matter raised within it in more depth if that would be helpful.

Yours sincerely

Richard Hall
Director of Strategic Infrastructure, Consumer Futures team