

Meeting held on Thursday 23 February 2017
 Venue: 21 Bloomsbury Street, London WC1B 3HF

Members in attendance

Board attendees	
Jonson Cox	Non-Executive Director, Chairman
Martin Lawrence	Non-Executive Director
Tim Waggott	Non-Executive Director
Mark Bayley	Non-Executive Director
Catherine Waddams	Non-Executive Director
Alison Munro	Non-Executive Director
Christine Farnish	Non-Executive Director
Cathryn Ross	Chief Executive
John Russell	Executive Director
Richard Khaldi	Executive Director
Aileen Armstrong	Executive Director
Jenny Block	General Counsel and Board Secretary
Other attendees	
Keith Mason	Senior Director, Thames Tideway Tunnel
David Black	Senior Director, Water 2020
Claire Forbes	Senior Director, Corporate Communications
Alena Kozakova	Chief Economist
Tim Griffiths	Director, Water 2020
Jon Ashley	Associate Director, Water 2020
Alison Cullen	Principal, Water 2020
Trevor Bishop	Principal, Strategy and Planning
Colin Green	Design Director, Water 2020
Ynon Gablinger	Principal, Water 2020
Andrew Chesworth	Director, Water 2020
Gordon Hutcheson	Principal, Water 2020
Nicci Russell	Director, Strategy and Planning
Adam Cooper	Director, Retail Market Opening

Andy Duff	Director, Finance and Governance
Peter Hill	Principal, Casework
Margaret Pyne	Principal, Casework
Jean Spencer	Chair of Steering Group and Regulation Director, Anglian Water
Michael Roberts	Chief Executive, Water UK
Sarah Hendry	Director, Defra
Sebastian Catovsky	Deputy Director, Defra

1. Opening Items and Declarations

- 1.1. The minutes of the Board meeting held on 26 January were agreed.
- 1.2. There were no conflicts of interest to declare by reference to the matters on the agenda.

2. Chief Executive Report

- 2.1. The Chief Executive gave an update on the internal and external environments, including:
 - Government initiatives that may have an impact on regulation in the sector, including the forthcoming Green Paper on Critical National Infrastructure, and the forthcoming Strategic Policy Statement which was expected to be published in draft shortly;
 - A number of meetings with appointees, including Thames Water, Southern Water and United Utilities; and
 - An update on the asset health targeted review that launched in February 2017.

3. Water 2020

Overview

- 3.1 The Executive presented the overview of the Water 2020 programme which focused on the development of the PR19 methodology consultation, due to be

published in July 2017. The Board noted the strong linkages across the areas under discussion in particular as between affordability, resilience and cost assessment.

- 3.2 The Board discussed the central themes of customer service, resilience, affordability and innovation which are expected to be the golden thread throughout the methodology consultation which would also set the bar for the sector in terms of Ofwat's expectations. It agreed that the consultation should aim to provide more clarity at an early stage, including to improve the quality of internal challenge and assurance within companies.
- 3.3 The consultation would also set PR19 in the context of the journey to PR24. While there would be one methodology consultation document, we would include separate standalone summaries for England and Wales, drawing out any differences to reflect the policy positions of the English and Welsh Governments.

Introduction to the approach to affordability

- 3.4 The Board discussed the main aspects of affordability and the potential trade-offs between the different strands of affordability, and between affordability and the other themes of PR19 e.g. resilience and customer service.
- 3.5 The Board discussed the definition of those at risk in terms of affordability. The Board also placed emphasis on affordability for all. The Board also noted the distinction between affordability and vulnerability, the former being related to the ability to pay water bills and the latter being related to the ability to receive an inclusive service.
- 3.6 The Board noted the twin objectives of affordability for all and measures to help customers struggling to pay bills. The Board noted in practice some issues may be eased in part by earlier support for customers before they got into severe payment difficulties.
- 3.7 It was noted that customer research indicated that customer willingness to pay for affordability measures varied across the country.
- 3.8 The Board emphasised the need for companies to understand the cost/benefit of the impact of their interventions and considered that Ofwat should review carefully the efficiency of companies' schemes to address affordability at PR19. In this regard Board was aware of the upcoming report by the National Audit Office on protecting vulnerable consumers in regulated industries.

Introduction to the approach to cost assessment

- 3.9 The Board received an introduction on the approach to cost assessment in PR19, the tools at Ofwat's disposal to improve efficiency and some of the changes that Ofwat is considering. The Board noted that Ofwat's approach to the cost efficiency challenge cannot be considered in isolation from other elements of the price control.
- 3.10 The Executive noted potential cost pressures in the next review period due to increased focus on resilience. It also noted the opportunities for a step change in efficiency due to the move to a totex and outcomes approach. The Board noted that it was also important to consider the link between costs and asset health, and companies will need to choose the right approach to deliver the outcomes that customers want at a level of risk and a price that they are prepared to accept.

Introduction to the approach to risk and return

- 3.11 The Board noted the range of work across the risk and return workstream, focussing on current market trends around debt and equity, and the impact of decisions in this context on other areas such as financeability and the balance of risk borne by companies. A key consideration is to ensure an efficient allocation of risk between customers and companies, to ensure the price controls appropriately align the interests of customers and company management.
- 3.12 In terms of managing risk and uncertainty, the Board noted the various mechanisms at Ofwat's disposal and the relative impacts of each.

Approach to the cost of debt

- 3.13 The Board discussed the proposed options for the setting the cost of debt for the PR19 methodology consultation, building on our previous consultation which set out our preferred direction.
- 3.14 The Board agreed with the recommended views to be reflected in the July methodology consultation.

Introduction to the approach to resilience

- 3.15 The Board considered a paper on the approach to resilience which focused on both our role as Ofwat and the risks/opportunities the sector faced.

- 3.16 The Board noted that considerations of resilience were not new; decisions on resilience had always been integral within the sector and to Ofwat's work and this lay at the heart of trust and confidence in the sector. Ofwat had a customer-centric approach incorporating both near-term and long-term planning considerations.
- 3.17 The Board agreed that Ofwat had to take account of the dual risks that some companies may not be adequately considering resilience, whilst others may be proposing an over prudent level of resilience and driving inefficient expenditure. Through PR19, considerations of resilience would be integral to our Initial Assessment of Business Plans, our work on outcomes, cost assessment and risk and return. The development of water and bioresource markets will also provide opportunities to further resilience.
- 3.18 The Board noted the programme of work across Ofwat's functions on resilience and the communications with our stakeholders on this issue. This included our work with the Water and Wastewater Resilience Action Group (WWRAG) on resilience metrics such as droughts, floods, and asset health.

Approach to assessing Water Resource Management

- 3.19 The Board received a paper on the evaluation of water resource management plans (WRMPs). The Board noted the objectives for WRMPs which are aligned with our strategy and vision for the sector.
- 3.20 The Board noted that the WRMP process is an important tool for identifying and planning resilient long term water resources. The WRMPs are also a key input to the activities for which companies will seek funding under the price control and this will be captured within company business plans. The Executive noted that assumptions were not common across companies, reflecting individual circumstances and customer preferences.
- 3.21 The Board considered that companies should be able to demonstrate through their WRMPs that they understood the outcomes they were trying to deliver (e.g. levels of resilience in supply) for their customers from customer engagement. The Board considered companies should be able to identify a portfolio of options for addressing supply-demand imbalances including supplies from water companies (water trading), leakage reduction and demand management solutions to develop the most cost effective approach. Further it was important that, as part of this exercise, companies with surplus should understand how they can help address issues for other company areas.

- 3.22 The Board noted that the Executive was engaging with stakeholders in the WRMP pre-consultation phase with the aim of identifying any issues (for WRMP assessment and business plans) early, and of working collaboratively with the EA and NRW, ultimately supporting the delivery of better WRMPs and better business plans.

4. Strategic Conversations:

Water resources long-term planning framework

- 4.1 The Board was pleased to welcome representatives of Anglian Water and Water UK who presented their report on the “Water resources long-term planning framework (2015 – 2065)”, published by Water UK in September 2016. The Board noted the key areas covered in the report.
- 4.2 The Board noted and welcomed the considerable work that had been undertaken, and that there was much more to do to build on this, if to be used to inform policy thinking at the level of detail required for the next price review. This related in particular to potential bill impacts and the benefits assessment. Without diminishing the potential benefits of investment in infrastructure to support greater resilience across England and Wales, the Board noted that it would expect companies to explore and test all appropriate measures to address the resilience challenge, whether through metering, leakage or other forms of demand management, as well as to explore opportunities and solutions for strategic transfers between regions, in addition to between specific companies.

The UK Strategic Policy Statement

- 4.3 The Board was delighted to welcome representatives of Defra to discuss the draft UK Strategic Policy Statement (SPS) which was expected to be circulated for consultation shortly. The Board focused the discussion on the key areas – long-term resilience and protecting customers – as well as the potential for further market reforms to drive innovation, including in light of experience of competition in the business retail market from April 2017.

5. Retail Market Opening

- 5.1. The Executive provided an update on developments since the January Board meeting, and the Board noted the good progress made over the last month completing the final elements of the regulatory framework. The Board noted that

the programme will begin to close down and handover to enduring programmes (mainly Market Outcomes and Enforcement) during March 2017.

- 5.2. The Board noted also that the principal remaining update to MOSL's systems was being implemented a week earlier than planned and other updates had been working effectively.
- 5.3. The Board recorded their thanks to the Chairman, Chief Executive and Chair of ARAC for their contribution to finalising the last assurance letter submitted to the Secretary of State.

6. Finance and Governance

Programme overview and ambitions

- 6.1. The Board discussed the overview of the Finance and Governance Programme, and its ambitions for the coming year and beyond. The Board also discussed the opportunities available (including views on the relative priorities, and how to deliver them most effectively).
- 6.2. The Board encouraged the Executive to continue to be prepared to shine a light on information and data relevant to the standards to be expected of companies in the sector and to incentivise improved performance to ensure the sector was resilient, high performing and trusted.

Cholderton Water

- 6.3 The Board discussed the proposed options for the future of Cholderton as a water company and the proposal to formally consult on the cancellation of Cholderton Water's licence and for it to become a private supplier. Wessex Water would become the water undertaker for the area currently served by Cholderton.
- 6.4 The Board considered the recommendations and agreed to consult on the proposal in light of the views expressed to date by a number of third parties, notably DWI, Defra and CCWater. However, it noted the importance of ensuring sufficient customer engagement and understanding of the implications of the proposal before a final decision was taken.
- 6.5 The Board confirmed delegated authority to the Chief Executive (or an employee authorised by the Chief Executive) to proceed to implement the changes required, provided that no material matters were raised by the consultation and the

Executive considered it had received assurance that there had been adequate communication with, and engagement on the part of, customers.

7. Casework / Market Outcomes and Enforcement

Introduction to the MOE programme

- 7.1 The Board received an update on the establishment of the Market Outcomes and Enforcement (MOE) programme which will replace the Casework and Retail Market Opening programmes.
- 7.2 The MOE programme will aim to regulate in a pro-market way; establishing an effective framework that improves information (e.g. quality and visibility), improves buyers' and sellers' ability to transact (e.g. reducing 'transaction costs') and incentivises outcomes that are fair and benefit customers.
- 7.3 The MOE programme will report to Board on its progress quarterly with a first overview of business retail market competition at the May Board meeting.

Regulatory lessons from other retail markets

- 7.4 The Board noted the paper setting out some examples of experiences in other regulated markets and some of the lessons that might be learned with a view to optimising our ability to respond effectively and appropriately. Multi-utility bundling was expected to emerge and the Board noted the important and generally positive role that Third Party Intermediaries could play in supporting the development of a competitive market.
- 7.5 The Board also noted that we had used insights from experience in other sectors to inform our regulatory approach to date already, in the design of the market architecture, and in our proposals on market monitoring.

Outcome of Market Monitoring consultation

- 7.6 The Board received an update on the outcome of the market monitoring consultation which was published in January 2017, and noted that the consultation had been well received. There was no suggestion that Ofwat should adopt any material change in approach, although a number of issues were raised on which further engagement with industry was needed.

- 7.7 The Board also noted the need to remain flexible in our approach to monitoring, particularly with respect to the type and frequency of information gathered, as our understanding of the market evolved.
- 7.8 The Board discussed the key themes running through the responses and approved the proposed approach to taking the consultation responses forward.
- 7.9 The Board confirmed delegated authority to the Chief Executive to finalise the details of the intended monitoring framework, subject to there being no material change in approach, with a view to publishing the final monitoring framework ahead of retail market opening.

Final Competition Act guidance

- 7.10 The Board discussed the updated Guidance on Ofwat's approach to Competition Act 1998 cases in the water and wastewater sector in England and Wales. The Executive noted that responses to our consultation were overwhelmingly supportive of the proposed updates to our guidance document, with respondents welcoming the greater clarity provided on our proposed approach. Additional detail or clarification was provided where appropriate in the final draft before the Board.
- 7.11 The Board delegated authority to the Senior Director, Customers and Casework to sign off the final guidance and the consultation responses document.

8. Any Other Business

Chairman's speech to Water UK City Conference

- 8.1. The Board provided feedback to the Chairman on the outline of his intended remarks at the Water UK City Conference.
- 8.2. There was no other business and the Chairman closed the meeting.

Jenny Block

Board Secretary

23 February 2017