

11 July 2017

Trust in water

**Delivering Water 2020:
consultation on PR19
methodology
Appendix 15: Approach to
impact assessment**

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Contents

1. Overview	2
2. Our approach to impact appraisal	3
3. Our approach to assessing the impacts of our policy proposals and decisions	7

1 Overview

Our 2019 price review (PR19) draft methodology sets out our proposed regulatory framework for the next price control period for monopoly water and wastewater companies which starts in 2020. Our PR19 draft methodology uses the policy framework set out in the [Water 2020: Our regulatory approach for water and waste water services in England and Wales](#), published in May 2016 (Our Water 2020 decision document).

We carried out impact assessments of our key Water 2020 policy proposals and decisions to help ensure that our approach was the most appropriate. In our Water 2020 decision document, we quantified the benefits and costs of our packages of regulatory policy proposals wherever that was possible¹. However, in some cases it was not possible or appropriate to quantify all of the impacts. In particular this was the case for the impacts on resilience and the environment. In these cases we described the impacts qualitatively so that they were incorporated into our decision-making on the Water 2020 policy approach.

Our PR19 draft methodology uses and builds on the regulatory framework set out in our Water2020 decision document. Our PR19 draft methodology involves more detailed proposals that will impact on how companies are regulated by Ofwat. Accordingly, we have built on the impact assessments undertaken and set out in the Water2020 decision document, and carried out impact assessments for the detailed proposals under each part of the PR19 draft methodology.

This appendix sets out our approach we have used to undertake the impact assessments in the PR19 draft methodology.

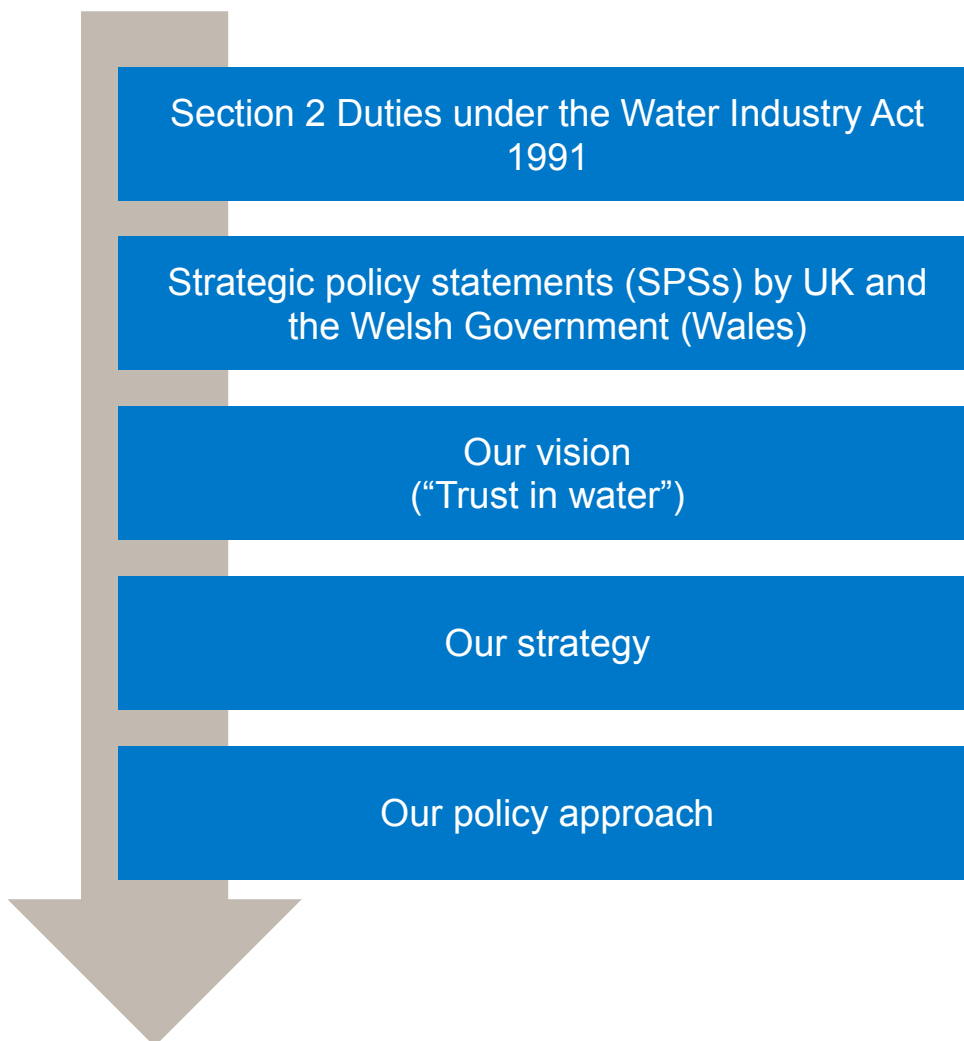
The impact assessments are set out in the appendices to the PR19 methodology consultation document.

¹ Quantification is based on the net present value (NPV) of the impact over 30 years using 2015-16 as the base year and using a discount rate of 3.5% (in line with the HMT Green Book).

2 Our approach to impact appraisal

Our PR19 draft methodology must be consistent with our legal duties; the strategic policy statements² of the UK and Welsh Governments; our vision, strategy and policy approach. Our approach to impact assessments therefore reflects each of these objectives as shown in Figure 1.

Figure 1 Our objectives



² By 'strategic policy statements' we mean the statements setting out strategic priorities and objectives for Ofwat that the UK and Welsh Governments can publish under sections 2A and 2B of the Water Industry Act 1991.

2.1 Our legal duties

Our legal duties under Section 2 of the Water Industry Act require us to set price controls in the manner we consider is best calculated to:

- further the consumer objective to protect the interests of consumers, wherever appropriate by promoting effective competition;
- secure that water companies properly carry out their statutory functions;
- secure that the companies are able (in particular by securing reasonable returns on their capital) to finance the proper carrying out of those functions; and;
- further the resilience objective to secure the long-term resilience of companies' systems and to secure that they take steps to enable them, in the long term, to meet the need for water supplies and wastewater services.

Subject to our main duties above, we also have duties to:

- promote economy and efficiency by water companies in their work;
- ensure that consumers' interests are protected in relation to any unregulated activities of water companies; and
- contribute to the achievement of sustainable development.

2.2 Strategic policy statements – UK and Wales

Our relevant functions, including our functions in setting price controls, must be carried out in accordance with the priorities set out in the UK and Welsh Government's strategic policy statements.

The UK Government has developed a draft strategic policy statement. Table 1 summarises the key priorities and objectives set out in the UK Government draft strategic policy statement. It also sets out Welsh Government policies and draft objectives, based on those in the Water strategy for Wales.

Our assessment criteria reflect the UK Government draft strategic priorities and Welsh Government policies and draft objectives. We have separately summarised how the PR19 draft methodology delivers the UK and Welsh Government priorities.

Table 1 UK Government draft strategic priorities and Welsh Government policies and draft objectives

UK Government	Welsh Government
Securing long-term resilience	Water for nature, people and business and natural resource management
Protecting customers	Improving the way we plan and manage our water services
Making markets work	Delivering excellent services to customers
	Protecting and improving drinking water quality
	21st century sewerage and drainage systems
	Regulating for a resilient and innovative sector.

2.3 Our vision and strategy

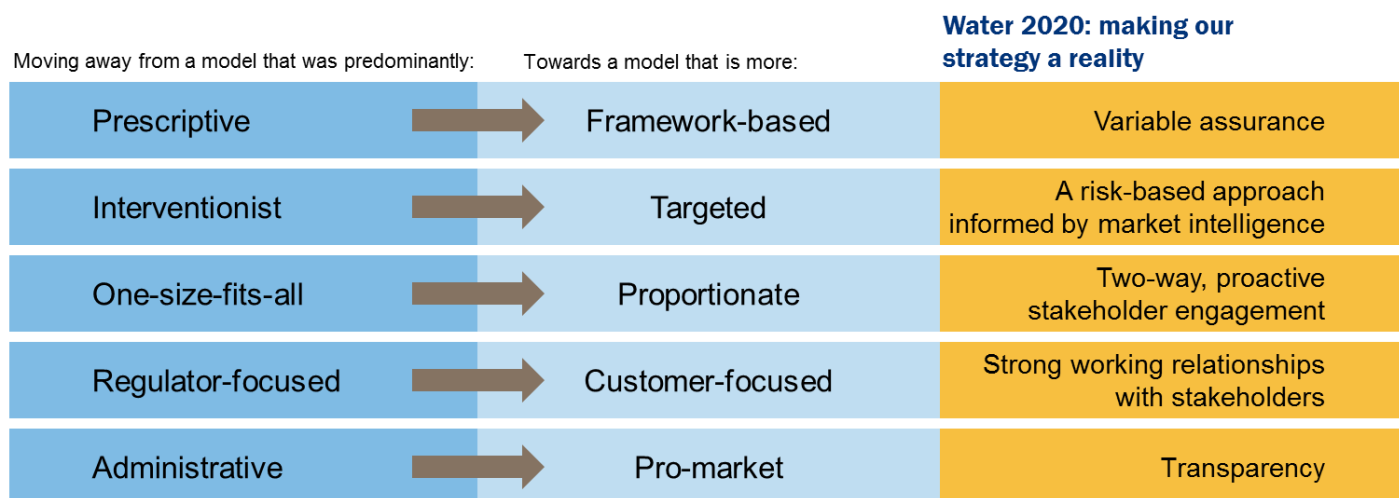
Our strategy is the means through which we fulfil our duties and the strategic statements of the UK and Welsh Government.

Our strategy “[Trust in Water](#)”, presents our shared vision for the water sector in England and Wales. It places emphasis on trust and confidence by customers in the provision of water and wastewater services. This can only be achieved by the sector, working with its stakeholders. As the economic regulator of the water sector in England and Wales, our role is to help it build trust and confidence with customers, the environment and wider society.

2.4 Our policy approach

We would like to move to a regulatory model which is targeted, framework based proportionate, customer focused and pro-market. Our PR19 methodology and the Water 2020 regulatory framework are important steps towards this model.

Figure 2 Our preferred regulatory model



Our PR19 methodology also needs to be consistent with our [enduring price control principles](#), as set out in PR14, and confirmed in our Water 2020 [July discussion document](#). At a high level these are:

- targeted price controls;
- proportionate price setting;
- effective incentives;
- ownership accountability and innovation;
- flexibility and responsiveness; and
- transparency and predictability.

3 Our approach to assessing the impacts of our policy proposals and decisions

In line with best practice, our impact assessment takes as its starting point the current situation, as established by PR14. This “do nothing” baseline represents continuation of the PR14 methodology and regulatory framework. This aims to ensure that we will only change our framework if there is a genuine benefit.

When carrying out our impact assessment, we have assessed the impact of each policy option against the impact of taking no action, the status quo or “do nothing” option, using the criteria set out in figure 3 below.

1. **Achieving our objectives:** Does the proposed option meet our legal duties, is consistent with the UK and Welsh Government strategic statements and our vision and strategy?
2. **How are objectives achieved:** Is the proposed option consistent with our regulatory model?
3. **Practicality:** Is the proposed option practical and implementable?

Figure 3 Assessment criteria

1. Achieving our objectives: Does the proposed option meet our legal duties, is consistent with the UK and Welsh Government strategic statements and our vision and strategy? In particular does it:

- further the **consumer interest** wherever appropriate through **promoting competition**;
- further the long term **resilience** of companies, supply and systems;
- secure that water **companies can carry out their functions properly**;
- secure that water **companies are financially viable**;
- promote the economy and **efficiency**; and
- ensure **affordability of bills**.

2. How are our objectives achieved: Is the proposed option consistent with our regulatory model? In particular does it:

- reflect a **pro-market** approach based on (i) promoting markets, (ii) avoids undue discrimination between customers and market participants and (iii) promotes competition wherever appropriate;

- **meet better regulation** principles including (i) is a proportionate and targeted intervention, (ii) reflects the use of a broad range of regulatory tools, (iii) is flexible and responsive, (iv) emphasises transparency and predictability;
- focus on **efficiency** including (i) providing effective incentives for companies to be efficient, (ii) encouraging ownership and accountability by companies of their compliance strategy and (iii) fostering innovation; and
- focus on **customer impacts** rather than outputs, including environmental challenges (water quality and scarcity); and takes into account the distributional impact of our policies on different groups of customers.

3. Practicality: Is the proposed option practical and implementable, taking into account:

- the resources required to implement the proposal;
- the costs of implementation; and
- the timescales required for implementation.

Our approach to the impact assessment is consistent with:

- [Our policy on impact assessment](#); and
- [HM Treasury's Green Book: appraisal and evaluation in central government](#).

In line with best regulatory practice, we have taken a proportionate approach to our analysis, providing greater detail in areas that are likely to have the largest impacts on stakeholders. We have not reassessed those changes to which we are already committed and have previously been subject to impact assessments, such as those in the Water2020 decision document, for example separate price controls for water and wastewater network plus, water resources and bio-resources. The Water 2020 decision document also set out the additional expected costs of the changes to the regulatory approach. The additional changes that we propose in this document are small compared to the Water 2020 regulatory changes. We have therefore not reconsidered these additional costs of our proposed changes.

Some policy proposals operate together as a bundle or package of measures, and we have assessed them on that basis rather than each element separately, for example the packages of changes for the bioresources market and the water resources market.