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Trust in water

# **Delivering Water 2020: Our methodology for the 2019 price review**

## **Appendix 14: Approach to impact assessment**

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## 1 Summary

This appendix sets out our approach to assessing the impacts of our policy proposals and decisions and our associated regulatory costs. Rather than include the impact assessment as a separate appendix, we have integrated it into our PR19 final methodology with more detailed evidence and analysis in the appendices. The relevant sections of the main document and associated appendices should be referred to for the evidence, assumptions and calculations we used to inform our impact assessment.

### Applicability to England and Wales

Parts of our impact assessment **apply equally to both** companies whose areas are wholly or mainly in England and companies whose areas are wholly or mainly in Wales.



For some parts of our impact assessment, where we have quantified the impacts for our policy proposals, we have assessed the benefits and costs separately for England and for Wales to reflect the different policy positions of the UK and Welsh governments. In so doing, our assessment reflects, where appropriate, the current legal framework and the allocation of executive powers between the UK and Welsh governments on the basis of company boundaries rather than the border between England and Wales.

## 2 Overview

Over the past three years, we have developed our approach to the 2019 price review (PR19) through the Water 2020 regulatory framework. In '[Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#)' (December 2015), we carried out an initial impact assessment of the specific regulatory reforms included in that consultation, which were necessary to implement PR19.

Since publishing the December 2015 consultation document, we have engaged extensively with stakeholders about our proposed approach, through a series of consultations, workshops and meetings. In May 2016, we published our decision document, [Water 2020: Our regulatory approach for water and waste water services in England and Wales](#), ('May 2016 decision document') that incorporated responses to the consultation. To make sure our proposals were targeted, proportionate and likely to produce the anticipated benefits, we also published an updated impact assessment reflecting our final policy position, stakeholders' evidence and other evidence. Our impact assessment included quantified benefits and costs and qualitative impacts of our proposals.

Since May 2016, in line with regulatory best practice, we have reviewed the assumptions underlying our assessment of the benefits and costs of introducing this package. Additionally, we have updated our analysis through qualitative assessment of the impact of additional policies which will constitute our PR19 final methodology.

We consider that the quantified benefits and costs still remain within the range we set out in our May 2016 decision document. This is because our proposals have not substantially changed since we undertook the assessment, and no other relevant conditions have changed which would alter the outcomes assessed. We also consider that our PR19 policies will have significant net benefits, based on the impact assessment of the individual elements of the methodology.

The impacts of our PR19 final methodology are set out in the technical appendices. This reflects that we have incorporated the impacts of our decisions into our decision-making.

### **3 Our approach to assessing the impacts of our decisions**

In our December 2015 consultation, we included an initial impact assessment of the regulatory policy options under consideration. The largely qualitative nature of this impact assessment reflected the early stage of the policy development process. The initial impact assessment set out how the proposals:

- met our Water 2020 principles and our statutory duties;
- were consistent with regulatory best practice; and
- affected stakeholders, including customers, companies, investors and the environment.

The initial impact assessment concluded that the proposals were expected to be net beneficial, based on an analysis of the proposed policy options with respect to:

- bioresources market proposals;
- water resources market proposals;
- direct procurement for customers;
- proposals to move from retail price index (RPI) to consumer price index including housing (CPIH) indexation for regulatory capital value (RCV) and prices; and
- customer engagement and outcomes.

In our December 2015 consultation, we sought and received responses to our impact assessment. There was general agreement with our approach to the benefit and cost categories. Some respondents provided more evidence, which we considered in the individual policy areas.

We had regard to stakeholders' comments in our updated impact assessment, which we published in our May 2016 decision document. We integrated the impact assessment into the decision document, with more details about the evidence and analysis in the appendices, to make sure our assessments of the impacts and our policy analysis were fully aligned.

Also, during the period between publishing the consultation document and the May 2016 decision document, we engaged with stakeholders through workshops, meetings and letters to better understand the potential impacts of our policies.

Our updated impact assessment in the May 2016 decision document quantified the benefits and costs of our decisions about:

- our final policy package for water resources, which concluded it would result in significant net benefits. The quantified total benefits range from £597 million to £1,254 million, compared to estimated total costs of between £23 million and £42 million. For England, the total benefits ranged from £588 to £1,232 million, compared to estimated total costs of between £20 million to £37 million. For Wales, the quantified total benefits ranged from £9 million to £22 million, compared to estimated total costs of £3 million to £5 million. We also noted other benefits, such as greater network resilience and potential reductions in unsustainable abstractions; and
- our bioresources proposals, which we estimated could lead to benefits between £372 million and £1,386 million, compared to the cost to us of running a separate price control, estimated at between £29 million and £58 million.<sup>1</sup> For England, the total benefits ranged from £359 to £1,338 million, compared to estimated total costs of between £26 million to £52 million. For Wales, the quantified total benefits ranged from £13 million to £48 million, compared to estimated total costs of £3 million to £6 million.

The updated impact assessment in our May 2016 decision document also included qualitative assessments of the benefits and costs associated with our proposals about:

- customer engagement and outcomes;
- the indexation of future price controls; and
- direct procurement for customers.

In line with regulatory best practice, for the final methodology we have reviewed our impact assessment again. We consider that the benefits and costs still remain within the ranges set out in our May 2016 decision document. This reflects both the continuation in approach from our decision document to our final methodology, and the fact that the decisions proposed in our final methodology build on the regulatory changes proposed as part of our part of Water 2020 regulatory package.

For example, the decisions to establish the separate controls in water resources and bioresources were made in our May 2016 decision document; these policies remain for our final methodology for PR19. As noted in [appendix 5](#), in establishing a separate control for water resources, our final methodology sets out more detailed aspects of how the control will work. We have assessed the options for these more

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<sup>1</sup> All quantified estimates on this page use 2015-16 prices, net present value (NPV) over 30 years.

detailed aspects as part of our final methodology. The same applies for the more detailed aspects of implementing the bioresources control and the assessment of the more detailed options is set out in [appendix 6](#).

In other policy areas, our final PR19 methodology contains updated impacts of our decisions.

In our final methodology, we have updated our analysis of direct procurement to include a quantitative assessment of the expected impact for customers ([appendix 9](#)) in particular, to take into account:

- analysis from other regulatory sectors where similar approaches have been introduced; and additional information we received from consultation responses.

We have used scenario analysis to estimate the possible impacts based upon some generic project sizes and concluded that DPC is likely to result in net benefits. The analysis draws upon the savings achieved in other sectors that have implemented DPC approaches and estimates of the costs of implementing DPC.

We have set out the analysis of key elements of our final methodology in the relevant chapters of the methodology document, including outcomes, resilience, cost efficiency, risk and return, and the initial assessment of business plans.

### 3.1 Assessment of options

Each of the policy options assessed in our final methodology takes our Water 2020 objectives into account. These objectives were developed to reflect our regulatory duties and strategy.

#### Assessment criteria based on Water 2020 objectives

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

- further the **consumer interest** wherever appropriate by **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 our objectives are 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;
- costs of implementation; and
- timescales required for implementation.

Our approach to the impact assessment is consistent with:

- ‘Ofwat’s **policy on impact assessments**’ (April 2011); and
- HM Treasury, ‘**The Green Book: appraisal and evaluation in central government**’ (July 2011), in particular, where we have used the recommended discount rate for our quantitative analysis.

The impact of some of our proposals could not have been quantified as robust data was unavailable. Our assessment criteria for policy options discussed above were designed to ensure that even in situations of data paucity, we have followed a thorough, logical process to determine which policy option is most beneficial.

## **4 Post-implementation development plan (PIDP)**

In our December 2015 consultation document, we set out our post-implementation development plan for reviewing the final policy decisions.

The objectives we set out for the review included the following:

- Are the policy objectives that led to the introduction of the measures still valid and relevant?
- If the objectives are still valid and relevant, is regulation still the best way of achieving those objectives compared to the possible alternatives?
- If regulation is justified, can the existing measures be improved?

We will carry out a post implementation assessment in due course in accordance with Section 8 of our impact assessment policy.