

OFWAT IDEAS LAB

SUBMISSION FROM ADAM COLLINSON

Introductory remarks

This submission contains a summary of my thoughts in response to Ofwat's request for input on how it should design future price reviews.

Responses to a number of the questions that Ofwat has posed in order to stimulate ideas are set out below¹, but by way of preface I make a few introductory remarks.

I have a longstanding interest in the water sector, but not a vested interest. I am a former competition lawyer, and worked with water companies for many years, helping them to manage regulatory investigations and to promote compliance, and advising on water regulation. I continue to follow with interest the activities of many of the sector's stakeholders including Defra, Ofwat, The Consumer Council for Water, and Water UK, as well as the think tank and charity Sustainability First.

In the aftermath of PR19, my impression is that trust between regulator and regulated is low, that the latest price review process has been particularly adversarial, and that the investment on both sides in terms of time and money in order to obtain the "right" outcome (because the stakes are so high) is at its highest level ever.

If we are going to ensure that right is done by the environment and the consumer, as well as allowing the regulator to achieve a difficult balance whilst still ensuring stability for the sector, the relationship between regulator and regulated needs to be reset, and trust needs to be regained on both sides. This will require adjustments in behaviour from both Ofwat and water companies, but PR24 should be designed with an objective in mind of rebuilding trust and confidence by each in the other, and where possible the price review process should be made simpler.

¹ I have not responded to all questions, and so have included only those to which I have proffered a response

Ofwat's questions (and my brief responses to them)

Q1 What could the water sector look like in 2040, and how can Ofwat and water companies work towards that vision?

A1 My vision would be the sustainable supply of clean, safe water via resilient infrastructure, with water companies enhancing the public's enjoyment of the natural environment and the land of which they are custodians. Everyone would value water itself as a precious resource and would also value the custodianship provided by the water companies. Collaboration between water companies in order to relieve pressures on supplies (whether in terms of catchment management, interconnection of networks, or other water transfer) would be commonplace, and would occur within a supportive regulatory environment. All sewerage companies would be making use of biogas as a sustainable source of energy to power waste water treatment works and investment to deliver that would be supported by Ofwat. Ofwat and the water companies would all be proud of the work that they are doing collectively to achieve this vision.

In spite of efforts by the industry, not enough people yet value water, and more needs to be done to make them do so. It is always going to be difficult to achieve this whilst network leakage levels remain high, so a way needs to be found to improve resilience across the country at the lowest possible cost.

Investment of this type is investment for the long term, and Ofwat needs to find a way to allow this to be funded having regard to issues of inter-generational fairness. It is not something that is likely to be capable of being fixed within a small number of five year review periods, so a longer term approach is required. Trade offs could be considered in terms of (a) creating greater industry incentives for cross industry collaboration and / or technology sharing to achieve rapid progress in improvements in infrastructure resilience and (b) removing some of the focus on inter-company comparators in the context of the regulatory regime.

Water companies are some of the UK's largest landowners, taking care of thousands of acres of reservoirs and countryside. It is not clear that the value

created by water companies for customers and citizens in terms of the amenity that they provide for citizens in this context is adequately recognised (or indeed that this amenity is promoted as well as it could be by the companies themselves). Greater promotion and recognition of this amenity value could potentially form part of water company performance assessment.

Q2 How do we best regulate to help companies to achieve long-term goals such as adapting to climate change, reducing leakage, improving water efficiency and delivery of net zero?

A2 There is a tension inherent in the price control framework resulting from the need for water companies to make long term investments (and to achieve long term goals), and the need to ensure that the burden of paying for these investments is distributed fairly between current and future generations. It should not necessarily be the case however that customers should bear all these costs. It may be appropriate for consensus to be reached between government, businesses and customers as to precisely what needs to be done, and then for consensus to be reached on how it should be paid for (ie which costs / the proportion of the relevant costs that should be met through bills, taxes, reduced investor returns, etc).

A way needs to be found for these long term approaches to be institutionalised into the regulatory / policy framework. Ultimately, it may be necessary or appropriate to have layered regulation, whereby “starting point” price controls are established for operational / day to day business, and additional allowances in terms of costs and funding are permitted for longer term projects and investments, with those additional allowances being projected to be recovered over a longer time profile, and an appropriate proportion of those allowances being recovered in each of the price control periods that fall within that longer time profile.

Q3 How do we encourage companies to ensure services are affordable for all, both now and in the longer term?

A3 It will be important to see the outputs from CCW’s independent review into the affordability of water.

It would seem appropriate for there to be a uniform definition of vulnerability across England and Wales, and across the water and energy industries, so that social tariffs are available to all customers who are considered to be vulnerable, and that they receive consistent and joined up treatment.

It seems ludicrous that concerns in relation to data protection impede the sharing of information between utility providers, when the aim of that information sharing is to provide better and more consistent support for those in energy or water poverty. It may be necessary to seek government support to change the law so as to facilitate data sharing between key utility providers.

Q4 How can we encourage companies to innovate and to take advantage of technological change to increase productivity, reduce costs and improve resilience, service and the environment?

A4 The price control framework does not give sufficient incentive to companies to take risks by innovating, because of the way it treats successful and unsuccessful risk taking. Where a company succeeds with an innovation it is (and its investors are) able to benefit from that innovation for the duration of the price control period, but the benefit is then clawed back for the consumer as price controls are adjusted. Where an innovation is unsuccessful the costs of failure are borne entirely by the investors. Deviating from what other companies are doing therefore implies only partial reward for success and a penalty for failure. The incentive to innovate is therefore dimmed, and this needs to be addressed if innovation is to be encouraged.

Q7 What, if any, could the role of the price review be in encouraging or incentivising companies to better deliver public value?

A7 See final para of response to Q1. A more imaginative approach towards assessing the public value that water companies can provide would be welcome. Once an assessment has been undertaken of what the public value (and the extent to which they value it), delivery of that value should be rewarded.

Q11 How do we encourage companies to collaborate and work in partnership with others, such as on nature-based solutions, to better achieve outcomes for customers and the environment?

A11 The creation by Ofwat of its Innovation Fund is to be welcomed. Where there are examples of successful collaboration with partners outside the sector, these should be highlighted and promoted. The more visible these types of collaboration become, the more water companies and third parties can be expected to explore opportunities to collaborate themselves.

It strikes me that there is something of a default position on Ofwat's part to use the price control framework to try to achieve everything it wishes to achieve. This may have contributed to the increasing complexity of the price review process.

Ofwat has already alluded to the fact that it may consider whether it could simplify the price review process by resorting to the use of other tools in its regulatory toolbox to encourage action by water companies. I would take this a step further and encourage Ofwat to strip out of the price review process **everything** that could effectively be dealt with through use of a different tool.

Adam Collinson
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