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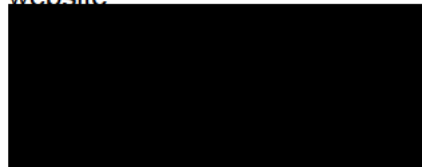
29 June 2023

Dear Ofwat,

Re: Consultation on changes to our NAV policy and assessment guidance

I am writing to you on behalf of independent Water Networks Limited (“IWNL”), part of the BUUK Infrastructure Group of companies, in response to your consultation on changes to your [New Appointments and Variations policy and assessment guidance](#), published on 1 June 2023. This letter presents a summary of our views on the proposals set out in the consultation and then responds in turn to the key issues as we see them.

I can confirm that this response is **confidential** and should **not** be published on the Ofwat website



Proposed changes to Ofwat’s NAV policy

...engage with you on these issues and for the chance to influence the future direction of this policy. While we are fully supportive of the intent of the changes proposed given that they will secure outcomes that align with the interests of consumers, we have some residual concerns about how they are implemented.

In particular, we note the contrasting approaches taken by Defra and Welsh government in issuing their revised Strategic Policy Statements (SPS’), which were published in March and December 2022 respectively. In this respect, Defra published an **open** consultation that recognised the potential value of competition while Welsh government laid its draft document before Senedd noting that “key [invited] stakeholders ha[d] worked together...to shape this SPS” and articulating its view that the “further promotion of competition is undesirable”. These observations illustrate the divergent approaches adopted by the respective governmental organisations as well as their contrasting positions on competition.

We note that, although the Defra SPS was published 16 months ago and closely aligns to the Ofwat “consumer objective”, we have yet to see concrete action from Ofwat to effectively

deliver against Defra's specified expectations. While we are fully supportive of the viewpoint that competition should deliver end customer benefits, and believe we can demonstrably evidence this, if Ofwat implements this proposed change to its NAV policy in England and Wales, we would expect to see equivalent changes to the regime to support the pro-competition expectations set out by Defra in its SPS.

The Welsh government Strategic Policy Statement

We were initially surprised to receive notification that Ofwat was consulting on changes to its NAV policy because of the publication of the Welsh SPS as Welsh government did not openly consult on this and we were therefore not aware that a revised SPS had been issued. While we understand that Welsh government engaged 'key stakeholders' in the process of revising its SPS, we note that we were not given the opportunity to influence the direction of this policy. We therefore have some concerns around the level of transparency regarding the process of revising, and the subsequent publication of, the Welsh SPS.

In addition to our issues regarding the process adopted by the Welsh government, we have concerns that some of the viewpoints expressed in the Welsh SPS do not directly align to the provisions of with the Water Industry Act 1991 (the Act). In this respect, we note that Section 2, paragraph 2A of the Act places an obligation on Ofwat to "perform [its] ... duties ... to further the consumer objective"; which paragraph 2B goes onto specify is "to protect the interests of consumers, wherever appropriate by promoting effective competition." Further, Section 2B, paragraph 1 of the Act provides for "Welsh ministers ... to publish a[n SPS]", while paragraph 3 states that in "formulating a statement ... Welsh Ministers ... must have regard to the duties imposed on [Ofwat in] section 2." The combined intent of these provisions enshrined within the Act therefore appear to stand in direct contrast to the statement made by the Welsh government in the SPS that "the promotion of in-market competition in the water industry is not a priority".

Mo [REDACTED] that the Welsh SPS appears to contain conflicting and / or dis [REDACTED] the following examples.

- [REDACTED] Ofwat should "develop the regulatory framework as applicable to Wales on the basis of sound evidence" but does not include any evidence to support its assertion that the "further promotion of competition is undesirable".
- Welsh government expresses a desire to "encourage companies to adopt circular economy principles...where waste is minimised, ...materials are reused..., [and] recycled materials replace raw materials..." but only larger companies can realistically operate in this way and the approach therefore discriminates against smaller players.
- Welsh government states that "the promotion of in-market competition in the water industry is not a priority" but concedes that "the principles of competition and markets can sometimes play a role in raising performance standards and driving efficiency; for example, comparative competition through benchmarking".

We note that the concerns we express above with respect to (a) the extent to which the provisions of the Welsh SPS are aligned to the Water Industry Act and (b) the consistency of the messaging contained within the SPS, may be symptomatic of the relatively closed approach that Welsh government took toward consultation on the draft. We believe that wider

more open consultation on the content of the SPS would have highlighted these issues and allowed them to be effectively addressed. The fundamental concerns we have identified regarding the Welsh SPS, raise further questions about whether it is the right time for Ofwat to make subsequent changes to its NAV policy approach. In this respect, we question whether there is a rationale to suggest that key affected industry stakeholders should be given a genuine opportunity to comment on the Welsh SPS recognising that it is being treated as a foundational document upon which further policy proposals are being built.

Translating the Welsh SPS into proposed changes to Ofwat's NAV policy

While we are fully versed in the hierarchy of regulation and understand that Ofwat is required to act in accordance with the Welsh Government SPS when carrying out relevant functions relating wholly or mainly to Wales, we note that Ofwat has a degree of discretion in the approach it takes to the implementation of supporting provisions.

In this respect, we see that Ofwat has taken a relatively stringent interpretation of the provisions in the new SPS which state that “the Welsh Government does not support the introduction of competition...where it cannot clearly be evidenced that it would be beneficial to customers”. Our views are very much aligned with the sentiment of this statement, and we strongly believe that any industry change should be based on clear evidence that benefits overall will outweigh the associated cost and that advantages will ultimately accrue to customers. However, we note that the draft wording in the Ofwat proposals refers specifically to a requirement on NAVs to “set out how the **end** customers and / or environment would benefit as a result of the applicant serving the site rather than the existing incumbent”. Adopting a stricter interpretation of the statements made in the Welsh government SPS, further reduces opportunities for NAVs to cite relevant benefits. It also ignores the significant benefits that NAVs deliver to developer customers and the indirect benefits that result where incumbent water and wastewater companies are incentivised to improve their performance.

In [REDACTED] commonality between the Welsh government and Defra SPS is [REDACTED] specifies an expectation, accepted practice suggests this should be expected...”. In this respect, we note the Welsh Government SPS [REDACTED] competition in water and wastewater markets were not preceded by a reference to these words, implying that it does not explicitly require action in this area. We therefore consider that Ofwat has taken a relatively strict interpretation of the specific comments made by Welsh government with respect to competition.

We can demonstrate clear end customer benefits where IWNL is appointed.

While we have concerns around the approach that has been taken to the development of the new Welsh SPS, the relative speed at which Ofwat has acted on the implementation of supporting policy compared to the pro-competition sentiments set out in the Defra SPS, and the relatively strict interpretation of the provisions, we are supportive of the policy intent. In this respect, as outlined above, we strongly believe that prior to making any industry change it should be clear that benefits overall outweigh the associated cost and, specifically, that advantages will ultimately accrue to customers.

We are confident that we already deliver the end customer benefits that the Welsh SPS is seeking to encourage; namely competitive prices, strong customer service and environmental benefits. While all NAVs are obliged to abide by the 'no worse off principle', to ensure that end-customers are not charged more than they would have been if they were served by an incumbent, we go further to offer our end-customers additional support that enhances overall affordability. Specifically, we match incumbent end customer tariffs, while also offering additional volumetric and billing discounts.

In addition, our 2022-23 IWNL customer statement, which is set to be published by 15th July 2023, will highlight the success we have had in terms of providing an exceptional service to our customers. We continue to deliver industry-leading levels of customer satisfaction; with frontier performance on the net promoter score (NPS), likelihood to recommend and written customer complaints.

Our environmental performance is also significantly better than that of our counterparts in the industry; with materially lower average leakage in 2022-23 as compared with the industry average value, reported by [Discover Water](#). While we recognise that this is partially due to the relative age of our infrastructure, we do work hard to effectively maintain our assets to keep leakage levels to a minimum and actively monitor the performance of our fully metered network. Finally IWNL and other NAVs have been instrumental in leading the implementation of Sustainable Drainage Systems (SuDS) for new developments. The impact and success of existing SuDS infrastructure has contributed to Defra's decision to initiate Schedule 3 of the Flood and Water Management Act 2010, which will mean that SuDS are an intrinsic part of every new development in the country.

We believe benefits can be demonstrated while minimising regulatory burdens.

We appreciate the efforts that Ofwat has made in trying to reduce the regulatory burden that NAVs, and IWNL as a company, face. We recognise the progress that has been made to improve competitive conditions and establish a level-playing-field for NAVs, but the pace of change is slow. We are concerned that this hard work may be undone if further steps in the NAV licensing process without equivalent change being made to the regulatory environment we face. We are also concerned that incumbent water companies' change in policy as a signal that Ofwat are not supportive of competitive markets and again offer poor service to NAV licensees.

These issues include the burdens already placed on NAVs during the licensing process which restrict our ability to effectively compete with incumbent water and wastewater companies; and mean that significant portions of the new connections market remain inaccessible to us due to the unnecessarily lengthy NAV licensing process. While we appreciate Ofwat's stated intent, in its 2023-24 forward workplan, that "every year, we seek to ensure that regulatory burdens are kept to a minimum while ensuring companies deliver the best outcomes for customers", this sentiment does not marry with our experience. In this respect, despite repeated requests to review the current approach and revise it to remove undue NAV regulatory burdens, the process continues to consume significant unnecessary resource and involve unduly lengthy timeframes. We are still required to submit extensive information to support our NAV applications, despite our strong track record and, while Ofwat has improved the timeframes associated with the NAV licensing process, it still takes 85 working days to review and approve

an application. This does not reflect best practice examples in other utilities. We are concerned that the proposed change set out in this consultation could add a further step, and further complexity to a process that we already consider to be disproportionately burdensome to the associated level of risk of a NAV appointment, particularly for established NAVs. We also note the disproportionately slow comparative progress that has been made; particularly in terms of the Bulk Supply Working Group which has been discussing the key issues for more than two years. This is especially of note given that discussions on NAV bulk supply provisions have been under ongoing open review since October 2017 when Ofwat commissioned Frontier Economics to complete [a study of the market for NAVs](#).

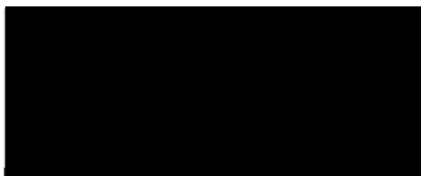
Next Steps

We therefore consider that, if Ofwat decides to implement this change, it will be of paramount importance that a pragmatic approach is taken. We believe it would be proportionate for Ofwat to explicitly commit to the establishment of a programme of work, including timeframes, that will secure effective delivery in line with the expectations set out by Defra in its SPS. We believe that this commitment should be provided prior to placing any further limitations on the ability of NAVs to compete fairly against incumbent water and wastewater companies through making changes to the NAV licence application process.

Further, demonstrating the delivery of benefits to end customers, could become part of the annual process, potentially combined within the company-based assessment (CBA) that Ofwat already carries out. We think that this would represent a more optimal way to minimise the associated regulatory burden that could otherwise be added to the NAV licensing process.

I hope that this letter is helpful. If you have any questions on any of the issues I have raised or would like to discuss these in more detail, please feel free to contact me.

Kind regards,



Keith Hutton
Group Regulation Director