



Ofwat's response to the UK Government's consultation on collaboration between economic regulators

Overview

Thank you for the opportunity to comment on the UK Government's consultation on options for embedding collaboration between economic regulators. This response supports the response provided by the UK Regulators Network (UKRN).

Ofwat is the economic regulator for the water and wastewater sector in England and Wales. We have duties to:

- protect the interests of consumers;
- ensure that the companies properly carry out their functions;
- ensure that the companies can finance their functions;
- promote economy and efficiency;
- further the resilience objective; and
- contribute to the achievement of sustainable development.

Ofwat fully supports and is committed to its role as a member of the UKRN, and views its creation as a real opportunity to maximise the benefits that both independent economic regulation and effective cooperation between regulators on key issues can deliver, leading to better outcomes for customers, businesses and the economy.

The consultation seeks views in particular on how Government might best support and encourage the UKRN, and more widely help to embed cooperation between the regulators. The three options presented are:

- **option 1:** monitor progress of the UKRN and review effectiveness of the UKRN in 2015;
- **option 2:** provide guidance to the regulators/UKRN on the Government's overall approach to cooperation; and
- **option 3:** introduce a statutory duty on regulators to cooperate.

Of the options presented within the consultation, we fully support option 1. We have not sought to respond directly to each of the questions raised in the consultation. We set out below four general points that we consider support option 1 as the most appropriate course of action at this time.

Overall, we:

- wholeheartedly endorse the creation of the UKRN and are fully committed to participating in effective collaboration with a defined, prioritised and resourced work programme;
- consider that implementing a statutory duty to collaborate could take the emphasis away from the principal objective of the UKRN, which is to maximise benefits for customers through better regulatory outcomes, by focusing instead on ensuring cooperation is taking place (the input, rather than the outcome for customers);
- consider that more clarity is required about what the Government believes the problem to be and/or the benefits it hopes to achieve; and
- consider that the principles of better regulation are a more appropriate route by which the Government could place emphasis on collaborative working between regulators.

Introduction of a duty to cooperate

We are of the view that the introduction of a statutory duty to cooperate would carry with it a number of risks that are not visibly outweighed by benefits. Each regulator has its own legal and regulatory framework and its own statutory duties with which it would need to balance any such duty to collaborate – the framework is different for each sector. A statutory duty to cooperate could compromise the flexibility that is currently in place across the sector regulators (and other members of UKRN) to engage in collaborative working, to the extent that the very objective of collaboration could be undermined because of differing interpretations and prioritisation within regulators. The consultation does not give any flavour or substance in terms of how the Government could provide meaningful guidance given such hugely varying duties and legislative frameworks across the sectors.

Our vision for the water and wastewater sector places trust and confidence at its core. A significant step towards this vision has been played out through our approach to the 2014 price review (PR14), which has placed customers at the heart of companies' business planning as well as placing the onus on the water companies themselves to own their business plans. Companies have engaged in the biggest ever conversation in this price review, with more than a quarter of a million direct customer contacts and each company having its own independent challenge group to provide assurance on its business plan.

Trust and confidence is necessary across the water and wastewater sector in the quality of drinking water, in the reliability and the resilience of services, that services will be value for money and will be affordable, in customer service and in fair dealing. More generally, customers and stakeholders need trust and confidence that decisions taken today will not have a detrimental impact on future generations. Trust and confidence of investors in the sector and its regulator are paramount, to ensure companies can finance their investment at the best cost for customers.

We shared our vision as part of our emerging strategy for the sector in June 2014 and it really resonated with customers, with the companies we regulate, with other regulators and with wider stakeholders. We set out the two principal drivers of that trust and confidence.

The first is outcomes. Crucially, are people getting what they need and want from the sector at a price they can afford? The outcomes that customers experience in the water and wastewater sector reflect a wide variety of interactions, across what is a very complex system that includes customers and service providers, and the regulator, but obviously also includes Government, other regulators, non-governmental organisations and investors. If the system as a whole is going to work well, in the best interests of customers, we need strong relationships across all of these elements.

So, the second driver of trust and confidence is strong relationships – relationships that are based on openness, honesty and fairness. The most obvious of these relationships is that between service providers and their customers. And that is something we have put at the heart of PR14: we have observed a real sea-change in behaviour within the sector and beyond. This approach has been broadly welcomed by investors, with whom we have had a number of meetings during the PR14 process.

These are all issues that can be translated across the different sectors and across the UKRN to play a fundamental part in what UKRN is hoping to achieve – maximising benefits for consumers in the regulated sectors through better regulatory

outcomes. We consider that the introduction of a duty could compromise the achievement of this objective and deny the regulators the flexibility to use their suite of regulatory tool-kits to allow relationships to flourish and conversations to happen – and to ensure continued investor and customer trust and confidence, through protected independence.

Best practice in policy development

The timing of the consultation, given UKRN's relative infancy, does not appear to follow best practice in policy development. In our view, the results of a new policy (in this case the UKRN) do not appear to have been given sufficient time to be generated for effective evaluation before reviewing the policy. Further, it is not clear to us from the consultation what 'failure' the consultation is intending to address or the benefits it is hoping to achieve. This appears to be acting against the principles of economic regulation, which state that policy interventions must be proportionate and cost-effective while decision-making should be timely and robust.

Measuring success

Further to the point immediately above, the consultation does not specify how any of the options, once implemented, would or could be measured – in other words, what would success look like? In our view, this would need to link back to costs and benefits, so that a robust benefits realisation exercise could be carried out.

We consider that consideration also needs to be given to the timeframe over which success will be judged. While we support option 1, we would suggest extending the timeframe from the current 'in 2015'. From April next year, our Chief Executive, Cathryn Ross, will be Chair of UKRN and, like her fellow Chief Executives, remain committed to ensuring that UKRN shows clear and targeted benefits for customers. The work Ofwat is leading for UKRN on the cost of capital, in which we are comparing approaches to setting regulated returns and identifying whether and how we could increase the level of consistency in our approaches, is just one example of this. This work will report further during 2015. Other examples of UKRN work designed to benefit customers across the sectors include projects on cross-sector resilience, infrastructure investment and affordability.

The principles of better regulation

Should the Government believe that further intervention is required to embed joint working between regulators, we consider that an endorsement of the principles of better regulation are, at the present time, the most appropriate route to doing so. Given the desire to reduce regulatory burden and encourage greater regulatory effectiveness, the impact of better regulation on cross-sector working could be emphasised further.

Ofwat
December 2014