 <b>Regulatory Policy Committee</b>	<b>Opinion</b>	
<b>Impact Assessment (IA)</b>	Introducing retail competition in the water sector	
<b>Lead Department/Agency</b>	Department for Environment, Food & Rural Affairs	
<b>Stage</b>	Final (enactment)	
<b>IA number</b>	Defra1346	
<b>Origin</b>	Domestic	
<b>Expected date of implementation</b>	Summer 2015 (SNR10)	
<b>Date submitted to RPC</b>	3 March 2015	
<b>RPC Opinion date and reference</b>	22 April 2015	RPC11-DEFRA-1128(3)
<b>Departmental Assessment</b>		
<b>One-in, Two-out status</b>	<b>Zero Net Cost</b>	
<b>Estimate of the Equivalent Annual Net Cost to Business (EANCB)</b>	<b>N/A</b>	
<b>RPC Overall Assessment</b>	<b>GREEN</b>	
<p><b>RPC comments</b></p> <p>The IA is fit for purpose. The Department has amended the IA following the passage of the Water Act through Parliament. The IA now presents a different preferred option, to allow water companies to choose to separate legally their non-household water supply business. This is intended to work alongside the previous option of reforming the licensing regime, to enable greater levels of competition in the non-domestic water supply market.</p> <p>The Department has responded to the comments in the RPC's previous opinion, and the RPC is able to validate the proposal as zero net cost for One-in, Two-out purposes, with an estimated net benefit to business of £9 million per year (revised from £8 million in the previous IA).</p>		
<p><b>Background (extracts from IA)</b></p> <p><b>What is the problem under consideration? Why is government intervention necessary?</b></p> <p><i>“The water and sewerage industry in England consists of vertically integrated regional monopolies. Although the current form of price cap (RPI-X) regulation has been successful, the sector is facing new challenges which demand reform. To meet these challenges the independent review of competition in the water sector led by Professor Cave recommended a series of reforms to facilitate effective retail competition for non-households. The Government have since committed to reforming the sector to ensure more efficient use of water and to protect poorer households. Intervention is necessary as there are a number of barriers to</i></p>		

*competition which are set out in legislation and need to be changed. Set against this is the need to ensure continued investment in water and sewerage infrastructure in the face of a range of challenges facing the water industry through to 2050 as set out in the Water white paper.”*

**What are the policy objectives and the intended effects?**

*“The policy objectives are to put a framework in place which enables all business customers in England to choose their water and sewerage retailer and to maintain investor confidence in the water sector so as to ensure secure and resilient supplies and infrastructure networks in the face of projected supply and demand challenges. The intended effect is that businesses will have the opportunity to switch suppliers, that actual, or threatened, competition will incentivise companies to reduce costs and prices, improve efficiency and increase service levels and that investors will continue to see the water sector as an attractive area for investment. This is in contrast to the current arrangements whereby efficiency and customer service levels are driven by targets set by Ofwat with very limited scope for business customers to demand their own bespoke arrangements.*

**Comments on the robustness of the OITO assessment**

The IA says that these regulatory measures are net beneficial to business (an IN with zero net cost). This is consistent with the current Better Regulation Framework Manual (paragraph 1.9.12) and, based on the evidence presented, provides a reasonable assessment of the likely impacts.

**Comments on the robustness of the Small & Micro Business Assessment (SaMBA)**

The measures increase the scope of regulation on business. Therefore, a SaMBA is required.

The SaMBA is sufficient. The Department estimates that the costly elements of the proposal that affect suppliers:

- will be directly related to the size of the business, so will not result in disproportionate costs; and
- are voluntary/permissive in nature – suppliers will choose to separate their non-household retail businesses only if it is likely to be beneficial.

The Department has also provided additional information demonstrating that only a single micro business operating as a supplier will be within the scope of the proposals. Furthermore, the Department expects that the costs to the micro business will not be disproportionate as, should the company choose to separate its non-household retail business, the costs will be proportionate to the size of the existing business.

Small and micro-businesses that are water customers are expected to benefit as a result of increased competition amongst suppliers.

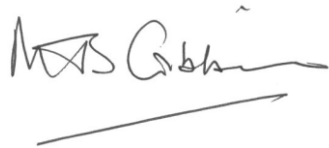
## Quality of the analysis and evidence presented in the IA

The measure will introduce a number of changes to the water supply licensing regime intended to improve its effectiveness in encouraging competition in the sector. This will reduce some barriers to entry associated with features of the existing regime, such as pricing of access. During the passage of the Water Act through Parliament, the Government's preferred option changed, so that the proposal now also includes an option to allow water supply businesses to separate non-household retail activity. Currently, without the option to separate their businesses, water supply companies are restricted to competing in only those markets served by their associated undertaker. The reforms to the licensing regime will enable new entrants to compete more effectively, with optional separation of activities enabling existing suppliers to compete in geographic locations outside those in which they currently operate.

The Department has increased the estimated proportion of companies that are likely to separate their non-household retail business as a result of incurring losses from greater competition. The change has been made in response to comments in the RPC's previous opinion highlighting the need to explain better the potential impacts of competition and to provide further evidence. This results in an increase in the estimated efficiency savings for non-household customers, but a reduction in the potential 'spill-over' benefits for household customers. The changes to the analysis and preferred option have led to a small change in the estimated benefits to business (to £9 million per year, from £8 million per year) and an increase in the net present value of the proposal to £211 million from £190 million.

On the basis that the Department has updated the analysis within an IA that was previously rated fit for purpose by the RPC, the Department's assessment – with the additional changes – is sufficiently robust for the RPC to validate the proposal as zero net cost for One-in, Two-out purposes, with an estimated benefit to business of £9 million per year in EANCBS terms.

**Signed**



**Michael Gibbons, Chairman**