

The regulatory outlook.

Life after the periodic review



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The future of regulation

- Regulating better
- Regulating over the longer term
- Regulating through change

Evaluating the periodic review

- Content
 - No one?
 - No Competition
 - Commission references
- Process - everyone?

Independent review of 2004 price review

- Examine how Ofwat carried out the review, suitability of the process and integrity of its application.
- Involved stakeholders.
- Published recommendations.

Recommendations from independent steering group

- 23 main recommendations
- 2 principal issues
 - Clarity of roles, powers and the rules of the game
 - Long-term planning and the periodic review cycle (currently five years).

Good points

- Ofwat more transparent and open
- Feedback on information submissions
- Well planned and managed
- No proposals for radical change

Not so good points

- More weight to customers' interests
- Environmental improvements are not optional
 - subject to disproportionate scrutiny
- Some methodologies 'opaque'
 - efficiency
 - capital maintenance

Regulating over the longer term

- Setting longer term context.
- Frequency of price reviews.
- Long term plans for:
 - maintenance;
 - water resources; and
 - enhancement.

Water Framework Directive

Welcome the principles:

- To incorporate economic analysis.
- To provide a basis for stakeholders to participate in making soundly based decisions on setting environmental objectives.
- Takes a long-term perspective over three river basin planning cycles.

Ofwat's aim is for water customers to pay fair share of implementation costs over the three cycles.

Huge challenge for the industry and regulators to get this right.

Regulation through change

- Internal structural change
- Competition
- Sustainability
- Incentives

Regulating through change

- Demise of the Director General
- Water Services Regulation Authority from 1 April 2006
- Smooth transition but

Regulating through change

New duties

- Competition
- Sustainability

New Competition Duty

New primary duty:

‘To further the consumer objective which is to protect the interests of consumers, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with, the provision of water and sewerage services.’



New competition regime

- Introducing market competition
- Limited opportunities
- Consultation with stakeholders

Messages

- Our approach will be fair to all players.
- We expect that the new regime will have a 'slow burn' commencement rather than a big bang.
- Licensees will need a clear understanding of where they can add value and how the system works.

Sustainability

Five principles:

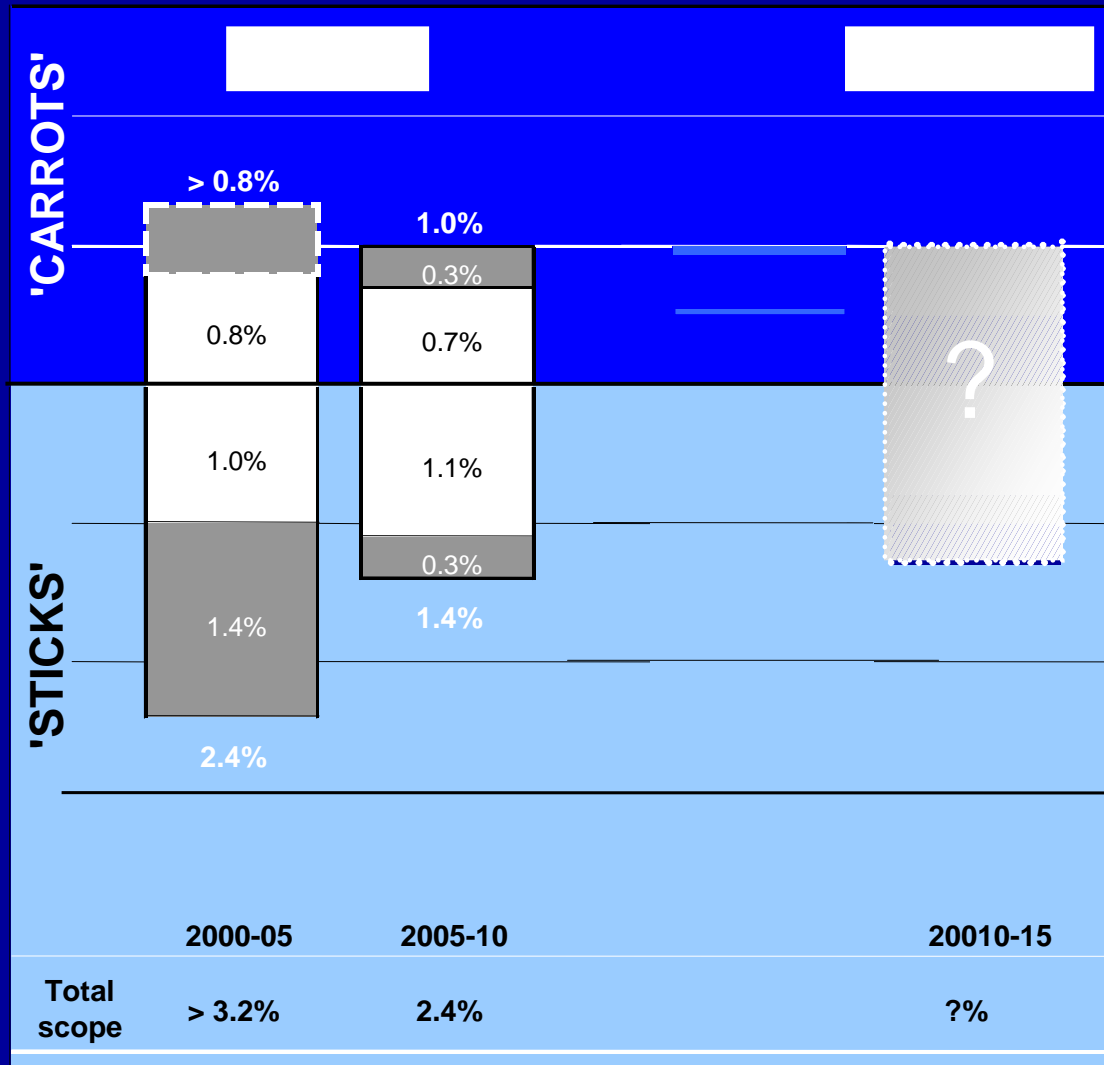
- Living with environmental limits.
- Strong, healthy and just society.
- Achieving a sustainable economy.
- Promoting good governance.
- Using sound science responsibly.

Incentives

- Efficiency
 - scope
 - relative
- Capital programmes
 - early start programme
- Performance

Efficiency

(eg. Operating cost efficiency assumptions – Water service)



Catch-up efficiency
 Continuing efficiency

Unquantified assumption made on the 'carrot' element of continuing efficiency at the 1999 review.

