

Dear Mark

Q1: The change in emphasis to using IA as a tool to help continuous policy development seems sensible, in the context of evolutionary policy agendas which require a series of milestones and checkpoints to secure implementation of sustainable and longer term solutions relevant for both the energy and water sectors. For example, as with RIIO, our own overarching price limits framework is intended to cover multiple price control periods, within which we expect to develop the regulatory regime incrementally – for example to reflect the Government’s legislative proposals for gradual market opening, and the longer term abstraction reforms which it and the Environment Agency are developing. Continuous use should also help to ensure the IA is used to develop policy, rather than being used as an afterthought or an exercise to support pre-determined policy decisions.

Q2: The three category approach to assessing impacts seems to align both with practical requirements and the different statutory duties in relation for example to efficiency, affordability and sustainability. It is therefore likely we will also need to be clear about categorising impacts in a similar way in water, as we share similar practical challenges and duties. However, because the proposed categorisation blends these two dimensions (practicality and purpose) there could be scope for some overlap and confusion unless the lines are well-drawn. For example longer term impacts are not always inherently hard to monetise – for example when physics is relatively predictable, as in the case of the drivers of some nuclear decommissioning costs, versus short/medium term weather impacts relevant to considering whether to accelerate network resilience investment. Similarly distributional impacts can be both relatively straightforward to measure and hard to value – e.g. assessing de-averaging impacts from the perspectives of equity and affordability and vulnerable consumers more generally.

Q3: The different time horizons proposed for assessing stress and security, versus natural asset and greenhouse gas impacts, accord with some relevant asset economic lives for the former, though in our sector we have a wide spread of such lives, leading to capital maintenance allowances and more recently proposals for totex as the basis for ex ante regulation of relevant network revenues. Equally the span of environmental impacts we need to consider in our sector goes wider than those on natural assets and greenhouse gases (e.g. shorter term odour issues) and hence there is a continuum of relevant time horizons for current and future consumers to which we must have regard in our regulatory policy. The referenced 2012 Ofgem paper envisages a more systematic approach to weighing the impacts over these different time horizons, but in doing so indicates that the weights attached to current and future consumers will be at GEMA discretion (2.9 in that paper) – in contrast to the consistent weights associated with the application of the Green Book in relation to the proposed CBA component of IAs, or alternatively those underlying the analysis on which the 2050 GHG target was set by Government. It may be helpful for the final document to clarify how the systematic approach will combine such potentially different weights in this way.

The other key element of the longer term framework of relevance is the treatment of wider legal frameworks in relation to assessing diversity benefits. The 2012 paper indicates that while tools such as real options analysis may help to illuminate the materiality of such longer term benefits, the continuation of existing legislation will be assumed as a test in such assessments. As the nature of future legislation following anticipated milestone review is in principle itself a key relevant uncertainty for the longer term, it may be useful to clarify whether and how it would normally be relevant to consider such uncertainty e.g. in analysis

of resilience and diversity benefits. Even in the shorter term we are likely to explore impacts for our price limits proposals with alternative assumptions about future legislation.

Q4: In relation to other comments on the proposed Guidance, I would make five:

Format: the proposal to enable flexible presentational formats for IAs seems sensible, though it seems to differ from the interpretation of an equivalent statutory duty by Ofcom, in that you propose normally to retain standalone summary or full IA documents, rather than fully embedding IA material within the body of a policy consultation. While there are arguments for both approaches, we see merit in a default presentational approach so that the same stakeholders know what to look for in different documents in a consistent way. In our case, we have somewhat greater discretion to interpret our relevant better regulation duty, and we will be giving thought to how the effective presentation of IA evidence, on a case by case basis, can help to secure continued improvement in the effectiveness of our policy consultations and communications. There may be potential for some joint regulator learning here to develop a consistent approach where appropriate.

Importance criteria: the table at 2.8 illustrating these does not include consumer impacts in the criteria. Without a word of explanation this might look odd to stakeholders in the context of your duties.

Draft final IAs: the distinction drawn at 2.25 does not mention these, while not excluding them. They would be relevant for example for final consultation proposals, following initial consultation on a broader range of options. It may be useful to clarify that such IAs could be relevant in some consultation situations.

“Where appropriate..do nothing”: the guidance seems to imply that the definition of a counterfactual for the CBA component of an IA is discretionary, which looks odd. Obviously a policy option to do nothing may not be appropriate or particularly realistic (e.g. options to implement more generally worded EU legal requirements), but assessing the impacts of factual options generally requires the definition of a clear counterfactual in any event. Perhaps this could be clarified.

UK versus other EU consumers: the narrative on cross-border effects and the Third Package (3.48) could usefully point up any basis by which trade-offs as between UK and other EU consumer impacts are addressed. The relevant issue in telecommunications is addressed on the face of extant primary legislation (Communications Act S3(6)) and it may be useful to note the extent to which the Third Package equivalently might require the prioritisation of other EU consumers in the event of conflict.

I hope some of these are useful.

Kind regards

Robin Pratt, Ofwat