

Meeting note

Monday 25 January 2016
 Centre City Tower, 7 Hill Street, Birmingham B5 4UA
 10.30 am to 1.00 pm

Sludge working group

Attendees	
Adrian Mercer	Veolia
Andrew Snelson	Anglian Water
Bill Lilly	Intervate
Daniel Davies	Welsh Water
Dave Musco	Yorkshire Water
Helen Richards	South West Water
James MacLean	Northumbrian Water
Jon Latore	United Utilities
Mat Davis	Environment Agency
Matt Wheeldon	Wessex Water
Peter Cramp	Sludgetek
Peter Trafford	Thames Water
Sam McGauley	Severn Trent Water
Julie Tate (only able to attend introductions only by phone)	Natural Resources Wales
Alison Fergusson	Ofwat
Brian Caire	Ofwat
Jacob Wood	Ofwat
Jill Marshall	Ofwat
Justine Dade	Ofwat

Meeting purpose

This meeting had several purposes:

- Introduce to stakeholders our sludge market and regulatory framework proposal;
- Give a chance to stakeholders to challenge our sludge market and regulatory framework proposal outside of the more formal consultation process;
- Set the terms of reference;
- Discuss the information platform;
- Set the format of the next meetings.

Summary of Actions

Action	By Whom	Deadline
Ofwat asked members to provide any evidence on transport costs or distances of sludge to feed into the sensitivity analysis of our model. This information will help Ofwat to ascertain the level of benefits that may result from implementing this mechanism. This information could be provided through the consultation response or directly.	Companies	
EA to liaise with Ofwat in providing information on Other Organic Wastes (OOWs)	Ofwat	
It was agreed that an aunt sally on the different types of transactions would be put together and circulated around.	Companies	To be circulated before the next technical working group meeting
Ofwat encourages stakeholders to reply to the consultation and provide evidence.	Stakeholders	10 February 2016

Notes of the meeting

The topics discussed during this meeting have been summarised in four tables below. The first table summarises the discussion related to our proposal sludge market and regulatory model. The second table summarises the discussion about the impact assessment. The third table summarises the discussion about the term of reference. The fourth table summarises the discussion about the information platform.

1. Our proposal sludge market and regulatory model

Issues raised	
Ofwat's model: 50km radius	<p>To better reflect reality, Ofwat's model should calculate distance between sewage treatment works (STW) and sludge treatment centres (STC) not between the sludge treatment centres.</p> <p>The 50km radius might be based on wrong assumptions. It would be useful to carry out sensitivity analysis (e.g. 30km to 70km).</p> <p>Action: Ofwat asked members to provide any evidence on transport costs or distances of sludge to feed into the sensitivity analysis of our model. This information will help Ofwat to ascertain the level of benefits that may result from implementing this mechanism. This information could be provided through the consultation response or directly.</p>
Ofwat's model: OOW data	<p>The model would better reflect all market opportunities if OOW centres were included in the analysis.</p> <p>The Environment Agency (EA) already collects information on capacity and location OOWs through the Waste Returns (quarterly) as part of its licence conditions. Ofwat should liaise with the EA to discuss this information.</p> <p>Action: EA to liaise with Ofwat in providing information on OOWs.</p>
Qualitative survey	<p>One respondent questioned why only 20% of the organisations contacted replied to the survey. It was hypothesised that only respondents interested in entering the market filled in the questionnaire, indicating a possible bias. Therefore, the survey might not truly reflect the market's intentions.</p>

<p>Asset stranding</p>	<p>A number of respondents considered that Ofwat may have underestimated the asset lives, especially those within sludge treatment. A downward bias may have resulted from a significant level of investment in mechanical equipment (which tends to have a lower asset life), especially in anaerobic digestion systems.</p>
<p>Resilience capacity</p>	<p>Companies need to keep some spare capacity in order to treat additional sludge when other STCs are taken off the network for maintenance. This could reduce the scope for trading.</p> <p>This capacity might be used for trading but only for short-term contracts.</p>
<p>Asset transfers from regulated to non-regulated sectors</p>	<p>Ofwat should look into the methodology to transfer assets from the regulated sector to the non-regulated sector. There is a need for a clear methodology to value assets.</p>
<p>Definition of terms and costs</p>	<p>Setting a standard for quantifying sludge might be an issue. Using volume is easy but does not reflect the “quality” of the sludge. Using calorific value is a more accurate reflection of sludge value but is more difficult to calculate.</p> <p>The Mogden formula does not take into account the level of ammonia which is high in sludge liquors. Another formula should perhaps be used to set liquor treatment costs.</p> <p>Setting a comparable cost basis across the industry might be difficult and costly to implement.</p>
<p>Financial resilience and accountability of contractors</p>	<p>The financial resilience of contractors is important for companies to trust the market and use contracts rather than build their own assets.</p> <p>What happen if contractors go bankrupt? Will Ofwat set a procedure to manage this kind of situation? Where will the responsibility lie?</p>
<p>Length of contract</p>	<p>Contract duration must be long enough to ensure a steady cash-flow. Otherwise, stakeholders will face difficulties when looking for financing options.</p> <p>There is a potential risk from short-term contracts with third-parties reducing its costs by not appropriately maintaining the assets.</p>

	<p>Stakeholders have to be careful about the renewal of contracts and ensure that they have alternatives if contracts are not renewed.</p> <p>However, long-term contracts might dampen competition.</p>
Challenges facing the successful implementation of the sludge market mechanism	<p>It was considered that both the transfer pricing issue and contracting issues (such as who is responsible for what) were much greater challenges compared to the information requirements.</p>

2. The Impact Assessment (table discussions)

Issues raised	
Costs of collecting data	<p>One table thought that they collect much of the data that would be published on the information platform. Therefore some companies were unlikely to need to update their internal systems. However, a subsequent comment by a company suggested that at least some companies do not currently collect the data and the process of doing so would likely to be costly and complex. There were also significant challenges around the comparability and quality of data.</p>
Environment Agency Costs	<p>It was considered that it was not possible to provide an estimate of this as the permitting system is complex. It was considered that the proposals would introduce further complexity, which would bring a cost, either as a result of more time spent by the regulator or through permit costs.</p>
Costs disaggregation	<p>How should companies disaggregate and allocate costs incurred not only through sludge but by combined sites?</p>
Upstream costs	<p>Upstream costs drive the quality of downstream input (i.e. sludge). How should these costs be reflected in sludge treatment costs?</p>

3. Terms of reference

Issues raised

Length of meetings	To make an efficient use of time, it has been suggested that meeting should extend over a complete day covering more topics. It was hoped that this would reduce the frequency of meetings.
Using other media	It was suggested that a conference call should be made available for stakeholders.
Final output	The final output of this working group should be set clearly in the terms of reference.
New entrants	Ofwat needs to consider how to best communicate with new entrants.

4. Platform

Issues raised	
OOW	<p>Will the OOW companies be included in the platform? Or only WaSCs? There is concern about asymmetry of information.</p> <p>It was suggested that incentives should be made available to encourage OOW to disclose information and participate in the market, such as, OOW's only gaining access to the platform after agreeing to share information.</p>
Identify who will use the platform	A potential alternative to publishing detailed data (e.g. available capacity, costs, location) would be for STCs to publish a "price to beat". Market participants can then bid if they believe they can offer a better price to treat sludge.
Type of data	<p>The type of data published will depend on who uses the platform. An example of dataset would be: treatment price, location and excess capacity. Other data such as the thickness of sludge might be useful as well.</p> <p>The requirements on the granularity of data have to be set (e.g. site-by-site, company-wide).</p> <p>Some data has already been made available by the Environment Agency (e.g. through the Waste Returns). Ofwat should use this data to avoid duplication.</p>
Update frequency	The frequency of the updates will depend on which kind of market develops. A market for short-term needs will require

	<p>frequent updates whereas a long-term market will require less frequent updates. Stakeholders reckon that the market will most probably be a long-term market and, therefore, annual updates should be sufficient.</p> <p>However, more frequent updates could help stakeholders (e.g. the Environment Agency) to identify unintended consequences sooner (e.g. deterioration in the quality of sludge spread to land) and take measures to avoid them. It was noted that there had already been case studies elsewhere where there had been a deterioration in the quality of sludge spread to land.</p>
Types of transactions	<p>Looking into the different types of transactions (e.g. WaSC to WaSC, new entrant to WaSC, new capital investment) might guide the platform and other design considerations.</p> <p>Action: It was agreed that an audit on the different types of transactions would be drafted and circulated around.</p>

Actions for next meetings

The next working group meeting will most probably take place on the 2nd March 2016. Stakeholders have agreed on the following actions for the next meetings:

- Send an early agenda so that stakeholders can choose the most suitable representative to attend the working group;
- Set a general agenda for every meeting in order to insure that every topics of interest will be covered;
- The following topics should be considered for the future meetings:
 - Understanding how the next price control will work;
 - Analysis of transports costs;
 - Consider how Northern Ireland and Scotland fit into the regulatory framework.