

Meeting note

Monday 26 July 2016
 Centre City Tower, 7 Hill Street, Birmingham B5 4UA
 10.00 am to 3.30 pm

Water resources working group meeting – Second meeting

Attendees	
Tim Charlesworth - Affinity Water	David Darley - Yorkshire Water
Jean Spencer - Anglian Water	Jerry Bryan - Albion Water
Liz Cornwell - Bristol Water	Polly Chancellor - The Environment Agency
Liz Franks - Dee Valley	Darren Leftley - Canal and River Trust
Crawford Winton - Northumbrian Water	Paul Harrison – Welsh Government
Frank Grimshaw - United Utilities	Peter Hetherington - Ofwat
Steve Morley - Portsmouth Water	Hanif Jetha - Ofwat
Lester Sonden - Sutton and East Surrey	David Young (Item 13 only) - Ofwat
David Hinton - South East Water	Rob Lee (Item 13 only) - Ofwat
Nikki Deeley - Southern Water	Stephen St Pier (Item 13 only) - Ofwat
Nagi Suzuki - South Staffordshire Cambridge	Riccardo Zecchinelli - Ofwat
William MacKveley - Severn Trent	Ian Pemberton - Ofwat
Leo Mackenzie - South West Water	
Phillip Dixon - Thames Water	
Daniel Davies - Welsh Water	
Luke Devial - Wessex Water	

Meeting purpose

Several areas were covered at the meeting:

- Ofwat's market information platform, with contributions from various stakeholders;
- the form of control for water resources price control;

- feedback from the first meeting of the access pricing for bilateral markets in England sub group; and,
- an update on wider Ofwat work directly related to water resources, including licencing, the water resources boundary and responses questions asked in the May document.

Action	By Whom	Deadline
Minutes: Ofwat to circulate the minutes to group members for comment. Comments should be sent to Hanif Jetha .	Ofwat, Group members	5 August for comments from group members
Ofwat to share calculations presented during the form of control item. This has been sent round to group members alongside the draft minutes. If you have any comments or want to discuss please contact Peter Hetherington .	Ofwat	Completed
Canal and River Trust to update group on status of paper on raw water transfers	Darren Leftley	5 August
Access pricing sub group to prepare materials to update the next water resources working group meeting on progress	Access pricing sub group	23 September
<p>Presentations for future working groups: Ofwat is looking for volunteers to present and facilitate discussions at future working groups. Among others topics available include:</p> <ul style="list-style-type: none"> • Resilience (in September); • Cost assessment for water resources (in September) • Form of control; • RCV allocation for water resources; • Bid assessment framework; and • Incentives for trading/interconnection. <p>If you are interested in this or other topics please contact Peter Hetherington.</p>	Group members	5 August for the September meeting, otherwise ongoing

Note of the meeting

Project management

The actions from the last meeting were discussed and the minutes and terms of reference agreed. It was noted that a page has been setup on the Ofwat website where all papers and minutes will be published.

Market information platform – the story so far

Ofwat provided an overview of the policy development of the market information platform, this covered Deloitte's proposed market design which was incorporated into the December consultation, the responses to that consultation, and our further review and analysis.

Water 2020 – water resource planning and third party options - recap from last paper and observation on May consultation

South East Water presented a summary of their paper prepared for the marketplace of ideas and expanded on it with their latest thoughts and reflections on Ofwat's proposals. The discussion covered the objective for reform of water resources, the barriers faced by third parties (both regulatory and information) and gave thoughts on how a market place for water could work. There was a wider discussion on the potential role of brokers in the market and whether they are likely to develop organically or if a regulatory appointed broker is required.

Competitive markets to tackle water scarcity

Wessex Water presented thoughts on how a competitive (bidding) market in water resources could work. The key feature of the proposals was for incumbents to "leave space" for third parties to meet some of the supply within period, but with companies, and third parties that bid early enough included in business plans and still delivering the majority of supply in order to meet long term demand in case new entrants do not materialise. The rest of the discussion focussed on differences in temporal and geographic needs for different water systems and the impact this has on information requirements and bids.

Thoughts on Ofwat 2020 – market information platform

The Canals and Rivers Trust provided background to their business and shared some of their market experiences in particular some of the difficulties that they have faced due to a lack of information availability. Specifically that data needs to be more consistent, detailed and accessible. The issue of terminology and jargon being a barrier was raised in wider discussion.

Water resource information necessary to support an efficient market - an entrant's view

Albion Water's presentation highlighted the difficulty entrants carrying out demand side schemes face in having the value of their scheme taken into account by incumbents when providing them. The difficulty to get hold of information on the

benefits of reducing demand or peak usage was also raised as was the need for a mechanism to be in place so that demand side scheme providers can be recompensed fairly.

Improving market information – Initial Ofwat thinking

Ofwat presented its initial thinking on the data incumbents should provide for the market information platform, and what third parties should include in bids. This prompted a discussion about the level of information and a general consensus that the level of information needs to be enough to make the market operate, but not so much that it creates unnecessary burden. There was also discussion covering a number of issues:

- Whether it would be appropriate to introduce a minimum standard for bidders to meet?
- The balance of work required by incumbents to support entrants to make a credible bid?
- Whether there should be an “expression of interest” stage before more formal bids are made?
- The bidding process, in particular when do bids become locked-in (i.e. when can an incumbent rely on a bid without fear it may be withdrawn?)
- The differences between two distinct bid types – local solutions (using available water) and national solutions (where services such as leakage control might be more appropriate).

Form of control

Ofwat presented its current thinking on the form of control, this included background on what the form of control is and why it has to be changed. A more detailed worked example was discussed and it was agreed to circulate the spreadsheet to group members. A general discussion followed with the following points and questions raised:

- There was a discussion on the differences between demand and capacity and how this would impact the measurement of the extent of entry
- There was a discussion of why replacement capacity is included under ‘new’ water resources but maintenance expenditure not included. Could this drive inefficient decisions to ‘keep patching up’ pre-2020 (protected) capacity when new (post-2020, hence at-risk) capacity would be a ‘better’ value solution?
- It was suggested that in a scenario with increasing demand, the only penalty that should be applied to an incumbent in response to bilateral entry is a

recouping of the funding costs as the incumbent will have received the money slightly before they need it, as with entry the incumbents new resources could have been deferred

The presentation was followed by group discussions on (1) how should capacity be measured (2) what policy gaps are remaining and how can they be addressed and (3) what potential unintended consequences are there and how can they be addressed. The feedback from these discussion are below:

How should capacity be measured?

- The group could not agree on whether it should be 'capacity' or 'demand', or how to measure it (WAFU? Capacity of source?). It was agreed to have a meeting over the summer to try and explore the issue further.

What policy gaps are remaining and how can they be addressed?

- There was a discussion around potential perverse incentives and how they could be avoided, e.g. we would not want companies to allow leakage to rise to reduce risk of under-utilisation penalty applying;
- There was a discussion around the timing of the measurement of utilisation, should it be annual for example, and if so financial or calendar?
- How the bidding market and bilateral market interact was discussed and it was noted there needs to be clarity on how entrants' bids included in incumbents' plans are incorporated
- There was a discussion over the unit cost approach proposed in the example and whether this was a sophisticated enough measure

What might be the unintended consequences are how can they be addressed?

- There was a discussion over whether companies could be incentivised to invest inefficiently in assets not included in the WR price control? (e.g. bankside storage, leakage reduction, demand management) to avoid risk of under-utilisation of water resource assets?
- Building on this there was a discussion over whether companies will raise maintenance expenditure and reduce new investment, even if it would be inefficient to do so (in the absence of the under-utilisation risk)?
- There was a discussion of how to incorporate leakage reduction services in the control, how does this interact with the under-utilisation risk measure?
- There was discussion on resilience and whether it would be adversely affected by the form of control
- There was a discussion around the WACC and whether the increased risk could lead to it increasing

- There was a discussion on the interplay between the bidding and bilateral market, it was speculated that companies may be pushed to accept uneconomic bids in the bidding market in order to avoid under-utilisation risk from the bilateral entry market? The links to access pricing were noted here and the need for this to be designed appropriately to avoid this happening.

Access pricing – update from sub-group

The access pricing subgroup is made up of representatives from five companies and will feedback to the main group. The sub group had its first meeting on 22 July and agreed to prioritise work on:

- How to use cost information to determine the access price; and
- How the proposed approach to access prices, combined with the form of control, will impact incumbents' and entrants' businesses.

Feedback on progress over the summer will be provided at the next working group meeting.

Ofwat updates

Licencing update

In the May document Ofwat proposed a package of licence modifications to enable policy decisions made in May to be enacted for PR19. For water resources this includes modifications for allowing separate controls and the market information platform. There is an ongoing process with incumbents on the changes and a consultation is due in the autumn.

The water resources price control boundary

Ofwat gave an overview of the latest thinking on the water resources boundary that will be out for consultation in August. The regulatory accounting guidelines opens on 17 August, closes 13 September and the aim is for changes to them will be confirmed by 30 September.

May document consultation responses (as of July 21)

Ofwat gave a summary of the responses to the two consultation questions asked in the May document on water resources, the summary captured all responses provided as of the 21 July.

Actions and agenda for next meeting

Feedback was provided on the interactive session on future topics held at the last meeting. Future meetings and topics to be discussed were then confirmed.