

# Meeting note

Thursday 8 September 2016, 10.00 am to 3.30 pm  
Centre City Tower, 7 Hill Street, Birmingham B5 4UA

## Sludge working group – 6th meeting

<b>Attendees</b>	
Alexander Maddan	Agrivert Ltd
Alison Fergusson	Ofwat
Alex Llewelyn	Northumbrian Water
Clive Humphreys	Environment Agency
Daniel Davies	Welsh Water
Dave Musco	Yorkshire Water
Derek Meachem	Gemserv
Eifiona Williams	Welsh Government
Jacob Wood	Ofwat
Frank Grimshaw	United Utilities
Helen Richards	South West Water
Jessica Allen	Anaerobic Digestion and Bioresources Association
Jill Marsal	Ofwat
Justine Dade	Ofwat
Kevin Wightman	Southern Water
Khalid Khan	Ofwat
Mark Jones	Ofwat
Peter Jordan	Ofwat
Rebecca Lamb	Wessex Water
Sam McGauley	Severn Trent Water
Simon Black	Anglian Water

Simon Furse	Water Industry Commission for Scotland
Steven Jackson	Kelda Group
Stewart Carter	Thames Water

<b>Action</b>	<b>By whom</b>	<b>Deadline</b>
<ul style="list-style-type: none"> <li>Prepare options on Sludge transfer pricing scenarios for discussion at the next meeting</li> </ul>	United Utilities	Next Meeting
<ul style="list-style-type: none"> <li>Develop the 'successful bid template'.</li> </ul>	Agrivert Ltd	To be confirmed
<ul style="list-style-type: none"> <li>Update the Sludge Market Information Tables</li> </ul>	United Utilities	First week in October
<ul style="list-style-type: none"> <li>Companies to submit nominees for Sludge Cost Assessment sub-group to Alison Fergusson</li> </ul>	All WACSS	30th September 2016
<ul style="list-style-type: none"> <li>Contribution to the Asset valuation discussion</li> </ul>	United Utilities and Southern Water	Next Meeting
<ul style="list-style-type: none"> <li>Distribution of questionnaire on the costs and benefits of installing new equipment for sludge measurement</li> </ul>	Ofwat	To be confirmed

## Note of the meeting

### Introduction

Ofwat welcomed everyone to the meeting and gave a brief overview of the scope of the day.

### **Form of Control: Discussion of issues raised by Welsh Water, facilitated by Daniel Davies (Welsh Water), Stewart Carter (Thames Water) and Jake Wood (Ofwat)**

Welsh Water presented their view with regard to the proposed sludge price control and 'How will it work in practice'. The presentation also made reference to their internal discussion note 'The implementation of the Average Revenue Control for Sludge Post 2020' published on the 9 June 2016.

The presentation explored Ofwat's proposals, the practical application of the sludge price control and the underlying assumptions:

- Average binding revenue limit
- 'Sludge revenue' will be recovered from customers through charge multipliers
- Sludge revenue is determined separately through tariffs in advance
- No trading

Welsh Water presented a process for calculating the control for the first year (2020-2021), and some worked examples with outturn volumes being higher or lower than forecast, the outcomes and potential incentives / risks.

Thames Water then presented the view from their perspective, which also considered the requirement for new investment to be at risk. Thames also raised an additional issue as to whether the tariff framework would incentivise the development of the sludge market by way of a worked example. This led to a brief discussion around transfer pricing which is proposed as a topic for the next meeting. United Utilities offered to work up some scenarios to aid the discussion.

Ofwat then presented on the form of sludge price control. The presentation considered the options for the over-arching design and the tonnes of dry solids average revenue control.

A comment was made that there is a big assumption that everyone measures sludge volumes accurately and on the same basis, which will get refined over time.

However, at the time of setting the price control these assumptions may be wrong and produce variances between companies.

Sludge cost assessment and defining efficient costs was raised and it was agreed that this should form part of the cost assessment working group.

The presentation then focused on the efficiency challenge by comparing it with the work done on the 2014 retail control and how it will relate to efficiency assumptions across all other 2019 price controls. However, it was noted that considerations may need to be given to special factors that affect efficiency, for example, there may be restricted access to the local land bank for biosolids recycling.

The discussion then considered what happens after the price control has been set and how it will relate to the network plus control. There were a number of comments:

- Querying the benefit in separating sludge revenues out from network plus revenues, beyond accounting separation.
- A question was raised on whether sludge control (average revenue control) should be treated separately to network plus (total revenue control) . One delegate thought that as revenues will be known for both that it did not have to be treated separately. Another delegate thought that they would need to be kept separate as sludge is a binding sludge control.
- One delegate pointed out that the Modgen formula already contains the 's' charge that is meant to reflect sludge costs.
- Ofwat may want to treat over / under recovery revenues differently when they arise because of measurement differences / inaccuracies that affect sludge volumes rather than those that arise from inaccuracies in the charging methodology.
- There was discussion about when to adjust for any over / under recovery. It was suggested that in-period adjustment was appropriate as we will not know the price control from 2025 and we wouldn't expect to see large variations.

## **Form of Control: Tonnes of dried solids**

Yorkshire Water and Ofwat presented a summary of the results from the questionnaire on 'Tonnes of dried solids' that was sent to companies following the previous working group meeting. Yorkshire Water led a discussion on using TDS as the basis of average sludge revenue control for PR19.

Yorkshire Water gave a reminder of the two measures proposed by Ofwat for PR19

- Tonnes Dry Solids per year (TDS)/yr – preferred

- Population Equivalent, PE, served (60 grams BOD/person.day)

Ofwat asked if wet tonnes solids were appropriate, to be comparable to the waste industry, but recognising that historically dry solids has been the industry measure.

Delegates commented that TDS is not the best measure for introducing competition across all aspects of sludge activities. They acknowledged that TDS may well be best overall, but is not really appropriate for transport costs especially with a lot of rural sites, as there is more to move as liquid in tankers, whereas for non-rural / larger works you can transport as cake.

Another delegate asked how individual charges for each process can be set within the overall price control.

Ofwat asked whether, if there is large variation on how to arrive at TDS but the range smaller for PE, is PE not a better measure? One delegate responded that PE is not a linear relationship with sludge production, and others commented that population varies, e.g. with tourism. Also the costs vary by rurality. The fewer the number of people connected to a STW the higher the unit transport costs.

There was a discussion on where the TDS should be measured. Suggestions included:

- at the boundary of when the sludge process starts i.e. transport post sludge thickening as per the RAGs;
- at the pre-treatment stage;
- at various points to cross-check consistency of measures.

There was also a concern over capturing the data from small STW's as to how much sludge they are producing.

The concept of a hybrid measure was discussed but the companies felt that this would not be appropriate.

There was a discussion on measurement methods: weighbridge, sensors, sampling etc. recognising that although all companies are not at the same point, there is the need for consistent historical data for cost assessment. However, it was acknowledged that if the information isn't available there is nothing that can be done.

It was agreed that there should be a consistent approach across all companies but this could lead to some companies using a less accurate measure to achieve this. A suggestion was made of using one measure for the accurate price control and one for consistent cost assessment.

The cost of installing new equipment could be disproportionate to the benefit gained from having the data, especially with regard to smaller site where sampling may be a viable option. It was agreed that Ofwat would ask companies about the cost and timescales vs the expected benefits to be gained from installing measurement equipment.

## **Sludge Market: Market Information**

United Utilities presented on 'Developing the Sludge Information Platform'. Comments made during the presentation included:

- The objective is to promote short term trades and to encourage new entrants into the market for longer term contracts;
- The information should include available capacity;
- There should be a defined minimum data set that all companies should publish with the freedom to add additional data as each company sees fit;
- The data should be sufficient to stimulate a conversation and not too detailed resulting in it being costly to maintain and update;
- There was concern that publishing certain types of data could harm companies' commercial positions, for example, the type of technology employed at sludge treatment sites.
- The view was that the data should relate to a single year but with the ability to flag seasonal variations?
- A counter argument was raised in that interested parties are always able to ask for information rather than companies publish vast amounts of data;
- There was a general recognition that the market will evolve over time;
- The group's view was that on the whole trades are likely to be local due to high transport costs but there could be exceptions due to lack of availability etc
- Should all the data cover all sites or just larger sites? The view was that it should be large sites as there is less benefit in publishing small site data. But it was agreed that a subset of information could be published for smaller sites.

The above is a summary of some to the items discussed and Frank agreed to take away these and all of the other points and update the example data collection tables for a follow on discussion at the next meeting.

## **Environmental Regulations – Update**

The Environment Agency gave an update on the actions arising from the July working group.

The Environment Agency reported that several conversations had taken place with Defra to look at the various options available, taking into account the changes that need to be or can be made to implement the suggestions made in July.

A more substantive report on progress will be presented back to the November working group meeting.

## **AOB / Future Working Group Sessions**

### **Cost Assessment**

Ofwat has decided to have a separate sub group for the sludge cost assessment activity, but run as part of the cost assessment work stream and to include only the water and sewerage companies. The recommendation is that companies could have two representatives at the cost assessment sludge sub-group, one with cost assessment expertise and the other with sludge expertise. Companies were asked to send through their nominees prior to the next meeting to Alison Fergusson.

### **Asset Valuation**

Ofwat gave a presentation on ' Look ahead to October: Valuation'

The topic will be discussed further at the October meeting and United Utilities and Southern Water offered to contribute to the discussion in particular to two of the options:

- Replacement value of processes
- Notional assets based on specified cost/technology/assets to treat given amount of sludge

### **Future Meetings**

The next meeting is scheduled for 20 October in Ofwat's Birmingham Office. It is anticipated that this workshop will discuss Asset Valuation, the updated market template and Transfer pricing and charging. An agenda will be circulated to attendees prior to the meeting. Provisional dates of future meetings are 29 November 2016 and 17 January 2017.