

Meeting note

Tuesday 13 December 2016
 Centre City Tower, 7 Hill Street, Birmingham B5 4UA
 10.00 am to 3.30 pm

Water resources working group meeting – Fifth meeting

Attendees	
Tim Charlesworth - Affinity Water	Darren Leftley - Canal and River Trust
Alex Plant - Anglian Water	Peter Thorn - Coal Authority
Liz Cornwell - Bristol Water	Polly Chancellor - The Environment Agency
Liz Franks - Dee Valley	Stuart Sampson - The Environment Agency
Sian Leek - Dŵr Cymru	Ancel Boucher – IBM
Crawford Winton - Northumbrian Water (for items 1-5)	Caroline Harris - Natural Resources Wales
Steve Morley - Portsmouth Water	Colin Green – Ofwat
Jim McLaughlin - Severn Trent	Freddie Levett - Ofwat
Pat Spain - Severn Trent	Iain McGuffog - Ofwat (for items 1-5)
David Hinton - South East Water	Ian Pemberton - Ofwat
Nikki Deeley - Southern Water (for items 1-5)	Mathew Stalker - Ofwat (for item 2)
Nagi Suzuki - South Staffordshire Cambridge	Khaled Diaw – Ofwat
Joanna Campbell - Sutton & East Surrey	Peter Hetherington - Ofwat
Phillip Dixon - Thames Water	Simon Harrow - Ofwat
Frank Grimshaw - United Utilities	Trevor Bishop - Ofwat (for item 7)
Tom Hall - Wessex Water	
David Darley - Yorkshire Water	

Meeting purpose

Several topics were covered at the meeting:

- The working group discussed a straw man for access pricing in bilateral markets in England, prepared by the access pricing sub-group;

- The group discussed what information the parties involved in the bidding market would want and what the bid assessment framework should involve and require companies to do;
- Ofwat provided project updates on RCV allocation for water resources discussed in November, Ofwat’s approach to pre-consultation for water resource management plans 2019 (WRMP19) and future engagement on water resources in the run up to the methodology consultation in July 2017; and
- There was a discussion on how water companies should approach resilience, utilising domestic and international examples, and what metrics could be used to measure it accurately. As part of this the policy framework and opportunities relating to water companies operating in Wales was discussed alongside Bristol Water’s approach to planning for drought resilience.

Action	By Whom	Deadline
Minutes: Ofwat to circulate the minutes to group members for comment. Comments should be sent to Hanif Jetha and Peter Hetherington .	Ofwat; group members	6 January
Access pricing for bilateral markets in England: The access pricing sub-group noted that there are many unresolved design questions within the presented straw man. Group members were asked to send through any views on the straw man (in particular the questions set out on slide 13) to Mathew Stalker and Peter Hetherington to inform future work in this area.	Group members	6 January

Note of the meeting

1. Welcome and introductions

Ofwat welcomed the attendees and thanked group members for their contributions since June. A brief update was then provided on the actions from the last meeting:

- The minutes have been updated with comments from members and have been published alongside the slides on the [Ofwat website](#);
- The analysis relating to the RCV allocation options presentation was sent out to group members;
- Ofwat has circulated the report produced by PWC for Ofwat on the “[Balance of risk: Risk and reward across the water and sewerage value chain](#)” which looks at cost of capital implications;

- There will be an update on the feedback received on RCV allocation for water resources (item 5.1);
- The access pricing sub-group will present a ‘straw man’ on their thinking on how to approach access pricing for the bilateral market in England (item 2);
- Southern Water’s [report on utilisation risk](#) was circulated to group members; and,
- Ofwat thanked group members for providing feedback on their experience of the working group and there will be an update on future engagement (item 5.3).

2. Access pricing for bilateral markets in England

Ofwat gave a presentation which covered the differences between bidding markets and the bilateral market. It explained how these markets could complement each other as well as setting out the overall aims of setting access prices. The importance of encouraging efficient entry by third parties for the benefit of customers was highlighted. This was followed by other members of the access pricing sub-group who set out a ‘straw man’; an example of how access pricing in bilateral markets could work in practice.

The ‘straw man’ came out of consideration of four key design questions:

- **What schemes an entrant can offer** e.g. physical introductions of water, or leakage and demand management services too;
- **What incumbent schemes are able to be displaced** e.g. Water resources schemes only, or also leakage and demand management;
- **How the compensation payment should be constructed and its availability to entrants** e.g. should the compensation payment pot decline over time as deficit reduces, and should the compensation payment pot be capped, or unlimited?
- **The role of the entrant.** e.g. how does entry interact with price review periods, can they offer more than the current deficit

The following key points were raised in discussion:

- It was noted that access pricing was a key consideration in other sectors (e.g. energy and post) and that it could be useful to consider if there are lessons water can learn from the approach taken in other sectors.
- It was noted that security of supply obligations on incumbents, would mean that entry and its benefits may be more difficult to realise in the water sector.
- It was suggested that only considering water resource schemes as displaceable may not be the best approach as if an entrant has a more efficient way of providing resource or managing demand/leakage then it

should be encouraged. However, it was noted in this case there is additional complexity relating to ODIs and performance commitments under the existing regulatory framework which would be need to be looked at if this approach was implemented.

- Participants considered that in the short term there is likely to be limited entry via the bilateral market, primarily because the length of contracts available are unlikely to be able to support investment in infrastructure to supply water in areas of deficit. However, it was recognised there must, in line with the Water Act 2014, be an access pricing framework in place to allow for such entry.
- Participants questioned whether using the in-AMP deficit to set the limit on compensation payment is appropriate because in some instances incumbents may only be proposing schemes to address future deficits with no deficit in period. Instead it was suggested that what was important was the timing of investment and that this should be the driver.
- Participants also questioned whether discretionary schemes within WRMP (i.e. those not deficit-related) would be displaceable.
- It was noted that in developing an approach, it may have to be a best-fit rather than theoretical ideal. This is to ensure any approach is proportionate to the potential benefits, for both incumbents, entrants and customers.

Action: The access pricing sub-group noted that there are many unresolved design questions within the presented 'straw man'. Group members were asked to send through any views on the 'straw man' (in particular the questions set out on slide 13) to [Mathew Stalker](#) and [Peter Hetherington](#) to inform future work in this area.

3. Break

4. Market information and the bid assessment framework

Ofwat gave a presentation about the market information that will need to be provided to facilitate efficient entry into the bidding market. As set out in the May decision document market information will be published on each company's website rather than on a central database with today's discussion helping determine what content would be published.

The group then split into four groups to consider what market information different parties in the bidding process will need:

- The information that **buyers of water supply** would be interested to know includes:
 - **About the source:** the type, reliability and quality of the source, the seasonality of yield, the location, environmental information, whether

- there are any outside factors (e.g. other users) that could reduce the amount of water available.
- **About the seller and deal:** the price, whether the transaction is for an asset or a supply of water, background on the seller (e.g. fit and proper test), contractual arrangements e.g. what would happen if the source fails?
 - The information that **sellers of water supply** would be interested to know includes:
 - **About the supply area:** detailed geographical/topographical information about the supply areas (the group discussed more specific than the WRZ information submitted in WRMP tables – e.g. treatment works, reservoir information), information about water quality, when the source is required including frequency/duration of use, reliability and population/housing growth forecast for the area.
 - **About the buyer and deal:** the price, the length of the contract, assurances around the quality of data, and, penalties and liabilities for failing to supply.
 - The information that **buyers of demand management** services would be interested to know includes:
 - **About the service:** how much the entrant could save the incumbent (e.g. water efficiency and costs), how this saving would be measured (i.e. what will the service address: leakage or per capita consumption (PCC)?), how the entrant will manage the split between wholesale and retail when implementing solutions and what is required to implement the solution (i.e. how much modification of the current system would be required).
 - **About the seller and deal:** The price, incentives in the contract (pain-gain sharing) and how quickly the solution can be rolled out.
 - The information that **sellers of demand management** services would be interested to know includes:
 - **About the supply area:** PCC, the size of deficit in the area, when and where the deficit is expected to occur, information about leakage, peak drought plan requirements and metering penetration (this could be solution-specific as the supplied technology could tackle leakage or PCC).
 - **About the buyer and deal:** The cost to beat, incentives in the contract (pain-gain sharing) and background information on ODI commitments made by the incumbent.

Ofwat then presented a recap on the bid assessment framework, setting out what principles this framework will cover as well as offering a 'straw man' of how it could be implemented. This included the potential use of bidding windows as they could be

useful from a practical perspective of managing workload and making it easier to link to the WRMP process.

The group then split into four groups and each covered a key question on the bid assessment framework:

- **What criteria and metrics should be used to assess a bid?**
 - It was suggested that this is already largely done through the WRMP process, and links heavily to the previous discussion on the information that buyers of water supply would be interested to know. For consistent treatment of options (whether it's for the WRMP process or an interim bid) the WRMP assessment process taken to assess options should be applied. This will be slightly different for each company.
- **What does good governance look like?**
 - Bids should be judged consistently, transparently (i.e. the criteria that bids are judged by should be openly available), proportionately, in a way that ensures accountability and there should be a quick and transparent appeals process (which could be run by Ofwat or an independent third party).
 - Governance needs to include and be consistent with EA processes.
- **What information should companies be required to publish when they receive bids and when?**
 - In a timely manner, companies should publish their pass/fail criteria, proof of compliance and the reasoning and justification behind their decision.
 - Companies should say how the bid fits within their WRMP / deficit reduction programme.
- **The ideal timeline?**
 - It was suggested that it is best to split this process into two parts:
 - a more formal process at the WRMP planning stage, where companies could be given more time to assess bids and compare these with other solutions before developing their constrained options list; and
 - a more flexible process during the WRMP implementation phase during which options are being delivered.
 - The discussion here noted here the links to potential 'material change' in WRMPs, which if it happens will require companies to re-consult on their WRMP.

5. Ofwat project updates

5.1. RCV allocation for water resources

Ofwat provided an update on issues companies should consider when developing their approach to RCV allocation for water resources and the content and timing of our upcoming guidance on this topic.

The guidance for RCV allocation for water resources will be published in January 2017 and Ofwat will be holding 1:1 meeting with companies before the Water 2020 Methodology Consultation is published in July 2017 to understand their approach to RCV allocation in response to the guidance. The guidance will summarise the key approaches companies could take to allocating the RCV for water resources, reiterating that there is no requirement to carry out a MEAV revaluation, and will set out Ofwat's process for assessing companies' proposals in a proportionate and risk-based manner.

5.2. WRMP pre-consultation

Ofwat provided an update on the approach Ofwat will take to pre-consultation for water resources management plans 2019. This approach was set out in a [letter](#) sent to Regulatory Directors on 8 December and Ofwat expects to have at least one meeting with each company, focusing on understanding how companies have approached key issues for the coming plan and the links to business plans. Ofwat also noted that any company correspondence regarding WRMPs should be copied to: wrmf@ofwat.gsi.gov.uk

5.3. Future engagement

Ofwat provided an update on how it intends to approach engagement in, thanking group members for providing feedback at the last meeting in November. Ofwat set out that it will in 2017 conduct more targeted workshops on specific issues (e.g. form of control) and the current water resources working group will meet less regularly. These more targeted workshops will be held on an ad hoc basis and relevant stakeholders will be informed when these meetings are to be held. This change in approach was prompted by feedback from stakeholders.

6. Lunch

7. Resilience

Natural Resources Wales (NRW) gave a presentation about the impacts that the Wellbeing of Future Generations and Environment Acts could have on how resilience

is considered in Wales. This was followed by Bristol Water who gave a presentation about how it is approaching resilience and the process it will use for WRMP19 and PR19. This includes considering whether it may need to consider other ways of assessing resilience options compared with traditional supply/demand options.

Ofwat gave a presentation about its thinking around resilience, highlighting work done by the Resilience Task and Finish Group, comparisons and lessons that can be learnt from abroad (e.g. Australia and the Colorado Basin) and considered what resilience is and is not. The following key points were made in discussion:

- When referring to reducing the severity of incidents, this includes the impact on a company's resources, the natural environment and also the number of customers affected.
- UKWIR WRMP 2019 Methods – Risk Based Planning (16/WR/02/11) project specified 3 options for drought resilience statements – these could be used as a starting point for defining drought resilience metrics.
- It is important to consider the terminology the sector uses when communicating about resilience with customers, as often the language used (e.g. 1 in 500 year incidents) might not be well understood by all customers.
- Further, companies will need to manage if customers say that the current level of risk is acceptable. Companies would need to engage with customers. Companies may need to consider wider aspects such as costs to the economy and wider society of only doing what customers say is acceptable, and nothing more. More work is required by both companies and regulators.
- Companies need to share responsibility with their customers on resilience (Level of Service etc.) but accountability for their duties remains with them – as it does for all organisations with duties.
- To achieve the greatest benefits, it could be useful for companies and the regulatory framework to first focus on outcomes rather than an immediate focus on tackling outputs.
- Questions around the role of markets were discussed and how they interact with resilience.
- As well as looking at international comparisons, it could be helpful to consider examples of increasing resilience from other sectors (e.g. capital requirements for banking/insurance).

The group was then split into four smaller groups to discuss how we should look to measure resilience:

- **Group 1:** The group considered that there should be a hard metric of resilience (based on likelihood, duration and consequence, minus mitigations). The group suggested that it could be similar to a security of supply index or possibly even a credit rating. The metric should take into account the duration of an event and the

group considered it needs to be at an asset or group of asset level rather than at water resource zone level. That said, the group thought it was important not to reinvent the wheel and to use existing measures and metrics where possible.

- **Group 2:** The group highlighted the interaction with company risk registers, noting that across companies there were likely to be common issues, albeit with different approaches to managing them. The group noted in the discussion the large range of existing metrics, like the Security of Supply Index (SOSI) and serviceability, which should not be forgotten about. Ultimately the view of the group was that a composite measure is likely to be needed, one that is at a high level understandable to boards and customers, with the underlying data sitting below.
- **Group 3:** The group considered it would be very important and also difficult to understand different appetites for resilience from customers. It was suggested that guidance on this could be produced by regulators/UKWIR. The group thought that the recovery from/susceptibility/frequency of shocks were key facets of resilience. The group also discussed how regulators will respond if customers' preferences for resilience are lower than what is potentially optimal and the interdependencies with wholesale wastewater.
- **Group 4:** The group considered it is best to take a holistic approach – linking water service, wastewater service, energy, environment and customers. Resilience and resilience metrics are not useful if they aren't easily communicable and there was discussion around 'informed/upskilled' stakeholder engagement about preferred levels of resilience. A spider diagram was proposed as a method of presenting various metrics so that different levels of resilience metric can be compared (current level, customer preference, government preference, national average, etc.).

8. Meeting close