

Albion Water Response to Bilateral Markets, Call for Information, June 2019 (submitted by e-mail)

Albion Water is a New Appointments and Variation (NAV) water company looking to compete with incumbents to serve new developments and non-household customers. Our primary interest is in the full serve approach to NAVs. Typically this involves the provision of a new local sewage works and water recycling.

Our approach to the bid market

We see the bi-lateral market helping in two ways for new developments served by NAVs:

- The water saved by a NAV recycling water from a local sewage works to provide non-potable water would form part of the bilateral market.
- A NAV arranging a bulk supply or new source of water to be carried to their development by the incumbent

To achieve this it is essential that the bilateral market is open to NAVs serving domestic customers as well as to non-household retailers. This is because:

- Water recycling and new sources of water to serve new developments has the same water resource benefit to the incumbent as serving non-household customers via retailers, and therefore should be open to the same process and compensation payments from wholesale incumbents.
- Developments, and in particular the decisions made about utility provision, can happen at any time rather than fitting in with the timings of the five yearly bid-market / WRMP / Business Plans.
- Recycling from local sewage works is a potential high growth area as large developments are increasingly away from existing infrastructure and treatment technology has improved rapidly (although there are further changes that Ofwat / Defra need to make to ensure that NAVs offering local waste water treatment can compete on a level playing field with incumbents).

Your document does not talk about how the compensation payment would work and under what circumstances it would be payable. Albion Water has previously made the point that incumbents should leave a small amount of their deficit / headroom unfilled via their WRMPs / bid market so that there is opportunity for the bilateral market to work on a continuous basis. If it turns out that the bilateral market does not fill the small supply/demand gap that has been left, then this can be caught up via the subsequent WRMP.

Questions

1a) Whether, in principle, they would be interested in selling water resources via means of a bilateral market;

Yes – we would look to sell the water saved via water recycling from new local sewage works serving new developments. This saving would attract a compensation payment from the incumbent as it would reduce the amount of water resources they would otherwise have had to provide.

1b) Whether, in principle, they would be interested in purchasing water resources via means of a bilateral market;

Yes – we can imagine serving a new development as a NAV with water provided by a third party and transmitted via an incumbent's network.

1c) Whether, in principle, they would be interested in playing some other role (such as providing water treatment services or providing other services) to support a bilateral market.

We cannot think of any circumstances not covered as either a seller or a buyer. There may be a role for a market maker. EnTrade is taking this role very effectively in water quality areas and the same approach could be applied to this market.

2a) the advantages or disadvantages bilateral markets might have compared with the trading arrangements currently available to them;

The key advantage of bilateral market is that trades can be done anytime and are not linked to the WRMP / Business Plan cycle. They can therefore fit in with the time frame needed for a trade to happen between a willing seller and a willing buyer. The more conditions that are removed from a market (such as timing) the more dynamic it will be.

The process is also likely to be quicker. We expect that the incumbents will have previously published their access pricing and any compensation payment available. The deal can then be done between with the buyer and the seller based on this information, without the need for substantial involvement from the incumbent.

By contrast the bid market involves a potentially lengthy process. It could easily be three years between water companies seeking bids for their draft water resources management plans and the final plans being approved by Defra and the associated business plan settled with Ofwat.

Bilateral markets are most unlikely to work without the compensation payment from the incumbent as the incumbent's network charges will remove the vast majority of the available margin.

2b) how bilateral markets could complement or conflict with existing mechanisms available for water trading;

We see bilateral markets complementing the existing WRMP planning process and the associated bid market. However as discussed above, in these processes incumbents must leave space for bilateral trades and in particular the continuous availability of compensation payments should new trades arise. The market will not develop if the WRMP / bid market fully plan all details water resource developments over the coming 5 to 25 years. Space (and funding) must be left for new solutions and opportunities that arise, including those which don't directly deal with the incumbent other than its (core) network function.

2c) whether they have any preference between the existing arrangements and bilateral markets (if so, why).

We have a strong preference for the development of bilateral markets, and for them not to be limited to non-household retailers. As a minimum they should apply to NAVs, but could also apply to supplies to private networks and social housing estates.

3a) The key policy benefits that they consider need to be captured and the best means of doing this;

The key policy benefit is to get better outcomes through competition. The combination of WRMP / bid market (which will do most of the work to maintain a balance) combined with a thriving, but probably small scale, bilateral market should lead to excellent outcomes in terms of resilient planning and efficient market based outcomes. We are keen that the same approach is taken in the provision of waste water infrastructure to serve new developments.

3b) The key policy risks that need to be mitigated, and the best means of doing this;

Creating space for the bilateral market means that regulators (Defra / EA) will have to accept that “every t will not be crossed and not every i dotted” in terms of how demand will be met in the WRMP. The plans will need to assume, for at least some of the projected deficit, that “the market will provide”, and regulators need to be comfortable that if the deficit is not filled then the more formal planning process can catch up any unsatisfied deficit.

3c) Whether there is a degree of prioritisation to the risks and benefits, and if so what needs to be captured as a priority and what might be better left for a more informed decision once some bilateral trading has become established?

No comment.

We would be more than happy to discuss this response with you if that would be of assistance.

Regards

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