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6 September 2019

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Bilateral markets - Call for information

This letter and supporting annex provides our response to the call for information on water resources bilateral markets.

We support the development of markets in the water sector, where they deliver long term benefits for customers. In our region, we have been successful in fostering the development of markets. This is demonstrated by high levels of activity by self-lay providers and NAVs, as well as the increasing levels of bioresources trading. We welcome the upstream Water Resources market and have recently refreshed our guidance for bidders.

Our region is the driest and one of the fastest growing. There is a real opportunity for greater flexibility in abstraction and water resources trading to support resilience in the long term. In developing our Water Resources Management Plan (WRMP), we assessed and included a number of third party options in our feasible option list. These are based upon detailed discussions with our neighbouring water companies, water management organisations and third parties.

We have a history of shaping the future of market-based solutions for water resources. We have made significant contributions to the sectorial discussion on water trading through our Trading Theory for Practice paper¹ and our research into water allocation through effective water trading paper.² Our contribution on abstraction reform and the role of markets was formed through our report 'Markets, water shares and drought: Lessons from Australia'.³

There are opportunities to learn lessons from the developments of other markets in the water sector and further afield when implementing the

¹ <https://www.anglianwater.co.uk/about-us/our-strategies-and-plans/future-challenges/trading-theory-for-practice/>

² <https://www.anglianwater.co.uk/about-us/our-strategies-and-plans/future-challenges/water-allocation-through-effective-water-trading/>

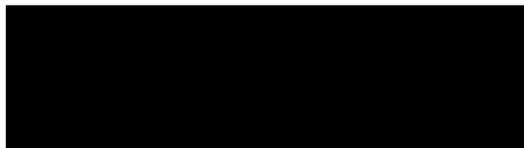
³ <https://www.anglianwater.co.uk/about-us/our-strategies-and-plans/future-challenges/markets-water-shares-and-drought---lessons-from-australia/>

bilateral market. An important consideration for the development of this market specifically is to ensure it supports rather than conflicts with the WRMP ambition of securing resilience. It also remains vitally important that these future arrangements continue the delivery of the highest standards of water quality and maintain customer confidence in both water quality and in security of supply.

We are keen to work actively with Ofwat to develop the bilateral market for water resources to ensure it delivers for customers and the environment.

We trust these comments will help inform Ofwat's work. Please do not hesitate to get in contact if you wish to explore anything further. Arun Pontin () would be a good point of contact in the first instance.

Yours faithfully,



Darren Rice
Head of Policy and Regulatory Strategy

Annex 1 – consultation questions and responses

1) A number of stakeholders have previously expressed interest in supplying water resources, either through the bidding market or in a future bilateral market. There are also a large number of WSSL licensees. We are interested in stakeholders' views on:

- a) Whether, in principle, they would be interested in selling water resources via means of a bilateral market;*
- b) Whether, in principle, they would be interested in purchasing water resources via means of a bilateral market; and*
- c) 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.*

This question is aimed at potential market participants. We welcome the development of this market and the opportunities it presents for bringing additional sources of water to market. Our region is the driest and one of the fastest growing. Given these factors, it is unlikely that we would sell water resources into neighbouring regions (without the development of new resources). However we will continue to monitor such opportunities as the market develops.

2) Owners of water resources currently have an existing route to market through the bidding market, while retailers can contract for water resources with the regional water company. We are interested in stakeholders' views on:

- a) the advantages or disadvantages bilateral markets might have compared with the trading arrangements currently available to them;*
- b) how bilateral markets could complement or conflict with existing mechanisms available for water trading; and*
- c) whether they have any preference between the existing arrangements and bilateral markets (if so, why).*

We recognise that multiple routes to market will ensure that the widest range of water resources are considered. However we are mindful that retailers contracting for water resources through the bilateral market may take a different view of risk than incumbents would through the bidding market. This is especially true where the suppliers are not out-of-area licenced water companies and so do not face the same public health duties.

While it's important that a wide range of resources can enter the market, water quality requirements are paramount. It is incumbent's responsibility to maintain safe supplies of water. This responsibility should not be compromised through operation of a bilateral market that allowed inappropriate resources to enter the market and water supply systems.

The access regime is a critical component of the success of this market and we urge Ofwat to provide further detail of its proposals for engagement with the industry. We would encourage industry workshops or task and finish groups for this purpose.

3) The legal framework allows for a number of consequential changes to regulatory instruments (such as licences and codes) to effectively implement bilateral markets. We welcome views from stakeholders on:

- a) The key policy benefits that they consider need to be captured and the best means of doing this;*
- b) The key policy risks that need to be mitigated, and the best means of doing this; and*
- c) 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?*

We believe the following considerations and risks are priorities. Our view is that these areas are sufficiently important that each needs to be fully addressed in the development of the bilateral market.

- Ensuring **efficient outcomes** for customers;
- Safeguarding **water quality**; and
- Ensuring the market does not undermine **resilience** and WRMP process.

Ensuring efficient outcomes

We believe that Ofwat should seek to update, or at least confirm, the quantitative benefits captured in Defra’s Impact Assessment. This assessment was undertaken six years ago. It is important at each step of implementing significant policy changes that the benefits driving such a change continue to be relevant. We note that the majority of the benefits captured by the upstream reforms relate to waste management.

We think there’s an important role for ensuring coordination of and appropriate access to the market. Roles and responsibilities need to be clearly established ahead of market opening.

We reiterate the point made above that the access regime, including pricing, is a critical component of the success of this market. In 2015 we published a report on ‘Potential approaches to Access Pricing in the UK’.⁴ As shown in our report there are multiple options for access pricing and we would suggest

⁴ <https://www.anglianwater.co.uk/siteassets/household/about-us/access-pricing-issues-paper-main-report.pdf>

industry workshops or task and finish groups for this purpose. We urge Ofwat to provide further detail of its proposals for engagement with the industry.

There is the potential for an interaction with on-going work within the industry on catchment services and catchment system operation. It is important that different use of water resources under the bilateral market does not undermine the benefits of active catchment management.

Safeguarding water quality

We support Ofwat's proposals for a phased implementation of the market whereby providers who do not have public health duties are only introduced to the market once the framework and safeguards are well established.

Drinking water sources must be subject to a risk assessment that is shared between parties; to the same sampling, analysis and regulatory scrutiny. We note the proposals of the Water UK Drinking Water PAG, which outlined a number of important safeguards.

Resilience and the WRMP

Our WRMP is ambitious, pushing further the frontier on leakage reduction, whilst building on the regional collaboration developed through Water Resources East (WRE) to deliver cross-sector approaches to managing water resources across our region.

Our region is the driest and one of the fastest growing. We believe there is a real opportunity for greater flexibility in abstraction and water resources trading to support resilience in the long term. However it is vital that this market does not undermine the long term, strategic choices that must be made to secure resilient supplies. This is particularly true for intermittent or unsecure supplies that might be made available through the bilateral market.

Where new entrants may not be able to guarantee the same security of supply as incumbents, what expectation would incumbents face to act as supplier of last resort? This raises significant issues as to how sufficient capacity should be funded and how it is included in company planning to ensure resilience in their supplies.

Ensuring the appropriate synergies rather than frictions between this market and resilient supplies is something that can be considered further through the access regime.

We are keen to see the upstream water resources market develop and we believe it is important that this becomes more established prior to a new market commencing. This will avoid confusion, and potentially abortive feasibility studies and negotiations if a third party decided to switch markets.