



Bilateral markets

An Ofwat call for information

Bilateral Markets - Call for Information

Introduction

1. The Consumer Council for Water is the statutory consumer organisation representing water and sewerage consumers in England and Wales. The Consumer Council for Water has four regional committees in England and a committee for Wales.
2. We welcome the opportunity to comment on Ofwat's Call for Information on Bilateral Markets. In the consultation paper, Ofwat raise a number of questions, some of them more relevant to potential market participants. In our response to the consultation, we have provided more general statements on issues that could have an impact on water customers in the development and implementation of bilateral markets.

Executive Summary

3. We welcome the collaborative approach taken by Ofwat. These partnerships show that bilateral markets for water resources are being considered as part of a wider regulatory landscape for water resources.
4. The cost of setting up a regulatory framework and the potential ongoing regulation of bilateral markets should not outweigh the value of benefits for water customers.
5. It is of vital importance that the regulation of bilateral markets ensures the maintenance of high drinking water standards.
6. We would like to see the 2013 Impact Assessment of bilateral markets updated to show a revised picture of the potential costs and benefits. This should include an analysis of the potential consumer benefits, and the scope for the establishment of bilateral trading arrangements.
7. We would like to understand how the development of bilateral markets would work in conjunction with the National Framework for Water Resources and the Regulators' Alliance for Progressing Infrastructure Development (RAPID) that are being developed. It is important that the different mechanisms fit together in a consistent way.
8. Bilateral markets should also not deter investment in long-term solutions to increase and maintain the resilience of water resources, where this is shown to be the most effective long term solution for consumers and the environment. These markets could be part of the solution to share resources more effectively.
9. Finally, a point to consider is how this market is explained/communicated to customers, for example:

- if there is a large amount of water being taken out of their region and ‘exported’ elsewhere (i.e. to a large, out of the area business), and
 - how customers would be remunerated by their wholesaler if the infrastructure they (the customers) have paid for is being used to supply (business) customers elsewhere.
10. If customers don’t understand the potential benefits from such a trade, or if they mistrust the motivations of their water company, this could undermine trust in the industry and what it aims to achieve with bilateral markets. CCWater has already seen evidence of customers’ scepticism in areas of the county where ‘exports’ have been considered (for example, Wales and the North of England).

Collaborative working

11. It is positive that Ofwat is working closely with Defra to ensure there is a good provision of information on bilateral markets. Also, that there are issues that are being discussed and addressed with the Environment Agency (EA) and the Drinking Water Inspectorate (DWI), as water trading could have implications for the protection of the environment and drinking water quality.
12. We support this collaborative working so that bilateral markets for water resources are being considered as part of a broader agenda, given that the development of these markets sits within a wider regulatory landscape for water resources. As acknowledged by Ofwat, these proposals are not standalone and (potentially) consider other sectors and types of consumers. We support this consideration of the wider context.
13. It is also encouraging to see that these proposals will also consider the regional groups to address water resources issues, and the National Framework for Water Resources to ensure proposals fit in a consistent way.
14. Finally, the recently created Regulators’ Alliance for Progressing Infrastructure Development (RAPID) could provide assurance that issues arising will be dealt with in a timely and coordinated way by the parties involved. We would like to engage with RAPID in due course to explore how consumers’ views can be used to test the legitimacy of their work.

General Benefits of Bilateral Markets

15. The cost of setting up a regulatory framework for these markets, and the potential ongoing regulation (which may require a form of market operator) should not outweigh the value of benefits to customers. The required regulation of the market, along with the likely environmental and drinking water quality issues that would need to be addressed in a trading arrangement, all have cost implications for ‘exporters’ and ‘importers’.

16. As we mentioned in our response to Ofwat's consultation '*Towards Water 2020 - meeting the challenges of the water and wastewater sector in England and Wales*'¹, any consideration of upstream competition should be based on a robust assessment (by Ofwat) of the risks and benefits to customers. Ultimately, the most cost beneficial and effective water supply solutions for customers and the environment should be identified and applied. This means that the creation of any new bilateral markets, where water is traded to retailers, should not deter essential investment in resource development, where this is needed as a longer term solution. This would in turn, be at odds with the recommendations of the National Infrastructure Commission (NIC)² to reduce water demand and build new resources (also known as the 'twin track approach') to ensure resilient water supplies. Indeed, the introduction of any bilateral markets should complement this twin track approach.
17. Customers will expect water companies to deliver services efficiently and to provide value for money. This means that customers should see the benefit of any bilateral markets, not just the retailers who are contracting with third parties. Customers of a wholesale company that is 'exporting' water in a bilateral trading agreement should be remunerated appropriately if the infrastructure they have paid for is used to supply retailers.
18. The opening of bilateral markets must demonstrate value to customers (from their opening) and ensure any risks to customers are identified and addressed. Ofwat will also need to identify how to protect customers in areas where the market is not possible (i.e. Wales). These customers may not be getting the benefit of improved services and reduced costs as those in the active market.
19. In 2013 Defra conducted an Impact Assessment of potential bilateral markets. At the time, the benefits were in the region of £1.75bn over 30 years (a central estimate and including water and waste management). This assessment showed that the benefits could be mostly achieved by avoiding capital and operational expenditure in maintaining new/existing water resources infrastructure and treatment investment. Although these figures seem substantial, they do not include other benefits such as environmental benefits or innovation. We also question whether an ongoing consideration of the pros and cons of bilateral markets should be in the context of an Impact Assessment that is 6 years old. We think this Impact Assessment should be updated if new data is available.
20. A revised Impact Assessment, should include a consideration of the validity of the assumptions (and their sensitivity) made in the original assessment.

¹ (2016) CCWater's response to Ofwat's consultation Water 2020 - Regulatory framework for wholesale markets and the 2019 price review <https://www.ccwater.org.uk/wp-content/uploads/2016/02/CCWaters-response-to-Ofwats-Water-2020-framework-FINAL2.pdf>

² National Infrastructure Commission (2018) Preparing for a drier future: planning for England's Infrastructure Needs. <https://www.nic.org.uk/publications/preparing-for-a-drier-future-englands-water-infrastructure-needs/>

21. The Cave Review³ also suggested that *‘bilateral markets can promote more efficient allocation of water resources to achieve better outcomes for customers in the form of cheaper and more resilient services’*. It is important that there is evidence that the introduction of bilateral markets would achieve this outcome before this initiative is launched. Consideration should also be given as to what would happen if the expected benefits for consumers and the wider environment failed to materialise.

Benefits to customers

22. One key point to consider is how this market is explained/communicated to customers, for example:
- If there is a large amount of water being taken out of their region and ‘exported’ elsewhere (i.e. to a large, out of the area business), and
 - How customers would be remunerated by their wholesaler if the infrastructure they (the customers) have paid for is being used to supply (business) customers elsewhere.
23. Trust in the industry and what it aims to achieve with this market could be further undermined if customers don’t understand the potential benefits or mistrust the motivations of their water company.
24. In addition, customers may have strong feelings about water being taken out of ‘their’ area to supply (large) businesses in another area, so there will be a need for appropriate messaging around these issues at a national and company level. This should give assurances to customers about the protection and resilience of their water supply in the short and long term.
25. Another aspect to consider is that (appointed) water wholesale companies don’t lose their ability to continue to provide the reliable and safe water supply that their customers expect. To be able to take part in the market, an exporting wholesale water company must be able to demonstrate that it can continue to provide resilient supplies to its customers, even if it is exporting some of its water to retailers. We would be concerned if companies were to compromise the resilience and reliability of their water supplies in order to take part in the market.
26. To ensure the reliability of water supplies, we would also like assurances that:
- Bilateral markets will align with long-term resource planning;
 - That water resources and price review planning processes in the future will take into account the role and activity of trades resulting from bilateral markets; and

³ (2011) Competition and Innovation in the water markets (The Cave review).
<https://www.gov.uk/government/publications/competition-and-innovation-in-the-water-markets-cave-review>

- That bilateral markets do not lead to drought resilience standards being eroded.

Water Quality Implications

Public Health considerations

27. As mentioned by Ofwat, we too would be concerned about potential water quality issues arising from the water supplied by third parties (different from an out of area appointed company), especially if different suppliers would be allowed to input water into the incumbents' network downstream of the treatment works.
28. We would like to see further consideration of the suggested 'phased approach' - where initially third parties would supply raw water to be treated by the appointed (wholesale) water companies and then, after public health issues have been addressed, these third parties would be able to treat the water themselves.

Environmental considerations

29. There are other quality issues that would need to be considered in the event of water transfer from region/source to another as part of the activity from these markets. These wider impacts are better understood; given that they are not different from those already considered in existing options to transfer water across different river basins.
30. As a result, we would encourage Ofwat (and others) to ensure the regulation of water transfers remains consistent. We would urge RAPID to consider the water quality issues - both in terms of public health and in terms of environmental health.