

Bilateral markets – call for information

United Utilities response



Question One. Stakeholders views on:

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

We welcome opportunities to participate in the water resource market. Potentially this could include sales through use of a bilateral market and once greater detail is available we will consider the potential for this.

There are circumstances where the selling water of resources could involve a significant initial investment, both to support the connection to an appropriate part of the network and to enable access to the water resource. We would need to consider which mechanism for selling water will give greatest confidence to be able to cover the investment needed to sell water resources.

This need for surety of investment suggests that the bilateral market would initially favour those opportunities requiring little or no new capital investment. In the longer term, with confidence having been established in the market, this challenge can be overcome, as is demonstrated within the electricity sector. The bilateral market depends on an end consumer, who could not be expected to provide the surety of long term commitment necessary for this investment.

It is our understanding that as an incumbent water company we would be unable, under the current proposed framework, to be granted a wholesale authorisation to supply water into this market. If this interpretation of the potential future framework is correct then any input into this market would have to be through an intermediary wholesale authorisation holder. The requirement to engage with an intermediary who holds an authorisation does not stop such engagement but does create an additional complexity.

Alternatively, as stated within the consultation, it may be possible for incumbent water companies to engage as a secondary water company providing supply to out of area retailers. It is unclear how an incumbent company would operate as this is not part of the obligations stemming from the appointment. We would welcome further clarity on how this would operate as it would be non-appointed activity undertaken by the appointee.

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

N/a. As an incumbent who has exited the non-household retail market we would be excluded from purchasing water resources via the bilateral market as we do not hold a business retail obligation.

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 will consider the scope for this, for example through providing treatment where we have capacity available. However, if we need to invest to provide additional capacity we would need to have confidence that the arrangements would enable us to recover the investment. The bespoke form the water treatment takes is dependent on the nature of the raw water and would require prices that reflect the applicable costs.

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Question two. Stakeholders views on:

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

There is potential that, if the bilateral market is working effectively, new and better sources to be identified and become available. The bilateral market potentially having greater scope to identify new sources as that identification is open to more parties.

Whilst the benefits above depend on the independence of source identification this also creates some challenges that would need to be addressed. The introduction of new sources into the supply network can, if not thoughtfully undertaken, result in significant detriment to the operation and efficiency of the provision of water supply. There will need to be measures in place to ensure entry is efficient in terms of the environment, treatability, network operation and customer protection and acceptability. These measures will need careful design as they need to ensure the appropriate protections are in place alongside the opportunity to have a functioning bilateral market.

As detailed within our response to question one, the alternative mechanisms may provide greater confidence that investment to support the supply of water resources will be recovered. This challenge can be overcome once the bilateral market is established and investors have confidence in its operation. Looking at how the electricity generation market works this lack of contractual surety is not a barrier to significant capital investment in generation. We would expect that it would take some time for confidence to build to promote equivalent capital investment in water resources through the bilateral market.

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

In particular circumstances, especially in relation to raw water where little investment is needed, there may be opportunity for the bilateral market to flourish. However, given the nascent stage of this and other market development it is unclear which mechanisms will provide greatest potential to deliver further water trading.

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

See answer to question one.

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Question three. Stakeholders views on:

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

The bilateral market has the potential to open up supplies from more environmentally sustainable sources, particularly from underutilised abstraction licences. We believe it is important that the environmental benefit of proposal be integral to the outcomes prioritised. Alongside those environmental benefits the end customer must benefit from these proposals. To generate a benefit it is essential that the quality of water supplied must be maintained, including the acceptability of the supply to customers and resilience.

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

Supplies being provided through the bilateral market that are consistent, reliable and assured to be long term provide far greater benefit through the support for long term resilience planning. The creation of a bilateral market has both the potential to improve resilience or reduce resilience, depending on how it is implemented. The consultation notes that there are issues as to how bilateral markets might align with long-term resilience planning and how the planning processes should take account of bilateral market trades. There needs to be sufficient confidence that a supply will be available for the long term if it is to be taken into account in determining whether additional supply capacity is needed.

There are a number of operational challenges that would need to be fully considered and addressed before any bilateral market could operate successfully. These challenges are likely to be greater when considering potable water rather than raw water. The consultation considers the potential for intermittent supplies. However, by their nature, intermittent supplies may not be adequate to meet demand requirements where the two do not coincide in volume or duration of availability. If there are to be intermittent supplies the consideration of savings from those supplies needs to account for the requirement to hold in reserve additional supply capacity. Likewise if supplies are short term, given the responsibility the incumbent water companies have on resilience, there would still be a requirement to hold sufficient capacity to provide a supply, should the short term supply be removed. In terms of short term or intermittent supplies entering supply, through the bilateral market, the benefits are limited by them not supporting long term obligations on resilience.

The consultation suggests that bilateral markets could create additional resilience for customers who want a higher service standard. However, the challenge to achieving varied service standards without a direct connection between source and customer is not inconsiderable and may be difficult to achieve.

We welcome the general approach to access prices for bilateral markets which Ofwat has already set out. We consider that it is important to maintain regional averaging of prices, maintain fair charges and provide scope for efficient entry. The approach proposed will contribute to achieving that. There are, however, some issues to resolve. In particular, it needs to be determined how additional costs will be recovered where a new supply creates higher network costs to supply the water to customers than the costs for existing supplies.

We have set out below a case study which highlights that any assessment of the provision or incorporation of an alternative water source needs to assess not only the requirement to meet the relevant water quality legislation, but also to consider customer acceptability, even where alternative sources may form a limited volume of the total flow, or where they may only be used on an intermittent basis. Water chemistry varies across sources and there must be safeguards in place to ensure that any change in chemistry does not adversely affect the acceptability of a water supply or indeed, the water quality

Accountability is key and does not just relate to water quality, but also the interaction of different waters and customer acceptability. We have had significant experience in relation to customer acceptability.

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Changes in the chemical composition of the water people receive, although considered wholesome under the Water Supply (Water Quality) regulations 2016 (as amended), have led to considerable concern being raised and rejection of the water by customers. The regulatory framework relating to the operation of the bilateral market needs to ensure that not only obvious water quality and safety measures meet the same standards applied to incumbent water companies, but that consideration of treatability and customer acceptability are paramount to a new source entering supply.

An example of the customer acceptability issues that arise can be seen from our experience in introducing a new source of water, which was blended with the current source, and supplied to customers in the West Cumbria area. As part of our commitments with the Environment Agency to minimise abstraction from an environmentally sensitive source, prior to the future revocation of the abstraction licence, we were required to find and subsequently introduce a water from a new alternate source. The process was subject to detailed investigations and it was confirmed (by external verification) that the most process appropriate alternative raw water source was groundwater from new boreholes. The groundwater source was appropriately treated and blended with water from the original source prior to distribution to customers. The groundwater source was introduced in 2017 as an interim measure until the West Cumbria project (Thirlmere pipeline) is complete.

Whilst the water supplied is wholesome and meets the requirements of the regulations, it has raised concerns from customers on the basis of acceptability as customers prefer the attributes and aesthetics associated with the original source compared to the mixed source. This has been the case even when the contribution of the new source has been only 20% of the flow leaving the water treatment works.

We continue to engage with customer groups and through work with CCWater, the Environment Agency, Public Health England and the Drinking Water Inspectorate are demonstrating that the supply is safe and wholesome and meets all technical requirements. However, our experience in this example does demonstrate the sometimes significant impacts on the customer experience that customers perceive and which can arise from introducing new water sources into supply, even when all key technical requirements for the safety and wholesomeness of the water have been met.

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?

Given the additional complications relating to treated water, we believe that an initial introduction of the bilateral market for raw water supplies, assuring that safeguards are in place to assess the impact on the acceptability of any treated water by customers, would enable testing of many of the mechanics required to operate the market ahead of resolving the additional complexities of treated water.