

06 September 2019

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Dear Ofwat

### **Bilateral Markets Call for Information**

Further to the recent Call for Information regarding bilateral markets, Wave has considered the proposals and offers the following comments. As a retail WSSL holder, we are potentially in a position to purchase water directly from alternative third-party water resource providers to sell to our business customers. With this in mind, we are supportive of the principle of bilateral markets. In particular, we believe bilateral markets can achieve better outcomes for business customers through further choice, greater opportunity for innovation, more resilient services and lower charges driven through improved efficiency. We are also supportive of the potential environmental benefits this could bring to the market. The challenge is to create a practical framework which delivers the economic theory.

In order to make this work in practice, we think that there would need to be a relatively simple framework within which retailers and water resource providers could identify and consider opportunities and risks. This might include a pricing and legal/contractual framework and a route for retailers to be made aware of potential available water resources. Otherwise, the time and cost associated with negotiation, set up and administration, could outweigh any benefits.

There may be opportunities for water wholesalers to develop commercial propositions where they have abundant water supplies close to the border of another water wholesaler. The challenges are likely to be the cost of pumping the water and the size of the network into which the water is being pumped, which may not be appropriately sized.

In practice, it's not clear how many opportunities there may be. Some business customers prefer the confidence provided by the current wholesale supplies and do not want to manage water assets. Business customers need secure and reliable water supplies and it's not clear to what extent a bilateral market can deliver this. If, for example, the water comes from a power supplier who only puts water into the system during their downtime (which in turn is driven by energy markets), then this might not be suitable for many business customers. But if the cost was significantly lower, then it could be worthwhile for a particular business customer with suitable storage to supplement their existing supply with alternative cheaper water wherever possible. Business customers might also be interested in alternative 'back-up' supplies during periods of drought, but it's possible that these alternative water resources would also be under extreme pressure at the same time e.g. those owned by farmers, land owners, self-suppliers etc, and therefore offer business customers little benefit. Therefore, a key issue is to clarify the balance of risk between the parties, in particular, to clarify liability in the event that the supply is not available to the business customer when expected.

It should also be noted that some business customers require specific water characteristics, for example soft water rather than hard water, or raw water rather than fully treated water. In principle, a bilateral market could also apply to these kinds of scenarios.

Business customers have investigated the potential for using local water resources including on-site boreholes in the past. Often there are limiting factors with respect to the Environment Agency and how permitting applies to boreholes. These issues therefore need consideration.

Business customers are likely to have concerns around the potential risk to water quality when a third-party water resource provider is introducing treated or untreated water into a network. Therefore, a practical issue will be to clarify the issue of liability in the event of a water quality incident. Too much risk placed on any one party could make opportunities unviable.

Part of the consideration should be to clarify why alternative water resources are not being used today – it might be that they are not large enough to be economically viable, the water quality is particularly poor or incompatible with water in the local network, the resource is not reliable enough to have sufficient value, the resources are simply in the ‘wrong’ place in order for it to be economic to connect into the existing water system, the regulatory framework doesn’t support it, the costs involved make it unviable etc. As suggested, suitable incentives may be needed in order to encourage the identification of opportunities. We note that the PR19 regulatory framework has set out that wholesaler investment post April 2020 will not be protected in order to act as an incentive for water-poor companies to find the most efficient solution. We are hopeful that this might stimulate bilateral trading options.

In the past, the connection cost to introduce water into a wholesaler’s network was prohibitive due to the perceived risk of contamination to their supply. This has been a key blocker that has prevented this type of opportunity developing. This is a critical area to clarify in order to make a bilateral market successful.

The industry needs to demonstrate that a bilateral market can work successfully, enabling business customers to build trust and be willing to consider alternative and innovative opportunities. Perhaps some kind of trial might help facilitate this.

We hope that our comments are useful. Do not hesitate to get in touch if you would like to discuss any aspect of our response further.

Yours sincerely



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Director of Regulation and Compliance

