Anglian Water Services Ltd
Lancaster House
Lancaster Way
Ermine Business Park
Huntingdon
PE29 6XU

Tel: 01480 323000
www.anglianwater.co.uk

Alex Whitmarsh
Ofwat
Centre City
Tower 7
Hill Street
Birmingham
B5 4UA

15th December 2020

Dear Alex,

Thank you for inviting comments and ideas on the next steps for the development of markets within the bioresources price control. We are committed to collaborate with OFWAT, our fellow WASCs, environmental legislators and regulators together with other industry and sector stakeholders to help open up bioresources market opportunities for the long term benefit of our customers and stakeholders. Indeed, we see benefits to our cost efficiency and environmental performance that could come from an active trading market.

From our own experience there are few blockers to ad-hoc or non-committed trades. We have engaged in such trades on a number of occasions with neighbouring WASCs over past years and are comfortable with the process of agreeing rates and contracts for this activity. For example, we have multi-year but non-committal contracts to receive sludge from several MOD sites in our region.

The challenge we face relates to the economic and environmental regulations and the commercial conditions to allow long term guaranteed trades to be undertaken with confidence and certainty.

Having taken an active part in the recent workshops on sludge liquor treatment recharging and completing the market survey questionnaire, we would like to highlight the following areas as challenges that are currently hampering the development of the bioresources market:

1. **Environmental Regulation** - Impact of ongoing uncertainties in the implementation and interpretation of environmental regulations, specifically –
   - the EA Sludge Strategy and the cost and practicality of moving sewage sludge treatment and recycling from the Sludge Use in Agriculture Regulations (SUiAR) to EPR with earned recognition via an assurance scheme such as the Biosolids Assurance Scheme (BAS)
   - the industrial emissions directive (IED), and
   - an emerging threat in terms of how Rule 1 of the Farming Rules for Water may be interpreted by the EA with subsequent impact on the available landbank for biosolids recycling
2. **Local planning policy** - Negative customer sentiment and local planning policy is likely to be harder to overcome for developments that involve trading or the import of sludge from outside the company licensed region

3. **Green & renewable incentives** - Impact of difference of renewable incentives set out by BEIS administers by Ofgem could have on market behaviours
4. **Clear guidance on gate fee setting** – Lack of clear guidance and principles for setting gate fees for guaranteed long term trades or for co-investment opportunities

Environmental Regulation

We see the ongoing uncertainties and delays in changes to environmental regulation as the biggest blocker to the opening of bioresources markets to long term guaranteed trades both with neighbouring WASCs or new third party entrants into the market. We identify three main areas:

a. Environment Agency Sludge Strategy Review - future change to Sludge Use in Agriculture Regulations
b. Implementation of Industrial Emissions Directive (IED) on Bioresources sites with biological treatment
c. Interpretation of the Farming Rules for Water.

The research and modelling we have conducted to date show material potential benefits for bioresources markets – but only once cross organic waste and water sector regulations allow for the co-treatment of sludge with other organic wastes. The delay to 2023 - whilst understandable given the requirement to divert resource to COVID response - will in our view severely inhibit third parties from entering the market for treatment and recycling of sludge. Furthermore, we are aware that the EA is concerned about long term guaranteed trades between WASCs. A view has been expressed that importing sludge from outside an incumbent WASC's operating area does not align with SUiAR and that in this case all treated biosolids product should be recycled under full Environmental Permit Regulations (EPR). Such an interpretation would be a serious threat to this type of trade until the outcome and subsequent changes are made following the sludge strategy review.

Uncertainty on the cost impact arising from the implementation of IED, in terms of both required capital investment and ongoing operating costs for increased monitoring, is also of concern. The timetable for the application and granting of IED permits runs to summer 2022 and as yet no water industry specific sector guidance is available and there is a wide range of opinion as to the investment required to meet IED requirements. Guaranteed long term trade gate fees will include capital as well as operational costs; uncertainty in this area has the potential to limit the number of viable long-term trades.

Finally, it has recently come to light that the EA's interpretation of the Farming Rules for Water Regulations 2018 is a major threat to companies' ability to recycle biosolids products, organic bio-digestates and other farmyard manures to agriculture. Recent guidance from the EA (summer 2020) suggests that biosolids should not be applied in the autumn, ahead of the sowing of winter cereals. This is the period of the year when most biosolids products, manures etc. are currently applied to land, and the ruling would remove most of the available landbank. Water UK and individual water companies have voiced concern directly with the EA and DEFRA, highlighting that applications of organic manures in the autumn pose less risk to the environment than spring applications. Furthermore, they have pointed out that since there is very little opportunity for biosolids application in the spring, a restriction of this nature would force the industry to adopt alternative higher cost and less sustainable alternatives such as incineration. Clearly any issue that restricts the times and volumes of bioresources products

that can be recycled to land will reduce the confidence of parties to be active in bioresources markets and commit to long term guaranteed trades.

Local waste planning policy

On several occasions in the past we have had difficulty securing planning consent for developments to treat our own sludge when those developments have been regional centres for sludges from across county borders. While we consider our licensed area as a single region, customers and planners – for understandable reasons - frequently take a more local view. Proposals for investment to allow for trading are likely to attract even greater scrutiny and attention, particularly if sludge imports are not even from the Anglian region. Local planning policy may explicitly presume against such developments being undertaken where sewage sludge is imported from outside the area where it is being produced.

Green and Renewable Incentives

The gate fee for any trade will be highly influenced by the technology deployed on sites, the time at which it was commissioned and hence the incentive to which it is accredited. For example, all of our sludge treatment centres generate renewable electricity from biogas using CHP engines; all are currently accredited under the now closed renewables obligations order (ROC). Newer facilities have tended to install gas-to-grid biomethane plants under the current Renewable Heat Incentive (RHI) schemes. The rules around these schemes (in terms of qualification to the scheme and the rate at which the incentive applies) are specific to sewage sludge and importing other waste streams would threaten the eligibility to claim the incentive. This also applies when sewage sludge is imported for co-treatment with other organic wastes. It is also common that different waste streams qualify for different incentive rates.

The RHI is due to be replaced by the new Green Gas Scheme from 2021. However, recent presentations on the new scheme suggests that only new plant where new digestion capacity is constructed can qualify. This will likely distort the market and incentivise new build rather than the use of existing capacity at sites where operators are not able to move onto the latest technology. As well as harming markets and trades, this will hamper the industry and wider sectors in meeting net zero carbon commitments by 2030.

Clear guidance and policy for gate fee setting

We support the ongoing work in this area. We would welcome a clear, common set of guidance which sets out the principles of how companies should set about building up the relevant areas of cost for long term guaranteed contracted trades. The recent work which Jacobs completed for Ofwat on sludge liquor treatment costs demonstrated there are significant differences in approach to this issue among companies. As we have already observed in discussions to date, those differences can have significant impacts on any calculated gate fee.

This guidance would also include:

- a clear methodology on how costs – in particular, overheads and shared assets - should be apportioned
- guidance on fixed and variable costs. For example, should companies use the assumed split between fixed and variable costs which Ofwat used at PR19 or continue to use their own assessments? Like liquor treatment costs, differences in the approaches used could have a significant impact on gate fees.

It is vitally important that the guidance and policies are clear, well understood and fixed for a given period. A change to Bioresources RAGs could expose companies to risk where cost is

accounted in the incorrect price control. For example, a change to the basis of calculating liquor treatment recharges after a long-term trade contract has been agreed could result in under- or over-charging.

Finally

We are aware that we have focussed in this letter on the barriers to the development of the bioresources trading market whereas our approach is typically to propose solutions rather than simply present problems. The fact is that the biggest barriers we have identified are not within the gift of either companies or Ofwat to remove and are dependent on the policy decisions made by other government bodies. What we can say is that we are doing everything within our power to promote beneficial change. For example,

- We initiated BAS and were the first company to be accredited to the standard. We insisted from the outset that BAS was designed to cater for and facilitate co-treatment
- We chair the industry biosolids network
- We are represented on all four working groups for the EA sludge strategy
- We arranged the call with the EA to discuss the technical issues around the proposed changes to interpretation of the Farming Rules for Water
- We are actively engaged via Water UK on discussions regarding renewable energy incentives.

We will continue to play an active part with all relevant parties to unlock the benefits which might arise from an active trading market.

We would also like to reflect on some of the systems complexities across bioresources networks. We have worked hard over recent years to move towards a “factory mentality” for our sludge treatment operations, applying this to all steps from the collection of sludge, transport, treatment (including production of our biosolids products for farmer customers and renewable energy generation) through to the logistics of recycling treated biosolids to land. It is particularly important for us to understand the inter-relationships between these operations and the impact of any changes, given the rural nature of our catchment and that 70% of sludge produced is transported into our STCs for treatment.

Finally, we have developed tools and a structure to allow us to apply systems thinking to both the investments we make and the tactical and operational decisions we take on a daily basis to operate at an optimum level whilst balancing cost and risk. The advantage of this is that we are able to evaluate trading opportunities and assess the impact which receiving or exporting sludge will have across our network. We have used these tools to identify potential trading opportunities with our neighbouring WASCs and third parties. For example, we have used the models to identify third party other organic waste digestor operators in our region that are of potential interest for possible trades. We are engaging in discussions with such parties in preparation of the day when changes to environmental regulation makes co-treatment a viable option.

Yours faithfully

Alex Plant
Director of Strategy and Regulation