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## **The regulatory and commercial framework for strategic water resource solutions a discussion document**

Dear Paul,

The ACWG welcomes the opportunity to respond to this consultation. We would like to take the opportunity to make some general comments about the proposals as a group. We agree with the logic and objectives of the proposals. Our members will provide more detailed answers in their company responses. We however have some general answers to the questions set in the consultation attached in the annex of this letter. We would like to confine ourselves to the proposals in the consultation on the funding the projects, water trading and project management.

There are some features that highlight the benefits of treating these projects more like a one-off asset infrastructure rather than sticking with a price control-based approach. We note that:

1. The uniqueness, size complexity of the project from technical and commercial standpoints
2. The creation of new types of risk including novel commercial arrangements associated multiple parties not experienced before.
3. Ability to equitably compare the technical difficulties in assessing projects, for example the differences between Reuse and STT
4. The differences between technical and regulatory perspectives in the development of the projects
5. Ability to price observable costs when compared with unobservable costs such as risk

Our projects are unique there is no credible efficiency yardstick to conduct the regulatory investment analysis particularly as they may cross three or more territorial monopolies or have new third parties involved such as a CAP (that have yet to exist until after Gate 4).

For trading water, the Bulk Supply Agreement (BSA) only works for the seller but is ultimately limited as it is only half the requirement for transfer projects. The seller must price the water differently than a normal contract as risk has to be built into the price. So far this component of the tariff has not been as big part of the price as it will be. It could well exceed the cost of physically sourcing the water. Understanding these “unobserved” costs will be an important part of the commercial framework. Using shared or infrastructure owned by a third party it potentially breaks down as it can only effectively price the water but must also consider include the value of transportation, a very different set of costs to combine in a bundled product. It follows that at least two types of contract

are needed one with the seller, the other with the asset owner or potentially with a transit network. In fact, we predict network costs are likely to be more straightforward than commodity charging.

You ask if there are any other approaches, we would support in question one of the consultation. Bespoke projects should be supported by third party assurance, and that other regulatory models approach could supplement that. This moves closer to the Northern Ireland living with water model for infrastructure projects<sup>1</sup>. As a neutral third party an honest appraisal can be conducted avoiding much administrative work. In contrast to previous times when this model has been used the regulator appoints the auditor rather than the company. We also note the collaborative approach used in Scotland where all stakeholders are represented is a useful source of ideas. We are thinking of the *insights* and not the model itself, developed by Stephen Littlechild<sup>2</sup> for water price controls.

Finally, the development of the SROs towards Gate 2 has a timeline to align with the regional plans, dWRMPs and PR24. We now have a number of key reviews of parameters that are likely to provide improvement in the approach. These include reviews of the environmental guidance, pricing of transfers and the ongoing development of the SROs to Gate2. The timing of these improvements is important whilst we manage stakeholder communications through the regional plan public consultation in Jan '22 and dWRMP in the autumn of the same year. It is a concern that changes to SROs is likely to have a material impact on their timing and choice in regional plans, and therefore impact Gate 2 onwards. This is likely to effect stakeholder and also investor confidence in the process.

It is recommended that the regulators and companies work together to review the risks, the timing and possible mitigations. This needs to provide end dates up to which each parameter may have changes. This will allow the programme to remain on track to let the regional plans make the least regrets best value decision for Gate2, or we need to accept and communicate externally that there is a likelihood that the regional plans will materially change in 2023, between draft and revised draft WRMPs, and therefore the chosen SROs. Note that this does not include other key parameters such as agreement on the environmental destination scope/timing, which will have a material effect on the SRO's required and their timing.

We look forward to discussing these issues in the next quarterly meeting.

Yours sincerely,

Tony Owen

Chair of the All Company Working Group (ACWG)

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<sup>1</sup> [link to consultation](#)

<sup>2</sup> Constructive engagement and negotiated settlements – a prospect in the England and Wales water sector? Energy Policy Research Group (2008) Cambridge [link](#)

## Annex 1

Question	Initial thoughts (final response due on 21 July)
<p>Q1. Which aspects of our initial thinking do you agree with or disagree with? What other approaches would you advocate and why?</p>	<ul style="list-style-type: none"> <li>• We welcome the clarity on a fair shares approach to drought conditions and look forward to developing the details of it. It will also need to cater for operational error or sub optimal operation aper</li> <li>• We support greater confidence for exporters in being able to recover their costs and returns and the transparency of costs for buyers.</li> <li>• We agree that the exporting company should be incentivised to trade where it delivers benefits for the exporters’ customers and the importers’ customers.</li> <li>• We strongly support existing trades being exempt from changes to the regulatory and commercial framework.</li> </ul>
<p>Q2. What have we missed that also needs to be progressed?</p>	<ul style="list-style-type: none"> <li>• We think you should have an open approach to DPC and allow for the companies to take forward schemes where this is better for customers as you recognised with Havant Thicket at PR19.</li> <li>• It seems too early for us to comment on what might replace RAPID. So far, the process seems to be working well with all parties working collaboratively.</li> </ul>
<p>Q3. We welcome views on our proposed next steps, including additional activities that we should be undertaking.</p>	<ul style="list-style-type: none"> <li>• We look forward to supporting the environmental task and finish group where appropriate. We would welcome the opportunity to discuss this.</li> <li>• We note that we cannot take firm approaches to price for the SROs we are developing until this workstream produces firm guidance and that you will still be consulting on policy options at the end of 2021.</li> </ul>
<p>Q4. We welcome views on NERA’s recommendations and our initial thinking on them</p>	<ul style="list-style-type: none"> <li>• We consider this discussion paper takes a sensible approach to addressing NERA’s recommendations.</li> </ul>