

RAPID
Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Our Reference Number: RAPIDR01

21st July 2021

Dear Sirs,

CONSULTATION ON THE REGULATORY AND COMMERCIAL FRAMEWORK FOR STRATEGIC WATER RESOURCE SOLUTIONS – A DISCUSSION DOCUMENT

Thank you for providing us with the opportunity to provide our views on the framework document. There are a number of areas of overlap with the Ofwat PR24 consultation document, and we have not repeated comments here that we have already made within our PR24 consultation response.

Overall, we have found the RAPID process to be constructive and helpful with our consideration of strategic water resource needs. We are particularly pleased with the amount of cross-industry collaboration that it has promoted, which has really helped to generate efficient, innovative and comparable options for the Gate 1 submissions. Within your consultation you posed three questions, which we have responded to in turn below.

Q1. Which aspects of our initial thinking do you agree with or disagree with? What other approaches would you advocate and why?

We agree with the majority of the aspects as presented. There are two areas where we think some clarity is required, and one area where we have concerns about the ability of the approach to deliver the resilience that we will require as a water company. These are:

- 1) In terms of the fixed and volumetric charging structure we think that there is a need to set principles that take into account scheme type, as apportioning costs according to capacity and operating costs will only work for certain scheme types. Whilst a framework based on capacity and operating cost is appropriate for schemes that are constrained by capacity of infrastructure, such a framework is not appropriate for schemes that are constrained by seasonally varying raw water availability and storage. In such cases the scheme costs may, for example, have to be apportioned according to effective storage reservation, or proportion of yield taken under specified hydrological conditions. We would therefore propose that framework principles are categorised separately according to a small number of source categories, designed to facilitate charging structures based on the amount that a given company uses the parameter that ultimately acts as the constraint on the scheme water resource benefit.
- 2) In terms of the proposals around trading incentives, we have found through recent experiences that a system which relies on sellers using market information to price a trade at a point just below the next best resource option faces problems associated with both the bid evaluation process and lack of knowledge parity. In terms of process, the identification of the next best option effectively requires a WRMP (or Regional Plan) investment appraisal. This process cannot be run as and when required in response to a bid, so bidders either have to provide their proposal as an input to the cyclical planning process, or rely on simple measures such as average incremental costs (AICs) to form their proposal. The problem with the former approach means that there is limited time and opportunity within the planning cycle to feedback and negotiate changes to the offer. In the latter case then issues around

timing of need, NPV considerations and, most critically, utilisation and capacity usage, mean that sellers are very likely to significantly over-price their offering, leading to lost opportunities. Because of these issues we would tend to support the approach suggested by NERA, where incentives are provided through a margin on costs, rather than quasi-market based pricing.

- 3) We two significant have concerns about the use of 'fair shares' for the allocation of water during drought and operational events. The first of these relates to equity of schemes. Any option that is identified and developed by an incumbent for its own customers will be designed to a given Level of Service (currently 1 in 500 year drought resilience under the WRPG), usually with something in the order of a 90% confidence (depending on Target Headroom approach), which includes climate change. The application of 'fair shares' *for conditions beyond that level of service* is therefore reasonable, but any application before that point would mean that shared/traded options are not comparable with the rest of the WRMP options. The second concern relates to the need to sanction third party operators against the consequences of poor operation, which can affect the amount of water that is actually available during drought conditions (e.g. delaying pumping to top up storage, failing the maintain assets leading to outages during the pre-drought period). As droughts are multi-year events, there are also technical problems associated with fair share calculations during drought conditions, and an incentive on the operator to favour the more immediate needs at the expense of conditions later in the drought. Although there is a potential efficiency to be gained through fuller utilisation of schemes where control rules are more dynamic, this will inevitably affect drought resilience. We therefore propose that the guiding principle should be that suppliers should commit to meeting a defined service level with associated failure penalties and hydrological/operational penalty thresholds, and fair shares should only be applied in the (highly unlikely) event that such thresholds are breached.

Q2. What have we missed that also needs to be progressed?

We think that the key items that need to be considered have been identified, with the exception of the points noted above.

Q3. We welcome views on our proposed next steps, including additional activities that we should be undertaking.

Affinity Water is already involved with the Task and Finish groups associated with addressing knowledge and policy gaps, and these cover all the main areas of concern to us. We have indicated through those groups that RAPID should make sure 'real world' examples are used where possible to identify framework risks and requirements.

Q4. We welcome views on NERA's recommendations and our initial thinking on them.

We generally support both NERA's recommendations and RAPID's responses to them as set out within the consultation document.

Yours Faithfully



Steve Plumb
Asset Strategy Director

