



Anglian Water Services Limited

Lancaster House
Lancaster Way
Ermine Business Park
Huntingdon
Cambs
PE29 6XU

RAPID

By email only: rapid@ofwat.gov.uk

Tel 01480 323000
www.anglianwater.co.uk

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Dear Paul,

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

I am pleased to attach our response to RAPID's discussion document on the regulatory and commercial framework for strategic water resource solutions. We very much welcome the opportunity to comment on RAPID's initial thinking at this relatively early stage in this year's work programme.

Overall, we support the direction of travel and think that all the key issues have been identified. However, there are some areas where we believe the proposals could be more radical, given the particular nature and scale of the solutions required to address the combined challenges of population growth, climate change and environmental improvements.

We are involved in the working groups that are co-ordinating the delivery of the work on the regulatory and commercial framework: we look forward to continuing to work together with RAPID and the rest of the industry. We would also like to take this opportunity to reiterate our support for the collaborative and constructive approach that RAPID is adopting in working with the sector and wider partners on what are unavoidably complex issues.

Our response to each of the questions in the document, is appended to this letter.

Yours faithfully

Alex Plant
Director of Strategy and Regulation

Registered Office
Anglian Water Services Ltd
Lancaster House, Lancaster Way,
Ermine Business Park, Huntingdon,
Cambridgeshire. PE29 6XU
Registered in England
No. 2366656.

an AWG Company

Which aspects of our initial thinking do you agree with or disagree with?

We broadly agree with the initial thinking set out in the document, and the eleven high level themes are a helpful way to categorise the key issues to be addressed.

These are some areas where we think the proposals could go further or need some refinement. We set these out in the bullets below:

- The proposals assume that we are operating within the constraints of the existing regulatory system. We think a more radical approach is required, considering alternative regulatory models for the oversight of the development and delivery of new water resources infrastructure of this scale and nature. The solutions are unique, high value and have complex planning and environmental considerations. In addition, many of the solutions in the process, and certainly those in the WRE region are likely to be multi-party and multi-sector in nature. This adds further weight to the argument that consideration be given to taking a wholly different approach to the existing regulatory framework, rather than just tweaking the current model.
- The majority of the technical proposals discussed in the document, particularly on charging mechanisms, are focussed on bulk transfers and trading between incumbents. The new resource options, as opposed to transfers, whether they be just multi-company, multi-company and multi-sector, or single company, multi-sector will present a broader set of considerations which will need addressing in different ways to the approach taken to bulk transfers and trading. We anticipate the delivery of key elements of the work of the Pricing, Incentives and Risk working group (which we are supporting) should help to address this.
- In Section 2.6.1 Fixed Charges, the document suggests that contract pricing should be based on companies paying no more than the cost for the next best alternative option. This leaves open the potential for companies to charge significantly more than the true cost, in the case that the next best alternative is significantly more expensive. This could lead to customers paying more in long term. This will be an issue that spans the life of the asset. The work on contract standardisation and charging should therefore seek to address this.
- We welcome the recognition of the benefits of adopting a multi-sector approach. This is a key area of focus for Anglian Water and WRE in the development of the South Lincolnshire Reservoir and Fens Reservoir. The document states it may be possible to address most of the multi-sector issues through side contracts without fundamental change to the main commercial model, but also helpfully recognises that where the multi-sector aspects are material, this may not be sufficient, and that a joint venture may be more appropriate. We agree that side contracts will not be sufficient for the scale of schemes that we have been jointly developing with partners. We anticipate the work package we have been involved in developing as part of the Pricing, Incentives and Risk working group, to establish a working legal and commercial framework for delivery multi-sector, multi-beneficiary assets, may help to point the way forward on these issues.

What have we missed that also needs to be progressed?

Broadly, we consider the scope of RAPID's initial thinking set out in the document to be comprehensive. However, there are some areas that we think either would warrant more

detailed consideration than currently set out, or are not explicitly discussed within the document. We set these out in the bullets below:

- In Section 2.2 the document discusses using the Water Industry Specified Infrastructure Projects regulations to licence the CAP, resulting in them being directly subject to regulation by Ofwat and DWI. We support this proposal and consider the issues around accountability and risk, specifically relating to level of service and water quality, warrant further detailed discussion within the working groups. We are in the process of progressing an AMP7 DPC and our direct experience is that the scale of the challenge in addressing these issues of accountability on water quality should not be underestimated. If the responsibility for water quality remains with the incumbent, then it is difficult to see how the risk of failure can be indemnified, particularly given the scale of the reputational risk involved. We think RAPID's proposals and associated programme of work should go further in addressing these issues, and we would be willing to share learning from our AMP7 experiences of DPC.
- The commercial and regulatory framework adopted for the delivery of the SROs needs to ensure that the integrity of the national and regional strategy remains. There is a risk with differing contractual arrangements and the complexities of the planning process that the overarching strategy for delivering security of supply could become compromised. Consistency within the commercial and regulatory arrangements across the SROs will also be critical for successful co-ordinated operations. This is recognised in Section 2.11 of the discussion document, but we wanted to take the opportunity to reiterate our view of the criticality of this point.
- We think there would be value in reflecting on existing multi-party resource agreements and to build in learning from these existing operational agreements. One example of a historical agreement which is still in use today is the Great Ouse Water Act. We recognise these agreements pre-date privatisation and the current regulatory framework under which we are operating, but in line with the point made earlier in this response about seeking to take a broader view of the regulatory framework, we consider there would be value in evaluating existing agreements, and collating views from those companies working within them.
- The way the gated process is currently set up, and the scale of the water resources challenges involved, mean there will be several SROs being progressing in delivery concurrently. We think there would be value in RAPID assessing in more detail how to ensure there is sufficient capacity within the market to support timely delivery. The materiality of this issue will become clearer at Gate 2 and with the outputs from the regional planning process.

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

We support the framework set out for next steps and the associated timing. We consider the working groups to be critical to delivering successful outcomes. Clarity around the detailed scope of each working group and co-ordinating and communicating the outputs will ensure the working groups are as effective and impactful as possible. We trust that RAPID will continue to adopt a transparent, no surprises approach to the delivery of the workstreams and associated policy recommendations.

The timeliness of the delivery of the programme is critical, as is ensuring alignment with the regional planning process. The next twelve months will see some critical decisions on the SROs which progress. This work of the RAPID regulatory and commercial framework programme needs to provide outputs in time to influence the post-gate 2 delivery strategies.

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

We consider that the discussion document has appropriately considered the recommendations from the NERA work, and have no further comments in addition to those already set out in this response.