

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

Severn Trent response

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We welcome the opportunity to respond to [RAPID's discussion document on the regulatory and commercial framework for strategic water resource solutions](#) and the engagement we have through RAPID's pricing, incentives and risk working group. I am responding as Severn Trent Water's representative on that group.

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

We strongly support RAPID saying it is not considering applying the new regulatory and commercial approach to existing trades (page 18). We consider this is absolutely essential to protect the integrity of existing bulk supply contracts that provide vital water supplies to many customers across England and Wales.

We support exploring the fair shares approach to drought conditions, where different sets of customers receive a fair – which may be a similar or equivalent – level of service during times of drought (pages 3, 27). We understand why a fair shares approach is attractive, but there could be significant regulatory and practical barriers to implementing the fair shares approach in practice especially for complex multi-company and multi-sector trades and with 15 out of 23 companies being designated areas of serious water stress¹. The barriers include that the approach might require a company to reduce its service to its customers due to another company's performance, who might not have managed its water resources as well. Another barrier is pricing the risk to both companies of the having to reduce the service to their customers into the commercial contract. We support exploring how to overcome these barriers.

We support exporters having high confidence in being able to recover their costs and returns (pages 3, 24). This is important to encourage exporters to develop their schemes.

We are interested in how the commercial and regulatory framework will ensure sufficient returns for exporters. You explain that strategic resource options (SROs) will be subject to Ofwat cost assessment consistent with its approach for other projects (page 24). This involves a standard regulatory return despite SROs being large-scale, novel projects covering several company areas with several partner organisations involved, some being new third parties such as competitively appointed providers (CAPs) or organisations from other sectors. The exporter therefore faces more risk than investments under the existing regulatory framework. We would therefore expect the return to be higher for SROs than allowed for in typical Ofwat cost assessment. We support the discussion paper saying the exporting company should be incentivised to trade so that it can be appropriately remunerated for the extra risk it is taking on (pages 4, 26).

The discussion paper sees having a CAP, such as through a DPC model, being applicable to SROs (pages 4 and 19). It also mentions standardising the commercial frameworks as much as possible, to provide a clear pipeline of projects that will appeal more to investors (pages 20-21). We think it would be best to keep an open mind for these large-scale and novel schemes and use whichever regulatory approach delivers the most benefit for customers of the companies involved, as was recognised with the Havant Thicket scheme at PR19. The regulators and water companies involved in schemes run by a CAP will want assurance about the construction and

¹ [Environment Agency \(1 July 2021\), Updating the determination of water stressed areas in England](#)

maintenance of the scheme to make sure it operates effectively. One issue that needs further investigation is whether a CAP can have the power to lay and maintain pipes as water companies do.

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

We think you are progressing the main workstreams. We recognise that new issues might arise as we work together to develop the regulatory and commercial framework.

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

We look forward to supporting the environmental task and finish group (pages 4, 13, 29) to consider the environmental risks for SROs.

We look forward to supporting the co-ordination working group in the coming months. We will be interested to see the consultancy study you have commissioned on co-ordination when it is ready (pages 5, 12, 32, 33). A crucial issue will be how the coordination of SROs interacts with companies' responsibilities for security of supply in their areas.

The discussion paper considers alternative approaches for planning strategic water resources in the future, what might replace RAPID and how much continued regulatory oversight will add value to SROs when they enter the delivery/construction phase (page 5, 30-31). So far, the gated process seems to be working well with all parties working collaboratively. Given the continued challenge to water resources posed by climate change there might be a need for a similar SRO process following on from PR24. We think it would be best to learn the lessons from the PR19 SROs before reaching a view on their future regulatory oversight.

You have mentioned that RAPID will be consulting on policy options for the commercial and regulatory framework at the end of 2021. We just want to make sure that you take account of this in companies' submissions to each SRO gateway. It means we will only be able to factor in commercial and regulatory aspects to our proposals once you have confirmed the framework in 2022.

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

We consider this discussion paper builds well on NERA's recommendations.

Best regards,



Jon Ashley
Head of Economic Regulation
Severn Trent Water