

## **RAPID discussion document on the regulatory and commercial framework for strategic water resource solutions**

### **Response from the West Country Water Resources Group**

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#### **Summary**

The programme of work that is currently underway to develop new water resources in order to meet the long term challenges of population growth, climate change, resilience and environmental conservation is very encouraging, and we are very supportive of the role of RAPID and the work being undertaken by water companies and regional groups to rise to the challenges. We agree that the gated process has encouraged collaboration between companies and with regulators that would not have happened otherwise.

Through the member water companies of the West Country Water Resources Group ( <https://www.wcwrq.org/> ) we are represented on most of the working groups and task and finish groups that are mentioned in your discussion document. We will contribute constructively to the discussions to help ensure that there are well developed policy options for consultation towards the end of 2021. We see this as crucial because the regional plans and draft water resources management plans will be consulted on in 2022, and a clear policy position is required for the strategic schemes to progress.

We have been through the discussion document and in the following pages we provide our detailed responses. Whilst we recognise that the discussion document is primarily about the regulatory and commercial framework, our comments also cover some general topics that are mentioned in section 1 of the document.

As we see it the most pressing issues are:

- Affordability is clearly massively important, but it seems to us that this issue has not been given sufficient consideration to date. Customers should be able to afford their water bill and we don't want to see anyone in water poverty. Affordability should be about whether customers can afford their bills, and not about the average bill level. It is well known that there are also significant future needs in the sewerage sector. The need to have water resource plans that are affordable also implies that it is feasible to flex the timing of particular requirements to achieve an affordable plan. However as it is, certain requirements are effectively cast in stone (improved drought resilience to 1 in 500 years by 2039, 50% leakage reduction by 2050, and the 25 year environment plan targets), alongside which there are public commitments to achieve net zero operational carbon emissions by 2030 and other targets.
- Fair shares during a drought. Whilst we understand the concept, in practice its application may be difficult in severe droughts. 'Fair' to whom? What is fair to Company A may not be fair to Company B? For example, if Company A has not managed its resources properly, is it fair that Company B has a derogation in service to its customers? The 'fair shares' approach may cause commercial problems because the financial risk is unclear and unbounded. Therefore we think greater consideration should be given to the interruptible supply approach before any final decision.

- Co-ordinated operations. National planning and coordination may be desirable, but if decisions on system operation or schemes were to be made nationally this would take responsibility for security of supply away from water companies. In the consultation it would be helpful to set out what the specific question(s) national planning is aiming to solve in this area and then set out what decisions would be made by which organisation so there is transparency on how any new future framework will operate relative to the current sector governance.
- Environmental destination. The request in the National Framework for regional groups to consider the long term environmental destination of their areas in collaboration with environmental regulators in addition to the ongoing historical approach of five year improvement programmes defined by the EA is a sea change in approach. This will take time to bed down and is unlikely to be fully resolved in the first round of regional plans. Difficult trade-offs across a range of environment issues will be required for strategic regional schemes to be delivered and a balance struck between local environmental impacts versus national benefits and the need to meet national and international targets on carbon emissions (embedded and operational). One of the aspects that seems most challenging is the request that plans and schemes meet current and future environmental requirements, given that the future requirements are not defined. It may also be helpful in the future consultation to be upfront on the need for these trade-offs
- Outcomes. In the parallel Ofwat consultation on PR24 the need to focus on the long term and ensure that the outcomes framework delivers the things that really matter to customers and the environment is re-emphasised. In contrast the RAPID discussion document appears to focus a lot on process. We think that space should also be made for a discussion about outcomes, ensuring the schemes are sustainable long term solutions that are deliverable and provide good outcomes for customers and the environment. These outcomes should consider the holistic costs and benefits, including financial, environmental and social costs and benefits.

We would be happy to meet to discuss any of the points in more detail.

### **Detailed responses**

The discussion document asks stakeholders to respond to four questions:

- Q1. Which aspects of our initial thinking do you agree with or disagree with? What other approaches would you advocate and why?
- Q2. What have we missed that also needs to be progressed?
- Q3. We welcome views on our proposed next steps, including additional activities that we should be undertaking.
- Q4. We welcome views on NERA's recommendations and our initial thinking on them.

Our responses are given overleaf.

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

**Chapter 1: Background**

1. We agree that there are significant future challenges for water resources nationally and we are very supportive of the role of RAPID and the work being undertaken by water companies and regional groups to rise to the challenges.
2. In chapter 1 Background it is mentioned that plans must be affordable while protecting the environment. We consider that it would be beneficial if there was some discussion about how affordability is defined and judged. Customers should be able to afford their water bill and we don't want to see anyone in water poverty. Affordability should be about whether customers can afford their bills, and not about the average bill level. There are also significant future needs in the sewerage sector (Drainage and wastewater management plan etc).
3. Therefore it would seem that the question of affordability would need to be addressed in company business plans for the five years of a price control and over the long term, in consultation with customers, the customer challenge groups and stakeholders. However in the timeline the business plan comes last after regional plans and WRMPs.
4. Regional supply-side schemes will require major investment alongside increased costs to deliver demand side water savings. We agree that it is essential plans are affordable. This implies that it is feasible to flex the timing of particular requirements to achieve an affordable plan, but as it is certain requirements are effectively cast in stone. For example the need to improved drought resilience to 1 in 500 years by 2039, 50% leakage reduction by 2050, and the 25 year environment plan targets. Companies have also made public commitments to achieve net zero operational carbon emission by 2030. Would there be merit in trying to assess whether the totality of all these requirements is affordable?
5. 1.2 RAPID's gated process: We are very supportive of the gated process and agree that it has encouraged collaboration between companies and with regulators that would not have happened otherwise. There was along of discussion about how the report templates could be improved after the accelerated gate 1 submissions. We believe that there should be further opportunities to improve the process including removing activities that are not material to decision making.
6. 1.6 PR24. The parallel consultation on PR24 discusses the need to focus on the long term and ensure that the outcomes framework deliver the things that really matter to customers and the environment, amongst numerous other topics. The RAPID discussion document appears to focus a lot on process: the gated process, regional planning, procurement, charging etc. We agree that these are very important topics. We think that space should also be made for a discussion about outcomes, ensuring that the schemes are sustainable long term solutions that are deliverable and provide good outcomes for customers and the environment. These outcomes should consider the holistic costs and benefits, including financial, environmental and social costs and benefits.

## Chapter 2: Initial thinking

7. 2.1 Market design. This section is headed market design, but describes an approach that is more akin to central planning. We agree that competitive wholesale market with producers feeding into an interconnected transmission system seem unlikely given the large upfront capital investment required and the operational complexities in water resources.
8. 2.2 Procurement of solutions and tendering. Whilst we can understand the rationale behind procuring the projects through a separate DPC contract, it is also essential to make sure the operational requirements of the scheme are fully embedded in the design and procurement. The main body of knowledge and experience of operation of water resources is in water companies, so a way should be found to include water companies in the procurement as well.
9. For schemes procured under DPC with the CAP carrying construction and O&M there needs to be a mechanism for the recipient to have assurance that the scheme is being maintained and is operable. Possibly there is a case for an independent owner's engineer role to scrutinise the CAP.
10. An aspect that might require further investigation are powers to lay pipelines. Under Section 37 of the Water Industry Act 1991 licensed water undertakers have the power to develop and maintain water mains and other pipes *within their own area*. How does this apply to CAP providers or other companies outside the area?
11. 2.5 Drinking water quality. We understand and support the risk assessment approach to drinking water quality. It is carried out against a background of fairly stable drinking water quality standards and policies. It is possible that this might change in the future and/or over the life of strategic resource scheme. For treated water transfers where the exporting company is responsible for treatment it may be necessary to include in contracts the ability for the exporting company to recover the costs of enhanced treatment to meet new standards.
12. 2.6 Charges. We agree that charging should be split between fixed charges to recover the costs of investment and volumetric charges related to water delivered. There would seem to be several other types of cost that also need consideration within these two broad categories:
  - Maintenance. It is essential that the schemes are maintained so that they are capable of operating at the design capacity when required. This will require routine maintenance and regular capital maintenance to make sure that their asset health is maintained. For large schemes with multiples sites of complex assets this will be a significant annual cost, that will need to be recovered by the exporting company from the importing company.
  - Lumpy capital maintenance. We provide below an example related to exceptional capital maintenance required at Wimbleball dam in 2014.
  - Electricity. One of the largest components of the volumetric operating costs will be electricity consumption for pumping. Who takes the risk of changes in the future cost of electricity?
  - Commissioning and sweetening flows. Piped transfers will require flow to be conveyed for commissioning, any recommissioning and for sweetening and

conditioning flows. These requirements will apply all year round and not just when there are droughts. Thus the water transferred may not be required to meet demand, and may have to be used in preferred to other cheaper sources.

- Regulatory treatment. It would be helpful to set out how the regulatory regime will treat the volumetric charge to the recipient company in a drought. As these events are infrequent, but not within control of the water undertaker, clarity on if the volumetric cost is at the risk of the water undertaker, or are they intended to be recoverable?
13. Wimbleball reservoir. Wimbleball is joint water resource for South West Water and Wessex Water. South West Water release water from the reservoir in dry periods to regulate flows in the River Exe for abstraction downstream. Wessex Water abstract directly for the reservoir for treatment and distribution to Taunton and surrounding areas. The dam is a 50 m high concrete buttress dam constructed between 1974 and 1978. In response to steadily rising drainage flows through the south abutment and foundation it was necessary to undertake major remedial works in 2013 and 2014. The works comprised construction of a replacement grout curtain under the dam, at a total cost of circa £10m. The cost was shared between the two companies based on an agreement dating back to the original construction. The work was funded at PR09 by Ofwat as an exceptional capital maintenance item. We mention this to highlight that the SROs will more than likely require lumpy maintenance during their design lives and that the cost will be need to recovered outside of base maintenance.
14. 2.7 Allocation and pricing of water during drought and operational events. This section discusses how water would be shared during a drought, which is clearly a very important issue. We understand the rationale for a fair shares approach as a proposal but this concept will need further development so that it is clear to all parties and ultimately that it can be explained to customers.
15. Specifically:
- ‘Fair’ to whom? What is fair to Company A may not be to fair to Company B. For example, if Company A has not managed resource properly, is it fair that Company B has a derogation in service? Ambiguity in contracts often leads to either inefficient solutions or failure to deliver a service. Whilst we understand the concept, in practice its application may be difficult in severe droughts. The NERA report recognises this with regard to liquidated damages. In a severe drought these could be material and hence the ‘fair shares’ approach is unlikely to work commercially as the financial risk is unclear and unbounded. We therefore think greater consideration should be given to the interruptible supply approach before any final decision. That gives firmer understanding of outcomes and is consistent with the interpretation of Section 37 of WIA as a planning duty. Without this there may not be a robust framework for decision making and accountability and in effect one fails one’s planning duty as a result.
  - Licence condition E requires water undertaker to not show undue discrimination in terms of services, including water resources. If Company A was providing a transfer but had not managed those sources efficiently, requiring Company B to derogate its services under a ‘fair shares’ approach, essentially it is discriminating against its own customers.

- The droughts that these schemes are designed to solve are severe multi-season droughts, and therefore the decision made in the early phase of the drought are critical as to whether the resource will be able to continue providing water in the latter stages of the drought. This may well be before any considering of triggering drought plan actions. This points to the need for strong incentives to develop operating rules and to follow those rules
  - We see a need to clarify the ownership of risk in decision making when using DPC and market approaches in contrast to the current very clear statutory duty of water company boards. Who owns what risk in deciding strategic options and who owns the operational risk that ensues? We would ask that the policy consultation sets out governance and accountabilities clearly for consideration by water company boards.
16. 2.8 Environmental regulation. We agree that there will be the need to consider difficult trade-offs across a range of environment issues for strategic regional schemes to be delivered. We think that there needs to be a step change in the assessment of these wider issues in the near future in parallel with regional planning, and that this is an area where RAPID should be involved. There will need to be a balance struck between local environmental impacts versus national benefits and the need to meet national and international targets on carbon emissions (embedded and operational). One of the aspects that seems most challenging is the request that plans and schemes meet current and future environmental requirements, given that the future requirements are not defined yet. It may also be helpful in the future consultation to be upfront on the need for these trade-offs as that also will help readers understand the context.
17. With regard to the examples of relevant areas to be considered, our comments include:
- Designated sites. In our region Natural England have expressed their view that no water should be exported until the current and future needs of designated sites within the region are addressed, including climate change resilience. We appreciate that the Habitats Regulations are inflexible, but it appears that such an approach would stop all transfers.
  - Water Framework regulations. We have worked hard to develop an high level strategy for dealing with these requirements and the requirements on the Habitats Directive for the Lower Hampshire Avon in the Bournemouth Water area. One of the on the approaches we have advocated is making incremental improvement with respect to environmental flow compliance over time, rather than holding out for a big bang solution. Such an approach emphasises maximising the use of existing infrastructure and local solutions before major regional investments, which we expect will be more affordable.
18. We have joined the Environmental regulation task and finish group, but only as a corresponding member due to other commitments.
19. 2.10 Solution development and delivery beyond 2025. We agree that the current process has engendered a more collaborative working and progress, and that there needs to be consideration to how this can happen post 2025 at lower cost. The overheads in terms of regulatory oversight and company management are significant. As set out in our recent gate one reports, the additional costs for the EA's National

appraisal unit and for NE input is c. 10% of the total costs, excluding the cost of RAPID itself. Partner costs and project management amount to a further ~ 20%.

20. Critical to deciding on the precise timing of strategic supply-side solution will be quantifying the uncertainty around demand-side reductions from leakage savings and consumption savings.
21. 2.11 Coordinated operations. We understand the importance of coordinated operation of the SROs and the systems that support them. National planning and coordination may be desirable, but as mentioned above, if decisions on system operation or schemes were to be made nationally this de facto takes responsibility for supply security. In the consultation it would be helpful to set out what the specific question(s) national planning is aiming to solve in this area and then set out what decisions would be made by which organisation so there is transparency on how any new future framework will operate relative to the current sector governance.
22. This will ensure that whatever decision is made there is confidence and line of sight back the question it is looking to solve.

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

23. Refer to our comments on question 1 above.
24. One of our SRO involves a scenario that doesn't seem to be mentioned. The scheme involves:
  - Diverting the effluent from a sewage treatment works to a river rather than discharge the effluent to the sea via an estuarial water body that is an SPA and SSSI. This will enable improvement in low flows in the river, and also facilitate an improvement in the water quality in the water body.
  - Abstract the water further downstream for export as raw water or treatment for local use.

This may end up involving three parties, each of whom will require their costs to be recovered together with risks and operating rules:

- The wastewater company who will divert the effluent
- The donor water company who will abstract the water from the river
- The receiving water company.

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

25. A consultation of the policy options in late 2021 prior to consultation on the regional plan in 2022 sounds fine.

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

26. We participated in the steering group meeting for the NERA study and don't have any further comments.