

YW response to RAPID discussion document on the commercial and regulatory framework for strategic water resources solutions

Introduction

This document provides YW's response to RAPID's discussion document on the commercial and regulatory framework for strategic water resource solutions¹. Our response is structured by the various issues / themes that the discussion document describes.

Transfers under drought (operational stress)

RAPID's approach appears sensible in principle, but it could be seen as a different interpretation of the S37 duty that has traditionally only been considered in relation to an undertaker's specific supply area. We would question the extent to which the proposed approach is workable and practically applicable, both contractually/legally and operationally.

We would welcome further clarification with regards to the idea of 'fair shares' and how this sits alongside existing Levels of Service (LoS) which may differ between companies and customer willingness to pay for improvements to LoS. There is a risk that companies who have already invested to achieve a given LoS could be 'penalised' for that historical investment if they risk failing to meet LoS from being required to transfer surplus to another region. This could penalise more resilient companies which would be a perverse outcome. Further, it could be a disincentive to trade if a company believes that it could risk 'losing control' of the LoS that it currently provides to its customers. We assume this approach is for water transfers facilitated by new strategic assets and not new or existing bulk supply agreements but it would be helpful to clarify this position.

If we think about how the risks outlined above might be evaluated and priced into contracts, then it is possible that future fixed contracts may not be achievable. It may be the case that a greater reliance on interruptible contracts will be needed that recognise that some risks cannot be managed within standard commercial frameworks. This is a fundamental area that needs further investigation to understand what is practically achievable.

Recovery of efficient investment costs

We are supportive of the overall approach set out in the discussion document. However, Defra guidance on charging stability and avoiding de-averaging of network costs could be challenging and will need to be thought through carefully.

In resilience terms we would expect to see variable utilisation with potential periods of either extremely low or extremely high use. The balance of fixed to variable costs will be important in the context of charging stability but may not be practically achievable depending on the anticipated utilisation pattern of the assets.

¹ <https://www.ofwat.gov.uk/wp-content/uploads/2021/06/RAPID-regulatory-and-commercial-framework-discussion-document.pdf>

With regards to 'strong financial protections if (transfers) are used less than planned', we would make a few points:

- There is a risk that the importing company is exposed to greater costs (penalties) if they make less use of transfers than planned. Consideration needs to be given on the potential wider impact this could have. For example, if the importing company has been better at reducing leakage / demand than planned and is less reliant on transfers. In this example the incentives on the importing company to reduce leakage/demand could be undermined by the risk of financial costs for reduced utilisation. What would happen if a future round of RP/WRMP identifies a different (in-region) option which had not been selected before and which makes the previous scheme largely redundant?
- The 'strong financial protections' could create the risk of a perverse incentive to use a transfer even during periods when it may not really be required, in order to avoid penalty/reduce costs. Further, if these transfers are genuinely to provide resilience during droughts or even extreme droughts, how do we judge of how often a scheme is planned to be used (and over what timescale)? How often a drought resilience scheme is used will depend on the weather, complex demand patters, how climate change evolves.

Incentives to trade

We are supportive of the overall approach in principle. However, we do have some reservations about the concept of incentives to trade and how they could distort decision making. If a trade is the right thing to do because it offers water resource resilience, then it should be selected through the WRMP options process. There is a risk (likely small) that transfers get selected as options because there is an incentive, and not because they are the right WR solution.

Complexity as well as scale of incentive should be given consideration but within the context of the overall WRMP.

Role of DPC

We are supportive of the overall approach.

SRO's would appear to be of the potential scale and complexity where a CAP would be effective. It will be important to understand if separate licensing arrangements are perceived to reduce or increase risk for CAP and delivery of schemes via DPC.

Environmental regulation

We are supportive of the overall approach and establishment of task and finish group. This is a complex area and resolution of the wide range of potential issues is fundamental to the successful delivery and operation of SRO's.

Drinking water quality

We are supportive of the overall approach.

Multi-sector solutions

This is a complex area and one that will become increasingly important as companies look to play their part in delivering the widest and most valuable outcomes for customers, society and the environment. Considering this, and Ofwat's recent PR24 consultation, we feel that this is an area deserving of much more attention.

The specific comment on "water companies funding their fair share" does nothing to address the wider issues around water company customers paying for non-statutory outcomes. This will become problematic without stronger guidance given the greater role that water companies will play in facilitating, co-ordinating and promoting collaborative approaches.

There is a risk that companies will be disincentivised to take on the role outlined above. As the document states "It would be for the water companies concerned to ensure that they could still meet all their statutory and regulatory obligations and mitigate any risks that changes to the non-water company aspects of the project could impinge on the value to the water sector." This reads as placing all the risk on to water companies. This could result in water companies only focusing on solutions that deliver solely for PWS, as this is a less risky course of action. One of the key challenges in bringing forward multi-sector solutions is the complexity of obligations and risks and how they are allocated appropriately across parties.

Reducing regulatory oversight

SRO's have demonstrated that separate 'enhancement' investment process on a different timetable to the conventional price review is possible and this approach should be developed so that the conventional price review can be scaled back. This would help to tackle the challenge of assessing efficient enhancement expenditure that does not lend itself well to econometric modelling and cost assessment benchmarking.

Co-ordinated operations

We see the effective coordination of operations as essential to realise the benefits promised from SRO schemes. How multiple SRO's interact will be just as important to ensure that the widest benefits in terms of resilience can be achieved as efficiently as possible.

The complexity of operational regimes and coordinated decision making needs careful consideration to get the right balance of costs vs benefits and incumbent companies will need to take a leading central role in the development of any such regime.