Regulators' Alliance for Progressing Infrastructure Development

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RAPID

The regulatory and commercial framework for strategic water resource solutions – the consultation outcome

Ofwat

Environment Agency

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About this document

RAPID, established in 2019, is the Regulators' Alliance for Progressing Infrastructure Development. We are a partnership of three water regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate (DWI). Natural Resources Wales (NRW) is involved in an advisory capacity and has a decision-making role for any solution involving Wales, Welsh policy and legislation.

RAPID's December 2021 consultation 'The regulatory and commercial framework for strategic water resource solutions – a consultation'[1] built on our June 2021 discussion document[2], set out our further progress on policy approaches on a range of areas of the framework, and sought further views on that progress, including in Ofwat's 2024 Price Review.

The consultation closed on 26 January 2022 and this outcome document provides a summary of the consultation responses we received, and the work we have subsequently taken forward.

We also outline the continuing work we are undertaking on the framework with the water industry, our partner regulators and with NRW.

[1] RAPID-Autumn-2021-condoc.pdf (ofwat.gov.uk)
[2] RAPID-regulatory-and-commercial-framework-discussion-document.pdf (ofwat.gov.uk)

Executive summary

RAPID's vision is resilient, timely, high-quality, environmentally beneficial water resources which deliver best value outcomes for customers. We seek to achieve this through regulators working together to promote the development of strategic water resource solutions (solutions) that address future challenges including climate change, environment and population growth and are in the best interests of water users, society, and the environment.

Many solutions require collaboration across more than one water company, and often with third parties. They may also require more complex commercial and regulatory arrangements than projects which are developed by an incumbent company for its own sole use.

The regulatory and commercial arrangements required may present new or heightened challenges – be that to environmental regulation, drinking water quality or economic regulation - with different funding arrangements necessary and a range of outcomes needing to be achieved.

We see benefits, and there is general support from water companies, in establishing common frameworks for addressing these challenges. These should reduce costs for individual projects and drive best value outcomes, mitigate risk of project delay, and help make the solutions being developed better able to adapt to challenges of the future. Stable regulatory and commercial frameworks will also increase the likelihood of successful solutions.

Our December 2021 consultation consulted on a range of areas which are part of regulatory and commercial frameworks and are relevant for the solutions being developed. These are:

- Planning for long-term outcomes - how we ensure that water companies are incentivised to deliver the right resources, at the right time, in the right place and achieve best value for customers, society and the environment.

- Development activities – considering the extent to which a RAPID-type framework is necessary over the longer term; issues related to competitive procurement models; options in relation to the water trading incentive; exploring to what extent water companies are incentivised to optimise efficient use of solutions and investment signals necessary to ensure assets are funded; as well as some regulatory issues from an environmental and water security perspective.

- Construction – considering the roles and responsibilities of the different partner regulators and how best to organise their involvement during the construction stage of the solutions, and discussion of the dynamics regarding negotiation of risk allocation and the different drivers of stakeholders.

- Service delivery and operations – considering options for development of the contractual structure for water trades, and design and delivery of the infrastructure supporting the solutions, including possible contract provision standardisation and solution operation at times of drought; the treatment of solutions in future price controls; proposals for a charging framework; and discussion around the feasibility for moving to a more co-ordinated network and the role of a system operator.

- Future proofing of our frameworks – seeking views on the optimal use of assets; timescales for seeing a fully integrated water trading system at a regional level; and whether there might be any other circumstances where destination clauses would be appropriate.

We received 14 responses to the consultation (summarised in this document) which asked a total of 18 questions. Not all respondents answered all questions.

We published the responses[3] (redacted, in line with Ofwat policy) on its website on 4 April 2022. We shared the responses with regulators (Ofwat, the Environment Agency, the Drinking Water Inspectorate and Natural Resources Wales).

We explained in the consultation how responses would inform the work of Ofwat's price review 2024 (PR24) methodology, and they have been taken into account in the draft methodology which was published on 7 July 2022.[4]

Overall, respondents agreed with our proposals, noting that the multi-faceted nature of solutions required new thinking on some aspects of the regulatory and commercial frameworks. There was broad support for a continuing role for a RAPID-type framework into both the construction phase of the current projects and for new strategic water resource solutions which water companies put forward in the future.

Respondents also put forward additional points for consideration, such as highlighting the possible role of green finance in solutions, and some additional barriers to construction such as supply risk challenges.

This document sets out the detail of the responses, our further progress and next steps.

[3] RAPID - The regulatory and commercial framework for strategic water resource solutions – a consultation - Ofwat (see the 'Responses' tab).
[4] Creating tomorrow, together: consulting on our methodology for PR24 - Ofwat

Contents

1. Introduction

RAPID, established in 2019, is the Regulators' Alliance for Progressing Infrastructure Development. We are a partnership of three water regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate. Natural Resources Wales is involved in an advisory capacity and has a decision-making role for any solution involving Wales, Welsh policy and legislation.

RAPID's December 2021 consultation 'regulatory and commercial framework for strategic water resource solutions – a consultation'[5] built on our June 2022 discussion document[6], set out our further progress on policy approaches on a range of areas of the regulatory and commercial frameworks within which water companies operate, and sought further views on that progress, including in relation to aspects of Ofwat's 2024 Price Review (PR24).

While common regulatory and commercial factors apply to all solution types, some may apply differently or be unique to a particular solution type[7], such as a bulk supply agreement for a water transfer. Commercial factors include contractual and charging arrangements, as well as how the operation of solutions might need to be co-ordinated given their size and complexity.

The current solution types being developed are water transfers, water reservoirs and water recycling. Desalination has also been considered, however as of the publication of this document, there are no desalination solutions in the gated process[8].

Solutions involving sourcing water from Wales must demonstrate benefit to the economy, people/society, and environment of Wales. Proposals that affect Wales will have regard to the interests of Wales, in particular sustainable management of its natural resources and other Welsh legislation and policies, to support delivery of the well-being goals for Wales. This

[5] RAPID-Autumn-2021-condoc.pdf (ofwat.gov.uk)
[6] RAPID-regulatory-and-commercial-framework-discussion-document.pdf (ofwat.gov.uk)
[7] Solution types can include: Water Reservoirs - an artificial lake where water is stored. As well as water companies drawing water from a reservoir to treat and put into supply, some reservoirs may release water into rivers to support river flows, and within the context of the strategic water resource solutions one water company can transfer water, by pipes or other means, to another water company; Water Transfers - (also known as bulk supply transfers) are one way to deal with the water supply and demand problem. They transfer water from areas of surplus to areas of deficit. The solution water transfers involve one water company transferring surplus water to another water company. This can be done from reservoirs through pipes or via open water transfers - where the water is discharged by the exporting company into a river or canal and abstracted by the importing company downstream; Water recycling - the treatment of final effluent from a wastewater treatment works via a water recycling plant (WRP) to an environmental buffer lake where it mixes with abstracted water before being fully treated to potable standard at a water supply works (WSW) to provide a potable water supply.
[8] Companies have ring-fenced funding to develop solutions to be 'construction ready' for the 2025-2030 period. RAPID (working with the partner regulators and Natural Resources Wales) assess the quality of companies' work on solutions at specific points (gates) to ensure that sufficient progress is being made, and to decide whether solutions should continue to receive ring-fenced funding for their further development or whether solutions should be removed from the RAPID programme.

includes application of the water resources planning guiding principles for developing water resources management plans[9]. We have ongoing constructive engagement with Welsh Government and Natural Resources Wales on these issues.

Our role is to provide advice and recommendations to the partner regulators – Ofwat, the Environment Agency and Drinking Water Inspectorate - and to Natural Resources Wales. The responses to the consultation are feeding into our advice to partner regulators and to Natural Resources Wales during 2022. Responses have also informed the work of the Environmental Regulations task and finish group and the Ofwat price review 2024 methodology. Ofwat published its Price Review 2024 (PR24) methodology on 7 July 2022 for consultation[10]. The consultation closes on 7 September 2022.

This document provides a summary of the comments made to the consultation and the work progressing on the different areas of the regulatory frameworks (economic, regulatory oversight of solutions, environmental and drinking water quality) and commercial frameworks. Appendix A sets out the number of responses received to each question and further detail of the comments / suggestions made.

[9] Water resources management plan: guidance | GOV.WALES
[10] Creating tomorrow, together: consulting on our methodology for PR24 - Ofwat

2. Regulatory frameworks – Economic

The consultation highlighted several areas of economic regulation relevant to strategic water resource solutions:

- ensuring best value solutions for customers (question 1)
- procurement approaches for construction and operation of solutions (question 3)
- incentivising water trading (question 4)
- incentivising water companies to deliver the optimum solutions whilst securing investment and links to asset utilisation and possible third-party involvement (question 5)
- the types of incentive and regulation that would result in appropriate allocation of risk between parties such as water companies and customers (question 8), and
- the treatment of water trades post-construction [of the solution] in future price reviews (question 10).

Consultation responses have informed the Ofwat price review 2024 methodology as explained below.

2.1 Ensuring best value solutions for customers

The consultation question sought views on any barriers or challenges to best value planning that had not already been identified in the May 2021 Ofwat consultation[11] on PR24.

In their consultation response, the All Company Working Group[12] noted that best value planning and the opportunity to deliver societal and environmental benefits in conjunction with securing water supplies are likely to be more costly than options that do not consider these wider benefits. They highlighted the future importance of green finance and ensuring contractual arrangements effectively embed sustainable outcomes.

The draft methodology sets out Ofwat's expectation that water companies should deliver long-term best value. This will require water companies to take account of wider environmental and social benefits, costs, risks and affordability of customers' bills when developing their investment proposals to enhance the performance and operation of their activities. RAPID expects solution sponsors to demonstrate how each solution delivers best value outcomes.

[11] PR24 and beyond: Creating tomorrow, together - Ofwat

[12] All Company Working Group is made up of Affinity Water, Anglian Water, Severn Trent Water, Southern Water, Thames Water, United Utilities, Wessex Water and South West Water working on the delivery of strategic regional solutions to support drought resilience in the south east of England.

Ofwat sets out how water companies should assess best value and evaluate wider benefits in more detail in Appendix 9 (Setting Expenditure Allowances[13]) of the draft PR24 methodology. The proposed approach to assessing best value builds on Ofwat's public value principles[14].

2.2 Procurement approaches

Chapter 3 of the draft PR24 methodology proposes that solutions should be constructed through a Direct Procurement for Customers (DPC) approach, where the project is above a size threshold of around £200m, with Ofwat reserving the right to explore the use of DPC for major projects below this size threshold.

In Appendix 5 (Direct procurement for customers[15]) of the draft methodology, Ofwat sets out why the proposal is the preferred option and the three options that had been considered.

Competitive tendering for delivery of solutions is important in ensuring the best value option for customers. Consultation responses highlighted the individual nature of the projects, with each having its own specific needs for its delivery. Issues such as how the water company tenders and how they run the procurement is a decision for water companies in selecting the best value option.

In the case of multi-sector reservoir (MSR) systems[16], RAPID, Anglian Water, Northumbrian Water, Yorkshire Water and Water Resources East jointly commissioned a report from CEPA and Agilia to consider the legal and commercial models that could facilitate the delivery of MSR systems, and the role of third parties. The CEPA report was published on 20 June 2022[17].

The report recognised challenges to such solutions such as identifying a solution that represents best value for each user and developing a financeable model for all users. However, given the potential benefits that an MSR system could deliver for customers, the environment and society, Ofwat considers it important for water companies to continue to investigate the delivery of MSR systems and develop working models, looking at how challenges can be addressed.

We are therefore proposing the following key areas of work over the next year:

- Establishing the case for a MSR system: where water companies are considering MSR systems we are asking them to investigate the needs and benefits case for the reservoir at

[13] Appendix 9 - Setting expenditure allowances - Ofwat
[14] Ofwats-Final-Public-Value-Principles.pdf
[15] Appendix 5 - Direct procurement for customers - Ofwat
[16] Multi-sector reservoirs are comprised of reservoirs and associated developments that collectively work together on an integrated basis to provide multiple benefits to multiple stakeholders and to the environment.
[17] Developing a commercial and legal model for multi-sector reservoir systems - CEPA/Agilia report for RAPID - Ofwat

both a project level and individual user level. Water companies will need to understand (a) the demand for an MSR approach and where the demand is, and (b) whether the individual use cases support an MSR system i.e. is it likely to offer best value for each user.
- Identify potential participants and funding streams: each user case will require committed funding and water companies need to test potential participants' appetite for an MSR as well as identify and develop mechanisms that could fund the different use cases.

Our role is to support water companies carrying out this work – improving the existing regulatory framework so that any emerging points, be they opportunities, gaps, or barriers, are addressed through our work. As part of this we are proposing to carry out a critical review of the models identified in the report, the barriers and risks, and where we may be able to unlock any barriers or make recommendations for others to do so.

2.3 Incentivising water trading

A water trading incentive provides an incentive for water companies to trade water as it may offer an efficient way to contribute to their provision of adequate water resources to meet the needs of their customers.

In our consultation, we set out the main drivers for providing incentives and the advantages and disadvantages of alternative approaches. We recognised that RAPID trades would require a different approach to the PR19 incentive but saw merit in adopting a consistent incentive across all forms of trade.

Responses indicated broad support for our proposed approach to incentives for water trading. Some respondents noted that legal and physical constraints meant that, in practice, the number of trades is likely to remain low for some time. Nevertheless, there was general agreement on the need to retain some form of water trading incentive to encourage water trading in the future.

The PR24 draft methodology sets out the proposed approach to water trading incentives both for PR24 and proposals as to how it might flex into future price controls. It confirms that:

- a water trading incentive is to be included in PR24 and future price review periods
- the intention is to provide regulatory certainty at the point of investment approval of a scheme, rather than when the trade begins, and
- separate consideration is being given to the incentivisation of capital expenditure, alongside incentives based on the revenue from the trades.

In Appendix 2 – water trading incentive[18] – of the draft methodology Ofwat sets out two high-level options that it is considering to replace the current water trading incentive at PR29.

2.4 Securing investment and efficiency

We sought views in the consultation on:

- how we should incentivise water companies to deliver the optimum solutions whilst securing investment and in particular on how they support best value outcomes.
- whether incentives should be applied to assets where there may be low utilisation and how stranding risk of strategic water resource options should be managed.

We intend to work together with the investor community and supply chains, to ensure that the frameworks developed are both investable and deliverable whilst ensuring best value outcomes for customers. We expect to undertake some market engagement in autumn 2022.

2.5 Treatment of trades post-construction in future price reviews

Since the consultation was published, a task and finish group (set up under the Regulatory and Commercial Steering Group and explained in the Next Steps Post-consultation section below) has been established to consider the treatment of the solutions in the price control. It is composed of members of RAPID, Ofwat and some water companies, to discuss how solutions should be treated in terms of revenue allowances and incentives.

2.6 Risk allocation between parties

As well as setting out in the consultation possible commercial models for solutions and a proposal for a high-level approach for risk allocation in projects, risk allocation refers to how various risks, such as those concerning construction, should be allocated as part of an investment framework between various parties including customers, water companies, and a competitively appointed provider (in Direct Procurement for Customers). We note that regulatory intervention should be designed to ensure that the allocation of risks is appropriate and that any allocation to customers is fair/achieves best value outcomes.

[18] Appendix 2 – Water trading incentive – Ofwat

Water companies should have regard to the Ofwat guidance on Direct Procurement for Customers expected to be published later in summer 2022.

We plan to further assess risk allocation and incentives on a solution specific basis taking account of the different characteristics of the solutions. The HM Treasury's Green Book supplementary guidance on risk[19] discusses how risk matrices could be used to better understand the risks associated with a project and therefore its viability. A risk matrix is used during an assessment to help distinguish the likelihood a risk will occur, and the impact that a risk is likely to have on a business. We are exploring the development of such matrices for each solution.

[19] Green Book supplementary guidance: risk – GOV.UK (www.gov.uk)

3. Regulatory frameworks – Regulatory Oversight, Environmental and Drinking Water Quality Regulation

The consultation highlighted several areas of environmental and drinking water quality regulation, as well as some elements of regulatory oversight relevant to strategic water resource solutions. It sought views on:

- whether options for a future gated process for new strategic water resource solutions be kept open (question 2)
- the best approach for ensuring regulatory oversight for RAPID solutions beyond gate five into the delivery phase (question 5), and
- the pathway for the resolution of environmental barriers and whether there were any others that needed to be considered (question 6).

While there was no specific question asked about drinking water quality, we explained how water companies must also comply with the requirements of the Water Industry Act 1991 and the Drinking Water Quality Regulations[20].

3.1 Regulatory oversight

There was majority support for both a future gated process for new solutions and our involvement in solutions beyond gate five.

On involvement beyond gate five, respondents felt that the gated process might be streamlined to reduce the administration required. There was support for both options 2 – enhanced co-ordination but still reliant on resources within partner regulators, and 3 – 'RAPID Lite'. There was a suggestion that there might be a subtle change of emphasis of our role towards 'sponsoring' the solution, as the decision to proceed with it would have already been taken. The need to have continued collaborative regulatory co-ordination was highlighted.

There was some concern from a procurement perspective that under the current gated process, all the solutions looked to be coming to the market for construction at a similar time, leading to bidders for construction of solutions potentially choosing between opportunities and weakening the competitiveness. It was suggested that flexibility in gate timings can mitigate this risk.

[20] Water Supply (Water Quality) Regulations 2016 in respect of any water undertaker whose area is wholly or mainly in England and the Water Supply (Water Quality) Regulations 2018 in respect of any water undertaker whose area is wholly or mainly in Wales.

The draft methodology sets out Ofwat's proposals to continue to allow funding for the development of strategic regional water resource solutions with a streamlined gated process. We are working with the partner regulators to explore the future scope and role of RAPID in providing regulatory oversight of the development of water resources beyond 2025.

Anglian Water suggested consideration of the regulatory oversight model for the Large Onshore Transmission Investments (LOTI), which was felt to have the flexibility to allow projects to come to market at different times thus removing some of the pressure on the market.

Following the consultation, gate one submissions and the development of the gate two guidance, we have concluded that timings for gate three and subsequent gates will have more flexibility, resulting in a staggering of solutions being tendered. We explained in section 2.3.7 (Solution progression) of the gate two guidance[21] that we are expecting timing and activities for gate three onwards to diverge between solutions depending on whether they are in preferred or alternative pathways and when within the 2025-30 period they need to be "construction ready".

3.2 Environmental

The consultation document explained the work that had been taken forward by the Environmental Regulations Task and Finish Group[22] to fully understand the risks of environmental regulation and policy associated with RAPID solutions.

The consultation document sought views on:

- the output of the group - which was a programme of work to review aspects of some regulatory issues which may prevent the solutions progressing or may affect choices of the optimal programme from an environmental and water security perspective; and
- whether the pathway for resolution of environmental barriers met the requirements of stakeholders and whether there were any other environmental or water quality issues that needed to be considered.

Respondents gave broad support for the work of the Task and Finish Group and its plan to investigate potential environmental policy barriers. However, there was notable concern around timings, with some policy areas not being resolved until after gate two submissions. It

[21] Strategic-regional-water-resource-solutions-guidance-for-gate-two_RAPID.pdf (ofwat.gov.uk)

[22] The group was established by the Environment Agency working with Natural England, Natural Resources Wales, water companies developing RAPID solutions, regional groups and RAPID.

was also noted that new issues can emerge at any point during development of a solution, and there was a need to maintain flexibility and regulatory liaison.

Table 1 below sets out the progress made on the actions set out in the consultation since December 2021. All these issues are also kept under review, with further updates made as necessary.

Table 1: Update on environmental issues

Policy / Position	Action	When
Water transfers that may impact upon a Habitats Directive site	New advice note confirming role of Regional Groups in safeguarding water for European sites now and in the future; and setting out position on functional linkage of land.	Issued February 2022
Exemption to meeting River Basin Management Plan (RBMP) objectives	Advice note on use of Regulation 19 of The Water Environment (Water Framework Directive) (England and Wales) Regulations 2017[23] with regards to solutions.	Issued May 2022
Approach to preventing deterioration (e.g., abstraction licence capping)	Document to clarify approach to licence capping.	Issued April 2022
Invasive non-native species (INNS) position statement	Position statement reviewed. Clarification that Regulation 19 of The Water Environment (Water Framework Directive) (England and Wales) Regulations 2017 cannot be applied to impacts caused by INNS.	Issued July 2022
Effluent redirection – clarification	A document of frequently asked questions has been developed.	Issued July 2022

As well as comments on actions related to preventing deterioration, consultation responses referred to the issue of abstraction licensing moving into the Environmental Permitting Regime (EPR) and potential changes that could impact on licence volumes and solutions. Clarification on the details of the move to EPR is therefore being added to the list of issues being considered (see table 2 below).

The point was also made that as well as considering the issues highlighted in the consultation, it was also important to consider the impacts of solutions on wider environmental outcomes such impacts on the natural environment including biodiversity, net zero, catchment resilience, amenity, and access.

[23] The Water Environment (Water Framework Directive) (England and Wales) Regulations 2017: Regulation 19 sets out how a failure to achieve good groundwater status, good ecological status or (where relevant) good ecological potential, or to prevent deterioration in the status of a body of surface water or groundwater, or to prevent deterioration from high status to good status of a body of surface water is not a breach of the environmental objectives set for it under regulation 12 in specific circumstances.

In addition to the points raised in table 1, the following issues are also being considered as set out in table 2 below.

Table 2: Additional environmental issues under consideration

Policy / Position	Action	When
Move of abstraction licences to Environmental Permitting Regime	Further detail on the implementation of the policy.	Further information expected 2023
Water Quality – emerging substances, status of water bodies & water quality standards (Emerging substances also links with drinking water quality. Environment Agency and Drinking Water Inspectorate are working together through RAPID to maximise this synergy.)	1. Water companies asked to support the Thames Water approach. 2. Frequently Asked Questions on water quality issues provided to water companies 3. Water companies are undertaking in-depth water quality risk assessment to determine any policy gaps	1. January 2022 and follow-up summer 2022 2. Issued in July 2022 3. Ongoing
Reserving water for abstraction for future use	Reviewing approach in relation to RAPID programme.	Target date: December 2022
Augmentation to mitigate abstraction impacts is deemed unsustainable	Work ongoing looking at financial, carbon and environmental implications. Review environment sustainability of schemes prior to next National Framework.	Target date: December 2023

3.3 Drinking water quality

The consultation explained how, as well as environmental regulation, water companies must also comply with the requirements of the Water Industry Act 1991 and the Drinking Water Quality Regulations[24]. These requirements include a duty to:

- ensure that all water supplied to premises for domestic purposes (drinking, cooking, washing, central heating and sanitary purposes) or for food production purposes, is wholesome at the time of supply, meaning that it meets the standards set out in the Drinking Water Quality Regulations. These include standards to ensure water does not contain substances that are harmful to health and regarding acceptability of water to consumers

[24] Water Supply (Water Quality) Regulations 2016 in respect of any water undertaker whose area is wholly or mainly in England and the Water Supply (Water Quality) Regulations 2018 in respect of any water undertaker whose area is wholly or mainly in Wales.

- so far as reasonably practicable, ensure, in relation to each source or combination of sources there is, in general, no deterioration in the quality of the drinking water, which is supplied from time to time from that source or combination of sources.

While there was no specific question asked about drinking water quality in the consultation, respondents recognised the fundamental imperative of compliance with drinking water regulations and welcomed the work underway.

The consultation explained that RAPID, with Drinking Water Inspectorate, planned to develop a principles framework that sets out how water companies can mitigate water acceptability issues and determine how those issues could be included in the gated assessment process.

The principles framework has been completed[25] and as part of our quarterly monitoring of progress on the solutions, water companies are required to highlight any possible issues related to drinking water quality. Such issues are also discussed as part of regular RAPID / water company check in meetings on the proposed strategic water resource solutions.

The consultation also mentioned the Drinking Water Inspectorate / Consumer Council for Water (CCW) research project, the aim of which is to understand public perception of water recycling for drinking water use. The research has now commenced and is due to complete end 2022, with publication in 2023.

Several respondents highlighted the importance of communication with customers around water acceptability and recycling issues.

[25] DWI principles framework is expected to be published on DWI website in early 2023.

4. Commercial frameworks

The consultation explained how commercial frameworks interact with the solutions. Commercial arrangements will need to be in place for all aspects of solution delivery – design, construction, finance, maintenance, the operation of solutions during time of drought or other operation events, to bulk supply and other charging arrangements.

The consultation also raised how the move towards greater collaboration and sharing of assets has important implications beyond contractual arrangements for how future assets are delivered, operated, and paid for, and how to better support and incentivise the co-ordinated planning, development and operation of new and existing water resources to deliver greatest public value across multiple sectors, in addition to resilient public water supply.

4.1 Contracts

The consultation sought views on a range of contract factors relevant for the solutions:

- different types of water supply contracts between water companies, competitively appointed providers (in Direct Procurement for Customers) and third parties (question 9)
- possible contract standardisation (question 10)
- the operation of solutions at times of drought or other operational events (question 13), and
- the use of destination clauses in water supply contracts (question 17).

We are taking forward further work on contract issues including water supply contracts, standardisation, and destination clauses; however, it is too early in the development of solutions to have progressed this work to any substantive degree.

On the operation of solutions at times of drought and other operational events, the consultation proposed a 'fair shares' approach to allocation and sought views for the development of the approach. Respondents were supportive of additional work to develop this approach further. We have established a Task and Finish Group (set up under the Regulatory and Commercial Steering Group and explained in the Next Steps Post-consultation section below) to progress this and the development of a set of principles for the operation of a fair shares approach.

4.2 Charging for water trades

The consultation set out high-level principles and options for water companies' charges for water trades with other water companies to be specified in bulk supply agreements.

The options for those charges were: fixed and volumetric charges; wholesale minus; Long Run Average Incremental Costs (LRAIC); and requirement in the form of principles.

Support was greatest for fixed and variable charges with the wholesale minus approach felt as being more appropriate for new appointees and not RAPID solutions. The LRAIC option was considered difficult to implement as the costs could be difficult to isolate and may introduce scope for dispute about solutions as the approach relies on costing solutions other than simply the one involved in the transaction.

It was suggested that requirements in the form of principles would allow flexibility as each trade would likely have bespoke pricing arrangements, but existing guidance would need to be enhanced to provide further certainty. Although there was a suggestion that it may be difficult to demonstrate compliance in this approach.

As we understand the solutions in greater detail – particularly from a commercial perspective, it is apparent that further thinking is needed, both to decide on any guidance between the charging options and to ensure our thinking takes account of the specific elements of solutions. Examples of the issues to be further developed include whether pricing should recover a share of current network costs as well as additional costs from solutions, charges for transits, how to determine the profits to be included in charges and how charges are amended to deal with new buyers and potentially new sources of supply.

4.3 Co-ordinated operations

The consultation explained our next steps for developing further our work on co-ordinated operations. We commissioned Baringa and Mott MacDonald to complete a study on regional co-ordination in the water sector. The final report will be published shortly.

The goal of this study was to review current and emerging arrangements in the water sector in England (with consideration of interfaces with Wales) and to identify potential future requirements for improving the institutional and regulatory framework so that it better supports and incentivises the co-ordinated planning, development and operation of new and existing water resources to deliver greatest public value across multiple sectors, in addition to resilient public water supply.

The study has identified a number of areas for further work with the objective of better facilitating the development and delivery of co-ordinated water resources infrastructure. It identified two broad themes:

- Interventions to support the near-term delivery of the strategic water resource solutions and wider implementation of the regional plans. These interventions include providing clarity around the funding models for multi-party solutions, allocation of risk, and the framework of commercial incentives.
- Areas to potentially improve future planning, development and delivery of resource options.

We have been progressing many of the key commercial aspects via the Regulatory and Commercial Steering Group, supported by task and finish groups.

5. Future proofing

The consultation sought views on:

- how the optimal use of assets might vary over their lifetime (question 15) and
- a realistic timescale to see a fully integrated water trading system at a regional level and how these developments should best be managed (question 16).

5.1 Optimal use of assets

Respondents generally thought that optimal use could vary significantly over some solutions, where climate change or abstraction licence changes alter the nature of the water resource systems or the nature of the system changes as more is learnt about it. It was felt also that capacity utilisation would change due to growth and climate change.

It was felt that adaptive planning within the Water Resources Management Plans (WRMPs), and consideration of the resilience of investments using scenario testing may somewhat mitigate these issues.

5.2 Fully integrated water trading system at regional level

There were a range of responses on this question with comments including that:

- the relationship between the regulatory processes and their timing was the key coordination issue, including the timelines of regional planning and their public consultations; price control submissions; and the planning regime.
- focus for trades could be on sub-regional, catchment scale initiatives where there were already high levels of engagement from stakeholders, with examples of innovative multi-party trading arrangements emerging in the East of England being cited, and
- water availability and environmental need were factors in the number of trades possible within regions.

We will consider the points raised in the context of our on-going work.

6. General question on next steps

We also sought views on our proposed next steps (question 18), including additional activities that we should be undertaking.

Respondents raised several additional points for consideration, with some being extensions of existing areas already under consideration, such as treatment of losses in contracts, which will be considered as part of the contracts work, and calculation of transit fees as part of the charging work.

Some respondents also suggested that further consultations might be beneficial on some areas of our work such as any agreed changes to the Regulatory and Commercial frameworks for the solutions. We will keep the need for further consultation under review with partner regulators.

7. Next steps post-consultation

7.1 Regulatory and Commercial Frameworks

This outcome document has set out our progress on regulatory and commercial frameworks following consultation responses.

Following those responses, we have also undertaken a review of our regulatory and commercial work programme. As well as continuing with our work on areas such as environmental regulation, our other priority work areas for the solutions are:

- Bulk Supply Charging and water trading incentives (recognising links with PR24 and the final methodology)
- Direct Procurement for Customers as applied to solutions – including risk and cost sharing, and the timing of procurement
- Commercial and contractual – including contract standardisation principles, the role of codes, and the possible role of a system controller / operator
- Building a sustainable framework – having regard to the next Environment Agency National Framework for water resources in England, the role of regional planning, and the future role of RAPID
- Supporting PR24 in setting funding allowances for solutions – linked to costs of solutions include construction and land acquisition.

We also undertake quarterly monitoring of progress on the solutions, and of any new regulatory and commercial issues which may emerge and consider whether they should be added to our work programme.

7.2 Engagement

We continue to engage proactively with partner regulators, Natural Resources Wales and with the UK and Welsh Governments.

As part of our engagement work following the consultation, we have also established a Regulatory and Commercial Steering Group – comprising representatives from the water industry. The Group has evolved from the earlier working groups explained in the December 2021 consultation.

The role of the Steering Group is to assist us with evaluating the prioritisation on different areas of the regulatory and commercial frameworks, as well as providing further input on thinking to develop solutions. This further thinking occurs through Task and Finish Groups,

commissioned by the Steering Group. The Steering Group updates the wider water industry and regulators at the RAPID Quarterly Liaison Meetings.

7.3 Progress across other RAPID work areas

We published our forward work programme for 2022-23[26] on 7 April 2022.

In our December 2021 consultation we also referenced other RAPID work areas – the gated process and regional planning. There has been further progress in these areas as explained below:

Gated process

RAPID's first role is to provide oversight of the gated process which supports, reviews and challenges the development and delivery of the strategic water resource solutions funded using the £469 million ring-fenced programme established as part of the 2019 price review.

We lead the assessment of the solutions at each gate and make recommendations to Ofwat on solution funding. Our assessment seeks to ensure that the solutions are on track and progressing in a way that offers value to customers and the environment. Where appropriate our recommendations may include interim measures to manage shorter-term risks identified through the solution owners' work.

Water companies made their submissions to standard gate one in autumn 2021 and our assessments of those submissions were published earlier this year on the Ofwat website[27]. Where water companies were on RAPID's accelerated gated programme, submissions were made to accelerated gate one in autumn 2020, and accelerated gate two in spring 2022. Our assessments of the accelerated gate one and two submissions have also been published[28] [29].

We are currently preparing for standard gate two submissions on 14 November 2022, with our draft decisions due 1 March 2023, and final decisions 7 June 2023. We are also looking ahead at planning for gate three, with gate three guidance published on 23 August 2022[30].

Regional planning

We have continued to act as an enabler for the effective implementation of the Water Resources National Framework in England. This has included coordinating the collaborative work of the five regional water resources groups and supporting the independent chair of the

[26] RAPID Forward programme 2022-23 - Ofwat
[27] Gate one submissions and final decisions - Ofwat
[28] Accelerated gate one submissions and final decisions - Ofwat
[29] Accelerated gate two and new solutions proposed at standard gate one, submissions and final decisions - Ofwat
[30] Strategic regional water resource solutions guidance for gate three - Ofwat

senior steering group and regional coordination group. We have worked with the regions throughout a period of reconciliation of their plans which aimed to make sure the plans were aligned on key interdependencies such as water transfers. We have also used the governance in place to identify opportunities for cross sector working and engagement beyond the water industry such as with the agriculture and power sectors.

We have continued to track and mitigate the risks associated with the development of the regional plans and supported coordination across government and regulators.

We have continued to develop national evidence to shape the regional plans through its modelling work in collaboration with academic partners. Outputs from phase 2 of this work are expected to be published later in summer 2022. We have also developed evidence to support regulators on cost benchmarking of proposals.

With a view to the future, we have worked across regulators and practitioners to understand how the current regional planning process is working and how it could be improved in future. We recognise that the work of the groups is still very much in progress. However, we want to capture any lessons learnt now so that improvements can be made in good time. We have gathered and collated structured feedback from practitioners, government and regulators and stakeholders. We have also held a series of workshops to understand this feedback in more detail. We are currently working across government and regulators to prioritise this and propose a work programme to put the necessary improvements in place for future planning rounds.

Each of the five regional groups published their emerging plans on 17 January 2022. Regulators fed back on these and we are expecting the draft plans – that take account of the feedback provided – on 14 November 2022. These will be published alongside individual water company water resources management plans (WRMP) which include further detail on proposals. The plans will then be finalised by September 2023.

Appendix A – Summary of consultation responses to each consultation question

The following 14 organisations provided a specific response to the December 2021 consultation:

ABB Ltd
All Company Working Group
Affinity Water
Anglian Water
Bristol Water
Hafren Dyfrdwy
Northumbrian Water
Severn Trent Water
Southern Water
South West Water
Thames Water
United Utilities
West Country Resources Group
Yorkshire Water

Dŵr Cymru advised that they had no comments on the consultation further to their response to the June 2021 discussion document.

The December 2021 consultation asked a total of 18 questions. Not all respondents answered all questions.

Planning for long-term outcomes

Q1. Are there other barriers and challenges to best value planning that have not already been identified in the May [2021] consultation on PR24 or that apply differently to the types of solutions being considered by RAPID? What needs to be done to address these issues?

There were 12 responses – the majority of which raised some further possible barriers and challenges to best value planning.

There was general support for Ofwat's 2021 Long Term Delivery Strategy discussion paper – shifting the focus from business planning over a five-year window towards long-term plans and contextualisation of companies' business plans within a long-term delivery strategy.

The All Company Working Group reflected that "best value planning and the opportunity to deliver societal and environmental benefits in conjunction with securing water supplies are likely to be more costly than options that do not consider these wider benefits". They also

highlighted the future importance of green finance and ensuring contractual arrangements effectively embed sustainable outcomes.

Environmental barriers were considered under question 6, however respondents suggested under this first question that further clarity was needed on environmental issues, such as changes to abstraction licensing. Environmental aspects were also considered to be a key barrier to conclusively demonstrating best value, as they could also substantially change the economics of projects and, when built, the economics of sourcing water resources.

The need to consider the complexity of resource sharing was also raised and the need this creates for certainty around regulatory mechanisms for cost sharing. It was explained that where solutions are shared between companies with different types of resources systems (primarily those systems that contain significant existing surface water storage versus those that do not) then the amount of benefit provided by a given capacity or storage volume will vary depending on the nature of the existing resource system.

Development activities /Other regulatory barriers to investability

Q2. Should the option for a future gated process for new strategic resource solutions be kept open at this stage? If additional regulatory intervention is required, which is the preferred option proposed?

There were 12 responses with wide support for the option for a future gated process being kept open.

In terms of the operating model for a future process, it was noted that the current gated process was quite rigid and had a high overhead and that a more flexible, lower overhead process, would deliver better customer and environmental value for money.

An option was proposed for compressing or combining gates where feasible. It was suggested that RAPID could alleviate some of the regulatory burden on water companies by playing a more inclusive role providing assurance of solutions to the three regulators.

In support of a future process, one company explained that most strategic water resource solutions had potential environmental 'showstoppers', which needed to be worked through with regulators before solutions could be included in future WRMPs and Business Plans.

Q3. Are there other approaches for procurement we should consider, or other pros and cons? Do you prefer one approach and if so what and why?

There were 12 responses.

There was broad agreement that the substantial investments that will be required to meet future water resource needs should be efficiently procured and delivered, and that this could

be achieved through competitive tendering, and that there should be flexibility on the tendering models.

There were a range of other points made in responses, including that there was a need to consider:

- How tender models could work in terms of packaging of projects into multi-procurements depending on revenue streams and how trading arrangements would support the funding of infrastructure.
- How to manage a multi appointee strategic solution where there is a supply agreement and potentially at least one additional water company involved.
- A possible emerging option for multi-sector solutions, that could seek financing through the UK Infrastructure Bank. This could include public and private partnerships (e.g. local authority support for water resource developments given the educational, economic or recreational benefits).
- The importance of contractual arrangements and the specifics of how costs should be shared between water companies was also suggested as requiring further review.
- Whilst there was agreement that DPC for large projects should be considered, it was suggested that it was in the interest of customers to retain the option of non-DPC delivery should the costs become prohibitive.
- That it might be necessary to explore alternative models to DPC in Wales to take account of Welsh Government policy.

There was also a suggestion that it would be helpful for further guidance from RAPID when considering multi appointee strategic solutions on other issues, such as: the appointee(s) role(s) in a multi appointee solution; and additional contracts or arrangements envisaged as required as part of either a multi appointee SIPR or DPC.

Respondents were also interested in the potential for using the Special Infrastructure Projects Regulations (SIPR) in England as the procurement model for solutions and requested further information on this.

Q4. What is your view on the policy options set out (or any others) to incentivise water trading?

There were 12 responses indicating broad support for RAPID's proposed approach to incentives for water trading. In particular:

- some respondents noted that legal and physical constraints meant that, in practice, the number of trades was likely to remain low for some time
- nevertheless, there was general agreement on the need to retain some form of water trading incentive to encourage water trading in the future

- some respondents argued that the limits on the proportion of revenue which water companies can recover through the trading incentive could significantly reduce the incentive to trade
- several respondents noted limited success to date of the current water trading incentive in encouraging new trades
- several respondents stressed the need for Ofwat and RAPID to commit to an approach to provide as much regulatory certainty as possible, and
- there were several detailed suggestions for principles for, and detailed design of, incentive mechanisms.

Q5. How should we incentivise companies to deliver the optimum solutions whilst securing investment and in particular on how they support best value outcomes, including any differences for alternative procurement models or multi-sector projects? What incentives should be applied to assets where there may be low utilisation and how should stranding risk of strategic water resource options be managed?

There were 10 responses.

There was some support for the RAPID proposals whereby cost recovery certainty is given to the relevant provider based on the plans and circumstances at the time, with flexibility to review and amend this at five-yearly planning cycles.

There was also a suggestion that a need for strategic long-term investment means that considerations beyond the five-year price review are critical.

There was support for the DPC procurement approach, which was providing confidence in cost recovery, although there was a suggestion that risk management could be further supported by enabling investment decisions to be made incrementally on an adaptive pathway.

On alternative models, it was suggested that there could be a separate transaction of water resources from the operation of the solution itself. Water resource prices could include environmental value and compensation payments as they are separate from other activities. Pricing would vary according to volume availability.

There were suggestions of resolving low utilisation / stranding by limiting the solution risk and allowing third party access; with the point made that low utilised assets were needed for resilience purposes.

Q6. Does the pathway for resolution of environmental barriers meet the requirements of stakeholders and are there other environmental barriers that need to be considered?

There were 12 responses.

Respondents gave broad support for the work of the Environmental Regulations Task and Finish Group and its plan to investigate potential environmental policy barriers. There was, however, notable concern around timings, given that some policy areas would not be resolved until after gate two submissions.

Other points raised included:

- possible linkage between investor confidence because of uncertainty around abstraction licence reform and the move of abstraction licences into Environmental Permitting Regime.
- The importance of consistent guidance on environmental issues.
- Further understanding on the requirements of Welsh legislation if water from a solution is supplied from Wales to England.
- Role of abstraction licensing / water resources management planning to deal with environmental issues.

One respondent highlighted the 'land take' required to develop environmental or social benefits that may not be core to the delivery of the core public water supply solution, although they might deliver wider public value, other multi-sector aspirations or opportunities. Also highlighted was the limited application of compulsory acquisition powers under the Development Consent Order Process and how it might risk constraining the potential wider public and private value that could be delivered in conjunction with the core public water supply benefits.

A respondent also expressed an interest in being included in any research undertaken around drinking water quality e.g., technology, customer perception and emerging solutions.

Construction

Q7. What is the best approach for ensuring regulatory oversight for RAPID solutions beyond gate five into the delivery phase?

There were 11 responses.

There was majority support for regulatory oversight for RAPID solutions beyond gate five, provided the benefits could be justified. Given the complexity of the projects most responses agreed that continued coordination across different regulators would be necessary, and it was important for this to proceed effectively.

One respondent was unclear of the additional value in extending RAPID regulatory oversight and thought that other regulatory 'interventions' would likely be in place including water quality, controls on planning and environmental consents, and Ofwat oversight of the

construction phase. Another respondent expected Ofwat to be the main regulator providing regulatory oversight in the construction phase, to the extent oversight was required.

Of those supportive of RAPID oversight beyond gate five, the consensus was in favour of option 3 (RAPID lite). It was thought that this would likely be the highest cost option but could be more efficient overall because it would make use of the existing governance procedures in place for partner regulators to continue the ringfenced work on regulatory oversight for the solutions.

Some suggested that regulatory oversight would vary depending on the complexity and procurement strategy for a solution, with regulatory support required for each solution varying also.

Q8. What are the types of incentive and regulation that would result in appropriate allocation of risk between the parties and ensure the right trade-offs are made?

There were 8 responses.

There were a range of views on incentives and regulation concerning the allocation of risk including the following points being made:

- The importance of clarity on ex-ante allocation of risk, and that risk allocation should be proportionate across users and suppliers. The point was also made that returns and pricing must also correspond to risk allocation.
- Whilst agreeing that, in principle, risk should rest with the party most able to understand and manage it, it must be noted that these allocations will have a commensurate impact on the returns required by investors and are unlikely to relate to the regulatory cost of capital identified as part of PR19 for example.
- The purchaser/client often end up paying for both the anticipated risks that do not occur and the risks that arise as a project progresses.
- For the construction phase of a project, the allocation of risk must be linked to the ability to bear it. Ineffective management would result in a premium on the Weighted Average Cost of Capital (WACC) with no corresponding improvement, resulting in more risk being borne by customers.

Service delivery / Co-ordinated Operations

Q9. Views welcomed on any other models [for water supply contracts] that should be considered, whether there are additional advantages and disadvantages and whether more prescription is necessary.

There were 2 responses on this section.

One had no fixed views on the options for contract structure, as each of them may have merits depending upon the parties involved and their preferences for control. They thought also that regulatory policy should be agnostic over these options, leaving the design up to the parties involved, with regulatory policy treating all contract structures on an equal basis.

The other felt that the structure of contracts should be standardised as being multi-party where the activities are separable from existing networks, and bilateral where the activity is incremental (e.g., a transit network). This links to their view that risk is best managed by separating the fixed construction cost of the solution from the ongoing variable cost, and by keeping payments for water resources separate from distribution and treatment.

Q10. What is your view on the areas identified for standardisation of contracts? Are there any other areas that should be considered?

There were 12 responses.

There was majority support for some conditions of bulk supply contracts being included as standard, although further development would be required as the detail of those conditions would be bespoke to each specific contract.

Responses suggested that standardisation of contracts would need to avoid being too prescriptive in nature, as this could restrict parties involved.

There was also a suggestion to use a set of high-level agreed principles to provide guidance on standardisation.

Q11. Do you agree with the issues and options set out for the treatment of trades in future regulatory periods?

There were 11 responses.

Some interest was expressed in RAPID considering the treatment of the solutions in the round with price reviews, suggesting that it would be important that the treatment of costs in the price review process was flexible enough to manage different Competitively Appointed Provider (in DPC) and delivery arrangements.

One respondent explained that sunk costs are reported on an ongoing basis for the exporter and suggested it would be proportionate for the importer to do so also. The suggestion was that in a price review, the importer's sunk costs could be funded similarly to its own sunk enhancement expenditure.

Another explained that where a Competitively Appointed Provider (in DPC) is not used (such as for in-house delivery by the water company), the enhancement expenditure of the

provider water company should be subject to regulatory challenge in a similar way to the usual challenge of enhancement expenditure in business plans.

It was suggested that the change in reporting of the importer's costs would align a water trading approach to a counterfactual where they developed new resources themselves with traditional enhancement expenditure. This would remove any in-house bias towards minimising base expenditure.

Q12. Do you agree with the options set out for charges associated with bulk supply agreements? Are there any other options that should be considered?

We received 10 responses. Responses put forward the following views on the charging options set out:

- Fixed and variable charges (option 1) may work as an approach for solutions where fixed and variable costs can be separately identified. This approach would mean that efficient infrastructure costs would be recovered with a high degree of certainty. A potential drawback to this approach was raised that some costs may be incurred when the asset is not being used. There was also a suggestion that continuous supplies could be charged on a volumetric basis with an expectation of a minimum level of utilisation of supply.
- The wholesale minus approach (option 2) while suitable for NAVs (new appointees), did not seem particularly suitable to RAPID solutions.
- Long Run Average Incremental Costs (LRAIC) (option 3) would be very difficult to implement in practice as the costs would be difficult to isolate and may introduce scope for dispute about solutions as the approach relies on costing solutions other than the one that is the subject of the transaction.
- Requirements in the form of principles (option 4) would allow flexibility as each trade would likely have bespoke pricing arrangements, but existing guidance would need to be enhanced to provide further certainty. It was suggested that it may be difficult to demonstrate compliance in this approach.

Q13. Do you agree with our next steps for the development of a fair shares approach for the allocation of water during drought and operational events?

There were 9 responses.

There was majority agreement with the fair shares approach in principle, although it was felt that its development and implementation could be challenging.

It was suggested that safeguards would be required to mitigate poor management or profiteering by operators that may lead to a lack of reliability or resilience for importing water companies under drought design conditions.

It was also thought that:

- It would be useful to have standard fair shares contract terms to provide a starting point for specific bespoke contractual negotiations.
- Contracts should provide for levels of service and penalty clauses in the event of non-delivery.
- The fair shares approach would require an arbitration process.
- Further work should be taken through a working group around compensation threshold and operating protocols.

There was also a suggestion that interruptible supplies remain in consideration, as taking a single approach may prevent companies from agreeing commercial terms on transfers where a low level of service may be acceptable for exporters and importers.

A key issue for fair shares in Wales would be for it to be consistent with the requirement that sourcing water from Wales demonstrates benefits to the economy, people / society, and environment of Wales. It was also mentioned that it was difficult to judge if Wales would benefit from supplying water to England as there remained uncertainties over the commercial and regulatory framework – such as how pricing and fair shares would apply. Further consultation on more precise guidance to help provide clarity was suggested.

There was agreement with the discussion in the consultation on section 37 of the Water Industry Act 1991, and that it did not prevent or limit a company's ability to enter into contractual obligations with regard to the supply of water including entering into contractual arrangements providing for a fair shares approach in circumstances of drought and operational stress. However, the company would need to do the necessary planning through its water resources management and drought planning to be able to meet both its section 37 duty and its contractual obligations.

Q14. Do you agree with the proposed next steps for co-ordinated operations? Are there specific barriers to regional co-ordination that should be considered?

There were 10 responses.

Most responses indicated that they were waiting for the publication of the Baringa study report before providing substantive comments on next steps or on any other barriers.

Those comments which were provided on proposed next steps for co-ordinated operations included:

- The critical issue would be which party carries what risk and who would have accountability to make what decision.
- Under current operations the body responsible for the service would be responsible for any failure of a water supply system in a drought, but in co-ordinated operations, decision making may be split.

- The effectiveness of water supply systems managing drought events depend on decisions on source operation often taken over a period of several months before the drought.
- Co-ordinated operations are essential to realise benefits from solutions, and water companies would need a leading role in the development of any operating regime.
- Consideration was needed on the role of regulation under co-ordinated operations including inter alia licensing arrangement, compliance & flexibility.
- Cyber security provided a potential challenge of having or managing integrated strategic networks, and the importance of the management of risk to critical national infrastructure.

Concerning specific barriers to regional co-ordination, comments were that:

- Co-ordination should reflect the specific geographical needs and be proportionate – considering the complexity and integration of areas
- Special consideration needed for multi-sector co-ordination given different needs and sector approaches to managing water resources.

Future Proofing

Q15. How significantly might the optimal use of assets vary over their lifetime?

There were 7 responses.

Respondents believed that optimal use could vary significantly over some solutions, where climate change or licence changes alter the nature of a water resource system, or as more is learnt about the nature of the system. This could lead to changes in the volume of water required or the frequency of utilisation to deliver a defined benefit.

It was also suggested that capacity utilisation would change due to growth, climate change and change in abstraction licence use. It was thought that adaptive planning within water resources management plans, and consideration of the resilience of investments using scenario testing may somewhat mitigate this, but potential variation remained a factor to be considered.

Q16. Over what timescale is it realistic to see a fully integrated water trading system at a regional level, with dozens of trades? How should these developments best be managed?

There were 12 responses.

Some responses supported an integrated trading system comprised of bilateral and multi-lateral contract arrangements. It was suggested that this would need to be flexible to incorporate the commercial arrangements that would be likely to change over the long-term.

However, it was suggested that significant changes to legislation to deliver a regional model would be required and may not be a priority with other key issues at the forefront.

Comment was made about the importance of certainty of the regulatory and commercial frameworks for managing any risks Wales might face if supplying water to English water companies. Although the respondent thought that RAPID would provide further clarity on the frameworks.

Several responses expressed uncertainty. One discussed the limited number of viable trading options. However, it was felt that this could increase as solutions were developed and regional planning matured. Another mentioned the lack of certainty to predict when trades, transfer volumes and scale would increase in demand compared to the current low plateau. There was a call for the regulatory and legal frameworks that are in place to encourage trading to provide investors certainty over the long-term to realise an integrated regional water trading system.

Q17. Are there any other circumstances where destination clauses [in water supply contracts, specifying where the water must be used, and thereby precluding re-sale] would be appropriate?

There were 11 responses.

The general view was that destination clauses should be avoided where possible to ensure maximum flexibility in the future.

It was thought that while such clauses could be required on environmental grounds, environmental issues could be covered through discharge permits or operating agreements.

Next Steps

Q18. We welcome views on our proposed next steps, including additional activities that we should be undertaking.

There were 10 responses.

Respondents raised some other issues considered to be important elements of the regulatory and commercial frameworks, and on which further work may be needed:

- The relationship between regulatory processes and their timing – seen as a key coordination issue for solutions. It was suggested that many issues needed to be addressed before PR24 business plan submissions and further prioritisation of regulatory and commercial issues was welcomed.
- Development of a framework for best value planning
- To consider outcomes-based regulation as part of regulatory and commercial frameworks

- The development of a framework for best value planning which water companies and regulators could all support
- Additional work on affordability of proposals and plans
- Possible workstream considering the total cost and bill impact of National Framework requirements
- Refresh of RAPID working groups and creation of an overarching steering group
- Several commercial issues including market power between buyer and seller; treatment of losses in contracts; calculation of transit fees; resale pricing; capacity rights and allocation for multiple party trading; abstraction licensing; system operation and incentives mechanisms

Some respondents also expressed their expectation for a further consultation on regulatory and commercial issues and sought clarity on possible timings.

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