

# AffinityWater

## Consultation Response to RAPID Regulatory and Commercial Framework



Affinity Water  
Tamblin Way  
Hatfield  
Hertfordshire  
AL10 9EZ

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Dear RAPID

**The regulatory and commercial framework for strategic water resource solutions – a consultation**

Thank you for the opportunity to respond to your consultation on the regulatory and commercial framework for strategic water resource solutions. Our response builds on our response to the previous RAPID discussion paper on this topic (as summarised in the current consultation). We welcome that RAPID has responded to feedback from companies and has built on this in the consultation paper.

Overall, we are supportive of RAPID's objectives and direction of travel in relation to the regulatory and commercial framework and its likely resultant recommendations to Ofwat, EA and DWI. We make specific points in response to the consultation questions below, where we think further development is needed. We remain keen to engage with the RAPID process, including development of the regulatory and commercial framework.

The appendix to this letter lists the relevant sections of the consultation document, the consultation question and Affinity Water's response.

We look forward to working with RAPID on the next stage of this process and hope our feedback to this consultation document helps to shape the direction of travel.

Yours sincerely,



Interim Director of Regulation and Strategy

## Consultation Responses

### Section 2.1 Planning for long-term outcomes,

**RAPID Question:** Are there other barriers and challenges to best value planning that have not already been identified in the May 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?

**AFW Response:** The main barrier that we consider has not been included relates to the complexity of resource sharing and the need this creates for certainty around regulatory mechanisms for cost sharing. Where schemes 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. For example, our ongoing work with Thames Water indicates that the SESRO scheme may offer significant 'conjunctive use' efficiencies for Affinity Water, as the provision of storage has a much higher benefit value to Affinity Water than it does to Thames Water. As these are such large, strategic schemes, the principles for contractually evaluating benefits and assigning costs need to be clear to allow certainty over the bill impacts to customers when considering long term business planning.

### Section 2.2 Development Activities,

**RAPID Question:** 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?

**AFW Response:** We support the option for including new strategic resources within a gated process. The current process has highlighted the complexity of the schemes and the importance of being able to fund and accelerate investigations. Most SROs have potential environmental 'showstoppers' associated with them, and these need to be identified and worked through with regulators before the scheme can be reliably included in WRMPs and Business Plans. If some of the current schemes are not able to progress then it is vital that alternatives can continue to be identified and investigated as required.

**RAPID Question:** 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?

**AFW Response:** The options for procurement have been broadly covered, and we agree that a range of options should be available depending on the exact nature of the schemes and the company resource systems involved. It is the details around contractual arrangements and the specifics of how costs should be shared between companies that requires further work in our view.

**RAPID Question:** What is your view on the policy options set out (or any others) to incentivise water trading?

**AFW Response:** We consider that it is unlikely that anything other than the bespoke basis proposed by RAPID could work for this type of scheme. For example, the nature of Affinity Water's resource system means that there is relatively little difference in need between a design event (1 in 500) and much lesser dry weather/drought events, with the utilisation heavily dependent on the nature of customer summer demand in a particular year. In order to promote efficient utilisation across companies it will need an incentive approach that can work across companies like Affinity Water, while at the same time accommodating companies where the need is much less frequent and more heavily related to storage/hydrology. Our recent experience of even small trades has shown that third parties that attempt to price trading arrangements based on the marginal cost of the next alternative can significantly mis-understand such issues, which generates contractual and negotiating barriers to potential trades.

**RAPID Question:** How should we incentivise companies to deliver the optimum solutions in particular how they would 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?

**AFW Response:** We would generally support the proposals offered by RAPID whereby cost recovery certainty is given to the relevant provider based on the plans and circumstances at the time, but there is flexibility to review and amend this at 5 yearly planning cycles. The high degree of uncertainty around growth, environmental destination and climate change means that a transparent and streamlined approach to this is needed. Such an approach would allow other companies to share in assets if monitoring indicates that the original parties' needs have changed, and is essential for promoting efficient use of strategic resources once they are built.

**RAPID Question:** Does the pathway for resolution of environmental barriers meet the requirements of stakeholders and are there other environmental or water quality issues that need to be considered?

**AFW Response:** Our recent experiences on the Grand Union Canal scheme have shown that new issues can emerge at any point during the development of a scheme. The availability of RAPID and the EA National Appraisal Unit has been a considerable benefit to addressing such policy issues as they arise. Therefore, while we support and agree with the pathway for resolution as outlined, we consider that it will be important to maintain flexibility and availability of regulatory liaison mechanisms for current and future SROs.

## Section 2.3 Construction,

**RAPID Question:** What is the best approach for ensuring regulatory oversight for RAPID solutions beyond gate 5 into the delivery phase?

**AFW Response:** Given the complexities in resource allocation and contract arrangements highlighted above, and the risks presented by quality and environmental regulations, we strongly support the Option 3 'RAPID lite' approach as set out in the consultation document.

**RAPID Question:** 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?

**AFW Response:** We welcome that Ofwat is considering these issues that could arise during the construction phase and is considering lessons learned from other markets and contracts. We highlight that 'utilisation risks' should be added to the list of risks where allocation needs to be considered.

## Section 2.4 Service Delivery,

**RAPID Question:** What is your view on the areas identified for standardisation of contracts? Are there any other areas that should be considered?

**AFW Response:** Affinity Water welcomes the work on standardisation of contracts, although there will need to be a balance between prescription and bespoke circumstances, as discussed above. Some areas of the contract may be capable of full standardisation. In others, it may be possible to adopt a 'menu' approach where companies can choose from a range of options. However, we expect there to be contractual areas where circumstances are wholly bespoke for strategic resources schemes and contract standardisation is not likely to be possible.

We would expect value for customers will be a key consideration with respect to the structure of contracts – for instance the 'in series' example is likely to involve a margin within each contract, which might increase the overall price to end customers, and therefore mean that, if they are possible, other contractual structures would be preferable.

**RAPID Question:** Do you agree with the issues and options set out for the treatment of trades in future regulatory periods?

**AFW Response:** We support the proposals around the treatment of import costs and for sunk enhancement expenditure to be treated as if it were an enhancement incurred by the company. It is likely that new strategic options will represent a considerable increase on the cost of water provision for the company and is likely to prejudice the botex efficiency position of recipient companies if it is not treated separately from the botex cost models. We are also supportive of Ofwat's proposals around regulating exporters' ongoing costs.

**RAPID Question:** Do you agree with the options set out for charges associated with bulk supply agreements? Are there any other options that should be considered?

**AFW Response:** The options as described appear adequate and the discussion of their appropriateness to different circumstances/ trades is logical. We agree that further guidance is likely to be needed beyond a principles based approach as different options are likely to be appropriate for different types of bulk supply.

**RAPID Question:** 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?

**AFW Response:** We support the development of the 'fair shares' approach as an overall concept. However, we note that there needs to be a focus on safeguarding against poor management or profiteering by operators that might lead to a lack of reliability or resilience for importing companies under drought design conditions. We welcome that RAPID recognises these issues and proposes that the industry explore service levels.

We agree with Ofwat's discussion around S37 of the WIA provided CAP and infrastructure providers have the same legal obligations as undertakers.

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

**AFW Response:** Yes. We continue to offer our support and input on this topic.

## Section 2.5 Future Proofing,

**RAPID Question:** How significantly might the optimal use of assets vary over their lifetime?

**AFW Response:** Optimal use could vary significantly for some schemes, particularly where climate change or the cessation of existing licences changes the nature of the existing water resources system or the anticipated nature of the system changes as we learn more about it. This could change both the volume required and the frequency of utilisation to deliver a defined 'ADO' benefit. Capacity utilisation will also change as a matter of course as a result of growth, climate change and environmental destination related abstraction reductions. We note that adaptive planning within the WRMPs, and consideration of the resilience of our investments using scenario testing may somewhat mitigate this, but potential variation nonetheless remains a factor to be considered.

**RAPID Question:** 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?

**AFW Response:** We agree with the consultation document that an integrated trading system would need to consist of bilateral or multi-lateral contract arrangements, and some oversight by a regional system operator type role could be required as the level of complexity increases. A spot market type arrangement would not work given the complex and meteorologically dependent nature of water resources. At the current level of regional co-ordination we consider that widespread trading should be in place in the next 10-20 years, depending on the lead time of the infrastructure enablers involved.

**RAPID Question:** Are there any other circumstances where destination clauses would be appropriate?

**AFW Response:** No, we cannot see a logical rationale for destination clauses.

## Section 3.0 Next Steps,

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

**AFW Response:** Many of the key questions raised above need to be addressed prior to the PR24 submissions, so we would support prioritisation and appropriate task & finish group arrangements.