

## **RAPID's consultation on the regulatory and commercial framework for strategic water resource solutions**

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

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January 2022

## **Summary**

The West Country Water Resources Group ( <https://www.wcwrg.org/> ) is one of the five regional water resources group. Our core members are Bristol Water, South West Water and Wessex Water. We are represented on most of the working groups and task and finish groups that are mentioned in section 1.5 of the consultation document.

Our responses to the consultation questions are given below.

## **Chapter Questions for stakeholders**

### **2.1 Planning for long term outcomes/ Best value/aligning incentives**

**Q: 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?**

We fully agree with the concept that plans and projects should aim to deliver 'best value' and that they should be set in the context of long-term strategies. However, we also think there is a long way to go until the concept is thoroughly understood and applied by both practitioners and stakeholders.

Barriers and challenges regarding 'best value' include:

1. Ofwat's PR24 consultation in May 2021 included eight occurrences of the phrase 'best value', mostly in the context of the design of the price control and the approach to assessment of enhancement costs. There is a potential barrier or challenge about how enhancement costs are assessed for 'best value' solutions. By definition 'best value' solutions are not 'least cost' and therefore an approach that relies on industry-wide econometric modelling or cost benchmarking will not provide sufficient funding, nor would it consider the specific regional or local best factors that determined best value. An alternative cost assessment method will be necessary such as a deep dive assessment that is a project specific.
2. Ofwat's PR24 May consultation refers to the Environment Agency's guidance for water resource planning. The guidance (included in Appendix A for ease) includes a very long list of factors. Whilst commendable it is hard to see how all these factors can be satisfactorily resolved in a single plan or easily articulated to external stakeholders. The first factor in the list is government policy and regulator expectations, and we welcome the indication that a best value plan can adjust the timing and balance of policy aims against other criteria.

3. We think that best value considerations apply to overall long-term **plans** rather than **schemes**. The PR24 consultation and the EA's water resources planning guidance rightly refer to best value plans. However, on occasion the discussion has been about best value schemes. We consider schemes to be the means to deliver on an overall plan. Also, any plan will always include a mix of schemes, some traditional infrastructure projects, some nature-based solutions etc.
4. Whilst 'best value' is simple in terms of concept, its application is more difficult. At its heart is the concept of 'trade-offs' - 'best value' to whom, over what timeframe and what measure. An alternative approach that could be considered is to ask whether the alternative choices are worse 'in the round'.
5. In the West Country Water Resources Group's regional plan for consultation we have deliberately not sought to present an optimised 'best value' plan because we consider that it is best to fully understand the strategic choices first. In particular there are very large uncertainties about the precise scale of the environmental needs in our region, which will require an extended period of scientific assessment before the 'best value' approach can be settled on.

This section of the consultation also mentions incentives for types of solution. It lists some examples of types of solution. Whether intentionally or not it implies that the examples are bad, whereas we consider that an in-company or in-region solution under the control of one or two companies is the holy grail, because it will be more straightforward to consent and deliver rather than because of any perceived financial incentive.

## **2.2 Development activities /Other regulatory barriers to investability**

**Q: 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?**

We agree that the current process has been very beneficial in catalysing a step change in work on strategic water resources and collaboration across the sector. We also agree that the current process has a high overhead burden and is cumbersome and transactional rather than truly collaborative.

It is disappointing that RAPID do not feel able to recommend a revised future approach.

We favour a streamlined gated process rather than development of the financial incentives because to us that seems more attainable in the short to medium term. The streamlined process should be less prescriptive, with gateways aligned to the project need and with greater freedom to make decisions as the projects develop and new information becomes available.

**Q: 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?**

We agree that the procurement approach should be designed to suit the needs of the project and its risks and opportunities.

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

We are supportive of continued development of water trading incentives. The low take up of new water trades suggests that the strength of the current incentive is not calibrated correctly. Therefore, we support the overall position that any new incentive structure should be designed to work for all water company trades.

We consider it important to recognise that the utilisation of the proposed schemes could be low and highly variable. This is because the predicted water deficits that the schemes are designed to meet are driven by relatively extreme design cases e.g., 1 in 500 year droughts, sustainability reductions that only apply less than 5% of the time etc. Thus, we agree with the importance placed upon the considerations under the proposed new approach.

The greater degree of regulatory certainty, protection for the exporters customers and ongoing adjustments to manage volume risk should all strengthen the overall incentive properties of water trading. It may be appropriate to separate out the concept of trading incentives and market mechanisms from how efficient costs are recovered from new infrastructure (e.g. Havant Thicket). We think there is scope for each subject to be developed separately.

This whole area might benefit from a simple diagram on how the role of pricing and incentives could work in the sector going forward.

**Q: 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?**

If the aspiration is that investment in new water resource capacity will be secured and given the scale of the investment required, we consider that this can only be achieved by dealing with the risk up-front, along the lines of the proposal in the last paragraph on page 21.

There may be some merit in considering different approach for different parts of the strategic resources options (SRO). The most fundamental part of any SRO is the new resource either a new reservoir or new effluent recycling scheme. This is the part that requires regulatory backing and effective management of risk so that the necessary investment is secured.

The transfers of water from the donor region to the importing region generally use technology that is conventional and should be more straightforward to consent and implement.

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

We understand that resolution of the environmental barriers is complex but it is disappointing that some of the issues (e.g., the reservation of water for future use) will not be resolved for almost a year.

In the West Country we have an SRO that is looking to exploit the Bristol Avon with an enhanced abstraction licence for the refill of a reservoir. The application for the abstraction licence is unlikely to happen for several years and its first use would not be until the late 2030s. As it stands another user could submit a licence application in the interim which would affect the feasibility the scheme. We would advocate that this policy issue is resolved sooner rather than later.

Table 1 in the consultation document mentions that the policy position on licence capping will be clarified in November/December 2021. At least one of our member companies, Wessex Water, have spoken to the Environment Agency about licence capping but we still have little clarity on if it will apply to our sites and how many and when it would apply from. We are awaiting more information from the EA.

We also see an inherent conflict between on the one hand being asked to prepare 'best value' plans which are required to reflect regulatory policy and expectations and on the other hand a workstream that is seeking to review and potentially revise those policies, along with other requirements such as the commitment to Net Zero.

We are pleased to see that work is proposed with the DWI on the principles to be applied. We agree that the issue of customer acceptability can be mitigated by communication with our customers. That is our experience on day-to-day water quality issues. But the timing of the SROs is quite different. Communicating with customers about a change in water quality that is forecast to occur in more than ten years' time (say 2035) may not be very meaningful.

### **2.3 Construction/ Risk allocation between partners**

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

On balance we favour option 2.

**Q: 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?**

Best practice is to allocate risks to those best placed to managed them. The approach outline on pages 29 and 30 sounds reasonable.

In addition we would highlight:

- In major construction projects there are numerous examples where detailed costed risk registers have been developed prior to contract award, only for the actual

construction to throw up different risk and cost over-runs. One of the potential downsides is that the purchaser/client ends up paying for both the risks that didn't occur and the newly arising risks.

- Some risks can be classed as on/off i.e., either they happen with large consequences, or they don't happen at all. An example is would a foot and mouth outbreak during construction which prevents traffic movements to the site. These types of risk may need to be treated separately.

## **2.4 Service delivery / Coordinated Operations**

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

We are content with the approaches proposed and agree that have some flexibility within a framework is a reasonable approach.

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

We think that the proposals set out here are appropriate. 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 should in theory remove any in-house bias towards minimising 'base' expenditure.

We think that to maintain the legitimacy of sector it is critical that ongoing efficiency is challenged, and any savings shared with customers. Therefore, as long as the incentive properties of the water trading incentive are calibrated correctly and ringfenced, we are supportive of sharing any additional profit with customers.

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

For new discrete infrastructure we think the certainty provided by fixed charges, irrespective of use, are essential to provide companies the certainty that is required to undertake upfront capital investment. The proposal for volumetric charges follows logically.

For other trades, we think that a similar approach in principle should be used. This could take the form of a wholesale minus approach, but then considering RCV run off, returns, and a portion of fast money as the "fixed charge" with the remaining fast money recovered through a volumetric charge (akin to the bioresources volumetric adjustment). This approach retains consistency across water trading and consistency with other bulk supplies. We would then expect them to have a similar level of prescription as the bulk charges for NAVS and so do not necessarily have to be integrated into the charging rules.

As highlighted above on incentives, the starting point that it would be helpful to set out is what the overall regulatory charging ethos is for a bilateral market. Is it to be based on a

'market value' (akin to a Long run average incremental cost (RAIC)) or efficient cost recovery (like Havant Thicket) as this choice in part determines the charging approach.

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

The meeting with Baringa/Mott MacDonald scheduled for the 21<sup>st</sup> January 2022 was cancelled. We will be able to comment more on this at or after the rescheduled meeting.

Notwithstanding this the critical question in our opinion is who carries what risk and who has accountability to make what decision. Currently it is clear that the failure of a water supply system to meet a drought will be the water company responsible for service. However, in co-ordinated operations the decision making may be split and the implications of a decision may not land on all parties equally.

This is particularly important in water resources because how well water supply systems manage drought events depends on decisions often taken over several months on how sources are operated. So this is materially different to say energy system operation.

## **2.5 Future Proofing**

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

We agree it is more than likely that the use of the proposed assets will change over their design lifetime i.e., over the 60 years after commissioning, almost up to 2100. It would be premature and futile to try design a single multilateral operating model now for a situation that may occur in 2050. Review clauses or break clauses with notice periods are quite normal.

We agree that destination clauses would best be avoided.

**Q: 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?**

In the West Country we don't envisage a fully integrated regional water trading system this century. There is already sharing of resources across the region with Wimbleball reservoir being used by both South West Water and Wessex Water and through a bulk import to Wessex Water from Bristol Water.

Whilst the regional plan forecasts significant deficits in the region the number of trades is limited to:

1. Between South West Water and Wessex Water
2. Between Wessex Water and Bournemouth Water (South West Water) (possibly bi-directional)
3. Between Bristol Water and Wessex Water (existing/modified)  
+ potentially
4. From Severn Trent Water to Bristol Water

5. Wessex Water to Southern Water.

Therefore the maximum number of trades is unlikely to exceed five, and some of these will be enhancements on existing agreements. We consider that these are best managed between the relevant companies.

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

We agree that the destination clauses should be avoided if possible to ensure maximum flexibility in the future. We can see a situation where they would be required on environmental grounds, but this can equally be covered through the discharge permits or operating agreement. An example is the plan to divert effluent from Poole sewage treatment works to the River Stour in order facilitate abstraction downstream.

### 3. Next steps

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

Our response to the discussion document in July 2021 highlighted a few other issues that don't seem to be covered in this consultation:

- Affordability. We would still like to see some work done on the affordability of the proposals and plans. We note that there is a project proposed with CCW and DWI on water quality. Is there a similar workstream to consider the total cost and bill impact of the National Framework requirements?
- Outcomes. We are still surprised how little outcomes are mentioned. We are firm advocates of outcomes based regulation.

### Appendix 2: Environmental Regulation Policies and Positions

We have a few comments on Appendix 2 of the consultation document:

- Item a) on page 74 mentions that there is a need to take into account the future needs of European sites. Given the design life of the SROs is up to 100 years in some cases, it is hard to understand how this is achieved. Will some guidance be provided?
- Item c) licence capping. See our comments above.
- Item f). We note that this policy will prevent any SROs that propose transfers out of the WCWRG region. Is that what is intended?
- Item g). See our previous comments.

## Appendix A Extracts from the EA's guidance for water resource planning

### 9.1 What is a best value plan?

The aim of a regional plan and your WRMP is to present a best value plan, both in the short term and the long term. Your WRMP must ensure a secure supply of wholesome drinking water for your customers and protect and enhance the environment.

A best value plan is one that considers factors alongside economic cost and seeks to achieve an outcome that increases the overall benefit to customers, the wider environment and overall society.<sup>[footnote 28]</sup>

A best value plan should be efficient and affordable to deliver, legally compliant and account for the range of legislation that applies to it.

### 9.2 What you should consider in compiling your best value plan

In compiling your best value plan, you should consider all the most appropriate options for your system (regionally and nationally where appropriate) taking into account the following factors:

- government policy and regulator expectations (see sub-section 9.3)
- regional plans (see Section 2)
- customers' preferences
- protecting and meeting the needs of vulnerable customers
- environmental improvements
- biodiversity
- costs
- benefits (both monetary and non-monetary) for customers, environment and society (such as public health, well-being, and recreation) and how these are distributed spatially and over time
- natural capital
- both short and long term risks and benefits, including delivery risk
- the flexibility and adaptability of your options to meet future uncertainties
- the resilience of your network and supplies (see sub-section 9.5)
- the regional and national need and the needs of other sectors
- the impact of your preferred programme on the affordability of your customers' bills
- the level of uncertainty and sensitivity of your assessment of best value
- non-drought resilience such as water supply system resilience
- economic factors such as affordability, distributional impacts, local regeneration and economic growth
- achieving net zero and the climate emergency
- (England) your objectives to further biodiversity and enhance the natural environment by providing opportunities for biodiversity net gain where planning permission will be needed and other measures to conserve and enhance biodiversity consistent with actions you can properly take
- (Wales) the biodiversity and resilience of ecosystems duty and well-being goals

A best value plan should be efficient and affordable with distributional impacts, societal equity and intergenerational equity considerations transparently discussed. It should be clear that the additional benefits identified could not be delivered more efficiently through other means.