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By email

1 August 2023

Dear Regulatory Director

Industrial Emissions Directive (England)

We have received representations from several companies with regards to a potential funding mechanism for costs of achieving compliance with the Industrial Emissions Directive (IED). This letter clarifies our position and sets out the requirements for a data request to inform a potential funding mechanism for PR24.

Background

In July 2019 following earlier discussions, before Ofwat's 2019 price review (PR19) final determinations in December 2019, the Environment Agency wrote to all Water and Sewerage Companies (WaSCs) to confirm the need to comply with the requirements of the IED. This was accompanied by a paper, presented to the EA / Water UK Strategic Steering Group¹ on 2 April 2019, which stated the need to ensure "all installations involving the biological treatment of sewage sludge obtain and operate under an environmental permit in as short a timescale as can reasonably be achieved".

At price reviews, Ofwat sets limits on the revenue that water companies (including WaSCs) can collect from customers during a five-year period through price controls. Price controls can only be changed during the period in a limited number of circumstances, such as through the interim determination mechanism in water company licences².

¹ The Industrial Emissions Directive Supporting Document, IED Supporting Document, WaterUK, 31 May 2023 states that "On 9th July 2019, Water and Sewerage Companies (WaSCs) received an official letter from Sarah Chare (Director of Operations) at the EA formally confirming the requirement to apply for permits following a paper tabled at an EA / Water UK Strategic Steering Group meeting on 2nd April 2019"

² The interim determination mechanism covers specific eligible items (including the relevant changes of circumstance set out in Condition B) where the impact meets the materiality threshold.

Ofwat set price controls for the 2020-25 period through the 2019 price review. As part of the PR19 process, each WaSC had the opportunity to make an enhancement cost claim or other representations in relation to IED compliance costs. If WaSCs considered that the July 2019 correspondence from the Environment Agency contained new information, then representations could have been made to Ofwat in response to the consultation on the slow track draft PR19 determinations (which closed on 30 August 2019). The PR19 final determinations were clear that if a company accepted its final determination, it would be accepting that it had adequate funding to properly carry out its regulated business, including meeting its statutory and regulatory obligations. This included any risk that these requirements might change (to the benefit or detriment of companies) during the 2020-25 period, subject to the uncertainty mechanisms included in the price control package.

Four water companies (including three WaSCs) exercised their right to ask for their price controls to be redetermined by the Competition and Markets Authority. As part of that process, Northumbrian Water and Yorkshire Water asked for and received a specific mechanism for the recovery of IED compliance costs. Both companies were allowed a 75:25 (customer:company) cost sharing arrangement and Northumbrian Water also received a further allowance of £6m a site for two sites.

The original deadline for full compliance with the requirements of the IED was 22 August 2022, with a further two years allowed to achieve compliance so that all aspects of the IED must be complied with on or before December 2024. The Environment Agency has recently written to companies seeking:

- details of company proposals to bring each facility up to the standard required by the IED and the Best Available Techniques (BAT) Reference Document for Waste Treatment³; and
- a commitment from companies to carry out any necessary works within this timeframe and achieve full compliance by 31 December 2024.

Companies need to comply with their obligations, and Ofwat's forthcoming 2024 price review (PR24) is not a reason for companies to delay compliance.

³ [Best Available Techniques \(BAT\) Reference Document for Waste Treatment \(BREF\). Industrial Emissions Directive 2010/75/EU \(Integrated Pollution Prevention and Control\), 2018](#)

Company representations

We have received two cost adjustment claims related to IED, in addition to Water UK's IED Supporting Document⁴, which concluded that investment required to achieve compliance with IED has increased significantly and is now estimated at around £2 billion across the water industry. This report⁵ says that much of the cost is driven by the Appropriate Measures document⁶, which was issued in September 2022, and has resulted in new standards that differ from those in place in July 2019.

Because the Environment Agency is responsible for setting the guidance and issuing the permits, we asked whether it agrees with the view that the Appropriate Measures document, or any other guidance, has changed the requirements since July 2019. The Environment Agency said that it does not agree *"that the Appropriate Measures for Biowaste or any other guidance has changed the regulatory obligations of water companies since 2019. Companies are expected to achieve BAT standard of operation and meet the associated emission limits (AELs) laid out in the BREF and BAT conclusions (BATc)⁷, which was published on 17 August 2018. Permit conditions are written to reflect the BREF and BATc and not the Appropriate Measures guidance."* We have also asked for the Environment Agency's views on the extent of water industry investment required to meet the IED requirements, estimated by the IED Supporting document⁸ to be close to £2 billion across the water industry. We sought to understand whether this upper end estimate reflected the Environment Agency's interpretation of the adequate requirements under the current guidance, to which the Environment Agency have stated that *"it is highly likely that £2 billion is at the extreme end of the cost range"*.

In addition, companies have said that both the scope and costs only become certain once permits are agreed. To date, only three permits⁹ have been agreed. We recognise that this may cause uncertainty in both scope and cost. It is also unclear whether there this would be a relevant change of circumstances for the purposes of an interim determination or, if there was, what costs would be reasonably attributable to that relevant change of circumstance. It is also unclear whether any requirements in final, issued permits could introduce new

⁴ Industrial Emissions Directive Supporting document, IED Supporting document, Water UK, 31 May 2023

⁵ Industrial Emissions Directive Supporting Document, IED Supporting Document, WaterUK, 31 May 2023

⁶ Biological Waste Treatment: Appropriate Measures for permitted facilities, Environment Agency, published September 2022

⁷ [BAT conclusions, Best Available Techniques \(Waste Treatment\), Published: August 2018](#)

⁸ Industrial Emissions Directive Supporting document, IED Supporting Document, Water UK, 31 May 2023

⁹ We have been advised that to date, three permits have been issued: Chelmsford (Anglian Water), Blackburn Meadows (Yorkshire Water) and Southport (United Utilities).

obligations when compared to those arising from the July 2019 Environment Agency's statement¹⁰ and the requirement to comply with the relevant BAT standards.

Furthermore, some companies have said that, given the scale of the works, they are unlikely to deliver all the improvements in their IED programme by the 31 December 2024 deadline and are planning instead to fully comply with the relevant requirements in the 2025–30 price control period.

PR24 Considerations

Because there is uncertainty in both scope and cost prior to agreeing permits for the implementation of IED, we are considering whether on an exceptional basis to provide funding and/or an uncertainty mechanism to allow companies to recover some implementation costs as part of PR24.

Some companies have said that they are only seeking costs in excess of those arising from the scope of IED compliance that they envisaged at the time of the PR19 final determination, or are proposing to absorb costs in AMP7.

Some companies have said that their IED improvements cannot feasibly be delivered by the 2024 deadline. However, we expect companies to make every effort to have permits in place and to deliver the required improvement works by the December 2024 deadline. To encourage companies not to delay, we will consider whether to provide funding for costs incurred during the period 2020–2025.

We are concerned that some of the IED costs that have been proposed could overlap with work that is funded through base expenditure allowances. Some of the estimated high costs might be indicative of insufficient maintenance of assets. We will therefore be requiring condition surveys to be undertaken for all qualifying sites to determine the extent of overlaps with base and/or whether current condition is impacting on the cost of achieving compliance. Further details relating to this will be circulated in due course.

To enable us to assess the requirement for additional funding and/or a funding mechanism as part of PR24 please complete the attached data request ([Appendix A](#)), providing details for all of your sites where IED applies, with a breakdown of cost incurred to date and forecast cost to achieve full compliance, differentiating between those sites that have agreed permits in place and those which do not. Companies should indicate whether they are intending to request additional funding as part of PR24, and if so, which costs this applies to. We are also requesting that companies confirm which cost lines they have allocated IED compliance

¹⁰ In July 2019, Environment Agency formally confirms to WaSCs that their sludge digesters are within scope of the IED and that installation permits will be required.

costs to. That can help us ring-fence outturn and forecast IED expenditure for a separate assessment and manage any potential impacts on bioresources base cost modelling.

As there is a potential overlap with net zero expenditure, please also include commentary covering the impact of achieving IED compliance on your PR24 net zero plans. At PR24 companies should consider how their net zero enhancement expenditure can build on the work undertaken to achieve IED compliance.

For the avoidance of doubt, the process of capturing and submitting forecast costs should not be a reason for delaying compliance.

The contents of this letter apply to English regulated facilities only, under the jurisdiction of the Environment Agency. We are still considering the appropriate approach in Wales.

Please send the data requested in [Appendix A](#) by no later than 22nd August 2023 to the following email address CostAssessment@ofwat.gov.uk.

Yours sincerely

Tim Griffiths
Director, Cost Assessment