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Summary

Water UK is the representative body and policy organisation for water and wastewater service providers across the UK. As the sector continues to play an active role in the development and operation of emerging and established markets, including the bioresources market, we welcome the opportunity to respond to Ofwat's consultation on Ofwat's proposed approach to funding bioresources activities at PR24¹. This response represents the considered and consolidated views of Water UK's members.

We note that of the recent suite of PR24 discussion papers, Ofwat's position with respect to bioresources is different in nature to other papers. Rather than exploring *whether* it is beneficial to make the reforms outlined, this consultation takes the reform as given and is focused more on *how* to implement the change in approach.

We do not consider this appropriate at this time, given that Ofwat's proposals effectively fail to recognise the highly material environmental regulatory challenges which persist both in terms of the Farming Rules for Water (FRfW) and the compatibility of bioresources with other organic waste activities. On the latter, we note that bioresources cannot be regarded as interchangeable with other organic wastes and there are regulatory barriers which impede the smooth integration of bioresources into the wider waste market.

Regarding FRfW, the change in the Environment Agency's interpretation of the rules has profound effects on the way in which the industry will have to manage bioresources. The full impacts are not yet apparent, but it is already clear that the changed interpretation does not in any way improve the prospects of the organic waste market being able to treat bioresources. It seems most likely that new assets will be required to divert at least part of the sector's biosolids production away from agricultural recycling, and significant capital investment may also be needed to meet revised regulatory standards for bioresources products.

We recognise that these impediments are not in Ofwat's gift to remove, that Ofwat has statutory duties to fulfil and that environmental regulations might change at some point in the future to enable the development of the full bioresources market that we all seek.

In this context, we welcome Ofwat's commitment to work collaboratively with other regulators, the industry and key stakeholders in the development of a Long Term Bioresources Strategy, by joining both the Strategic Project Advisory Board and the Technical Project Steering Group for this project.

¹ <https://www.ofwat.gov.uk/consultation/our-proposed-approach-to-funding-bioresources-activities-at-pr24/>

It remains clear however that no other part of the water industry value chain faces the prospect of such short-term and longer-term uncertainty as bioresources.

Given this, we ask Ofwat to reconsider whether the reforms advocated in the PR24 discussion document represent a sensible change at this time given the wider uncertainty and the longer-term challenges facing the sector, which should be our collective principal focus.

We suggest that instead, Ofwat develops its approach in a different direction, aimed at appropriately and efficiently managing that future uncertainty, which can include support for competitively procured options where appropriate. There would also be benefits in including bioresources within the scope of the long-term adaptive planning framework, given the significant uncertainties faced by this area of the sector's activities.

Specific observations

In addition, we have some more specific observations on the detail of the proposals in the consultation:

- To back-cast the cost data required for the models Ofwat proposes would require large numbers of assumptions and estimates. The margin of error in the data for this would be very large.
- The proposal to use forecast costs in models raises some problematic issues; however, it will be important that the regulatory approach recognises that given the uncertain environment noted above, past expenditure is unlikely to be a good guide to future expenditure requirements.
- The pattern of historical investment in bioresources has been uneven. We therefore see a risk that the inclusion of depreciation in the proposed cost models would not accurately forecast future capital maintenance costs.
- Ofwat's framework could better support third-party interventions that increase competitive activity in the sector, by providing regulatory certainty for sludge treatment capacity that has been competitively tendered.
- We retain an open mind about whether growth variables in the models can accurately control for future growth-driven investment.
- Ofwat's preferred option for remunerating new quality-driven investment (including an allowance for annualised cost over one regulatory period) will deter investors and third-party entrants concerned about the risk of asset stranding.
- In view of the critical need for investment to deal with high levels of uncertainty in the sector, we prefer the alternative approaches, and investors and third-party entrants will naturally expect a return for investing in bioresources that is commensurate with the risks they face.
- Ofwat's proposed approach to generate the gate price would not require a bioresources RCV, which raises questions over the inclusion of the bioresources RCV in the reporting of stated RCV, on which we would welcome further clarity.
- Ofwat should not under-estimate the importance that investors attach to the RCV and its stability, transparency and certainty over time. It underpins the sector's ability to access capital markets at a relatively low cost and the investability of the sector overall. Any move by Ofwat to change its approach to RCV will attract a high degree of scrutiny and the potential for significant unintended consequences is considerable.