



# **Review of barriers to water rights trading**

## **Final report**

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## **1 Introduction**

In Ofwat's May consultation paper<sup>1</sup>, the specification for a joint project between the Environment Agency and Ofwat was set out. The objectives for that project were to:

- ensure we understand what are the barriers to abstraction licence trading;
- recommend options for overcoming the barriers; and
- ensure we understand the risks posed to regulatory control, drought and water resource planning frameworks, security of supply and the environment.

The project commenced in July 2008 and has been working on assessing the current state of trading in England and Wales, considering international examples of trading, undertaking research into the barriers to trading and making recommendations for removing these barriers.

At its first meeting, held on 1 October, the steering group agreed four areas that the project should concentrate on. These were:

1. mechanisms to give the market more information and facilitate bringing traders together;
2. measures for liberalising the administrative processes associated with trading;
3. measures around the nature of licence conditions; and
4. measures which could help move towards more sustainable abstraction in the short to medium term.

This paper presents the final recommendations of the project agreed by the joint steering group in relation to each of the four areas. The recommendations from this project will be fed into the Cave Review of Competition in the Water Industry. Annex 1 provides the joint Environment Agency / Ofwat response to the interim Cave report in relation to discussion on trading.

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<sup>1</sup> Ofwat's review of competition in the water and sewerage industries – Part II, Ofwat, December 2008

## ***2 Measures to provide more information to the market***

Research undertaken by Synovate<sup>2</sup>, attached as Annex 2 has confirmed that traders and brokers believe that a high level of consistent information is required on water rights trading, before trading will be successful. Mechanisms need to be introduced that will provide the market with as much easily accessible information on trading as possible and facilitate bringing traders together.

Ofwat and the Environment Agency believe that it is important that all relevant and non-confidential trading information is made available electronically. The development of an electronic public register holding all abstraction information is considered vital for enabling trading to progress. The electronic public register would hold all of the information that is currently held in the public register rooms at Environment Agency area offices. This would include information such as the licence number, name of abstractor, licensed quantities, location maps and existing conditions on the licence for example.

The information on the Environment Agency's and Ofwat's external website pages in relation to water rights trading, also needs to be updated.

Further consideration of an independent website purely for trading is also considered appropriate. The creation of a separate website devoted purely to trading has been successful in other countries and is an approach that needs to be explored in more detail for implementation in this country.

### **Benefits:**

Providing trading information to the public, in an electronic format, would offer numerous benefits;

- all the trading information would be stored in one central location;
- the information would be easily accessible, understandable and have a clear link to CAMS information on water availability and licensing policies;
- the information would be accurate and up to date;
- the number of abstractors approaching the Environment Agency with unsuitable trading proposals would be reduced;
- the provision of information could be done in house and progressed in the short term and on the whole without legislative changes (with the exception of obtaining powers to request price information).

The mechanisms to provide more information to the market can be progressed in the short term, delivering benefits to the market by the end of 2009/10.

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<sup>2</sup> Exploring views on the potential for more active water rights trading. Synovate UK, December 2008

**Recommendations:**

- The Environment Agency will review and update all internal and external guidance on trading and provide updated training to staff, in particular those within the NPS;
- The Environment Agency and Ofwat will review their external websites to ensure that all relevant and non-confidential information on trading is available;
- The Environment Agency will produce and publish the following information;
  - an explanation of the water rights trading system;
  - relevant case study examples;
  - a list of FAQ's on key issues;
  - a set of clear and explicit general trading rules in relation to easy versus complex trades;
  - a set of clear messages in relation to issues such as the presumption of renewal for time limited licences and where reductions in volume may occur;
  - a set of clear messages in relation to the effect of EU Water Framework Directive (WFD) and Habitats and Birds Directives (HD) on licences and trading; and
  - rules regarding the types of conditions traders could expect to get on their licences as a result of a trade and in what type of situations different conditions may apply.
- Ofwat will produce and publish the following information:
  - details of all water rights trading information issued by the Environment Agency;
  - details of the interaction between the abstraction regime and the public water supply sector;
  - links to all information produced by the Environment Agency
- The Environment Agency and Ofwat will pursue through the Cave review the legislative changes required to allow the obtaining and publication of price information relating to trades;
- The Environment Agency and Ofwat will promote through the Cave review the need to consider an independent website purely for trading;
- The Environment Agency will consider the use of the annual billing run to promote trading and asking abstractors to register their interest, following the establishment of any website; Ofwat will investigate the national security issues associated with the development of an electronic public register containing public water supply data, to reach an appropriate basis on which this information can be made available; and
- The Environment Agency will investigate the feasibility of developing an electronic public register, pending resolution of national security issue by Ofwat.

### **3 Measures for liberalising the administrative processes associated with trading**

A clear, transparent and nationally consistent process for dealing with water rights trading is required. The process for handling applications and dealing with enquiries on abstraction needs to be as efficient as possible and undertaken in a way that is understandable to all involved.

The Environment Agency is already progressing with work in this area as part of the Streamlining Abstraction Processes (SAP) project with the move of all abstraction licence applications to the national permitting service (NPS) in November 2008. The move to a NPS will greatly benefit abstractors. All permitting work is now carried out in one national team, so the service they receive will become more efficient, transparent, cost-effective and customer led. Abstraction licences will be delivered in a more consistent manner and abstractors will have only one point of contact for all of their enquiries. The Environment Agency is committed to continuing to build on this service.

The measures to liberalise the administrative processes associated with trading is already underway. Consequently no further work is considered necessary at this time and the focus of the project will be to ensure that the other recommendations are implemented successfully and that they function effectively.

#### **Recommendations:**

The Environment Agency will:

- ensure that the new processes being developed within the SAP project consider trading aspirations;
- review the application of SAP in relation to trading by the end of 2011/12, to ensure that the streamlined process is delivering benefits to trading; and
- review the benefits of the NPS in relation to trading by the end of 2011/12, to ensure that the new centre is delivering appropriate and consistent advice to traders.

## **4 Measures around the nature of licence conditions**

The Synovate research has confirmed that abstractors feel that the requirements to trade are often complex and specific. It is perceived that a considerable amount of knowledge is required to fully understand all the relevant conditions applied to licences. The addition of conditions to a licence by the Environment Agency, at the point of trade, has also been cited as a disincentive to trading.

The importance of providing more information to potential buyers and sellers on the nature of conditions applied to licences as a result of a trade has been recognised by both the Environment Agency and Ofwat. Both organisations are committed to putting more information in the public domain on the types of conditions that are applied to traded licences and the reasons for them. As discussed in section 2, both the Environment Agency and Ofwat are committed to making trading information available electronically. Both organisations will update their external website pages and further consideration is required to the development of an independent website purely for trading. The Environment Agency will also produce and publish information relating to the types of conditions traders could expect to get on their licences as a result of a trade and in what type of situations different conditions may apply. It is hoped that a higher degree of certainty could be established in relation to the terms of a licence should a licence holder wish to trade their licence.

Abstractors need certainty about the value and tradability of their licence when discussing the opportunities to trade. They also need to be aware of the situations in which new conditions would be applied if they proceeded with the trade.

The Environment Agency will consider the reasons why conditions are placed on licences, to establish whether a greater degree of certainty can be given to those who wish to trade. As a result of the joint project, the Environment Agency will take forward additional work in this area and will, for example, make publicly available guidance and/or rules that can be followed when trading. The overall aim is to better specify the basis of the Environment Agency's decision making on individual trades, while continuing to protect the environment and secure the proper management of water resources.

### **Benefits:**

By providing potential buyers and sellers with better information on the nature of licence conditions it will mean that;

- potential buyers and sellers will have more confidence in the value of their water rights;
- increased liquidity in the market place in the future; and
- abstractors are more informed from the beginning and they are clearer about the conditions that may get attached to their licence if they trade in a certain location.

The measures associated with the nature of licence conditions can be progressed in the shorter term, delivering a review of licence conditions in relation to trading by the end of 2010/2011.

**Recommendations:**

The Environment Agency will:

- undertake further work to explore clearer specification of conditions on licences that increase certainty in the value of the right;
- ensure that more information is available on the types of conditions that are applied to licences as a result of trades;
- assess the options for developing a set of publicly available 'rules' at a water resource management unit level on the types of conditions that will be applied to licences traded in that area;
- identify any legislative changes that may be required to allow the additional conditions to be added to licences; and
- share the findings of this work with Ofwat to discuss the approach to licence conditions.



## **5 Measures to help achieve sustainable abstraction in the short to medium term**

The Environment Agency and Ofwat agree that the issue of unsustainable abstraction must be addressed at the same time as the other barriers to trading, to allow a freer market to exist. This would remove some of the need for regulatory intervention and fewer constraints would be added to licences when traded. Removing the unsustainable abstraction issue will create a more sustainable platform on which a market for trading could operate. However, the measures to reduce abstraction to sustainable levels need to be undertaken in a manner that does not disincentive trading.

Measures need to be introduced which will help catchments move towards more sustainable levels of abstraction in the shorter-term, alongside the existing mechanisms under section 52 and section 61 of the Water Resources Act 1991.

A number of options have been discussed to assist with delivering the Environment Agency's RSA programme and to achieve sustainable levels of abstraction in all catchments, meeting CAMS and WFD targets. The Environment Agency and Ofwat agree that the following options should be considered further:

- Review feasibility of reverse auctions to 'buy back' unsustainable licences at the lowest price;
- Request ability for the Environment Agency to make ex-gratia payments to abstractors on the agreed changes to licences to deliver the RSA programme; and
- Investigate options for a review the Environment Agency abstraction licence charging structure to ensure that charges reflect the true economic, social and environmental value of water and to include pricing signals to reduce abstraction.

The first two options (review of reverse auctions and making ex-gratia payments) require legislative change to assist in the speedier delivery of sustainable levels of abstraction in all catchments. These options will be progressed further by the Environment Agency with input to the Cave review.

The remaining option (investigating the options for a review of the Environment Agency's abstraction charging structure) will be commenced in promptly ahead of a review of the charges scheme.

**Recommendations:**

The Environment Agency will:

- consider the use of reverse auctions in more detail and will;
  - commit to reviewing the practicality of using reverse auctions for delivering sustainable abstraction;
  - assess the viability of reverse auctions at current RSA sites and in relation to CAMS and the WFD targets;
  - promote through the Cave review the need for the Environment Agency to be able to make payments to licence holders (in relation to section 51 of the Water Resources Act 1991), following a reverse auction and the surrender of a licence or part of a licence.
- promote through the Cave review the need for Government to consider providing the Environment Agency with the power to make ex-gratia payments to abstractors on agreement to voluntarily modify or revoke licences to deliver our RSA and WFD targets;
- investigate options ahead of a review of the current abstraction charges scheme to ensure our charges are more cost reflective of the value of water; including consideration of;
  - charging on abstracted volume;
  - inclusion of pricing incentives to drive down demand; and
  - linkages to charging aspirations within the Environment Agency's water resources strategy and unified charges scheme project.
- promote through the Cave review the need for Government to consider amendment of the Environment Agency's cost recovery framework to ensure reflective charges and appropriate incentives can be set; and
- provide our views on the feasibility of a cap and trade system to the Cave Review for further consideration.

## **6 *Legislative Requirements***

The legislative requirements to deliver the recommendations of the joint project can be summarised as:

- a new power to allow the Environment Agency to obtain trade price information and make this available as public register information;
- a new power to allow the Environment Agency to make payments directly following a reverse auction and the related receipt of an application to revoke or vary a licence under s51 WRA91, to facilitate the use of, and gain the benefits from, reverse auctions;
- a new power to allow the Environment Agency to make ex-gratia payments to licence holders who voluntarily agree to change / revoke their licences to deliver Habitats Directive and/or Water Framework Directive objectives; and
- consideration of changes to the cost recovery framework within which the Environment Agency sets its charges to allow the Environment Agency to review its charging structure for abstraction licensing and improve pricing signals to ensure that the abstraction charges better reflect the true environmental, social and economic value of the water.