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### 8.1. Background and purpose

At PR14 we introduced water trading incentives to encourage companies to trade water where it is beneficial to do so. Analysis by other stakeholders, our own research and consultation with stakeholders identified that there are significant barriers to water trading and that these barriers mean that companies do not always trade water where it would be beneficial for them, customers and the environment to do so. While the move to totex at PR14 should help encourage water trading we consider that the barriers to water trading will not be fully addressed by other changes we are making to the price control framework and that targeted water trading incentives are required.

In the medium term, the upstream provisions of the Water Act 2014 should encourage the development of markets in water resources and enable new entry. In the meantime, the targeted incentives to encourage water trading should help realise some of the benefits of increased water trading more quickly. An increase in water trading should also help improve the resilience of companies' water supplies by increasing interconnections between their networks.

We have used export incentives as part of price reviewd in the past, for example at PR04. However, we revised its operation following analysis of how the previous incentive worked and consultation with stakeholders.

The import incentive was new for PR14. Our analysis identified that existing cultural and behavioural biases mean that companies are likely to continue to retain a preference for ownership and direct control of water resource assets rather than importing water from other companies. Water companies also have limited experience in designing and using effective contracts for water trading, so there may be additional costs associated with them establishing appropriate processes to manage trading. For these reasons we introduced a targeted incentive for imports for 2015-20.

However, we consider the barriers to importing, and the associated costs, are likely to reduce over time as companies gain experience of water trading. So, we consider that the main purpose of an import incentive is to act as a stimulus to change cultural and behavioural biases and, therefore, once those biases have been addressed there may no longer be a strong case for an import incentive.

We will keep our use of targeted water trading incentives under review as new evidence emerges and longer-term reforms are implemented.













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