

Negotiating bulk supplies – a consultation on our guidance

About this document

This consultation sets out our proposed guidance to the water and sewerage and water only companies in England and Wales to help them negotiate bulk supplies and to reduce barriers to water trading. Over the past three years, we have been working with the companies, the UK Government, regulators and other stakeholders to promote the use of bulk supplies where they are the efficient solution to a supply/demand balance issue.

A bulk supply is the supply of water from one appointed water company to another. Companies can draw up a contract between them (a 'bulk supply agreement') that sets out the terms and conditions of a bulk supply, including the price. Our objective for this guidance is that it makes negotiating bulk supply agreements easier for companies.

In this consultation, we set out:

- what the draft guidance is;
- why we have developed it; and
- how we have developed it.

We also ask for stakeholders' views on the question on page 4.

Contents

Responding to this consultation	3
Consultation question	4
1. Introduction	5
2. Why do we need guidance on negotiating bulk supplies?	8
3. How have we developed our guidance?	12
4. Our proposed guidance	14

Responding to this consultation

We would welcome any comments on this document. Please email them to ian.hopkins@ofwat.gsi.gov.uk or post them to:

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The closing date for this consultation is **12 March 2013**.

We will publish responses to this document on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

Consultation question

We welcome all comments in relation to this consultation. It would help us to improve the guidance if, when responding to the question below, you explained the reasons behind your answer.

Q1 Do you have any suggestions for how we could improve the draft guidance?

1. Introduction

Stakeholders have raised concerns that there are barriers to water trading which include the difficulty of negotiating bulk supply agreements. We are consulting on draft guidance for negotiating bulk supplies because there are benefits to customers from more water trading. This guidance should help water companies negotiate bulk supplies and make water trading easier.

Bulk supply agreements will reflect the needs of the parties and the nature of the services provided. Our guidance is not intended to limit the scope or terms of agreements developed by parties, rather, the guidance provides a check list of areas a bulk supply agreement could cover. The guidance does not prescribe the approach companies should take to each area in their agreements. Water and sewerage and water only companies in England and Wales negotiate bulk supplies between themselves. It is up to them how they use our guidance.

This guidance complements Government policy on bulk supplies and our price review proposals for water trading. We describe how this guidance fits with the other measures to promote bulk supplies in section 2.

1.1 What is a bulk supply?

A bulk supply is a supply of water from one appointed company to another.

Each appointed water company has a legal obligation to provide water services to its customers in its area of appointment. It can choose how it does this. One possible method is for one company to pay another to supply it with a water service, which the company can then use to serve its customers. The technical term used in the Water Industry Act 1991 (WIA91) for this type of supply is a 'bulk supply'. The companies involved draw up a contract (a 'bulk supply agreement'). This sets out the terms and conditions for the bulk supply.

Bulk supplies are sometimes referred to as 'water trades' as they are a way for water companies to trade water. To transport the bulk supply from one company to another company involves an 'interconnection' usually in the form of a pipe.

A bulk supply can also be made for sewerage services. Our guidance considers only bulk water supplies. This is because it is bulk water supplies that will generate the main benefits for companies, customers and the environment, as summarised in section 2. However, the guidance has some relevance to agreements for bulk sewerage services.

1.2 What is an appointed water company?

Under the WIA91, every part of England and Wales has a company that is licensed (or ‘appointed’) to provide water, sewerage or water and sewerage services to that specific geographic area.

Most customers receive these services from 20 appointed water companies existing at privatisation in 1989, or formed through subsequent mergers.

Some customers receive their services from newly-appointed water companies that have been licensed by us (‘new appointees’) and which serve very small, local geographic areas often no more than a single development in size. The new appointees replace the previous appointed company for those geographic areas and take on all of their responsibilities.

1.3 Types of bulk supply agreement

There are two main types of bulk supply.

- First, there are bulk supplies between one existing appointed water company and another. These often involve the transfer of large volumes of water. For example, the providing company might expand one of its existing water resources to provide a large volume of water to supply the receiving company’s customers.
- Second, there are bulk supplies from an existing appointed company to a new appointee. The main difference here is that these usually involve the supply of fairly small volumes of water. For example, a new appointee might supply a new housing estate using a bulk supply from an existing water company.

The providing and receiving companies have different requirements depending on the type of bulk supply they need. This document aims to provide an overall guide to companies on what they should include in their bulk supply agreements. But we recognise that some of the areas we suggest are more relevant to the first or second category of bulk supply.

For example, we suggest that a bulk supply agreement should be drafted to allow for the addition of new sites or connections. This is likely to be of more relevance to the second category of bulk supply when a new appointee wants bulk supplies for several sites within one appointed water company’s area.

1.4 Our powers in relation to bulk supply agreements

Ofwat's role in determining the terms of bulk supply agreements is limited to situations where the parties are unable to reach agreement. In general, we expect water companies to negotiate bulk supply agreements themselves without any intervention from us.

The parties may fail to agree on:

- the terms of a proposed bulk supply agreement;
- how the terms of an existing agreement should be changed; or
- whether the terms of an existing agreement should be cancelled.

In these circumstances, the relevant companies can ask us to determine the terms of the bulk supply. Under sections 40 and 40A of the WIA91, we have powers to determine the contractual terms of actual or proposed bulk supply agreements, including those that involve a bulk supply between:

- existing appointed water companies; and
- an existing appointed water company and a new appointee.

We can only make a bulk supply determination if we are satisfied that the various parties cannot reach agreement.

Before we make a determination, we must agree that the proposal, variation or termination of the agreement (whichever is applicable) will secure the efficient use of water resources or the efficient supply of water.

This guidance **does not alter** our powers under sections 40 and 40A of the WIA91 and is without prejudice to the exercise of our powers.

However, it would be quicker and less costly for all parties if they could reach agreement without a determination.

2. Why do we need guidance on negotiating bulk supplies?

2.1 Bulk supplies are not realising their potential

Our statutory duties and our strategy recognise the importance of ensuring the water and sewerage sectors have the incentives to manage water resources in an environmentally, socially and economically sustainable way.

There have been very few significant new bulk supply agreements since privatisation in 1989. In April 2009, the final report of the independent review of competition and innovation in water markets (the ‘Cave review’)¹ commented on the lack of bulk supplies since privatisation despite their potential benefits. The Cave review considered that bulk supplies should account for more than 4% of water supplied given the companies’ different water surplus and deficit positions.

Water trading through bulk supplies should deliver the following benefits.

- It should allow companies and customers a share in the potential **financial benefits** that could arise from efficient water trading. In March 2010, we identified about £1 billion of potential savings in England and Wales from more water trading compared with the proposals in companies’ draft water resources management plans. Also, in June 2010, the Environment Agency published work by the Water Resources in the South East (WRSE) group that identified £500 million of potential savings from sharing resources in the south-east of England.
- It should increase **resilience** and deliver more flexible options for companies to meet short-term deficits – such as those caused by drought. Many water companies have already linked up their networks internally to take advantage of these benefits. One such example is United Utilities’ West–East link which enables the company to share water resources across its region more easily.
- Longer-term trades should reduce the pressure on the **environment** from abstraction in water scarce areas by moving water from areas where it is relatively plentiful to areas where it is relatively scarce.

¹ ‘Independent Review of Competition and Innovation in Water Markets: Final report’, Martin Cave, April 2009
<http://archive.defra.gov.uk/environment/quality/water/industry/cavereview/documents/cavereview-finalreport.pdf>

In its 'Changing course' documents published in April 2010² and June 2011³ Severn Trent Water also identified the benefits of water trading described above.

2.2 The difficulty of negotiating bulk supplies

If there are so many benefits from water trading, the question arises about why there have been so few bulk supply agreements since privatisation. In September 2010, Defra published a study of stakeholders' views of what they perceived to be the barriers to interconnection and why companies are not taking advantage of the benefits of water trading. This covered the barriers that we⁴ and others such as the Cave review, Severn Trent Water and Water UK⁵ had identified.

Defra's report identified 29 potential barriers of varying importance and set out some initial high-level options for dealing with them. Several of the barriers relate to companies' concerns about bulk supply contracts⁶.

In discussions with us, stakeholders have also identified the cost and difficulty of negotiating bulk supply agreements as one of the barriers to interconnection. They have raised the risk that the agreement may not deliver the volume of contracted water, especially in emergency or drought situations. Several stakeholders considered that some form of guidance from Ofwat or a model bulk supply agreement might make it easier to negotiate bulk supplies.

2.3 Fit with Government policy and Ofwat proposals

This consultation on guidance for negotiating bulk supplies fits with Government policy on bulk supplies and our price review proposals. This is illustrated in figure 1. Together, the measures form a package to help promote bulk supply agreements.

² 'Changing course', Severn Trent Water, April 2010

<http://www.severntrent.com/upload/pdf/Changing%20Course.pdf>

³ 'Changing course through water trading', Severn Trent Water, Ernst & Young, June 2011

http://www.stwater.co.uk/upload/pdf/STW_Water_Trading_FINAL_9_June_2011.pdf

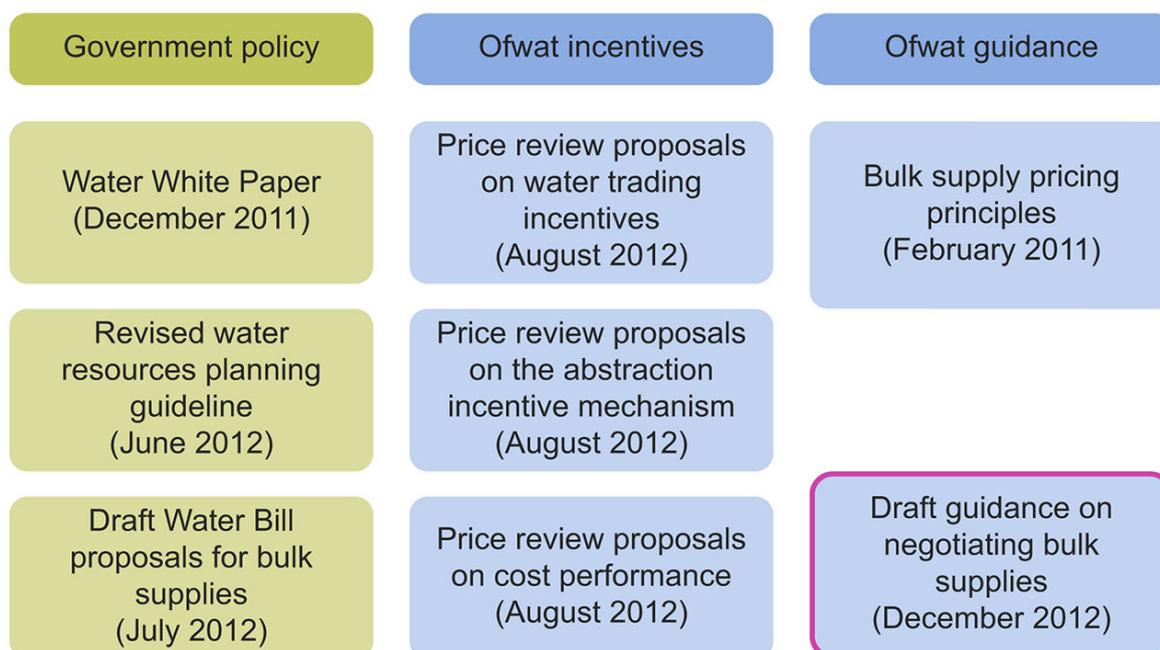
⁴ 'A hypothetical model for upstream water markets in England and Wales – a technical paper', Ofwat, January 2011 http://www.ofwat.gov.uk/future/markets/upstream/pap_tec_20110124model.pdf

⁵ 'Meeting future challenges – a blueprint for policy action', Water UK, June 2010

<http://www.water.org.uk/home/news/press-releases/mfc9jun/mfc-final-revised3.pdf>

⁶ Barriers 24, 25, 26 and 29 in particular reflect companies' concerns about bulk supply agreements.

Figure 1 Measures to promote bulk supplies



Government policy

The UK Government is supportive of measures to promote interconnection of water companies' networks, water trading and bulk supplies. Its Water White Paper⁷ emphasised the importance of water trading and interconnection. And it set out the Government's expectation that water companies consider all options for meeting their supply and demand balance when preparing their water resources management plans. The options considered should include interconnectivity across company boundaries, opportunities for trading water and other cross-boundary solutions.

The UK Government reiterated the importance it attaches to water trading, and cross-boundary and third party suppliers in the Water Resources Planning Guideline, published in June 2012⁸ and the draft Water Bill⁹ published in July 2012. Our proposed guidance on negotiating bulk supplies complements the UK Government's efforts to promote water trading and bulk supplies.

⁷ 'Water for Life', CM 8230, Defra, December 2011, <http://www.defra.gov.uk/environment/quality/water/legislation/whitepaper/>

⁸ 'Water resources planning guideline – the guiding principles for developing a water resources management plan', Environment Agency, Ofwat, Defra and the Welsh Government, June 2012 <http://publications.environment-agency.gov.uk/PDF/GEHO0612BWPD-E-E.pdf>

⁹ 'Draft Water Bill', CM 8375, HM Government and Welsh Government, July 2012 <http://www.official-documents.gov.uk/document/cm83/8375/8375.pdf>

The Welsh Government set out its views on water trading in the Water Resources Planning Guideline¹⁰. The Welsh Government expects companies to consider all options to balance supply with demand, including water trading. But the Welsh Government expects water companies operating wholly or mainly in Wales to only agree bulk supplies where it would not be detrimental to the company. Where a water company proposes to transfer water from a water resource zone of a water company which is wholly or mainly in Wales, it should provide an opportunity for Welsh Ministers to give views on its plan. Our proposed guidance on bulk supplies is consistent with the Welsh Government's views on water trading.

Ofwat price review proposals

This consultation on draft guidance for negotiating bulk supplies fits with our proposals for the next price review. We are proposing to take forward water trading incentives at the price review in 2014¹¹. These are designed to overcome some of the economic regulation barriers to water trading that we – and other stakeholders – have already identified. We are also proposing to implement an abstraction incentive mechanism (AIM). The AIM is intended to discourage companies from abstracting water at low flows from sensitive water sources. So, it discourages companies from using sensitive water sources for bulk supplies.

We are also proposing to change our approach to cost performance incentives. Our proposals aim to avoid there being an undue bias for companies to favour capital expenditure ('capex') over operating expenditure. This should remove a disincentive for importers to consider bulk supplies.

Other bulk supply guidance

Our draft guidance on negotiating bulk supplies complements the bulk supply pricing principles we published in February 2011¹². That document sets out the principles we propose to use when determining the price terms of bulk supply agreements referred to us for determination.

¹⁰ See footnote 9.

¹¹ 'Consultation on wholesale incentives for the 2014 price review', Ofwat, August 2012
http://www.ofwat.gov.uk/pricereview/pr14/wholesale/prs_web120825wholesaleprice

¹² 'Bulk supply pricing – a statement of our policy principles', Ofwat, February 2011
http://www.ofwat.gov.uk/competition/inset/pap_pos110228navbulksupply.pdf

3. How we have developed our guidance

We have developed our guidance on negotiating bulk supplies over the past 12 months with input from:

- the appointed water companies;
- new appointees;
- water supply licensees;
- other regulators;
- the UK and Welsh Governments; and
- consumer representatives.

We used a model bulk supply agreement as our starting point, which we put together following a review of the model agreement that forms part of our access codes guidance and a review of existing bulk supply agreements that have been negotiated between companies.

We used an industry workshop in January 2012 and a working group in March 2012 to consult with stakeholders on the model agreement. We took account of the feedback we received at those events – and from other correspondence – and revised the model agreement.

We have decided to publish guidance rather than a model bulk supply agreement for the following reasons.

- We are concerned that a model bulk supply agreement could become a default agreement for the sectors. This might restrict the companies' ability to negotiate their own terms to reflect the particular circumstances of their supply. In other sectors there are standard agreements that most companies tend to use. For example, in the electricity sector most large generators tend to use standard contract forms such as the Grid Trade Master Agreement (GTMA). While these standard contracts can make reaching agreement easier they also reduce flexibility. For example, the standard contracts tend to impose obligations that are not necessarily appropriate for smaller generators.

- The independent Gray review of Ofwat¹³ identified that while Government and the regulators must set the policy objectives and required outcomes it would be much better for companies to take the lead and to have the flexibility to devise innovative solutions that are in the best interests of consumers. The review was also concerned about a tendency for companies to become dependent on Ofwat and to focus on responding to Ofwat's requirements rather than to customers. A guidance document to facilitate bulk supply negotiations fits better with this approach than a model bulk supply agreement.

Our guidance captures the useful feedback that we received from stakeholders on the model agreement. We would welcome stakeholders' views on whether our draft guidance addresses adequately those areas of bulk supply agreements that are important to them.

¹³ 'Review of Ofwat and consumer representation in the water sector', Defra, July 2011, <http://www.defra.gov.uk/publications/files/ofwat-review-2011.pdf>

4. Our proposed guidance

This chapter sets out our proposed guidance to facilitate water companies' bulk supply negotiations. To help the companies in their negotiations, we suggest that a bulk supply agreement could cover each of the 14 areas listed below. It is for water companies to negotiate their own bulk supply agreements.

We have suggested some areas that bulk supply agreements could cover. But water companies must also make sure that they abide by their statutory obligations in their bulk supply agreements. Companies will also need to comply with competition law in their bulk supply agreements.

4.1 Price and non-price terms

The parties would expect a bulk supply agreement to include both price and non-price terms so that they know what services are being provided at what price. It might speed up negotiations if non-price terms were set first so that the parties know what services are being priced in the agreement. But we recognise that negotiations can be an iterative process where the non-price and price terms evolve during the negotiations.

The price terms could include:

- a standing charge and volumetric rate for the water supply, or different types of water supply, provided for in the agreement;
- charges for any volumes of water the recipient takes which are above the maximum amount allowed in the agreement;
- a minimum charge which the recipient pays whether it takes any water or not;
- a connection charge;
- charges for the provision of information;
- an infrastructure charge as defined in section 146 of the WIA91; and
- rules about the periodic adjustment of charges (see section 4.6).

The non-price terms could include many of the issues covered in the rest of section 4 – such as the ownership and responsibility for the assets used in the supply, the quality of the water and the duration of the agreement. Some other non-price terms which could be included in the agreement but which are not discussed further in section 4 are the commencement of the agreement, how charges are to be paid and how the parties are to operate the bulk supply.

4.2 Facilitating the addition of new sites or connections

New appointees sometimes apply for several new appointments within one existing water company's area of appointment. If the new appointee does not have its own water supply, it will need a bulk supply from the existing water company.

If it is likely the new appointee will apply for more than one bulk supply, it would make sense for the first bulk supply agreement to allow for the addition of new sites or connections to that agreement. This could be done, for example, by keeping the main terms of the agreement the same and adding schedules to the agreement to include additional sites or connections.

We recognise that different bulk supply agreements might be needed for different sites or connections between the same parties if the circumstances of the sites or connections are significantly different. For example, a water company with a water supply surplus might negotiate two bulk supply agreements with a neighbouring water company that has a deficit. If the exporting water company was providing one supply from a dedicated borehole and the other from its integrated water supply network it might want to agree different terms to reflect the different risks to the bulk supply.

4.3 Ownership and responsibility for the assets

It would make sense for the agreement to be clear about who owns and who is responsible for the assets that are used to provide the bulk supply. This is important – if there is a problem with the bulk supply, it would be better if it was clear which party is responsible for remedying that problem. It is also important for the parties when negotiating the price terms of the contract to know which party is providing which service with what assets.

There can be a distinction between the ownership and responsibility for the assets used to provide the bulk supply. For example, a supplying company might build an interconnection pipe from its integrated water supply system to that of another company to provide the bulk supply. The supplying company might own the pipe because it was the company that built it. But the receiving company might want to be responsible for operating flows in the pipe because it might be an important supply for the receiving company. In this case, the ownership and the responsibility for operating the interconnection pipe belong to different companies.

There could also be examples where the ownership of the assets used to provide the bulk supply is split between the supplying and receiving company or a third party. An example of this is the Elan Valley supply from Dŵr Cymru Welsh Water to Severn Trent Water. We understand that the reservoirs are owned by Dŵr Cymru Welsh Water and the interconnector pipe is owned by Severn Trent Water.

4.4 Measuring the water supplied

The parties to the bulk supply agreement need to know whether the water due to be supplied under the terms and conditions of the contract has been supplied. Also, most bulk supply agreements are likely to have charges based to some extent on the volume of water delivered.

So, a bulk supply agreement would need to specify how the water supplied is to be objectively quantified. In most cases, a meter will be used, which will need to measure the water supplied to the degree of accuracy specified in the agreement. To ensure the accuracy of meter readings, we suggest that meters should be tested in accordance with the Measuring Equipment (Cold-water Meters) Regulations 1988.

Even with testing, there can be occasions when a meter is found to be faulty. To prevent a possible impasse between the parties the bulk supply agreement could specify the mechanism for determining the volume of water supplied in this case.

4.5 Quality of the water supplied

Water can vary in quality and there are existing bulk supplies for raw (untreated) water, partially-treated water and potable (drinking) water.

For example, a new appointee supplying a housing development, if it needs a bulk supply, will require a potable water bulk supply for its customers. For potable water, the standards imposed by the WIA91 and the Water Supply (Water Quality) Regulations 2000 will apply to the bulk supply. It is the company receiving the bulk supply that is responsible for the quality of water supplied to its customers.

For partially-treated non-potable water, the agreement might state the quality of the water to be provided and how it is to be assessed. This could be done by specifying the treatment process to be applied to the non-potable water before it is supplied or by specifying the water quality parameters the non-potable water should meet.

Water companies have already developed water quality terms which can be added to existing bulk supply agreements that do not deal with water quality issues sufficiently well. These terms could be used in new agreements.

4.6 Adjusting charges periodically

Price terms can be set in different ways. For example, some bulk supply agreements include volumetric charges for the supply of water. Other bulk supply agreements include charges that reflect contributions to the capital costs of building the bulk supply assets or the on-going costs of operating the bulk supply.

As well as setting out the price terms, the bulk supply agreement might also explain how those price terms are to be adjusted to allow for inflation. Typically, bulk supply agreements include provisions for annual adjustments to the price terms to allow for inflation, although the parties could agree different frequencies of adjustment. The adjustments could be by set amounts, percentages or linked to measures of specific costs or general inflation. If the parties agree that no adjustment is to be made to the price, they could set this out for clarity.

A bulk supply agreement could allow for an interim review of price terms, in which case it should set out how that review is to take place. In 2006, we determined some of the terms of a bulk supply from Southern Water to South East Water¹⁴. One of the issues was whether the price terms, which included an annual increase, should be reviewed at any point during the 20-year contract period. An advantage of not reviewing the price terms is that both parties have certainty over the price for the duration of the agreement. An advantage of reviewing the price terms is that they can be adjusted for unforeseen circumstances. In the circumstances of the Southern Water and South East Water case we determined that there should be a review of price and volume terms at ten-year intervals after the agreement started.

4.7 Interruptible or firm supply

The receiving company might want a different level of supply security from its bulk supply depending on its circumstances. For example, the receiving company might be able to use its own storage or alternative water sources to accept temporary interruptions to its supply in return for a lower price. The supplying company might be able to save costs by interrupting the bulk supply within the terms of the agreement.

¹⁴ 'RD 1/06: Section 40 order determining terms for a bulk supply', Ofwat, March 2006, http://www.ofwat.gov.uk/sustainability/waterresources/ltr_rd0106_s40detbulksupply

The bulk supply agreement could include details of any allowed interruptions. If it did so, it would need to explain the number and duration of interruptions that the supplier could make and under what conditions interruptions could happen. There might be a link between when the supplier can make interruptions and interruptions for planned maintenance, emergencies and water shortages.

Interruptible supplies are well established in other sectors. For example, in the gas sector National Grid can interrupt supplies to certain sites for up to 45 days in each year. In return National Grid reduces its transportation charge. Several water companies, for example Anglian Water and Severn Trent Water, already offer forms of interruptible or stand by supplies to their large user customers.

4.8 Interruptions of supply to carry out planned maintenance

Planned maintenance can disrupt the flow of water from the supplying to the receiving company. The receiving company will want to know when maintenance will happen so that it can make alternative arrangements to supply its customers.

The bulk supply agreement could put a requirement on the supplier to minimise the frequency and length of any disruption to the bulk supply as a result of planned maintenance work. The agreement would need to define what is meant by ‘planned maintenance’.

The agreement might set out the process by which the supplier will consult the recipient over the timing of planned maintenance. It could specify how far in advance the supplier should notify the recipient of the planned maintenance. The supplier might also have to allow a reasonable period for the recipient to express its views. The agreement could require the supplier to consider the recipient’s views before making a final decision on the timing and duration of the maintenance.

4.9 Co-operation in emergency situations

Emergency situations could arise during the period of a bulk supply agreement that affect the quality of the water supplied, the volumes of the water supplied or some other aspect of the bulk supply agreement. It would be helpful if the bulk supply agreement explained how the parties will deal with emergencies. In that case the agreement would need to define what is meant by an ‘emergency’.

The agreement could also set out the obligations on parties to co-operate in emergency situations. This could include:

- co-operating to prevent an emergency from occurring;
- notifying the other party of the existence and cause, if known, of the emergency;
- ensuring, as far as is reasonably practicable, that any emergency has the minimum possible effect on the supply of water to either party's customers;
- agreeing reductions in supply to both sets of customers where this is reasonable to prevent or mitigate the effects of an emergency;
- ensuring that priority is given to vulnerable customers if a supply of water is restricted because of an emergency, and co-operate in agreeing categories of vulnerable customers;
- using all reasonable endeavours to restore the supply;
- investigating the cause of an emergency that has occurred; and
- sharing any lessons learned to prevent a recurrence of the emergency.

4.10 Co-operation at times of water shortage

One of the biggest concerns companies have about bulk supply agreements is what happens during times of water shortage. The agreement could address this concern by specifying what is to happen during a time of water shortage. It might also place an obligation on both parties to co-operate in such situations.

The terms relating to water shortages could include:

- an obligation for the supplier to notify the recipient when the initial drought triggers in the relevant supply zone are reached;
- a definition of the circumstances under which the supplier may limit the water it supplies under the agreement;
- an obligation for the supplier to notify the recipient if it intends to apply for a Drought Order or impose a temporary ban on the use of water by some or all of its customers; and
- provisions relating to the actions the recipient should take to reduce water taken from the bulk supply in the event of a water shortage.

If the parties have agreed an interruptible contract (see section 4.7) the supplying company might be able to use the terms of interruption to deal with the duration of the water shortage.

4.11 Liability for planned and unplanned interruptions

There are several reasons why water from a bulk supply might be interrupted. These include non-emergency situations – such as planned maintenance – and emergency situations. If a bulk supply agreement covers interruptions it would be sensible for it to be clear where liability for interruptions lies in each situation.

In the energy sector, some contracts specify payments to be made by one party to the other if certain terms of the contract are not met. These payments can, under certain conditions, fully discharge the party's liability for failing to meet that particular term of the contract in that instance.

4.12 Duration

Bulk supplies often involve one or both of the parties making investments in their water resource and (or) network assets to provide the service. Some of these assets might be specific to the bulk supply and might not be usable for alternative supplies. For example, the supplying company might be able to redeploy a new water resource to supply its own customers, but it might not be able to use an interconnection pipe for other revenue-earning purposes.

It might take many years for the revenues from the bulk supply to cover the cost of the dedicated bulk supply assets. A bulk supply agreement might therefore need to be long enough to allow for the parties to recover the costs of the assets.

A long duration agreement can create problems if circumstances change and the agreement is no longer beneficial for one or both parties. This issue is discussed in section 4.14.

4.13 Dispute resolution

Disputes might arise from time to time with regard to the bulk supply agreement. It would be sensible for the agreement to include a provision to resolve disputes. We suggest that this comprises an internal escalation process that must be followed before a matter may be referred to arbitration, the courts or some other form of formal adjudication.

Some energy contracts specify a time limit after which a party cannot raise a dispute about the other party's previous performance of the contract. For example, the contract might specify that parties must raise a dispute about an incorrect payment within a year of the payment being made.

The dispute resolution provision relates to disputes over the operation of the bulk supply agreement. This is different from a failure to agree the terms of a bulk supply agreement, or a variation or termination of an agreement, which can be submitted to Ofwat for determination as provided for in sections 40 and 40A of the WIA91.

4.14 Termination

The agreement should set out how it can be terminated by either or both parties.

Ways in which a bulk supply agreement could be terminated include:

- on the termination date in the agreement;
- if the parties agree to terminate the agreement by mutual agreement;
- if the recipient stops being the water company for an area that is supplied by the bulk supply;
- if either party ceases to be an appointed water company;
- if Ofwat makes an order under section 40A of the WIA91 terminating the agreement;
- if there is a material breach of the contract which is not remedied. A material breach could include repeated failure to pay on time or a one-off failure to pay on time which was not corrected within a specified period; and
- if the other party becomes insolvent or takes steps to shut down its business.

As discussed in section 4.12, a bulk supply agreement might need to be long enough to allow the parties to recover the costs of the assets involved in the supply. It might also need to be flexible to allow for changing circumstances. A possible approach in the case of a bulk supply agreement would be for the agreement not to allow termination within a set period, but after that period has ended the agreement could be terminated on notice. An alternative approach is for the agreement to run for a fixed period, with no provision for termination on notice. This would require the parties to renegotiate the agreement at the expiry of the fixed term.

If the agreement may be terminated on notice, it would be helpful for the notice period to be sufficiently long to enable the party that received the notice to refer the matter to Ofwat, and for Ofwat to make a determination.

There are several existing bulk supply agreements that pre-date privatisation in 1989 that run in perpetuity. These agreements can create problems because circumstances can change over time and a party which finds the contract to be unfavourable cannot end the agreement.



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