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Our ref

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Dear Ian

**Negotiating bulk supplies – consultation on guidance**

This letter is in response to the consultation on the guidance for negotiating bulk supplies. We provide more detailed, section specific comments in the appendix to this letter.

We question whether the proposed guidance will progress the overall debate on trading and bulk supplies and contribute the objective of removing barriers to water trading. As outlined in the 2011 Trading Theory in Practice<sup>1</sup> collaborative paper, negotiation of contracts was not seen as one of the main problems. Our experiences are that more important challenges between parties are the agreement on the level of service and resilience of bulk supplies.

The status of the guidance is not clear given the current development of the Draft Water Bill. Section eight of the Bill suggests that should the Bill be passed, Ofwat will be empowered (under new s40B) to develop and issue "codes" in respect of bulk supplies. We assume that this guidance is designed to align with the current law but seek clarification on how the guidance would change were Ofwat granted the power to develop such codes and whether at such a point the guidance would be replaced.

We are pleased that Ofwat recognise that the guidance is not intended to limit the scope or terms of agreements. We agree that ultimately the exact nature of agreements remains a matter for the parties to decide. Every agreement will be different and reflect the specific circumstances with the bulk supply. This view is not reflected in section 4.2 of the guidance which assumes homogeneity in the nature of bulk supplies and their negotiation. Furthermore, section 4.2 seems to

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<sup>1</sup> <http://www.anglianwater.co.uk/assets/media/trading-theory-for-practice.pdf>

suggest that bulk supply contracts should have a degree of open-endedness dependant on future sites. We do not believe that is beneficial guidance for negotiating contractual arrangements.

In addition to our detailed comments in the appendix, there are some omissions from the guidance which we believe merit inclusion, specifically:

- Bulk supplies for large user insets;
- Links with Water Resource Management Plans and Business Plans
- How the criteria in section 40 and 40A (facilitating competition, supplier recovering costs, etc) will be applied in determinations
- Water for fire fighting supplies.

Please do not hesitate to contact me if you wish to discuss any of these points in greater detail.

Yours faithfully

**Jean Spencer**  
**Regulation Director**

## **Appendix one – Section specific comments**

### 1.1 What is a Bulk supply?

The guidance states that each appointed water company has a legal obligation to provide water services to customers in its area of appointment. Legally, we also have obligations to supply customers out of area.

### 1.3 Types of bulk supply agreements

The guidance generalises that bulk supplies between existing appointed companies are associated with large volumes of water. So far as the first type is concerned, there is no reason why agreements between two existing appointed water companies will necessarily be for a large volume. An incumbent might want a bulk supply so that it can serve a new housing estate inside or outside its area.

It may also be more useful to differentiate between network supplies and those that go directly to supply a cross border development (a bulk supply with direct end users).

The guidance omits several other types of agreements. In addition to the two specified in the guidance:

- where the bulk supply is associated with an inset for a large user (currently above 50ML)
- where it involves a source in one water company's area, which then goes through another undertaker's pipes, before finally being supplied back to the original water company to serve either another part of its existing area or to serve a new inset area some distance from its existing boundary.
- where a company (existing or new appointee) seeks a supply from one water company via another company's water mains. Section 66C provides for a secondary water undertaker to be involved when a WSL supplies a customer, but there is no reason why that should be limited to the WSL regime and it should be mentioned as a possibility in the context of insets.

The guidance suggests that Ofwat recognise that some suggestions are more appropriate to the first, rather than the second, type. This depends upon the circumstances and should be left to companies' discretion. For example, we have used the "schedule" approach in agreements with Thames Water and Cambridge Water, whereas so far we have sought individual agreements for new insets because of their different circumstances

Within the guidance, so far as the second type is concerned, this should not be limited to new appointees. There is no reason why an incumbent should not seek an inset appointment to serve a single housing estate, which might be outside its area.

### 1.4 Our Powers in relation to bulk supply agreements

It would be useful if determinations were made in a timely manner and perhaps if there were clear guidance and standards it would remove the need to have to

refer to Ofwat. New entrant approaches are non-standard across the industry and expectations are based on experiences in other areas and not necessarily consistent with WI Act, DWI or competition law.

### 2.1 Bulk Supplies are not realising their potential

Mechanisms need to be in place to incentivise cross border supplies rather than the traditional solutions that are applied. There needs to be a clear understanding that water trades can be more beneficial to the end user and the likely recovery of costs. Network limitations may also exist in order to convey bulk supplies to other areas. This combined with the cost for the provision of water may mean water trading is an unsustainable option. In our experience it has been environmental issues that have prevented bulk supplies realising their potential.

The benefits which are identified only apply to bulk supplies between 2 existing water companies. None of the identified benefits apply to bulk supplies associated with an inset. Indeed, the latter might add costs, lessen resilience (especially for the inset area) and do not have any environmental benefit.

### 4.1 Price and non-price terms.

What may be useful is a published list of terms as standard offer from each existing company. This may identify non-price terms such emergency procedures, contact protocols and connection procedures. Other elements such as levels of service for responses might be suggested here.

The price terms list does not include capital contribution. While it is understood that it is not comprehensive list it should be recognised as a significant term.

### 4.2 Facilitating the addition of new sites or connections

Often clauses which could be classed as an agreed standard approach can change due to specific requirements related to a sites or changes in relation to negotiating parties policies or procedures. In theory it could simplify, however, in practise it is likely to increase complexities and future issues.

Guidance should be provided around a prospective appointee applying for a water connection prior to a variation being granted. It is unclear where potential issues arise around duty of the incumbents in areas such as water quality.

As described above, the use of a "schedule" should be left to companies' discretion and is likely to be as relevant to agreements between 2 existing incumbents.

Moreover, it says that if the new appointee does not have its own water supply, "it will need a bulk supply from the existing water company". Not necessarily, it might be better if it was served by means of a bulk supply from a neighbouring water company, which might or might not involve a secondary water undertaker. Or, it might have a bulk supply which is insufficient for all its needs or all its circumstances and might simply want a top-up bulk supply.

#### 4.3 Ownership and responsibility for the assets

Operation of assets should be considered when connecting directly to a source of treatment (either water or waste) or areas where there are limited resources. This would provide assurance around network integrity and regulatory compliances.

#### 4.4 Measuring the water supplied

This holds through not only for water but also for wastewater bulk waste discharges. It could be argued that this is more important to ensure regulatory compliance, mitigate against the risk of flooding and ensure treatment capacity. It may be important to highlight this, as our policy is to have a discharge meter. This has been an area of challenge by appointees.

It would help if the guidance also recognised that supplying companies might take steps to limit the quantity to that which had been agreed and thereby avoid an exceedance.

#### 4.5 Quality of water supplied

This is something that should be also extended to include wastewater discharges. Agreed quality ensures septicity levels are controlled.

A Protocol has now been agreed nationally to ensure proper liaison over water quality matters and it would be helpful if that was referenced in Ofwat's guidance

#### 4.7 Interruptible or firm supply

The Guidance should make it clear that an interruptible supply will not always be appropriate and should only be used where the primary reason for the supply is for "non-domestic" purposes

#### 4.8 Interruptions of supply to carry out planned maintenance

The appointees or those companies who have responsibility to domestic customers and supplied from a bulk supply should have minimum notification terms agreed on emergency, planned and unplanned maintenance. It should be agreed with the incumbents on how information should be exchanged and managed. This should be in line with the incumbents' existing system. If alternative requirements are required it is likely to have an impact on costs.

It would be helpful if Ofwat gave guidance on the period of notice that should be given in respect of planned works as this is one area where there should be some consistency. Likewise, to avoid ambiguity, the definition of "emergencies" (i.e. which are unplanned) should also be consistent across companies.

#### 4.12 Duration

We believe the guidance here is too simplistic – more probably than not, it will need to have a long duration to give certainty to the two companies. Both will want to reference it in their Water Resource Management Plans and the link to that Plan should be specifically mentioned here.

#### 4.13 Dispute Resolution

The guidance says the dispute resolution procedures are different to the rights to seek a determination under sections 40 and 40A. This is true to some extent, but they are still very closely linked. The party which loses the dispute may ask Ofwat to make a determination. It would be helpful if the guidance was clearer about the link and said something about the circumstances where Ofwat might or might not exercise their Determination powers immediately following a Dispute.

#### 4.14 Termination

It would be helpful if the guidance was a little clearer. For example, the receiving company might not be able to accept termination even for a "material breach". If the receiving company would need to amend its WRMP or needed to include a replacement proposal in its Business Plan for consideration at the next Periodic Review.