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Dear Ian

### Consultation on Negotiating Bulk Supply Guidance

We welcome guidance from Ofwat on negotiating bulk supplies. The draft guidance provides a helpful checklist of terms to consider including in a bulk supply agreement.

In our view, the main ways in which barriers to water trading which could be overcome by having a robust bulk supply agreement are by having clarity on security of supply and a clear pricing methodology that reflects marginal costs and terms of cost recovery. We would be pleased to discuss our response in more detail with your team.

The comments below refer to various sections of the guidance.

### Price and non-price terms

The draft guidance includes a list of price terms that could be included in a bulk supply agreement but leaves the application up to the trading parties to agree. The February 2011 policy principles document<sup>1</sup> equally does not set a detailed methodology for bulk supply pricing. The current situation leaves considerable scope for negotiation on a case specific basis, but equally creates uncertainty and may lead to unnecessary requests for determination in line with S.40 of the WIA. In our water trading paper<sup>2</sup>, we called on Ofwat to "*Develop a fair and transparent pricing framework for the market, underpinned by the use of marginal costs.*" We would encourage Ofwat to continue working with the industry to develop such a framework, rather than waiting for a series of precedent determinations. Given the recent inclusion of a water trading incentive in the Future Price Limits methodology, we would expect water trades that receive the buyer or seller incentive

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<sup>1</sup> [http://www.ofwat.gov.uk/competition/inset/pap\\_pos110228navbulksupply.pdf](http://www.ofwat.gov.uk/competition/inset/pap_pos110228navbulksupply.pdf)

<sup>2</sup> Changing Course through Water Trading (June 2011);

[http://www.stwater.co.uk/upload/pdf/STW\\_Water\\_Trading\\_FINAL\\_9\\_June\\_2011.pdf](http://www.stwater.co.uk/upload/pdf/STW_Water_Trading_FINAL_9_June_2011.pdf)

to be priced on a broadly consistent basis. In the absence of specific guidance this may well be achieved through determinations.

A first step in developing the methodology would be to set out in what circumstances various price terms might be appropriate and, in particular, how the non-price terms of a bulk supply agreement might impact upon the price that the recipient should pay. For example, in section 4.7, the draft guidance states that the receiving company might accept temporary interruptions in supply in return for a lower price. It would be helpful to have some guidance on factors to consider in calculating the price variance for taking this additional risk. We would be pleased to work with Ofwat and others in developing this methodology.

### **Security of supply**

The main barrier to water trading which can be addressed through the negotiation of a bulk supply agreement is the concern of water companies about security of supply and the concern that, in times of drought, for example, a donor company may choose to stop supplying water under a bulk supply agreement in order to use that water within its own area of appointment. Section 4.10 of the draft guidance includes terms which companies could consider including which would apply in times of water shortage. We would welcome some further guidance from Ofwat on how these terms may affect the price that a receiving company should be expected to pay.

### **Liabilities and remedies for breach**

One of the barriers to water trading which has been identified is a preference for water companies to own and control their own water resources rather than rely on a supply from the third party. The receiving company's remedies for a breach of the donor company's supply obligations are therefore key in providing confidence to receiving companies that a donor company will comply with its obligations. The draft guidance could be improved by including examples of the remedies that a receiving company may have if the donor company does not comply with its obligations.

### **Integrated set of guidance**

Currently the draft guidance provides a range of items to consider when setting prices. The February 2011 document, "*Bulk supply pricing – a statement of our policy principles*" contains detailed principles for the fixing of prices. And subsequently, the final determination of the *Dwr Cymru - Albion Water case (November 2011)* contains specific pricing factors to consider for various types of bulk supplies (non-potable, emergency supplies and case specific versus general supplies). Going forward once further work has been done on pricing principles, we would recommend creating a single integrated guidance document would prevent confusion between these documents and allow continual improvement and adaptation over time. For example, the Regulatory Accounting Guidelines, (currently in their 5<sup>th</sup> edition) contain all the relevant guidance relating to regulatory accounts and has developed over the years.

If you have any queries on the above, please do not hesitate to contact Kristin Garrett on 07703 717879, [Kristin.garrett@severntrent.co.uk](mailto:Kristin.garrett@severntrent.co.uk), or myself Neil Corrigan on 07917 013 436, [Neil.corrigan@severntrent.co.uk](mailto:Neil.corrigan@severntrent.co.uk).

Yours sincerely



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