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Dear Peter

WATER TRADING INCENTIVES: DŴR CYMRU TRADING AND PROCUREMENT CODE

Thank you for your invitation to comment on Ofwat's 24 November 2015 consultation on Dŵr Cymru's draft trading and procurement code. We set out some general comments first, and then make two specific points.

Thames Water wholeheartedly supports water trading and welcomes the incentive framework put in place by Ofwat to encourage trading and the more efficient allocation of resources. In practice, however, the potential scope for water trading in south east England is likely to be limited. For example, our Water Resource Management Plan ("WRMP") highlights the fact that our baseline forecast indicates significant deficits in four of our Water Resource Zones ("WRZs") and only small surpluses in our other two WRZs. It would be prudent, therefore, for Ofwat, water companies and third parties to maintain a realistic expectation of the scope and scale of potential benefits of further water trades. We have written to you separately on this point in relation to Table 12 in Annex 2 of Appendix 2 of the December 2015 Water 2020 document.

Establishing a Trading and Procurement Code – like the Network Access Code – has two important benefits. First, it helps to standardise the basis for negotiating trades by setting out a clear set of assumptions and terms, including the process for agreeing trades in a rational and non-discriminatory manner. This helps to assure Ofwat and trading partners that trades will be conducted efficiently and properly. Second, it gives potential trading partners a greater understanding of the context for trading, showing where water is relatively scarce or plentiful in each company's water resource zones and how the natural environment shapes the company's approach to managing water resources. In conjunction with a company's water resource management plan, the Trading and Procurement Code should promote greater efficiency in the allocation of water resources, for the overall benefit of customers and the natural environment. It is also important, however, that the drive for greater efficiency and transparency does not hamper a company's ability negotiate on a commercial basis. Trading partners should not be given an unfair commercial advantage over incumbent companies. To do so means customers end up paying

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more than they otherwise would have done. Ofwat needs to recognise this as it develops its Water2020 proposals for a water resources price control and information database.

Our specific points are as follows, and are based on our understanding of Ofwat's guidance on preparing the Trading and Procurement Code (set out in the July 2013 PR14 final methodology paper and Appendix 3).

First, Dŵr Cymru's draft trading and procurement code is well drafted and accessible. It achieves the aim of being a relatively simple document, avoiding administrative burden but allowing scrutiny of agreed trades and providing relevant context for water trading. The length and balance of the document feels about right, with content split evenly between background information and the trading principles. Importantly, the draft trading and procurement code recognises that it is not a document that can be read in isolation, and that successful water trades need to be supported by reference to WRMPs and Network Access Codes.

Second, we note that Dŵr Cymru defines a qualifying trade as one which is agreed with another water company. We interpret the Ofwat guidance more widely. Page 24 of the main PR14 methodology paper says "incentives will apply only to relevant price regulated companies" but is not clear whether both trading parties need to be incumbents. We believe the scope for trading and the potential benefits from trading could be greater if appointees were able to receive incentives from trading with non-incumbents (including commercial customers). It seems sensible to encourage appointees to seek new water from all possible sources. Also, excluding imports from non-incumbents from the incentive framework could bias the water resources market away from 3rd parties – in direct contradiction to the aims of Ofwat's Water2020 proposals.

We believe it is important for the correct application of the incentive framework if Ofwat clarified this ambiguity as soon as possible. One opportunity to do so could be in the form of an update to the PR14 Reconciliation Rule Book.

I reiterate our support for water trading and the work Ofwat is doing to improve the management of water resources for the benefit of customers and the environment. We are happy to discuss these points with you in more detail, if you would find that helpful.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Colm Gibson', is written over a light blue rectangular background.

Colm Gibson
Head of Economic Regulation