

SEVERN

TRENT

Trading and Procurement Code

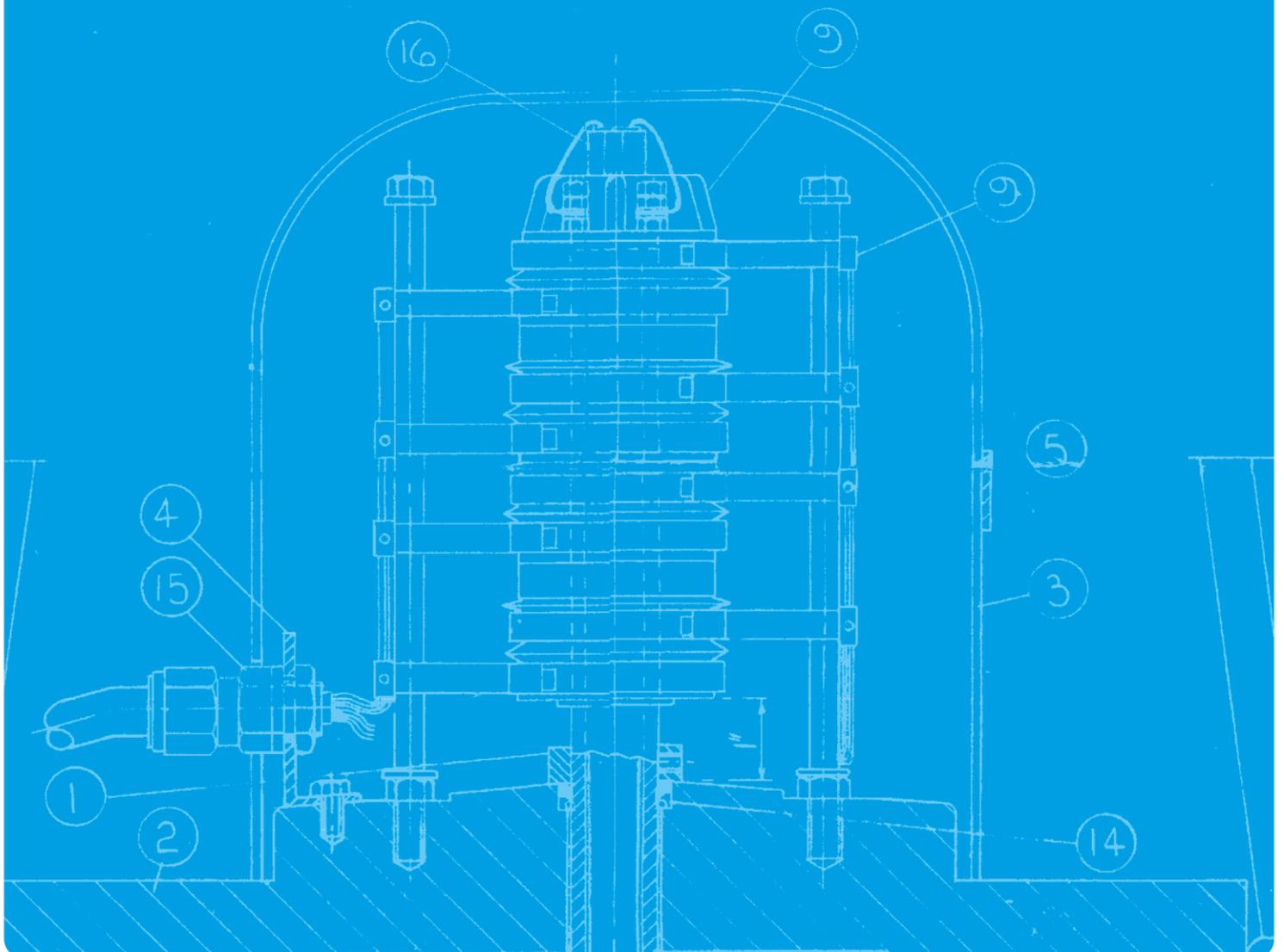
Ofwat-approved

Severn Trent Water

Version 1.1

Author William Mackveley

Date November 2017



Trading and Procurement Code

Document guide

- Section 1 introduces our Trading and Procurement Code;
- Section 2 introduces Severn Trent, our main regulators, water resources and position on water trading (including existing trades);
- Section 3 sets out the key principles of water trades;
- Section 4 contains a glossary of terms
- Section 5 provides useful reference materials.

Version control

Version	Date Completed	Comments
1.0	August 2017	Original document
1.1	November 2017	Ofwat-approved code

1.0 Introduction:

This is the Severn Trent Water (Severn Trent) Trading and Procurement Code (“Code”). It has been written to clarify the policies, principles and requirements that are applicable when third parties, including other water companies enter into trades with Severn Trent.

1.1 Purpose of the Code:

In this Code we make clear our position that we are in principle willing to trade with third parties including other appointed water companies in a sustainable manner for economically efficient volumes of water. This includes raw, part and fully treated water.

Ofwat, the Water Services Regulation Authority is keen to encourage water trading between appointed water companies and other third parties where it is environmentally and economically rational to do so. Ofwat introduced a financial incentive at the 2014 Price Review (PR14) to further encourage water trading in companies’ water resource management plans (WRMPs), where it is efficient to do so. To protect customers, Ofwat requires appointed water companies wishing to benefit from the financial trading incentives to be able to demonstrate compliance with an approved Trading and Procurement Code. Ofwat will assess new trades for compliance at the next price review (PR19), to determine if a trade qualifies for a financial incentive.

1.2 Use of the Code:

This Code should be read in conjunction with the Severn Trent Water Network Access Code, available on our website. Where we enter into a trade for the export of water, such trades will be carried out in accordance with the operational and commercial arrangements contained within the Network Access Code.

We expect this Code to form part of a wider set of tools being developed by Ofwat to further encourage efficient water trading. We will keep our Code updates in accordance with Ofwat’s requirements and principles.

This Code will be available to view on our website.

1.3 Contact Details:

Any queries or clarifications relating to this Code should be directed to:

Mr William Mackveley
Senior Business Strategy Analyst
Strategy and Regulation
Severn Trent Plc
Severn Trent Centre, 2 St John’s Street, Coventry, West Midlands, CV1 2LZ.
Email: William.Mackveley@severntrent.co.uk

Any general queries relating to our Water Resource Management Plan should be directed to:

Mr Marcus O’Kane
Wholesale Environment Planning and Strategy Manager
Wholesale Finance and Performance
Severn Trent Water

Severn Trent Centre, 2 St John's Street, Coventry, West Midlands, CV1 2LZ.
Email: Marcus.O'Kane@severntrent.co.uk

2.0 The Severn Trent position on water trading

This section provides an overview of Severn Trent, our water resources, our position on water trading, and an overview of our main regulators.

2.1 Severn Trent:

Severn Trent is an appointed water and wastewater company providing clean water to 7.7 million people, and sewerage services to 8.7 million people in an area covering 21,000 square kilometres in the Midlands and mid-Wales. It is one of the largest companies in England and Wales, and is listed on the London Stock Exchange in the FTSE100.

Our area of operation shares borders with Dŵr Cymru (Welsh Water), Dee Valley Water, United Utilities, Yorkshire Water, Anglian Water, Thames Water, Bristol Water, Wessex Water and South Staffs Water. We also border on the areas served by newly appointed water undertakers (NAVs) including Independent Water Networks Ltd and SSE.

The water and wastewater supply areas are shown below in figure 1.

Figure 1: Water and Wastewater Supply Areas



2.2 Our Regulators:

We provide water and wastewater services to our customers in line with economic, environmental and drinking water quality regulations in accordance with UK and EU law, including the Water Industry Act 1991, the Competition Act 1998, the European Habitats Directive and the Water Framework Directive these are enforced by our regulators:

- Water Services Regulation Authority (Ofwat) is a non-ministerial government department, they are the economic regulator for the water and sewerage sectors in England and Wales, and are responsible for ensuring that the appointed companies provide consumers with a good quality and efficient service at a fair price. Ofwat seeks to encourage water trading between appointed water companies and non-water companies, and has developed a financial incentive to facilitate this.
- Drinking Water Inspectorate (DWI) was formed in 1990 to provide independent reassurance that water supplies in England and Wales are safe and drinking water quality is acceptable to consumers.
- Environment Agency is our main environmental regulator and regulates our environmental activities in England.
- Natural Resources Wales regulate our environmental activities in Wales.

2.3 Water resources:

For the purposes of water resources planning, we divide the company supply area up into 15 (water resource zones) WRZs. These zones vary widely in scale, from the Strategic Grid which supplies the majority of our customers, to the small WRZs of Mardy and Bishops Castle which supply much smaller populations.

Our 15 WRZs as shown below in figure 2.

Figure 2. Water Resource Zones



Our WRMP is a 5 yearly document we publish to explain our proposals for making sure we have enough water available, in the right place and at the right time to supply our customers in an affordable and sustainable way to 2040.

Over the next 25 years we face a number of challenges which we must address in order to maintain reliable water supplies to customers. Our plan in 2014 included:

- Replacing approximately 85 million litres per day of licensed water abstraction that is no longer environmentally sustainable due to tighter environmental regulations;
- Meeting the demand for water from the additional 1.6 million people expected to be living in the region;
- Coping with potentially lower river flows during dry periods as a result of climate change; and;
- Ensuring that we invest at an appropriate rate to address asset deterioration as our network ages.

Without new investment, our Strategic Grid and Nottinghamshire WRZs face some significant supply shortfalls in the long term as a result of the need to reduce abstraction from unsustainable sources and the potential impacts of climate change. These two zones will require new sources of water supply.

Our other 13 WRZs are less impacted by the need to reduce unsustainable abstractions, our modelling also shows they are more resilient to the impacts of future climate change risks. As a result our long term plans in these zones are to optimise the operation of our existing sources, and to manage demand through water efficiency and leakage control measures. This position will be updated as part of the WRMP19 process.

2.4 Water trading

We fully support water trading between companies where it is environmentally and economically rational to do so. Water trading can be a means of ensuring that existing water resources are used more efficiently and effectively, when water is traded from areas of surplus to areas of deficit. Trading has the potential to protect customers' water bills by helping to reduce the costs of developing new water resources.

We have 43 bulk import and 24 bulk export supply agreements with a number of our neighbouring water companies. Our largest import is with Welsh Water via the Elan Valley Aqueduct, averaging over 300MI/day, and our largest export is with Yorkshire Water averaging over 50MI/day.

We are actively involved with the water resilience planning of our neighbouring water companies through our participation in the Water Resources East (WRE) and Water Resources South East (WRSE) working groups. We have setup a river Severn work group to better understand the environmental and regulatory effects of water trading along the river, and also to provide a forum for other stakeholders, including regulators and other water companies to share their views on using the river Severn for additional water trading.

3.0 Key principles of the Trading and Procurement Code:

We are prepared to trade with both appointed water companies and other third parties in a non-discriminatory, transparent and responsible manner. Such qualifying trades will only be agreed to when there is sufficient evidence to ensure that there will be no detrimental impacts to either our customers or the natural environment. We will also only agree to import trades where it is economically beneficial to do so when taking into account quantity, quality, environmental and other relevant criteria.

Our Code is aligned to the guidance offered by Ofwat concerning water trading, any qualifying trades we take part in will be conducted in accordance with this Code. Any appointed water company wishing to receive an incentive for trading, both from imports and exports, must conform to an Ofwat-approved Trading and Procurement Code.

We will keep our Ofwat-approved Code up to date with Ofwat's requirements and principles, and make publically available on our website.

Water trade exports made by us will be done so in accordance with our Network Access Code, the latest version of which can be found on our website. For all qualifying trades, we will share with Ofwat the processes followed to demonstrate compliance with the Code when applying for water trading incentives. This should reassure both regulators and potential trade partners of the open and transparent processes.

The following Trading and Procurement principles, which set out the way we will approach proposed water trades with companies and third parties, are based on the guidance published by Ofwat.

3.1 Transparency and audit:

We are committed to following transparent processes for assessing and operating water trades, as evidenced by the methodologies set out in our WRMP, without compromising the commercial position of any potential trading partner. We remain committed to working constructively with other stakeholders.

For all successful qualifying trades we will prepare an audit report that will examine the processes followed during the trade negotiations, and demonstrate that we have complied with all aspects of this Code. This will be submitted alongside our business plan for PR19.

3.2 Contract durations:

We will seek contract lengths that are fair and proportionate to both parties. Where large volumes of water are to be traded, we would prefer contracts of duration greater than 25 years, with long notice periods. This should allow both parties sufficient time to make alternative arrangements where alternative sources of water are required to maintain resilient supplies.

3.3 Ending trades:

We currently have several import and export trades with other appointed water companies, and report to Ofwat on these trades on an annual basis. In order to qualify for trade incentives, the qualifying trade must have been agreed no earlier than July 2013 and be operating between April 2015 and March 2020. We assure Ofwat and other interested parties that we will not manipulate

any of our existing trades in order to falsely obtain trading incentives. We expect the same of our current trading partners. If we agree to any new water trades, the audit report prepared for Ofwat would evidence that the trades are new and not an existing one that had been artificially ended and restarted.

3.4 Assessing costs:

We will assess the costs of any potential water trade in the same manner to which options are considered in our WRMP. The environmental and economic credentials of all potential trades will be tested against the same Strategic Environmental Assessment (SEA) criteria as our internal schemes. We will take all reasonable steps to ensure costs are correctly allocated and fully recovered, and that trades are delivered at the least overall economic cost.

3.5 Relationship with WRMP:

Water trading will be considered equally against a number of options that will make up our WRMP 19 to maintain supply/demand balance across our 15 WRZs. The approach we will take for WRMP 19 will be similar to that taken at WRMP 14 (further details can be found in WRMP 14 Appendix D) and will comply with the latest water resources planning guidelines.

Trades are also considered as part of our involvement with the WRE and WRSE.

3.6 Economically rational trades:

We will commit to agree trades where it is economically sound and to the benefit of our customers, taking into consideration alternative supply and demand management schemes as part of the WRMP. A trade can only be economically rational if the whole-life cost is less than that of comparable alternatives, taking into consideration such factors as; water quality; sustainability; resilience; transport costs, etc.

3.7 Environmentally rational trades:

We are committed by UK law to protect the natural environment. Therefore all potential qualifying trades must not compromise our commitments. Our WRMP is aligned with these requirements, and we are proactively working with our environmental regulators to manage both water quality and flow issues arising from our abstractions. We will only agree to qualifying water trades where these would not have a negative environmental impact.

3.8 Imports to Severn Trent:

The following principles will be adhered to when pursuing qualifying trade imports:

Equal and fair treatment:

We will treat all current and prospective trading partners fairly. Trading options will be considered with the same level of scrutiny and rigour as our own internal supply / demand solution options as part of our WRMP.

Non-discriminatory procurement:

It is obligatory for all appointed water companies to consider water trades during the WRMP planning process. We are willing to enter into trade discussions with any third party on a non-discriminatory basis for example, we will provide all bidding parties with the same information.

As evidenced in Appendix 4 of our WRMP 14 we have considered a number of potential water trades with different parties.

Economic purchasing:

We will only agree to trades where it is economically efficient to do so. Such decisions will be based on the principles set out in our WRMP. This means that we can reassure our customers and regulators that we would only purchase the most economically sound water resources available, taking into consideration factors such as water quality and quantity.

Competitive processes:

Our future position for balancing water supply and demand makes it possible that an import from a third party would be feasible. We are obliged under UK and EU competition law and wholeheartedly support the use of competitive processes where more than one supplier is bidding to supply water. Should this be the case, a structured and competitive process would be applied to select the successful supplier. The details of which would be shared with Ofwat when applying for any water trading incentives.

Managing imports:

We manage our public water supply network over 15 discrete WRZs. We will work with our trade partners to ensure water imports into Severn Trent are as efficient as possible. Existing assets will be used where possible.

3.9 Exports from Severn Trent:

The following principles will be adhered to when pursuing qualifying trade exports:

Equal and fair treatment:

We will treat all current and prospective trading partners fairly. Trading options will be considered with the same level of scrutiny and rigour as our own internal supply / demand solution options as part of our WRMP.

Cost assessment:

All qualifying potential trades will have their costs assessed to the same level of detail as other options considered in the WRMP and will be based on whole-life costings. Economic, environmental and social characteristics will be analysed to ensure that the trade is beneficial and least cost overall. We will seek to allocate costs correctly and ensure that costs are fully recovered from any trade agreement.

Managing exports:

We will work with our trade partners to ensure our water exports are as efficient as possible, utilising existing assets and infrastructure to ensure costs are minimised where possible. Where new infrastructure and assets are required to enable exports, these will be built as efficiently as possible. If the whole life total cost threshold is in excess of £100 million we would look to consider using direct procurement from third parties as a means to deliver these investments.

3.10 Other key principles:

Assignment:

The trading partner must not assign a qualifying trade agreement to any other party, without the prior consent of Severn Trent Water.

Compliance:

We will comply with all relevant laws and legislation, including the Competition Act 1998, and expect the same from our trading partners. Trades will need to comply with the Severn Trent Water Network Access Code, where applicable. Regulators will be kept informed (where necessary) when qualifying trade proposals are received.

Cooperation:

Severn Trent and our trading partner(s) will cooperate with each other in the interests of the continuous provision of wholesome water in the case of potable trades and water resources in the case of raw water trades. Such provisions will take account of the maintenance and integrity of the public water network including associated treatment facilities where applicable.

Managing emergencies:

We will have primary responsibility for managing emergency procedures relating to our water networks and water resources. Trading partners will be expected to cooperate with our emergency procedures during times of emergency when security of public water supply is threatened.

Qualifying trade:

A qualifying trade is a new agreement with a third party including appointed water companies for the import of water and a new agreement with appointed water companies in the case of water exports. In order to qualify for trade incentives, the qualifying trade must have been agreed no earlier than July 2013 and be operating between April 2015 and March 2020.

Trade agreements:

A trade agreement will need to be signed by both parties before a qualifying trade can commence. Such agreements will contain the terms and conditions of the trade.

Trade effects:

All qualifying trades must have no detrimental impact to our customers in terms of service provision and/or water quality. In addition qualifying trades should have no detrimental impact on the natural environment.

Trade partners:

A qualifying trade must be made between wholly unrelated parties. This does not preclude other companies within the Severn Trent group entering into trades which do not qualify for water trading incentives.

Water quality:

Trades can be for potable, raw and part-treated water. Traders must abide by the Water Quality Protocols as specified by the DWI.

4.0 Glossary:

Abstraction	The process of removing water from the natural environment.
Abstraction License	The licence required to abstract water from the natural environment.
Consumer Council for Water (CCW)	The statutory consumer body for water and wastewater consumers in England and Wales.
DEFRA	Department for Environment, Food and Rural Affairs.
Drinking Water Inspectorate (DWI)	The Drinking Water Inspectorate (DWI) is the independent regulator of drinking water in England and Wales, ensuring that water companies supply safe drinking water that is acceptable to consumers and meets the standards set down in law.
Drought	A prolonged period of abnormally low rainfall, leading to a shortage of water. In the United Kingdom this is defined as 15 consecutive days with daily precipitation totals of less than 0.2mm.
Environment Agency (EA)	Regulator for the natural environment in England.
Instrument of Appointment	The water (and sewerage) companies operate under Instruments of Appointment, granted by the then Secretaries of State for the Environment and Wales, or by the Director, to provide water and sewerage services in England and Wales. The Instrument of Appointment imposes conditions on the companies, which the Director is required to enforce.
Megalitre (Ml)	1 million litres of water.
Natural England	Natural England is the non-departmental public body of the UK government responsible for ensuring that England's natural environment, including its land, flora and fauna, freshwater and marine environments, geology and soils, are protected and improved.
Natural Resources Wales	The regulator of the natural environment in Wales.
Ofwat	The Water Services Regulation Authority (Ofwat) is a non-ministerial government department they are the economic regulator for the water and sewerage sectors in England and Wales.
Potable	Water supplied for domestic consumption and/or food production purposes, as defined by the WIA91.
PR14 (PR19)	Periodic Review - every five years Ofwat, the economic regulator for the water and sewerage industry, sets price limits that enable water and

	sewerage companies to finance the delivery of services to customers, in line with relevant standards and requirements. The most recent was made in 2014 (PR14) and the next one is due in 2019 (PR19).
Price Control	The limits set by Ofwat on the charges that appointed companies can make for their services.
Sustainability Reduction	Reduction in licensed abstractions required by Environment Agency in England and Natural Resources Wales in Wales to ensure abstractions are not having a detrimental impact on the natural environment.
Water (and Sewerage) Undertaker	A company appointed under the WIA91 to provide water (and sewerage) services in respect of a geographical area of England and Wales.
Water Trade	An agreement between two or more companies to transfer water between them.
WIA91	The Water Industry Act 1991.
WRMP	The Water Resource Management Plan is an appointed water undertaker's strategic plan for managing water supply / demand balance over a 25 year period.
WRZ	Water Resource Zone, the largest possible zone in which all resources, including external transfers, can be shared and, hence, the zone in which all customers will experience the same risk of supply failure from a resource shortfall.

5.0 Useful reference materials:

The following list contains useful documents to accompany this Trading and Procurement Code.

Competition Act
Drinking Water Inspectorate
Environment Agency
Habitats Directive
Ofwat's Guidance on Trading and Procurement Codes
Natural Resources Wales
Severn Trent Water's Network Access Code
Severn Trent Water's Water Resource Management Plan 2014
Severn Trent Water's Water Resource Management Plan 2014 – Appendix D
Water Acts
Water Framework Directive
Water Resources East
Water Resources South East