

May 2018

Trust in water

Trading and procurement codes consultation – response document

About this document

On 15 February 2018, we issued [a consultation](#) on proposed updates to our guidance on trading and procurement codes. The consultation was published alongside a [draft updated guidance](#) document which set out the detail of the proposed updates. Trading and procurement codes are linked to our water trading incentives for water companies¹ and help protect customers and the environment by ensuring that only economically and environmentally beneficial trades will receive an incentive payment.

This document sets out the reasons why we have now issued updated guidance and the decisions we have reached after consideration of the consultation responses, including changes we have made from the draft guidance. It should be read in conjunction with our final guidance available at:

- [Trading and procurement codes – guidance on requirements and principles](#)

¹ In this document we use the term “water company” to mean a company that holds an appointment as a water and/or sewerage undertaker under the Water Industry Act 1991. This document applies to the 17 largest water companies in England and Wales that are subject to full price control regulation and therefore are able to produce trading and procurement codes to claim water trading incentives.

1. Executive summary

Water trading can benefit customers, the environment, and water companies. To encourage water trading our water trading incentives offer greater rewards for exporters and lower costs for importers for new trades. To protect customers and the environment we require water companies that want to claim the incentives to demonstrate new trades comply with an Ofwat-approved trading and procurement code. The requirement for codes and compliance with them ensures that only economically and environmentally beneficial trades will receive an incentive payment as part of our price review process.

We first published the requirements and principles companies should follow when producing their trading and procurement codes in 2013, as part of the 2014 price review (PR14) methodology. These are designed to ensure a well-functioning water trading market that works in the interests of customers and the environment. For example:

- the codes help protect the environment as incentives will not be available for any new trades that result in an increase in unsustainable abstractions; and
- the codes protect customers as incentives will not be available if companies procure supplies on a non-competitive basis or artificially end and restart existing trades.

Compliance with codes will be assessed as part of our price reviews, with incentives paid in subsequent periods.

In our [final methodology for the 2019 price review \(PR19\)](#) we confirmed we will maintain water trading incentives for new trades beginning in 2020-25 and maintain the requirement for trading and procurement codes to claim the incentives. We also noted that as the guidance for the codes is now over five years old it would need to be updated to reflect the latest market and regulatory developments and to provide early clarity on the requirements to claim incentives for new trades that start in 2020-25.

In our consultation issued in February we set out:

- **Changes to the guidance for new trades in 2020-25** - We proposed to modify a requirement to align with the decision to maintain incentives for 2020-25 period, and added three extra principles. The new principles ensured alignment with the separate water resources and network plus controls,

company bid assessment frameworks and aimed to provide greater evidence and transparency of assurance.

- **Changes to the approval process for new codes** – We proposed to streamline the approval process to include a shorter four week public consultation and then an automatic approval if no comments are received.
- **The update process for existing approved codes** – We proposed companies with approved codes based on the 2013 guidance would update them after the release of the updated final guidance and before PR19 business plan submission.

We received ten responses to the consultation. Across the questions there was a broad range of support for our proposals and the published final guidance confirms our changes and new approval process. However in light of stakeholder feedback we modified our approach to updating existing codes and have delayed this until 2020 to avoid clashes with business plan development and the water resources management plan (WRMP) process. A summary of responses received in each area and our final decision is provided in table 1.

Table 1 – Overview of consultation responses and our final decisions

Consultation area	Summary of respondents views	Our final decision
Changes to the guidance for new trades in 2020-25	All respondents supported the proposal to include the new requirement and three new principles in the guidance	For claims at the 2024 price review (PR24), the final guidance for trading and procurement codes is expanded to include requirements 1-3 and principles 1-12.
Changes to the approval process for new codes	All respondents agreed with the streamlined approval process for new codes	The approval process is now a four week consultation. If no comments are received the code is automatically approved.
The update process for existing approved codes	While there was broad support for our proposal one respondent suggesting delaying this update until after September 2018 to avoid clashes with business plan and WRMP development	To delay the timescale for updating existing codes to align with the final guidance until June 2020.

In the rest of this document we provide:

- a full overview of stakeholder views and our response (see section 2)
- a summary of next steps (see section 3)

2. Overview of respondents views

This section provides an overview of each consultation area, a summary of respondents' views, and a discussion of our analysis and final decision. It is structured as follows:

- Changes to the guidance for new trades in 2020-25 (see section 2.1)
- Changes to the approval process for new codes (see section 2.2)
- The update process for existing approved codes (see section 2.3)

2.1 Changes to the guidance for new trades in 2020-25

Our February consultation

We set out one new requirement and three new principles that would apply for incentive claims for new trades in 2020-25.

- **Requirement 2: The trade must be or have been operating between April 2015 and March 2025** - This brings our guidance in line with our decision to maintain water trading incentives at PR19.
- **Principle 10: Appropriate allocation of incentives between relevant controls** - To reflect our introduction of separate controls for water resources and network plus water at PR19, companies should ensure that incentive payments are allocated appropriately between the controls.
- **Principle 11: Consistency with the company's bid assessment framework** - To support the bidding market, where third party providers can bid to provide supply or demand options, at PR19 we will require companies to produce bid assessment frameworks. This link to the frameworks will strengthen their implementation and help ensure consistency between the two processes.
- **Principle 12: Evidence of assurance processes** - Assurance is in part already embedded in the requirement for transparency but introducing a separate principle helps formalise this requirement. This recognises the long-term nature of water trading and the importance of clear decision making and company ownership.

Respondents' views

All ten respondents agreed with the new additions to the code. Respondents noted that the changes were in line with the core expectations of any approach to trading

and were necessary and proportionate to ensure the effective operation of the codes in 2020-25.

There was also one request for clarification, as one company queried whether the new requirement would prevent companies claiming the balance of any incentive payments earned over 2015-20 at PR24.

Our analysis and final decision

Given the full agreement from respondents we confirm that the final guidance will include the new requirement and three new principles set out above and in full detail in section 3.1 of the final guidance. In response to the request for clarification we confirm that the requirement does not preclude companies claiming the balance of any incentive payment at PR24. We have added text to clarify this point to the final guidance.

2.2 Changes to the approval process for new codes

Our February consultation

We noted that while we have already approved a number of codes after a public consultation period, we had only received two consultation responses across all the consultations, both by large water companies on early codes. This low response rate indicated a need to change the approval process for new codes.

Reflecting on the low response rate we proposed to streamline our current approach by shortening the public consultation period to four weeks (from six) and to move to automatic code approval if no comments are received (rather than have an Ofwat approval process over six weeks). We noted this approach ensures consistency with codes that we have already approved while maintaining transparency and the opportunity for stakeholders to comment on draft codes.

Respondents' views

All ten respondents agreed with the revised approach to approving new codes. Respondents considered the changes were appropriate, reasonable, and efficient.

Our analysis and final decision

Given the full agreement from respondents we confirm that new codes will follow the streamlined approach for approval set out above and in full detail in section 4.1 of the final guidance.

2.3 The update process for existing approved codes

We noted that our previous guidance said Ofwat might conduct an annual review of approved codes and provide further guidance to companies by the end of June each year. Companies would have six weeks to make changes and resubmit the resulting draft code to Ofwat for approval.

We considered that the consultation and the updated guidance formed our review of the approved codes and hence we would expect the seven companies with existing approved codes to update and resubmit their codes to Ofwat for approval in June 2018. We noted that this would ensure all codes were aligned and updated in time for PR19 business plan submission.

Respondents' views

Nine respondents agreed with the proposed timelines and it was noted that it was in line with expectations. However one respondent disagreed with the timeline and proposed that the update process should be delayed until after the business plan submission in September 2018. Supporting this it was noted that the changes will only apply to water trades during 2020-25 (not those to be claimed at PR19) and the updated process in June would clash with business plan development and the WRMP process.

Our analysis and final decision

We have reviewed and reconsidered the options for the resubmission of codes and have decided to delay the requirement to update the existing approved codes until June 2020. This is later than the September 2018 timetable proposed by the respondent, but will ensure there are no clashes with the PR19 process for either Ofwat or the companies. It is also early enough in 2020-25 to provide certainty on the incentive arrangements for new water trades. Companies can submit their updated codes sooner than June 2020 if they feel it is appropriate.

For the avoidance of doubt this decision applies to the following seven water companies: Dee Valley Water, Dŵr Cymru, Northumbrian Water, Severn Trent Water, South East Water, Thames Water, and United Utilities.

3. Next steps

The table below summaries the key next steps for trading and procurement codes and water trading incentive claims.

Table 2 – Overview of timeline for trading and procurement codes and water trading incentives

Date	Item
May 2018	Ofwat publishes final guidance for trading and procurement codes .
June-August 2018	Any companies who do not have an approved trading and procurement code but would like to submit a water trading incentive claim at PR19 for a new trade in 2015-20 will need to get their codes approved. Any new codes should follow the final guidance published alongside this response document.
3 September 2018	Companies submit PR19 business plans and any water trading incentives claims for 2020-25. To submit a claim, water companies will need to have a trading and procurement code approved before business plan submission. Companies should submit: <ul style="list-style-type: none"> • the water trading reconciliation rulebook model – this was updated and rereleased alongside the PR19 final methodology to reflect the requirement for the incentive payments to be allocated between the water resources and network plus water controls; and • a short report setting out how the trades meet requirements 1-3 and principles 1-9 of the final guidance. This should include an overview of the trade itself, which explains the assets used across the water resources and network plus water controls. Justification should also be provided for the proposed split between the water resources and network plus water controls.
June 2020	The seven companies identified in section 2.3 will update their codes to include the new requirements for 2020-25 and submit them to Ofwat for approval.
PR24	The process for claims, including of the balance of any incentive payments from PR19, will be set out in the final methodology for PR24. Any new claims will need to demonstrate that requirements 1-3 and principles 1-12 of the final guidance are met.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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