

# Trading and Procurement Code

Draft for consultation

Wessex Water

June 2018

## 1. Introduction

This is Wessex Water's Trading and Procurement Code ("**Code**"). This Code sets out the policies, principles and requirements that apply when appointed water companies and third parties enter into water trading agreements with Wessex Water.

### 1.1 The purpose of this Code

Wessex Water Services Limited ("**Wessex Water**") is, in principle, keen to trade with other water companies and third parties that wish to either provide an export or receive an import of a reasonable volume of cost-effective water resource that can be reliably delivered to the agreed terms.

The Water Services and Regulation Authority ("**Ofwat**"), wants to encourage an increased level of water trading as it can bring a number of benefits to customers and the natural environment. In order to help encourage water trading, Ofwat has introduced water trading incentives for both exports and imports. In order to qualify and claim these incentives a company must produce and comply with an Ofwat-approved Trading and Procurement Code. Compliance with the Code will ensure that incentives are only available where trades are economically and environmentally beneficial.

### 1.2 Using the Code

We will keep this Ofwat approved Code up to date and publicly available via our website. Ofwat also publishes all approved Trading and Procurement Codes on its website.

This Code should be read in conjunction with our Water Supply Licencing Access Code ("**Access Code**"), which is available on our website. The Access Code sets out the operational and commercial arrangements that will govern applications for use of, and supply from, our supply system for the purposes of competition under the Water Supply Licence (WSL) provisions. Where we seek to import water, we will base these trades on the Access Code. The latest version of the Access Code is available on our website <http://www.wessexwater.co.uk/Wholesale-competition/>

### 1.3 Contact details

Please direct any queries relating to this Code, our Water Resources Management Plan or about water trading in general to:

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## 2. The background to Wessex Water's water trading

This section provides an overview of Wessex Water, including our water supply arrangements and the regulatory framework within which we operate.

### 2.1 Wessex Water

Wessex Water is a statutory water and wastewater company in southwest England (Figure 2-1). We supply water to 1.3 million people and nearly 50,000 businesses (via water retailers) and provide sewerage services to over 2.8 million people.

We supply around 340 million litres of water a day to customers, using more than 70 sources and water treatment works, and 11,800 km of water mains. We share borders with Bristol Water, South West Water, Bournemouth Water, Southern Water and Thames Water.

Figure 2-1: Wessex Water supply area



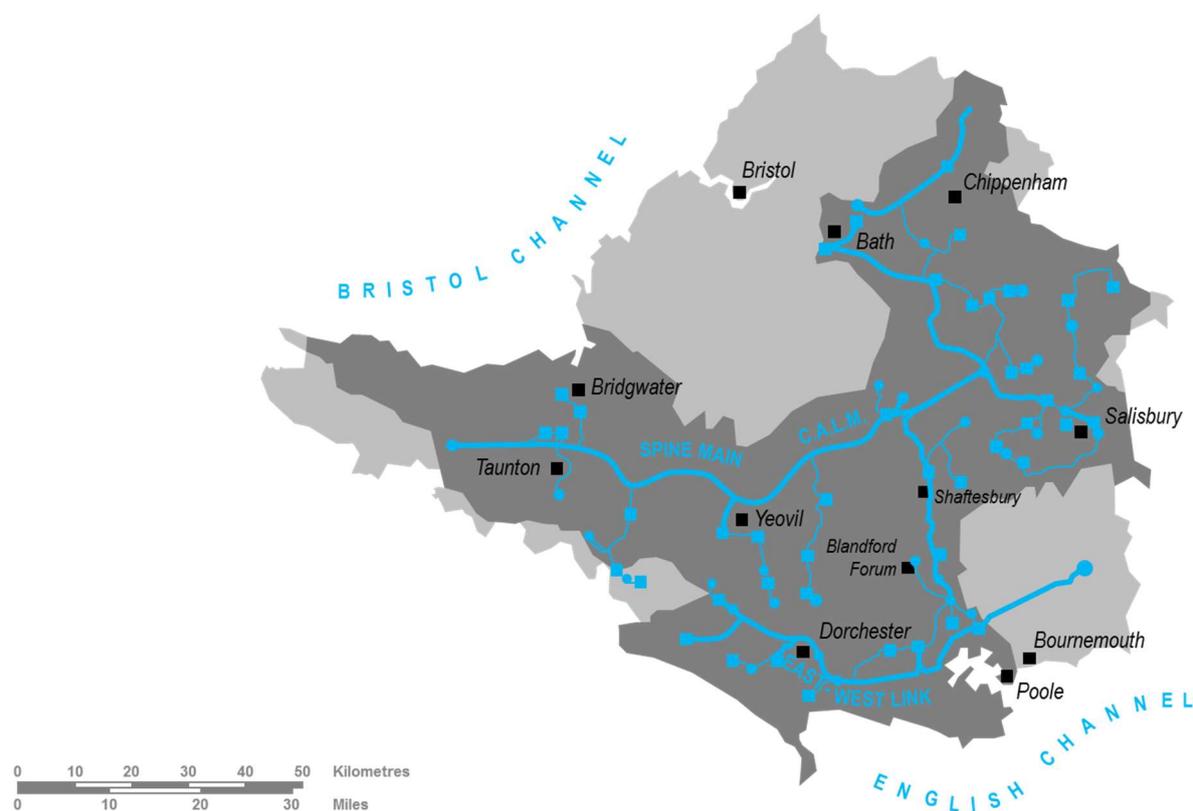
### 2.2 Water Resources

We operate our supply system as a single water resource zone (Figure 2-2). Recent investments to our supply grid has increased connectivity across our region between areas of surplus water to areas of demand. This investment has also delivered environmental improvements and enhanced resilience for our customers, without the need to develop new water sources.

Approximately 75% of the water we supply comes from boreholes and springs that tap into the chalk and limestone aquifers of Wiltshire and Dorset. The remaining 25% of water originates from reservoirs in Somerset.

Through the water resources management planning process, every five years we assess whether we have sufficient water supply to meet our customers' needs. The latest round of planning has identified that we have a surplus of supply over demand for the next 25 years – see [www.wessexwater/waterplan](http://www.wessexwater/waterplan) for more details.

**Figure 2-2: Integrated water supply network showing strategic mains, sources and reservoirs**



## 2.3 Regulatory framework

As an appointed water undertaker, we operate under a comprehensive framework of statutory and regulatory obligations, which are set out in UK and EU legislation, including the Water Industry Act 1991 (as amended by the Water Act 2003 and Water Act 2014), the Competition Act 1998, the European Habitats Directive, and Water Framework Directive. These obligations set out the specific environmental and economic standards which we must meet. We are regulated by the following bodies:

- **Ofwat**, the economic regulator for all appointed water and wastewater companies and water-only companies in England and Wales. Ofwat sets limits on the charges that these companies can make for their services (“price controls”), in a 5-year Periodic Review process.
- The **Environment Agency (EA)**, responsible for regulating the amount of water companies are allowed to sustainably abstract from the environment, and for

protecting and improving the quality of water bodies. The EA issues companies with abstraction licences and discharge consents.

- The **Drinking Water Inspectorate (DWI)**, responsible for providing independent reassurance that water supplies in England and Wales are safe and that drinking water quality is acceptable to consumers.

## 2.4 Water trading

Wessex Water recognises that as a company with surplus supply, we have a role to play in bringing about environmental, customer and economic benefits by trading with companies that have projected deficits in supply.

Our current water supply infrastructure is not entirely isolated from other companies, and we already have arrangements for bulk water trading of treated water with several neighbouring appointed water companies including new appointments and variations (NAVs). We do not currently have any raw water trading agreements in place.

We have ten existing import arrangements. Seven of which are for transfers of less than 1 MI/d to help support small communities near the boundary of our supply area. Two of the arrangements are for imports of between 1 to 3 MI/d and we have a larger strategic import from Bristol Water near Bath that can be used at volumes of around 11 MI/d.

We have eight existing export arrangements all of which amount to less than 1 MI/d on average.

In addition to providing baseload water supply to an area, trading also presents an opportunity to develop greater operational resilience for planned and unexpected outage events. An example of this is the bi-directional resilience supply agreement with Bournemouth Water. This allows the transfer of up to 10 MI/d between the two companies and up to 20 MI/d on a short-term emergency basis thereby improving the local resilience in the Poole and Bournemouth area.

In 2017, we became a founding member of the West Country Water Resources Group. The group was formed to discuss common water resource issues and explore future opportunities to ensure the best use of resources both within the south west region and outside, by transfer to other companies.

### 3. Principles of the Code

Wessex Water is committed to trading with other water companies and third parties in a transparent, sustainable and responsible manner that will benefit our customers and the natural environment.

To claim incentives Wessex Water must demonstrate that new water trades comply with an Ofwat-approved trading and procurement code. Ofwat has provided guidance on the requirements and general principles to be included in a Code.

In the sections below, Wessex Water sets out its approach to water trading and how we have followed the Ofwat guidance. This Code provides the basis for more detailed, commercial negotiations with potential trade parties.

#### 3.1 Trading requirements

To qualify for an incentive payment, water trades (export or import) must:

- **be agreed in July 2013 or later.** This means that a contract relating to the water trading arrangement must be signed by both parties;
- **be or have been operating between April 2015 and March 2025.** The agreement must be operating in practice and generating revenues during the 2015-20 price control period (1 April 2015 to 31 March 2020) or the 2020-25 price control period (1 April 2020 to 31 March 2025). The export incentive will not reward revenues accrued before 1 April 2015. The import incentive applies to expenditure during the relevant price control period only.
- **be between unrelated parties.** Water trading should be between unrelated entities and not within the same group of companies.

#### 3.2 Principles

Wessex Water is committed to following the high-level principles identified by Ofwat and these principles will govern the way in which Wessex Water negotiates and enters into water trading agreements.

##### 3.2.1 *Principles that will be followed when we are seeking a water trade import*

###### Non-discriminatory procurement by importers (Ofwat Principle 1)

The water resources planning process requires appointed water companies to consider new water trading opportunities. Wessex Water commits to undertaking new trading discussions on a non-discriminatory basis and as such will provide all parties with consistent information.

###### Economic purchasing by importers (Ofwat Principle 2)

In contracting for the provision of water resources, Wessex Water will purchase from the most economical sources available, having regard to the quality, quantity and other relevant aspects.

### Use of competitive processes by importers (Ofwat Principle 3)

Where appropriate, Wessex Water will seek to secure water supplies through an appropriate competitive process.

### **3.2.2 Principles that will be followed when we are seeking to export water**

#### Correct assessment of costs (Ofwat Principle 9)

Wessex Water does not have standard tariffs against which export charges will be based. Charges will be calculated to ensure the cost of the export agreement is fully recovered having conducted an accurate assessment of the cost of supplying the maximum volumes reserved by the agreement. This assessment will include maintenance and operation costs of specific infrastructure in place to supply the export. The cost of abstraction, storage and transmission pumping costs will be apportioned to the supply and, where appropriate, any opportunity costs of entering the agreement will be taken into consideration. Where appropriate, export charges may use wholesale charges as a basis of the calculation. Where possible, Wessex Water will use existing infrastructure to minimise the costs of a trade.

### **3.2.3 Principles that will be applied to all water trades (imports and exports) with companies and third parties**

#### Contract lengths (Ofwat Principle 4)

We are committed to negotiating fair and reasonable trading arrangements that meet the needs of both the importer and the exporter. Arrangements will be guided by the framework set out in the 2013 *Negotiating Bulk Supplies* publication by Ofwat.

Wessex Water commits to a reasonable contract duration that is appropriate to the nature of the supply and any case-specific factors.

In the case of a new export, the duration will take into account any risks to existing customers, including the payback duration of any infrastructure developments required to facilitate the transfer. Transfer volumes should not alter Wessex Water's overall supply-demand balance in its supply area from a position of surplus to one of deficit during the term of the contract. If the supply is related to a specific source, the contract duration should not exceed the constraints of any time limited abstraction licences.

In the case of a new import, the duration should be for a long-enough period to represent a meaningful contribution to system resilience or deployable output with due regard for the five-yearly cycle of water resources management planning. Where appropriate, notice periods will be linked to the time it will take to develop alternative sources of water.

#### Transparency (Ofwat Principle 5)

Information about our water resources position is set out in our Water Resources Management Plan – this is updated every five years following public consultation and made available on our website: <http://www.wessexwater.co.uk/waterplan/>

Alongside our Water Resources Management Plan, Wessex Water also publishes key information to support the bidding market for water resources, demand management and

leakage services. This 'market information' is available on our website via the weblink above and also on Ofwat's website<sup>1</sup>.

For new trading arrangements that qualify with the conditions set out in Section 3.1 of this Code, our technical external auditor will undertake an audit to review compliance with this Code. The audit report will be included as part of any Business Plan submission where Wessex Water considers there is a qualifying arrangement. We will also make the audit report available to Defra, the Environment Agency and the Drinking water Inspectorate.

Wessex Water regularly engages with stakeholders and third parties through many forums including the Wessex Water Partnership (WWP) and Catchment Panel. The WWP monitors and reports on the delivery of Wessex Water's current investment programme against outcomes and performance commitments. It also provides advice and challenge on policy areas such as customer engagement, customer service, affordability, tariffs and preparation for the next price review. It is independently chaired and members of the panel include representatives from the Environment Agency and the Consumer Council for Water.

The Catchment Panel meets quarterly to review and challenge Wessex Water's environmental performance and progress towards the delivery of the current environmental programme against outcomes and performance commitments. It also provides advice and challenge on policy areas and preparation for the next price review. Members of the Catchment Panel include representatives from the Environment Agency, Natural England, the National Farmers Union, RSB, WWF-UK and academia.

Wessex Water also shares information with other companies about supply demand water availability and potential trading opportunities through the West Country Water Resources Group.

Wessex Water is subject to the Environmental Information Regulations 2004 – when requests are made for environmental information we endeavour to respond with the information in a timely manner, in accordance with the Regulations.

#### [Link to water resources management plans \(Ofwat Principle 6\)](#)

Wessex Water's Water Resources Management Plan is developed following the latest regulatory guidelines. The identification of potential deficits in the supply demand balance will be addressed by the analysis of options to either provide new supplies or reduce demand. New water trading agreements will be considered equally against other possible options and developed in a manner that is consistent with this Code.

Similarly, the identification of surplus in the supply demand balance allows Wessex Water to explore new water exports to support neighbouring companies with projected deficits.

Details of our latest water resources management plan can be found here:

[www.wessexwater.com/waterplan](http://www.wessexwater.com/waterplan).

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<sup>1</sup> <https://www.ofwat.gov.uk/regulated-companies/markets/water-bidding-market/water-resources-market-information/>

Regional trading opportunities are also considered by the West Country Water Resources Group of which Wessex Water is a member.

#### Rational economic and environmental flows (Ofwat Principle 7)

Wessex Water will ensure that any new trades are both economically and environmentally rational.

Economic modelling will be undertaken to ensure the economic rationality of a new water trading agreement.

For new exports, Wessex Water will consider the payback duration of any infrastructure developments necessary to facilitate the transfer. Wessex Water will also consider the income benefits and any impacts on customer bills.

For new imports, Wessex Water will undertake a cost benefit assessment process which considers a range of factors including required construction costs, environmental and social costs and benefits (including carbon), capital maintenance costs and operational costs.

A basic premise of the Water Resources Management Plan is that abstraction should only occur at environmentally sustainable levels. Where concerns have been raised at specific sources Wessex Water has undertaken investigations in collaboration with the Environment Agency to determine the impact. Where necessary, abstraction licence changes have been agreed. Wessex Water expects that any new trading arrangements will ensure and demonstrate environmental rationality to ensure the continued protection of environmentally sensitive abstraction sites.

For new export arrangements, Wessex Water will provide information to the potential importer on the sustainability of the sources involved in the transfer and would expect similar information from any company or third party that Wessex Water imports water from.

#### No artificial ending of trades (Ofwat Principle 8)

Wessex Water reports to Ofwat on the import and export arrangements it has with other companies through information submitted annually and as part of the Water Resources Management Plan.

Wessex Water provides assurance that it will comply with the guidance and not seek to artificially end any existing trading arrangement to exploit the incentives for trading. Wessex Water expects all trading partners to take a similar approach to the maintenance of existing trade agreements.

Upon the agreement of a new trade, Wessex Water will implement internal audit and reporting measures that will document compliance with this Code and evidence that the trade was new and not one that had been artificially ended and restarted.

### Appropriate allocation of incentives between relevant controls

Upon seeking to claim incentives for new water trading agreements, Wessex Water will allocate the incentives to the relevant price controls following the guidelines set out in Ofwat's final methodology for the 2019 price review (Section 4.3.1 of Appendix 5) that categorises trades into three types:

1. Source to source: trades of raw water, primarily concerning only raw water assets for both the exporter and importer;
2. Source to raw water distribution/storage: which would involve the transfer of raw water from the exporter's water resources assets to the water distribution or storage assets of the importer; and
3. Treated to distribution network: involving the transfer of potable water between network plus water assets of the exporter and importer

Wessex Water will allocate the export incentive based on the costs of making a trade and will allocate the import incentive based on the charges paid for the trade. For example, raw water transfers (Type 1) will be allocated entirely to the water resources price control whereas treated water trades (Type 3) will require the incentive to be appropriately proportioned allocated across both the water resources and network plus controls.

### Consistency with the company's bid assessment framework

Wessex Water's bid assessment framework will be submitted as part of the PR19 business plan in September 2018. The bid assessment framework has been prepared in accordance with Appendix 8 of Ofwat's PR19 final methodology<sup>2</sup>. The framework will support the bidding market for water resources, demand management and leakage services and is therefore relevant to overall resource management and future trading opportunities.

This Code will be consistent with the bid assessment framework.

### Evidence of assurance processes.

For new trading arrangements that qualify with the conditions set out in Section 3.1 of this Code, our technical external auditor will undertake an audit to review compliance with this Code. The audit report will be included as part of any Business Plan submission where Wessex Water considers there is a qualifying arrangement.

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<sup>2</sup> <https://www.ofwat.gov.uk/publication/delivering-water-2020-final-methodology-2019-price-review-appendix-8-company-bid-assessment-framework-principles/>

## 4. Glossary

Abstraction	The process of removing water from the natural environment.
Abstraction license	The licence required to abstract water from the natural environment.
Access Code	Water Supply Licencing Access Code. Sets out the operational and commercial arrangements that will govern applications for use of, and supply from, our supply system.
Discharge consent	Consent issued by the Environment Agency to discharge potentially polluting liquids to water courses and groundwater
Drinking Water Inspectorate (DWI)	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.
Environment Agency (EA)	Regulator for the natural environment in England.
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.
Ofwat	The Water Services Regulation Authority (Ofwat) is the economic regulator for the water and sewerage sectors in England and Wales.
Periodic review	every five years Ofwat sets price limits that enable water and sewerage companies to finance the delivery of services to customers, in line with relevant standards and requirements.
Supply demand balance	A calculation undertaken through the water resources planning process to determine the balance (surplus or deficit) between the demand for water and available supplies.
Water Resources Management Plan (WRMP)	A strategic plan for managing water supply demand balance over a 25 year period that appointed water undertakers have a statutory responsibility to prepare and maintain.
Water resource zone	An area or unit in which the management of demand and supply is largely self-contained (although may include bulk transfers) and customers in the zone experience the same level of service.