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South West Water Bournemouth Water

Trading and Procurement Code

Draft for Consultation July 2018



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1 Introduction

This is the South West Water Trading and Procurement Code (“Code”). This document has been written to set out the policies, principles and requirements that will apply when appointed water companies and third parties enter into water trading arrangements with South West Water.

This code covers the three water resources zones (WRZ) in the south west peninsula and also the Bournemouth WRZ

1.1 Purpose of the Code

Ofwat, the Water Services Regulation Authority, introduced water trading incentives at the 2014 price review (PR14) to encourage water trading. To protect customers and the environment, Ofwat requires that water companies who want to claim the incentives comply with an approved Trading and Procurement Code, demonstrating that all trades entered into are both economically and environmentally beneficial. Ofwat will assess new trades for compliance as part of the next price review (PR19), with incentives for qualifying trades being paid in the next period.

Through publication of this code, we provide reassurance to potential market participants that we are willing to trade with any other water company and third party, provided that the trade is for economically and environmentally rational sources of water that will make a beneficial contribution to our/their water resources position.

1.2 Use of the Code

South West Water will keep its Trading and Procurement Code up to date and publicly available, via its website. The approved code will also be available on the Ofwat website.

This code should be read in conjunction with the South West Water Access Code, which sets out how licensed entrants to the industry can use the company’s public water supply system to supply water to a customer’s premises, through a supply of water introduced by the licensee into the supply system. The latest version of the Access Code is available on the South West Water website.

1.3 Contact Details

Please direct any questions relating this code to - marketenquiries@southwestwater.co.uk

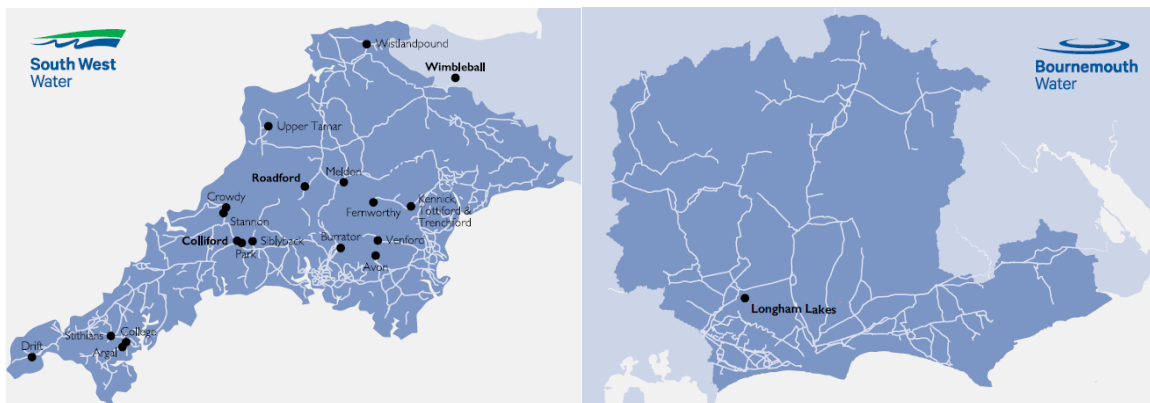
2 Our position on water trading

This section provides an overview of South West Water, our main regulators, our water resources and an overview of our position on water trading.

2.1 South West Water

South West Water provides regulated water and wastewater services to a population of 1.7 million across Devon, Cornwall and parts of Dorset and Somerset.

From 1 April 2016, the trade and assets of Bournemouth Water were merged into South West Water Limited. Bournemouth Water's licence as a water only undertaker under the Water Act 1991 was terminated and South West Water's licence was modified to cover the Bournemouth Water area. South West Water Limited is therefore responsible for delivering services in both the original South West Water area of operation and the Bournemouth Water area of operation.



2.2 Our Regulators and Watchdogs

South West Water operates under a number of statutory obligations including those detailed within the Water Industry Act, the Companies Act, the South West Water Licence, and the Competition Act.

Since privatisation, there has been a strict system of regulation within the water industry, which is in place to safeguard the best interests of customers, other stakeholders, and the environment. South West Water has developed and established processes and procedures for ensuring obligations are adhered to in all material aspects.

Our main regulators are:

- Drinking Water Inspectorate (DWI): The DWI is responsible for setting and monitoring the high standards of drinking water quality that we supply.
- Environment Agency (EA): The EA is responsible for protecting and improving the environment. It controls all of the water we take from rivers, streams and underground sources and monitors the water we return to the environment.
- The Water Services Regulation Authority (Ofwat): Ofwat is the economic regulator for the water and sewerage industry in England and Wales. It regulates the price, investment, and service package that customers receive, as well as overseeing the sector's competitive markets.
- Consumer Council for Water (CCW): CCW is a statutory consumer body for the water industry. It is responsible for representing all customers in England and Wales.

2.3 Water Resources

We provide water and sewerage services over a region of nearly 4,300 square miles (11,137 square kilometres) of Devon, Cornwall and small parts of Dorset and Somerset. Over our region, we provide clean water to 97% of people, with 3% having private supplies, and take away used water from 88% of people, with 12% having private sewerage arrangements, like septic tanks.

We divide our region of operation into four main strategic water resource zones (WRZs), each of which is a standalone area principally based on a large strategic reservoir:

1. Colliford Zone:

This area largely supplies the Cornwall area. The main source of water is Colliford Reservoir on Bodmin Moor which works in conjunction with two former china clay pits and smaller reservoirs and river intakes across Cornwall

2. Roadford Zone:

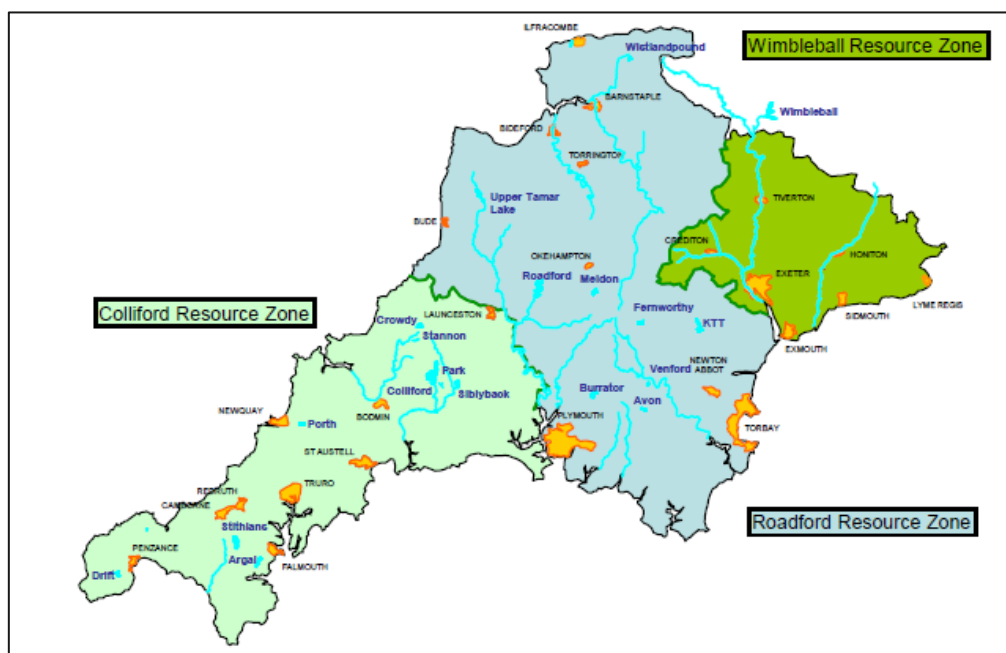
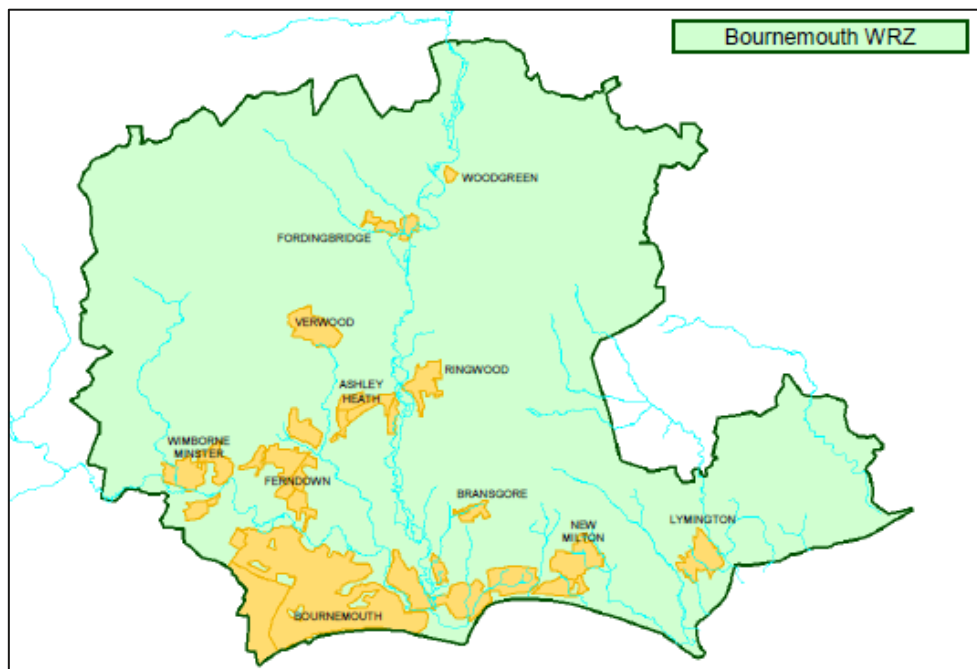
This area largely supplies North and South Devon. The main source of water is Roadford Reservoir, which works in conjunction with smaller reservoirs and river intakes in the area

3. Wimbleball Zone

This area supplies East Devon, including Exeter. The main source of water is Wimbleball Reservoir on Exmoor, which works in conjunction with the River Exe and various groundwater sources across East Devon

4. Bournemouth Zone

Sources of water in this area are dominated by direct run-of-river abstractions from the River Stour in Dorset and the River Avon in Hampshire with interconnectivity across the zone



A WRZ is defined as the largest possible zone in which all resources, including external transfers, can be shared. A WRZ is therefore a zone in which all customers experience the same level of service and the same risk of supply failure from a resource shortfall.

To understand if a WRZ has sufficient water to meet customers' needs, we set out a Water Resources Management Plan (WRMP). The WRMP details how we intend to maintain the balance between water supply and demand for the next 25 years. It sets out how we expect water supply and demand to change over time, what challenges this may give us and how we plan to solve them if they occur. The plan is refreshed every five years and published on our website.

In all our WRZs, we do not expect a shortfall between supply and demand over the next 25 years even if no action is taken. As the future is uncertain we performed a number of tests to see how sensitive our supply-demand forecasts are to key risks or policy decisions. Some scenarios give rise to small supply-demand deficits in the medium to long-term, however as the deficits are both small and in the future there is sufficient time to act and mitigate the risk.

Implementing the strategy set out in the WRMP ensures all our zones remain in surplus of the whole planning period with some additional headroom to manage future risks.

2.4 Water Trading

We fully support water trading between companies where it is environmentally and economically rational to do so and believe trading water in a sustainable way can encourage growth.

Our WRMP details the strategies where we believe water trading has potential for economic growth. Continuing dialogue with other companies on possible water transfers will help us to understand better the use of water in our region and ensure availability of existing sources and their resilience to future droughts. These strategies have the potential to protect our customers' water bills by using a more economical and environmental trading option.

As per our bulk supply register (2017-18)¹, we currently have two bulk exports in place, providing Wessex Water Limited around 10 mega-litres a year.

¹ Ofwat 'Water trading ('Bulk supplies') register 2017-18'

We also support water trading between water companies and third parties (where it is beneficial to customers and the environment), and have met with the National Farmers Union (NFU) regarding this area of work.

3 Principles of the code

Appendix 3 of Ofwat's PR14 Methodology Statement² details the standard points to be addressed in a Trading and Procurement Code. These requirements and principles were updated and published in a new guidance³ by Ofwat in May 2018 to reflect the latest market and regulatory developments.

The guidance is structured as principles that apply to imports, exports and both. Since South West Water aspires to be an importer and an exporter, our code addresses all relevant issues detailed and sets out the way we will approach proposed water trades with other companies and third parties.

In the following sections, we set out our approach to trades with other parties under the guidance set out in the Ofwat PR14 Methodology and the new May 2018 guidance. We will keep the code up to date with Ofwat's requirements and principles, and make it publicly available on our website.

3.1 Managing Imports

We manage our water supply network over four discrete WRZs. We will work to ensure imports are as efficient as possible and look to minimise costs of imports where possible. We will adhere to the following principles when pursuing qualifying trade imports:

3.1.1 Non-discriminatory procurement

We are willing to enter into trade discussions with any third party supplier of water and will treat all current and prospective trading partners fairly.

In order to ensure the procurement of third party imports are carried out on a non-discriminatory basis, we provide bidding parties with the same information and assess them under the same scrutiny as our in-house supply options.

² Ofwat (2013) 'Appendix 3: Trading and procurement codes – requirements and advice on principles to be included'

³ Ofwat (2018) 'Trading and procurement codes – guidance on requirements and principles'

We also hold discussions with neighbouring water companies to advertise opportunities and promote competition.

Further detail of our procurement process will be provided in our bid assessment framework.

3.1.2 Economic purchasing

Where we consider the option to import water, we will only agree to trades where it is economically efficient to do so, and taking into consideration factors such as:

- water quality;
- water quantity;
- the impact on customers; and
- the effect on the natural environment.

3.1.3 Competitive processes

We seek to secure water supplies through an appropriate structured competitive process.

Further detail of our procurement process will be provided in our bid assessment framework, which will meet the requirements specified in [appendix 8](#) of Ofwat's PR19 final methodology.

3.2 Managing Exports

We will work with our trade partners to ensure exports of water by South West Water are as efficient as possible and look to minimise costs, for example by using existing infrastructure and assets where possible. Where trades are pursued, we will ensure that there is no impact on our ability to supply water to our customers and the level of service they receive.

3.2.1 Correct assessment of costs

We will approach the costing of a potential water trade in a manner consistent with the way in which we assess costs of other options set out in the WRMP.

For any trade we will want to calculate the 80-year Average Incremental Social Cost, and the 25 year total NPV including environmental and social costs, so that it can be compared to other options on a fair and transparent basis. We will also work with our potential trade partner to ensure that the costs are the full expected cost (including financing) to ensure it can be compared with other options on a fair basis.

3.3 Import and Export Principles

3.3.1 Commencement

Qualifying trades must have been agreed in July 2013 or later. A trade agreement, containing the terms and conditions of the trade, must be signed by both parties before the trade can begin.

3.3.2 Operation period

Qualifying trades being claimed for at PR19 must be operating in practice and generating revenues during the period from 1st April 2015 to 31st March 2020, or from the 1st April 2020 to 31 March 2025 if being claimed for at PR24.

3.3.3 Trading partners

A qualifying trade must be between wholly unrelated parties (i.e. a trade between South West Water and any other company in the Pennon Group will not qualify). A trading partner must not assign a qualifying trade agreement to another party without prior consent from South West Water.

South West Water and our trading partner(s) will cooperate with each other in the general interests of continuous provision of water and integrity of the water supply network.

3.3.4 Contract lengths

We will agree contract lengths that are reasonable and fair to both parties. We will consider both short and long-term trades, and the contract duration will depend on the circumstances of the specific trade being discussed.

If the trade concerns large water volumes, we would ensure long notice periods to allow both companies sufficient time to make alternative arrangements if alternate water sources are required to maintain supplies.

When setting contract lengths, we will choose a reasonable duration, appropriate to the nature of the supply and other case-specific factors.

Exports

The contract length will take into account any potential risks to existing customers including payback duration of any infrastructure needed to supply the water.

The volume should not put any WRZ into deficit within the contract duration and if the supply is related to a specific source, the length of contract should be within the abstraction licence period of consent.

Imports

The contract length will depend on the circumstances of the specific trade being discussed. As a general rule, we will seek to ensure water is available over a long enough period to represent a meaningful and secure contribution to deployable output. Consideration will be given to the WRMP cycle and other associated planning regimes. In most cases, the preference is for a contract term of at least 20 years with long duration notice periods linked to the time we would need to find alternative sources of water.

We also recognise the ongoing reform agenda associated with water resources. Where appropriate, we will seek to include appropriate break clauses within the contact terms to allow for future legal reform. This is to avoid locking parties into long term trades that may hamper the development of new (as yet undeveloped) water markets.

3.3.5 Transparency

South West Water is committed to an open and transparent process for trading. Central to any trade is information about our water resources position, which is set out in our WRMP and published on our website.

We have also completed and published our Market Information data set which can be accessed using this link [market information page](#). This publication further strengthens our approach to transparency.

Information about agreed trades will be submitted to Ofwat as part of existing reporting requirements, which include a list of all of our current bulk imports and exports.

We will keep Defra, Ofwat, DWI and Environment Agency (as appropriate) fully informed of any qualifying trade proposals made to us, any proposals we make to others, and any trade agreements that are made, through existing reporting interfaces.

3.3.6 Water Resources Management Plan

Our WRMP incorporates the consideration of water trading within the selection of options to maintain the supply-demand balance in each of the WRZs. The approach taken for selecting options under the WRMP is wholly consistent with the approach for agreeing water trades. We use a multi-criteria assessment for the WRMP⁴ and use the best performing programme.

3.3.7 Economically rational trades

Water trades will only be agreed when it is economically sound and beneficial to customers to do so.

The economic rationality of any new water trade agreement is underpinned by our WRMP, where we use a systematic cost-benefit approach to analyse options to manage the supply-demand balance such as 25-year NPV, 25-year Environmental & Social Cost NPV, the 80-year Average Incremental Social Cost estimate, estimation of the impact on customer bills these are all used to determine if the trade will be economically rational.

3.3.8 Environmentally rational trades

South West Water is committed to protecting and enhancing the natural environment and acting collaboratively for the benefit of its current and future generations. Our WRMP is supported by guidance from the Environment Agency (EA). We will also ensure that any water trade we agree will not compromise our obligations under UK and EU legislation.

We will only agree to qualifying water trades where they would not have a negative environmental impact and ensure protection of environmentally-sensitive supply areas.

We will undertake a Strategic Environmental Assessment (SEA) for any water trade. An SEA measures and evaluates the predicted environmental effects of a plan or programme, such as water trade. A trade would be tested in order to assess its effect on the environment. SEA identifies potential conflicts and environmental opportunities, suggests mitigation and monitoring measures and makes recommendations to the plan-makers for improvements to the trade.

If we were to have an import or an export that was assessed as having an adverse environmental impact we would seek to discuss with the EA, and any trade would be subject to their approval if it had abstraction license implications.

⁴ See table A.7.14 in our Draft Water Resources Management Plan for further details

3.3.9 Ending trades

South West Water assures Ofwat and other interested parties that we will not alter any of our existing trades in order to exploit financial incentives for trading, and expect all of our trading partners to take a similar approach to the maintenance of existing trade agreements.

Any qualifying trades that are pursued will be evidenced in our audit report to Ofwat to demonstrate that the trades are new and not an existing one that had been artificially ended and restarted.

3.3.10 Compliance

South West Water will comply with all relevant laws and legislation, including the Competition Act 1998, and expect the same from our trading partners.

3.3.11 Allocation of incentives

We will ensure incentives are appropriately allocated between the relevant wholesale controls, i.e. for water resources or network plus water, in compliance with Ofwat's guidance. Currently, we are not forecasting any new trades over the 2020-25 period.

Our approach to allocating any such incentives will be determined by the nature of the trade in question. For example:

- Source to source trades – these are transfers of raw water between water resource assets. With such trades, we would expect the incentives to be allocated entirely to the water resource control(s).
- Source to raw water distribution/storage trades – these are transfers of raw water between water resource assets of the exporter and raw water distribution or storage assets of the importer. With such trades, we would expect the incentives to be allocated between the water resource and network plus controls, with the majority being allocated to the water resource control(s). The exact allocation would be determined by the nature of the assets involved, which party developed the assets, and the extent that they are utilized.
- Treated to distribution network trades – these are transfers of potable water between networks plus water assets of the exporter and importer. With such trades, we would expect the incentives to be allocated between the water resource and network plus controls, with the majority being allocated to the network plus control(s). As per the

above, the exact allocation would be determined by the nature of the assets involved, which party developed the assets, and the extent that they are utilised.

Further detail of the guidance on allocation can be accessed in [appendix 5](#) of Ofwat's PR19 final methodology.

3.3.12 Consistency with the bid assessment framework

South West Water will publish a bid assessment framework, which sets out the policies and processes for assessing bids from third party water providers, and ensures the bids are assessed fairly with regard to the principles of transparency, non-discrimination and proportionality.

We will ensure that our Water bid assessment framework is consistent with this Trading and Procurement Code, and will assess on an ongoing basis the alignment of the two documents as further updates are made. We have reviewed Ofwat's bid assessment framework principles ([appendix 8](#) of Ofwat's PR19 final methodology) ahead of developing this procurement code, and consider the code to be consistent.

3.3.13 Assurance processes

South West Water's assurance processes are designed to ensure risks are identified and mitigated appropriately. We follow an approach built upon three lines of defence: local quality controls and performance reviews; policy setting and compliance checking; and external scrutiny. This assurance framework is applied to all areas of the business, including key projects as they arise.

Trade proposals will be assessed against a scale of risk, taking into account water quality, reliability, revenue, and local environmental factors. Projects classed as major or severe risk, presenting a material impact of the aforementioned factors, will undergo rigorous external scrutiny and independent audit. For all qualifying trade proposals that are pursued, we will carry out an internal audit examining the processes followed during the trade negotiations and assess compliance against the code, specifically including a water quality, cost-benefit, and environmental assessment. This audit report will be provided to Ofwat.

Further detail on South West Water's assurance framework is provided in its Assurance Plan available on the South West Water website. Further detail on its approach will be provided as part of the Business Plan submission.

3.4 Additional principles

3.4.1 Emergencies

South West Water has 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. Equally we will cooperate and follow the trading partners' procedure wherever possible.

3.4.2 Trade effects

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

3.4.3 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 Glossary of terms

The Water Services Regulation Authority (Ofwat): Ofwat is the economic regulator for the water and sewerage industry in England and Wales

Price Review (PR): The process to review price limits set by Ofwat and the revenues that water companies can recover for their services. The PR process occurs every five years

Access Code: A document setting out water companies procedures for allowing licensees access to their supply systems

Abstraction: The process of removing water from the natural environment

Drinking Water Inspectorate (DWI): The DWI is responsible for setting and monitoring the high standards of drinking water quality that we supply

Environment Agency (EA): The EA is responsible for protecting and improving the environment. It controls all of the water we take from rivers, streams and underground sources and monitors the water we return to the environment

Consumer Council for Water (CCW): CCW is a statutory consumer body for the water industry. It is responsible for representing all customers in England and Wales

Water Resources Management Plan (WRMP): A strategic plan to ensure companies have sufficient water to supply the public and maintain adequate water in the environment.

Leakage: Treated water lost from the distribution system. It includes water lost from the companies' distribution networks and supply pipe losses from consumers' pipes

Official Journal of the European Union (OJEU): A publication in which all tenders from the public sector, which are valued above a certain financial threshold according to EU legislation, must be published

The Department for Environment, Food and Rural Affairs (DEFRA): The UK government department responsible for safeguarding the natural environment, supporting the food and farming industry, and sustaining a thriving rural economy

5 Links to useful materials

Ofwat trading and procurement code guidance	https://www.ofwat.gov.uk/wp-content/uploads/2018/05/Trading-and-procurement-codes-guidance-on-requirements-and-principles-final2.pdf
Access code	https://www.southwestwater.co.uk/globalassets/document-repository/regulatory-submissions/wsl-network-access-code-2017-final.pdf
South West Water's Water Resources Management Plan (WRMP)	https://www.southwestwater.co.uk/environment/a-precious-resource/water-resources-management-plan/
South West Water's Drought Plan	https://www.southwestwater.co.uk/globalassets/documents/draft-drought-plan-2017---full-report.pdf
South West Water's Whistle Blowing Policy	https://www.southwestwater.co.uk/link/e9c6db76e6cb4015bfbd7aafac80c919.aspx
South West Water Code of Conduct for Suppliers	https://www.southwestwater.co.uk/globalassets/documents/south-west-waters-code-of-conduct-for-suppliers-v2.pdf