

Bilateral Markets Call for Information  
Ofwat  
21 Bloomsbury Street  
London  
WC1B 3HF

28 August 2019

Dear Sir/Madam

This letter sets out the views of Northumbrian Water Limited (NWL) in response to the “Bilateral markets - Call for information” published by Ofwat in June 2019.

**Northumbrian Water is a strong supporter of markets**

Northumbrian Water is a strong supporter of markets where these act in customers’ interests. We believe that harnessing the opportunities offered by well-structured markets in the water sector can ultimately drive value for money for customers, improve resilience and, in so doing, help strengthen the legitimacy of the sector.

We have a track record of supporting the development of markets. We have already undertaken the largest water resources trade made in the industry since privatisation in the form of a 20 year, 20 Ml/d agreement with Thames Water. We played a leading role in creating the non-household retail market and continue to facilitate open competition through our role as wholesaler. We are actively pursuing opportunities in the bio-resources market, and have facilitated competition in local networks and developer services through constructive engagement with participants in these markets including NAVs, SLPs, and developers.

We will set out in more detail the extent to which we support the development of markets in the broader sense in our response to Rachel Fletcher’s letter dated May 2019.

Specifically regarding water resource markets, we particularly welcome Ofwat’s recent decision to allow funding for Strategic Regional Water Resource Solutions, an important pre-requisite for improving resilience and efficient water trading.

In the remainder of this document we set out some observations in relation to bilateral markets, in the spirit of helping ensure that these proposals are taken forward in a manner which is ultimately beneficial for the sector and its customers.

**This Call for Information is a good first step, and we believe further analysis may be required**

We welcome the call for information as a first step to progress the bi-lateral markets agenda which should gauge interest from potential entrants. Our view is that further analysis may then be required to further understand the market opportunity. While water trading analyses have been conducted previously, the possibility of bilateral markets presents a different set of circumstances.

Such analysis could focus on the location of surplus water (perhaps through abstraction licence information), and the potential costs of inputting it into the incumbent's network. This could give valuable insight into any potential barriers to a successful market, from which proposals could be further developed.

**Adequate provision will be required to ensure water quality continues to be protected from source to tap**

Care will be required to ensure that any new raw or treated water resources are introduced in a manner which does not adversely impact water quality standards or customer acceptability.

Further detail on this point is well set out in Water UK's response to this call for information, which we support. (We have not repeated this here)

**The balance of risk for new entrants**

Our experience with water trading thus far has been limited to trades with neighbouring water undertakers. Our trade with Thames Water, however, does give us the advantage of a stable and long term (20 year) arrangement which matches the period for which we expect to have a surplus.

While other (i.e. bilateral) arrangements may well be more appropriate in different circumstances, to avoid significant barriers to entry it will be important to ensure that the degree of financial commitment required of potential new entrants (especially if new long life assets are required to provide connectivity) is consistent with the level of commitment which retailers are able to provide – particularly with regards to contract duration.

### **Supplier of Last Resort (SOLR) considerations**

The certainty offered by our long term arrangement with Thames also facilitates robust water resource and resilience planning for both parties.

Under a bilateral market, consideration will need to be given to SOLR duties and any knock on implications for the efficient functioning of the water market as a whole for customers.

For example, should the SOLR duty fall to the incumbent, protections would be required to avoid the need for the incumbent to incur costs providing additional headroom in order to mitigate against the risk of failure of a 3<sup>rd</sup> party resource provider resulting in a regional shortfall.

Such protection could be offered through appropriate licence terms for 3<sup>rd</sup> party providers. For example an equivalent of the current “condition K” for incumbents could require the water resource to be ring fenced in the event of financial failure, with additions to protect against the 3<sup>rd</sup> party switching off or reallocating the resource.

### **Conclusion**

With adequate consideration given to the above points, further development of water markets along these lines could be a useful further means of improving resilience and efficiency for customers. We would welcome the opportunity to discuss the issues raised by the consultation further.

Yours faithfully,

Jim Strange  
Head of Economic Regulation