

# Pricing for SROs

## Type of SRO and scheme

- At its simplest is Direct Procurement for Customers (DPC), with one water source and one incumbent
- DPC can have a fixed cost of construction, which is sunk and regulated through the DPC mechanism
- Some DPC arrangements will also identify ongoing variable costs
- As SRO schemes involve more parties and existing assets, variable costs become more complex for pricing

## Volume to be charged

- Based on agreed "fair share"
- Even if firm contract, the volume used will vary in practice
- Volume may be limited in particular circumstances e.g. operational emergencies or drought

## Pricing

- Keep water resource prices separate to prices for other activities (and can include environmental value / compensation payments)
- Split between fixed and variable
- Balance may vary with commercial model, but sunk costs generally fixed
- Variable costs will vary with how firm volumes are
- When volumes are limited, pricing may adjust (e.g. penalty rates)

## Hierarchy of pricing for SRO

- **Set competitively (fixed and variable)**
- **Directly observable (variable)**
- **Adjusted from average (wholesale plus / minus)**
- **Alternative / Long Run Incremental (for incremental capacity)**



# Simple Bilateral WR Contract

Company B WR incremental need	15	MI/d
Company A incremental cost	40	p/m3
Price from B	50	p/m3
Volume of A increment	50	MI/d
Volume of A WR incremental need	35	MI/d
A original Water resource cost	23.0	p/m3
Net cost of increment	36	p/m3
Revised average WR cost	23.4	p/m3
B original Water resource cost	20.0	p/m3
Net cost of increment	50	p/m3
Revised average WR cost	20.3	p/m3

**Seller (A)**

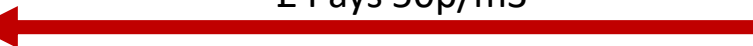
50MI/d – Own Needs 35MI/d  
Incremental WR cost 40p/m3

Average cost increases from 23 to 23.4p/m3  
Net of compensation payment income

Delivers 15MI/d



£ Pays 50p/m3



Delivers

**Buyer (B)**

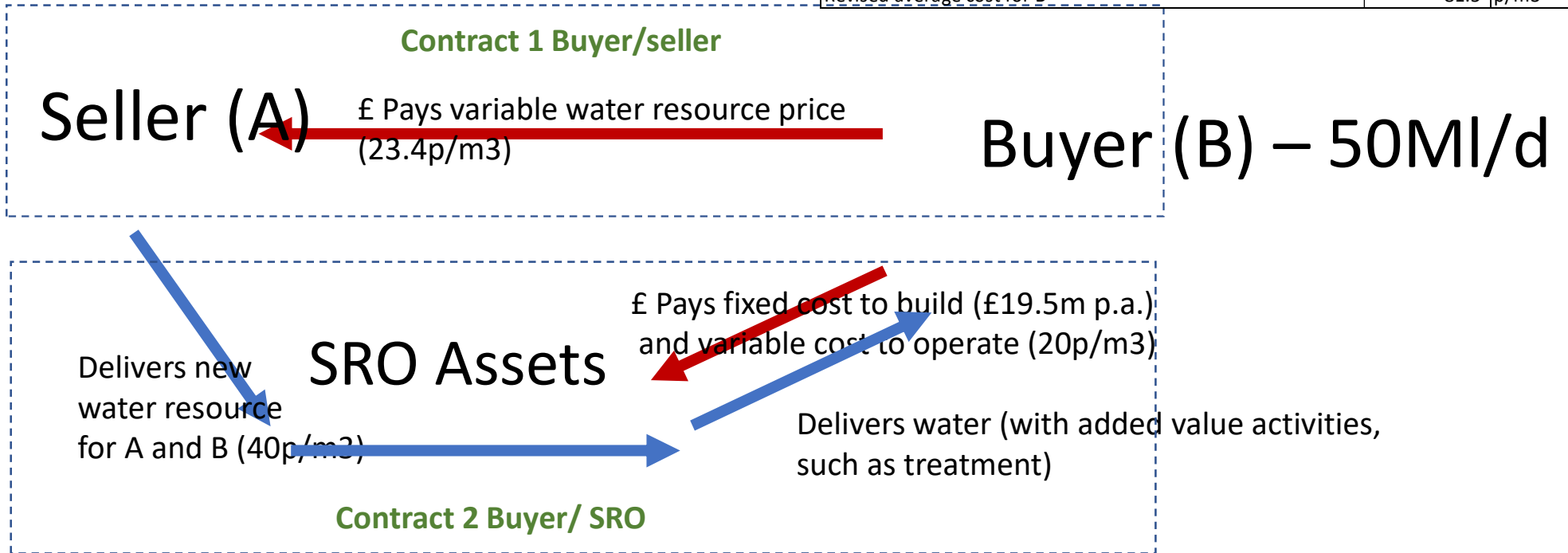
Needs 15MI/d  
Own incremental cost 50p/m3





# Simple DPC Arrangement

Builds plant	50	MI/d
Builds pipe to B	50	MI/d
Fixed cost	£300	£m
Asset life	25	years
Rate of return	2.50%	
Contracted (targeted) operating cost	20	p/m3
Fixed annual cost	£19.50	£m
Total expected annual cost	£23.15	£m
Cost (p/m3)	126.8	p/m3
Existing cost of B (treatment and bulk distribution)	80	p/m3
Revised average cost for B	81.5	p/m3

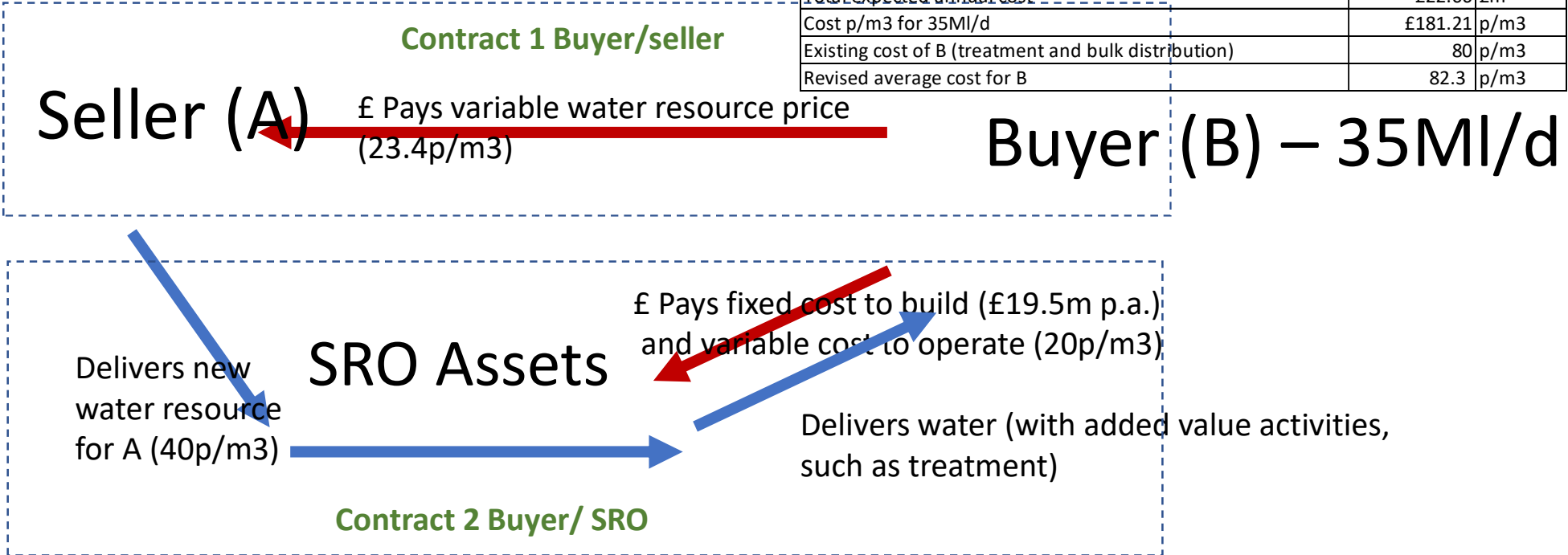


In this case the SRO develops the Water Resource (bidding in to A), or A has surplus water. [bristolwater.co.uk](http://bristolwater.co.uk)  
 The key point is that water resource transaction is separate to SRO treatment and distribution activities.

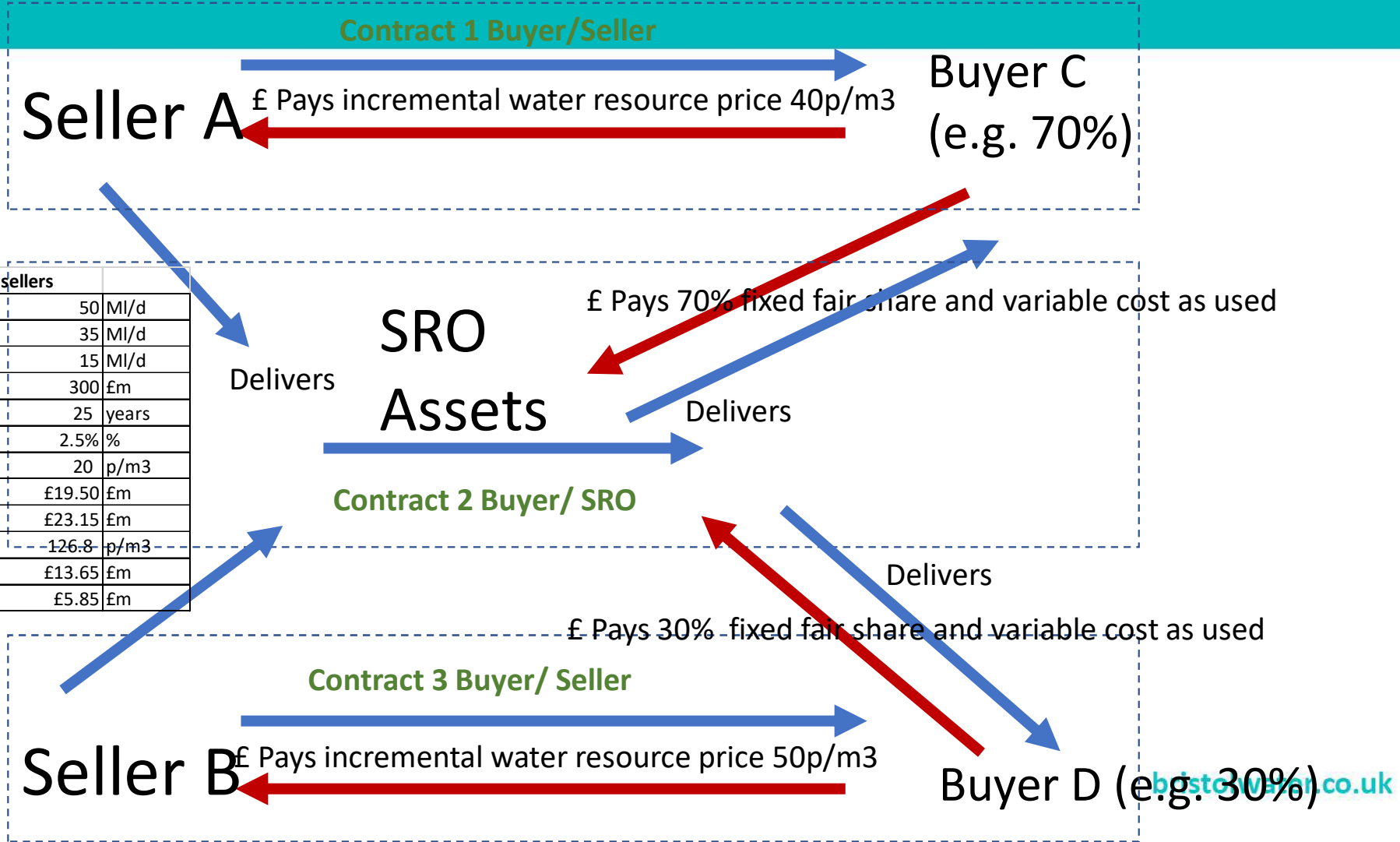


# Simple DPC Arrangement – Buyer only takes 35MI/d instead of 50MI/d capacity

Scenario 3 - DPC where buyer volume reduces below capacity		
Actual volume	35	MI/d
Builds pipe to B	50	MI/d
Fixed cost	300	£m
Asset life	25	years
Rate of return	2.5%	%
Contracted (targeted) operating cost	20	p/m3
Fixed annual cost	19.5	£m
Total expected annual cost	£22.06	£m
Cost p/m3 for 35MI/d	£181.21	p/m3
Existing cost of B (treatment and bulk distribution)	80	p/m3
Revised average cost for B	82.3	p/m3



# Multiple separate buyers and sellers

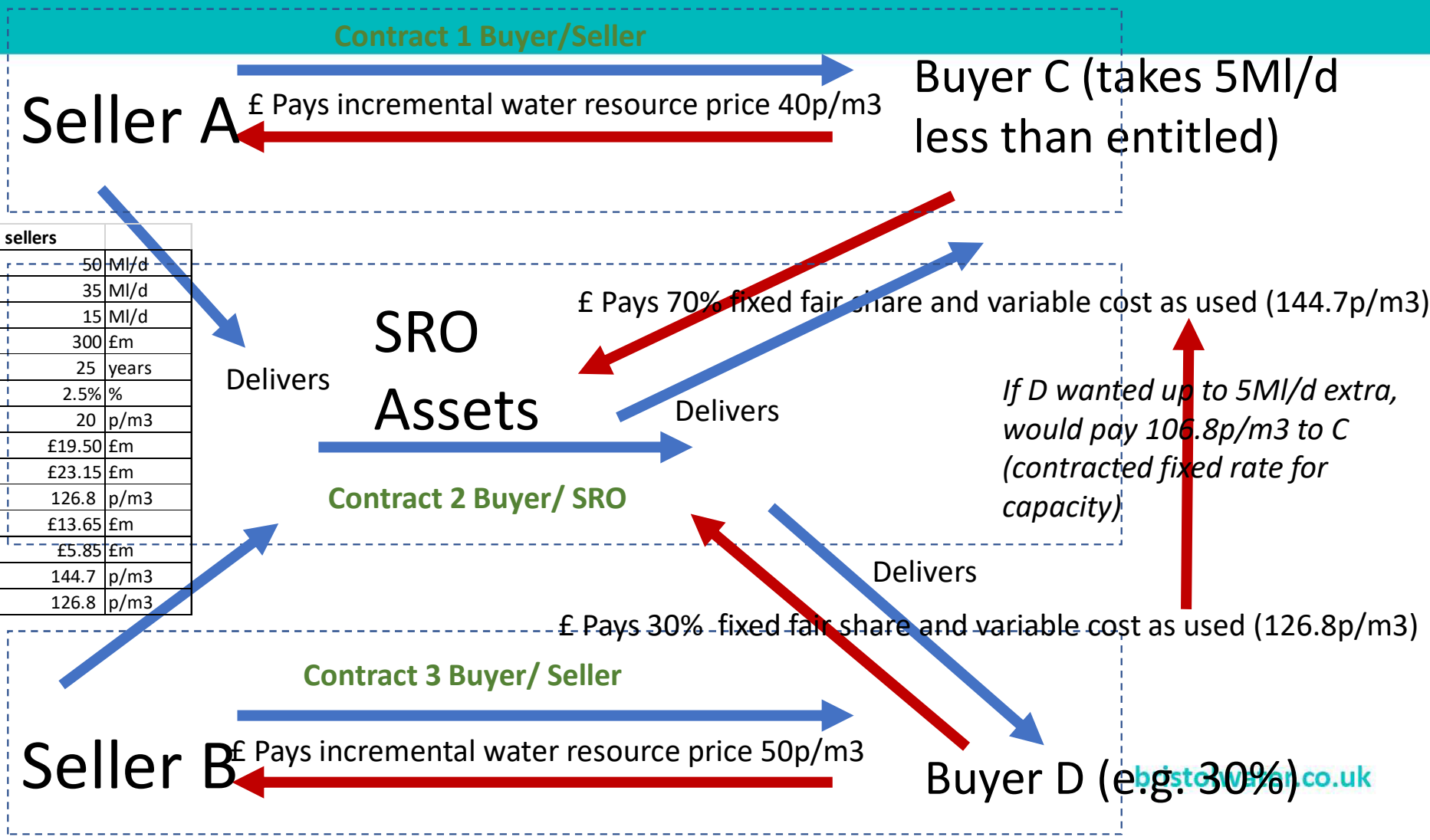


**Scenario 4 - multiple buyers and sellers**

Constructed volume	50	MI/d
Fixed share to company C	35	MI/d
Fixed share to company D	15	MI/d
Fixed cost	300	£m
Asset life	25	years
Rate of return	2.5%	%
Variable operating cost	20	p/m <sup>3</sup>
Fixed annual cost	£19.50	£m
Total expected annual cost	£23.15	£m
Cost p/m <sup>3</sup> for 50MI/d	126.8	p/m <sup>3</sup>
Fixed for C	£13.65	£m
Fixed for D	£5.85	£m



# Multiple separate buyers and sellers – C takes 5MI/d less



Scenario 4 - multiple buyers and sellers		
Constructed volume	50	MI/d
Fixed share to company C	35	MI/d
Fixed share to company D	15	MI/d
Fixed cost	300	£m
Asset life	25	years
Rate of return	2.5%	%
Variable operating cost	20	p/m <sup>3</sup>
Fixed annual cost	£19.50	£m
Total expected annual cost	£23.15	£m
Cost p/m <sup>3</sup> for 50MI/d	126.8	p/m <sup>3</sup>
Fixed for C	£13.65	£m
Fixed for D	£5.85	£m
Cost p/m <sup>3</sup> for 30MI/d for C	144.7	p/m <sup>3</sup>
Cost p/m <sup>3</sup> for 15MI/d for D	126.8	p/m <sup>3</sup>



## Interconnection and transit network pricing (non-buyer or seller)

### If new capacity (interconnection):

Either same as SRO – competitive procurement or identified/separately monitored fixed and variable (operational) cost

### Transit network

Fixed cost (agreed)  
Variable cost – average variable cost of bulk distribution (wholesale minus)

### If incremental use (interconnection):

Wholesale minus  
Seller price - Either average (if spare water) or incremental (if developing new interconnection for own supply demand balance - has benefit of linking to time horizon for contract  
Could base on incremental WRMP cost for transit company (less incremental water resources and treatment)

### Transit network (spare capacity)

Variable cost – average variable cost of bulk distribution (wholesale minus)  
Could be an average transit allowance (set by Ofwat per Ml/d) based on all schemes, to avoid disincentives to trade.