



Enabling new water resources – a consultation on commercial arrangements – policy outcome

About this document

The Regulators' Alliance for Progressing Infrastructure Development (RAPID) was set up in 2019 to help accelerate the development of new strategic water resource options (SROs) and address potential regulatory barriers. RAPID is a partnership between the three water regulators; Ofwat, the Environment Agency and the Drinking Water Inspectorate but also works closely with others including Natural Resources Wales and Natural England. Natural Resources Wales (NRW) is involved in an advisory capacity and has a decision-making role for any strategic water resource solutions involving Wales, Welsh policy and legislation.

Working in partnership with Ofwat, the Environment Agency, the Drinking Water Inspectorate, and Natural Resources Wales (for cross border solutions), RAPID facilitates collaborative working on SROs with water companies. For example, RAPID provides feedback to Ofwat to enable Ofwat to make decisions on continued ring-fenced development funding for SRO project progression.

RAPID's November 2023 consultation 'Enabling new water resources – a consultation on commercial arrangements'¹ set out our thinking and assessment of policy options on commercial frameworks for the projects, specifically in relation to commercial/contractual models including bulk supply water transfer agreements (BSAs) and associated policy, such as charging.

The consultation closed on 20 March 2024. We published the responses we received and a summary of them in September 2024², setting out our next steps on further policy development. This policy outcome document updates on that further work.

We should also acknowledge that since the consultation closed there have been a number of developments. In our Price Review 2024 (PR24) final determinations, we accepted an increased portfolio of 30 major projects in total with 27 to be delivered by way of Direct Procurement for Customers (DPC) or Specified Infrastructure Project Regulations (SIPR) and 3 for in-house delivery which did not meet the requirements of DPC or SIPR, but which will still need RAPID oversight. The full list of projects proposed for inclusion in the programme of major projects is set out in, "PR24 final determinations: Major projects development and delivery"³.

There has also been a lot of Government focus on how water infrastructure is often essential to underpin growth and they have set up the Water Delivery Taskforce which is focused on

¹ [Enabling new water resources – a consultation on commercial arrangements, November 2023](#)

² [Enabling new water resources – a consultation on commercial arrangements – summary of responses, September 2024](#)

³ [PR24 final determinations: Major projects development and delivery – Ofwat – January 2025](#)

improving water infrastructure and ensuring water companies deliver on their PR24 commitments.

The Government also established an Independent Water Commission in October 2024, chaired by Former Deputy Governor of the Bank of England, Sir Jon Cunliffe, to deliver recommendations to government on reforms to the water sector. The Commission is focused on ensuring there is a sufficiently robust and stable regulatory framework to:

- attract the investment needed for the future
- speed up infrastructure delivery
- restore confidence in the sector

It reported its initial findings in June 2025⁴ and will be reporting final findings in summer 2025.

⁴ [Independent Water Commission: Interim Report – June 2025](#)

Executive summary

RAPID's 2023 consultation, 'Enabling new resources – a consultation on commercial arrangements', discussed the importance of having consistent and standardised commercial and regulatory frameworks for water resource infrastructure solutions in the RAPID programme.

The development of consistent frameworks with common standards can unlock programmatic benefits for the pipeline of major projects and result in better value for customers through reducing transaction costs, avoiding first of a kind premium on each project, attracting a lower cost of capital, and achieving increased competition through repeatability of the pipeline.

The consultation focussed on commercial delivery models for water infrastructure major projects and contractual arrangements for water transfers. Since the consultation and our September 2024 summary of responses document, RAPID has worked collaboratively with Ofwat and engaged with stakeholders (water industry, investors and supply chain) to explore further the issues raised to facilitate further policy development.

This policy outcome document sets out details of that policy development, provides key stakeholders with clarification about how we anticipate the commercial and contractual arrangements to develop and explains next steps and timings. In summary, RAPID and Ofwat:

- continue to advocate a default commercial model (Lead Party) as the optimum way forward, and set out the work we have progressed looking at the allocation and mitigation of risks of the model;
- have further developed proposals for standardised guidance for water companies on negotiating bulk supply agreements and the form that this guidance should take. There will be a consultation on the draft guidance later in 2025; and
- have re-examined the proposed elements of the bulk supply agreement charging model, undertaken analysis and illustrative modelling and explained how we have developed the model further.

The development of the commercial framework aligns with Ofwat's statutory duties and functions. Since the consultation, Ofwat has been leading on this work and will continue to do so, with less involvement from RAPID. RAPID will continue to engage on cross-regulatory issues and provide support as appropriate. Ofwat will undertake further consultations and publish guidance on these policy areas. Ofwat has established a specific Major Projects Guidance website⁵ through which it will provide regular updates. RAPID encourages water

⁵ [Ofwat – Major Projects Guidance website](#)

companies and interested stakeholders to engage directly with Ofwat to discuss any elements of the policy areas covered in this policy outcome document.

RAPID will continue to focus on work with partner regulators on reducing barriers within other cross-regulatory issues such as environmental regulation.

RAPID recognises the need for continued visibility, transparency and engagement with stakeholders, and Ofwat will continue that engagement with the water sector through the Regulatory and Commercial (R&C) Steering Group (which will be a joint RAPID and Ofwat forum) and the All [Water] Company Working Group, and through bilateral engagement with investor and supply chain sectors; and attendance at external events to enable information sharing.

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1. Introduction

The water sector is facing significant challenges from climate change, population growth and aging infrastructure. Customers, regulators, and Governments are clear that change is needed; we need greater resilience to drought, significantly better outcomes for the environment and more responsive services for customers. Society expects that water will be available for users while also protecting and improving the environment we live in. Addressing these challenges will require major new investments including large infrastructure projects. If no action is taken between 2025 and 2050, there is forecasted to be a shortfall of around 4,000 million litres of water per day in public water supply which will not be addressed by reducing leakage and demand alone. This means that we must act now, and act together, to develop new water resource infrastructure supply solutions which counter these combined risks in the coming years.

The water sector has established arrangements for strategic regional planning to deliver future water needs for England, in particular through regional planning groups⁶. Each region's plan must consider how the region will be resilient to a range of uncertainties and future scenarios. It must identify a set of options that provide the best value to customers, society and the environment rather than simply the least cost. These plans are reflected in statutory Water Resource Management Plans (WRMPs) and shape investment in water resources over many years through business plans. This has led to water companies' development of strategic water resource option projects (SROs) in order to deliver new strategic water infrastructure.

Most of these projects will involve bulk supply water transfers. This is the transfer of a supply of water from one appointed water company to another. Bulk supplies are sometimes referred to as 'water trades' as they are a way for water companies to trade and transfer surplus water, between geographical areas, to other companies and areas which need more. Water companies can draw up a contract between them (a Bulk Supply Agreement "BSA") that sets out the terms and conditions of a bulk supply, including price and how the project operates under distress scenarios.

Many of the best value solutions to develop strategic water resources therefore also require collaboration across more than one water company, often with third parties, and with new major infrastructure to facilitate the water transfer. Such solutions require more complex commercial arrangements as compared to projects designed to serve individual company areas. And they present new or heightened challenges to water sector regulation – be that environmental regulation, drinking water quality or funding, charging and outcomes. RAPID

⁶ Regional planning is not required in Wales as a whole, but Welsh companies and stakeholders are also contributing to planning for cross-border options. Options involving sourcing water from Wales must demonstrate benefit to the people and environment of Wales. Proposals that affect Wales will have regard to the interests of Wales, in particular sustainable management of its natural resources and Welsh legislation and policies.

sees benefit in establishing common frameworks for addressing these challenges: these should reduce costs for individual projects, mitigate risk of project delay, and help make water resource arrangements better able to adapt to challenges of the future.

In 2013 Ofwat published 'Negotiating bulk supplies – a framework'⁷. This was non-statutory guidance for water companies to assist them in negotiating bulk supply agreements and to provide a clear indication of Ofwat's approach if a matter is referred to Ofwat under either sections 40 or 40A of the Water Industry Act 1991. Under these provisions, Ofwat can determine the terms of a bulk supply agreement (or vary or terminate a bulk supply agreement), if the parties are unable to agree and one of the parties refers the matter to Ofwat.

Having been developed in 2013, primarily for the new appointee market, the guidance does not deal with the possibility of there being multi-parties to a bulk supply agreement nor does it deal with the possibility of both parties to the bulk supply agreement paying for new infrastructure to facilitate the bulk supply.

Since issuing that guidance, the Water Industry Act 1991 was also amended and Ofwat now has the ability to issue statutory codes and rules in relation to bulk supplies⁸. To date, Ofwat have chosen not to use these new provisions, continuing to rely on the 'soft powers' of non-statutory guidance.

As a result of the increased complexity, RAPID has been working closely with Ofwat to consider the commercial (governance and charging) arrangements required for the successful delivery of projects. In particular this has covered:

- Commercial structures;
- Additional factors needed in the negotiation of bulk supply agreements; and
- Charging arrangements for those bulk supply agreements.

RAPID issued a consultation, in November 2023, seeking views on these issues and our developing proposals for ways forward. In September 2024 we published a summary of the responses to the consultation which also set out our next steps post consultation.

RAPID has concluded on the policy frameworks set out in the original consultation and is now issuing this policy outcome document setting out the further work we have undertaken with Ofwat who will be taking the policy frameworks forward and implementing them. For each issue we signpost our proposed policy direction.

⁷ [Negotiating bulk supplies – a framework – Ofwat – August 2013](#)

⁸ See sections 40B – 40I of the Water Industry Act 1991 (inserted into the Act by the Water Act 2014).

2. Commercial structures

To enable the supply of water between water companies, particularly where new infrastructure is needed, clear and effective commercial and regulatory frameworks must be in place.

In PR24, Ofwat stated that major new infrastructure should be delivered by competitive delivery models. For all major new infrastructure (over £200m whole life totex), water companies need to assess whether they can deliver the scheme by Ofwat's Direct Procurement for Customers (DPC) framework, or where appropriate the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (SIPR) model used for Thames Tideway Tunnel (TTT).

DPC is a process whereby companies put major infrastructure projects out to competitive tender for delivery by third parties for all discrete projects above the size threshold. The successful third-party bidders for DPC projects, known as the Competitively Appointed Providers (CAPs), will be responsible for designing, building, financing, maintaining and potentially operating the infrastructure. SIPR provides a regulatory process for competitively tendering for large and complex water and wastewater infrastructure. Third-party delivery through SIPR may be available where projects meet the required threshold test. This model requires the infrastructure to be specified by the Secretary of State or Ofwat if in their opinion a project meets this test. Under SIPR a third-party Infrastructure Provider (IP) is appointed and may be issued with a project licence, therefore being directly regulated by Ofwat.

Robust commercial structures were identified as being critical to delivering new and complex infrastructure involving multiple water companies and being delivered by third-party providers.

The consultation discussed potential approaches, proposed a 'Lead Party' model as the default commercial structure, and invited respondents to share their views and considerations, including any suggestions for alternative approaches.

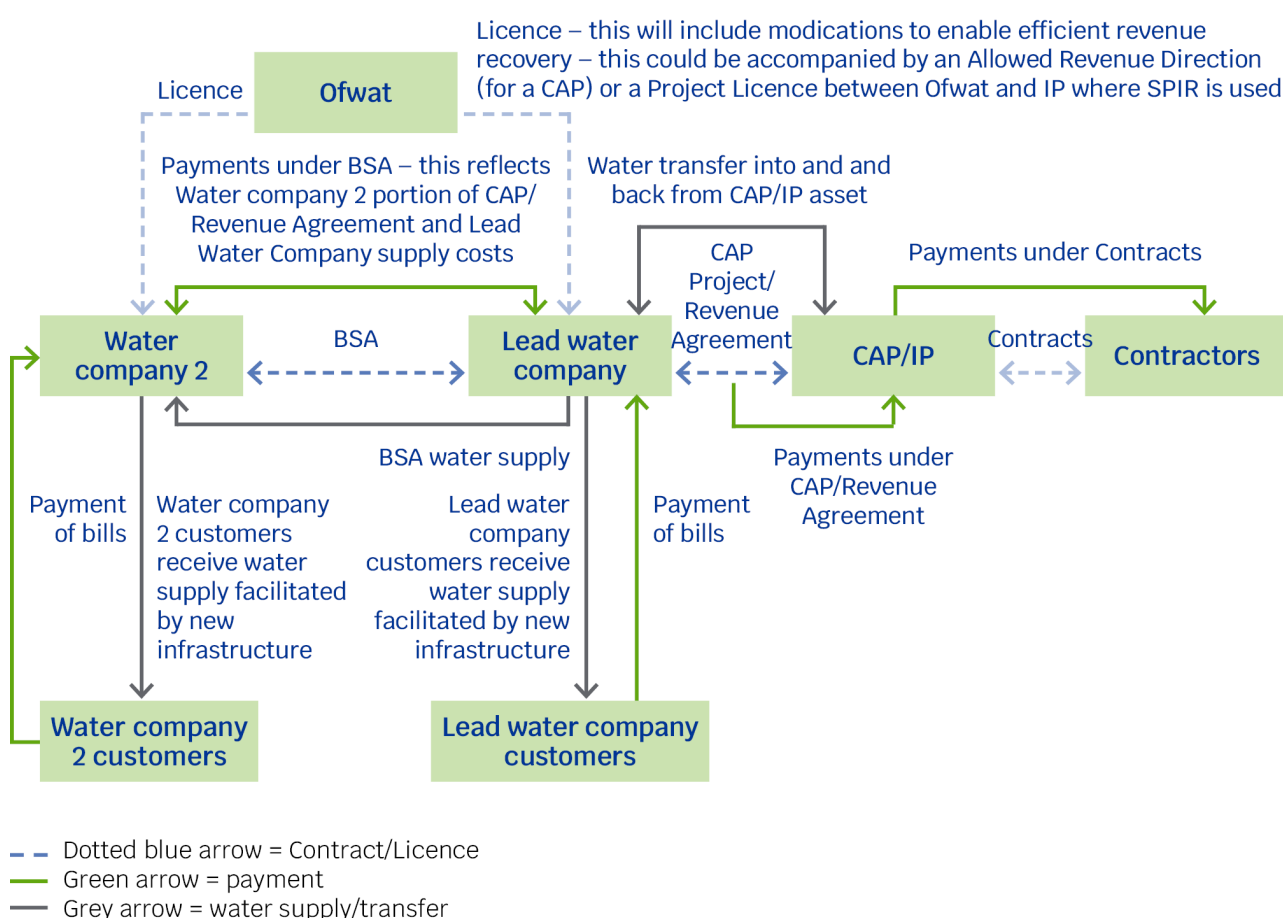
In our September 2024 summary of consultation responses document, we explained that following consideration of the consultation responses, RAPID continued to consider the use of a default commercial model as the optimum way forward. However we acknowledged points raised by consultation responses about the lead party model and the allocation of risk (specifically counterparty credit). We subsequently undertook further engagement with respondents to discuss those points in more detail. We re-cap below on the points raised in the consultation responses and set out our further consideration of the issues and policy proposals.

2.1 RAPID's preferred model

The 2023 consultation proposed water companies adopt the default commercial structure of the Lead Party model, unless deviations could be justified on a Value for Money (VfM) basis. A standardised approach was proposed to improve transparency, ensure equity across customers and unlock programmatic benefits to deliver greater value for money for customers. However, RAPID also acknowledged the individuality of the solutions and recognised that in very remote cases, a “one-size-fits-all” approach may not work, and that where appropriate, elements of the model may need to be specifically tailored.

Under the Lead Party model, one water company (the “Lead Water Company”) procures a third-party provider to design, finance, build, operate, and/or maintain the relevant infrastructure that facilitates a multi-water company supply. The Lead Party enters into a contract with the third-party provider, and into bulk supply agreements with other benefiting water companies.

Figure 1: The Lead Party Model



In developing this approach, RAPID also considered an alternative model – the Multi-Party Model. This model would involve multiple water companies jointly contracting with the third-party provider and all companies managing shared infrastructure responsibilities and

payments. We did not consider this as the preferred default model due to the additional complexity and management / interface risks present in the model.

In addition to the Lead Party model, the 2023 consultation considered the role of the third-party provider (particularly the IP) and whether it should have an extensive or more limited role. The two options considered were: an infrastructure only role – where the IP designs, builds, finances, operates and/or maintains the infrastructure that facilitates the bulk supply transfer; and an "entire (or full) service" model—where an IP takes on additional elements, potentially including contractual and regulatory responsibility for abstraction and supply. The full service model was not favoured due to concerns around blurred regulatory responsibilities, and questions as to whether an IP would be financeable, if it took on a more extensive role.

The consultation acknowledged the impact of commercial models on the allocation of risks and responsibilities, and explored two examples of risks that would need to be considered:

- Financial/Credit Risk: Single vs multiple payment counterparties and exposure to default.
- Supply Risk: The need to incentivise continuous supply, especially in drought scenarios.

In the 2023 consultation, RAPID sought stakeholder views on these models, encouraged discussion on alternative models, and invited views on associated risks and mitigations.

2.2 Consultation responses

2.2.1 Types of commercial structures and a default delivery model

In the consultation we asked:

Q2.1. Do you agree that there should be a default commercial structure across all solutions, with deviations permitted by exception and depending on the specific circumstances of the solution?

Q2.2. a) Do you agree with the preferred commercial structure being a lead party model? b) Do you agree with the preferred commercial structure being an infrastructure only model?

Q2.3. Please provide suggestions for any other commercial structure you consider may be appropriate either as the default approach or for exceptional circumstances.

Most respondents supported having a default commercial structure, recognising the benefits of consistency, efficiency, and reduced complexity. However, some highlighted the need for flexibility to accommodate project-specific individualities and to enable innovation. All respondents recognised the benefits of the Lead Party model and considered it to be a suitable default.

There were no other models proposed as an alternative default model across all DPC/SIPR projects (although a Combined Lead Party Model was proposed for SIPR delivered projects – see below).

Respondents felt that the Lead Party model provided benefits in terms of simplicity and clarity around responsibilities and relationships, which may result in it being more attractive to the market.

2.2.2 The role of CAP / IP for solutions

Most respondents to the consultation supported the use of an infrastructure only role. Benefits raised included aligning responsibilities with existing expertise/experience, avoiding the duplication of activities between the water company and the CAP/IP, and the clarity of interface between water companies and the CAP/IP.

Several respondents suggested that while some operation and maintenance (O&M) did take place under the infrastructure only model, the current regulatory framework would not allow the potential benefits of entire service to be fully unlocked, as under the current statutory framework the CAP or IP would not be able to hold responsibility for water companies' statutory obligations for water supply and water quality. As such, water companies would still need to retain responsibility and risk around those duties, limiting the extent to which an entire service model would be possible or introducing duplication. However, it was suggested that potential legislative change to allow the CAP/IP to take on wider obligations should be considered and explored in the future.

Some respondents suggested that the inclusion of O&M would increase the pool of interested investors, create opportunities for innovation in the maintenance of assets, and ensure alignment of incentives for all parties involved.

RAPID notes that elements of operations and maintenance are not exclusive to an entire service model and are included by default under the infrastructure only model, potentially unlocking some of the benefits discussed. Only water company respondents made a case for third-party responsibility for abstraction and supply to customers, which is a key element of the entire service model, raising questions about the investability of such a model.

2.2.3 Commercial structures: Responsibilities and risks

In the consultation we asked:

Q2.4 We welcome your views on the different risks and responsibilities associated with different models. Please provide comments on risks not detailed in the paper which you consider may have a material impact on the choice of commercial structures.

Q2.5 Please provide comment on ways in which risks identified in Q2.4 may be mitigated.

A key risk raised in the consultation and the responses was counterparty credit risk. Whilst it was acknowledged that counterparty credit risk will be a factor in any commercial model involving multiple parties, some respondents felt that without further mitigation, the Lead Party would be exposed to significant counterparty credit risk if the Lead Party held sole responsibility for the full payment to the CAP/IP, regardless of whether it was able to recover the relevant payment from non-lead parties through a BSA.

An alternative model proposed to manage counterparty credit risk was the Combined Lead Party (CLP) model. This model was proposed only for projects delivered under SIPR, due to the size and complexity of these projects. Under the CLP model, the Lead Party would procure the IP, but both the Lead Party and the importing water company (or companies) would have separate revenue agreements with the IP. The main feature of the model is that it would bifurcate charges paid by importers between those they would make directly to an IP (for capacity/financing), and those paid to the water company selling the water to the importer (for water supply).

The companies proposing the CLP model felt that the model provided benefits in relation to counterparty credit risk – removing this risk from the Lead Party and transferring it to the IP. The model also potentially provided financeability benefits for an IP as it would have a direct line of sight to the importing parties.

However, further development and market testing of the model undertaken by water companies indicates that whilst investors in an IP may place weight on having a direct line of sight to counterparties, it also indicates that in general they may prefer the simplicity of dealing with one Lead Party.

Respondents raised concerns about additional risks including supply risk, regulatory risk, reputational risk, affordability for customers, timing of delivery, drought risk/force majeure, and downside risks associated with large projects. However, many of these risks were not associated with a particular model and were instead raised as risks to be mitigated and managed regardless of the commercial structure used.

2.3 Discussion, decisions and next steps

2.3.1 Commercial structures: default model Lead Party (infrastructure only) model

Taking account of responses and suggestions, RAPID and Ofwat continues to consider that a default Lead Party (infrastructure only) model has benefits for both solutions and customers. Nevertheless, given the wide range and individual nature of the solutions, we acknowledge that it is not possible to apply the model in the same way to each solution.

We recognise that many of the views on the need for flexibility concerned the allocation of risks and responsibilities, which will always, to an extent, be project specific. The extent of a third-party provider's obligation to maintain and operate infrastructure is also likely to be project specific. We also acknowledge stakeholders' suggestions of regulatory change to enable a full-service model in the long term, and we will continue to assess the viability of this approach in the future.

Flexibility would need to be considered on a case-by-case basis, where companies have demonstrated a clear need for a variation. This approach will ensure that the benefits of standardisation are retained whilst still allowing solutions to adopt commercial structures that accommodate for any unique aspects.

Therefore, in order to support the standardisation of commercial structures and the benefits this may unlock, RAPID's conclusion is that a single commercial model – Lead Party (infrastructure only) model – should be the default approach across all applicable projects.

We consider there to be limited circumstances in which the unique aspects of a solution would be so significant as to require a complete deviation from the Lead Party model. Any such deviation would need to be justified based on best value for customers and be clearly demonstrated on a case specific basis.

RAPID and Ofwat would expect the sponsoring water companies of the solution to demonstrate sufficient consideration of the use of the default Lead Party (infrastructure only) model, and to work with both RAPID and Ofwat in making the case for a variation to the Lead Party model. This will require that they show why the Lead Party model, with mitigations, could not yield a better value outcome than an alternative approach, and to clearly lay out the proposed bespoke arrangements for their solution.

2.3.2 Risks: Counterparty credit risk

Given the benefits of the Lead Party model, Ofwat has been considering whether the concerns about counterparty credit risk can be addressed within a Lead Party model. In

summary, the risk we are trying to mitigate is the risk on the Lead Party that comes with a hard obligation to pay the IP or CAP the full IP or CAP charge received from its customers and from the co-sponsors. The co-sponsors have a hard obligation to collect the IP or CAP charge from their customers and to pay that on to the Lead Party. The concern is if the co-sponsors go into financial difficulty, and potentially special administration, and fail to comply with that obligation in whole or part.

We recognise the importance of addressing this risk and have considered various ways of mitigating it, including by the following:

- placing a licence condition on all relevant water companies to comply with the BSA, including making payments under BSA;
- a 'pay-when-paid' model that applies to payments from the Lead Party to the IP or CAP (i.e. the Lead Party will only pay the IP or CAP what it actually receives from each co-sponsor – so if they default on 10% of what they own, the 90% that has been paid will be transferred to the IP or CAP). This transfers counterparty credit risk to the IP who is likely to need a liquidity buffer to deal with this risk;
- provision of collateral from co-sponsors – (e.g. Parent Company Guarantee; letters of credit; pre-payment facilities);
- regulatory protection – E.g. a notified item which is triggered when a Lead Party has to make payments to an IP or CAP in circumstances where a co-sponsor party has defaulted (such notified item would be conditional on other factors). The additional revenue this would provide means that the customers of the Lead Party would be providing temporary credit relief which would subsequently be recovered from the defaulting co-sponsor;
- insurance products if available in the market; and
- contingent direct charging (which would allow an IP (but not a CAP) to collect charges directly from the customers of a defaulting party in certain circumstances. This approach applies on the Thames Tideway Tunnel.

In light of the above, we consider that the primary mitigations that could be used to mitigate counterparty credit risk are likely to be a combination of the following:

- licence amendments requiring the parties to a BSA to comply with the BSA. This will bring the BSA within Ofwat's remit enabling Ofwat to take enforcement action for non-compliance with the BSA;
- for solutions with significant counterparty credit risk, we would support a 'pay when paid' arrangement, so that the risk of non-payment from a co-sponsor falls on the CAP or IP rather than on the Lead Party. In each instance, this may depend on market engagement;
- in circumstances where the counterparty risk falls on the CAP or IP, the CAP or IP will need to size its liquidity facility accordingly.

We consider that these measures may provide suitable mitigation for situations in which significant counterparty credit risk arises in complex SIPR or DPC projects and would expect companies to explore these options before departing from a Lead Party model.

3. Bulk Supply Agreements

The Bulk Supply Agreement (BSA) is a bilateral agreement for a supply of water between a water company (Exporter), that has (or will in the future have) surplus water, and another water company that needs or wants the water (the Importer). The number of BSAs within a project correlate to the number of Importers, making multi-party projects challenging to scope and manage.

The BSA primarily defines the service the Importer will receive, what they will pay for that service, and the remedies that it can expect if the right standard of service is not received.

In the November 2023 consultation, we sought views on various issues concerning the framework in which strategic water resource infrastructure assets would operate, in particular:

- The framework for negotiating bulk supplies and standard BSA provisions
- Operation of assets, especially during drought scenarios or other operational events
- Whether the framework should be in the form of Ofwat guidance or statutory codes and rules for water companies negotiating bulk supply agreements.

In our September 2024 summary of consultation responses, we explained that our actions going forward would be:

- BSA guidance – to undertake further work to develop new guidance on negotiating bulk supply agreements and to consider the development of standardised approaches based on the areas set out in Appendix 1 of the consultation [Draft framework for a standardised bulk supply agreement], as well as any additional points raised within consultation responses. We would take steps to develop and consult on this in early 2025.
- Operation of bulk supply transfers during drought or other operational events – we were completing work on some scenario development to look at how the policy might be applied in practice, as well as considering the potential interplay of planning mechanisms (WRMPs, regional plans and drought plans) with the policy approach. We were discussing further with water companies.
- Use of statutory code for BSAs – taking account of the views expressed by respondents, we intended to consider further the need for a statutory code in late 2025.

In this chapter we consider all issues discussed in Section 3 of the consultation, and give a summary of the issues, explain the responses received, explain what we have done since September 2024 and conclude with an explanation of our policy direction.

3.1 Framework for negotiating bulk supplies

We proposed that when developing bulk supply agreements there is a need to have a consistent approach which would help achieve greater standardisation. Our conclusion was that water supply transfers from SROs would require new guidance for negotiating the associated bulk supply agreements.

In the consultation we asked:

Q3.1. Do you agree with our conclusion that the solutions in the RAPID programme require a new guidance framework for negotiating bulk supplies?
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Q3.2. Please provide your views on the areas likely to be required in bulk supply agreements for RAPID projects as set out in Appendix 1 and please list any areas that you consider are missing from Appendix 1.

3.1.1 Consultation responses

Most respondents agreed that the existing guidance was not sufficient for current RAPID solutions and associated transfers which have fundamental differences from existing BSAs, such as the involvement of third-party CAPs/IPs, joint payment for new infrastructure, and the complexities involved with multi-party solutions.

3.1.2 Discussion, decisions and next steps

Since publishing our consultation and summary of responses documents, we have been further developing the regulatory and commercial frameworks with respect to BSAs and plan to publish detailed guidance which will supplement our 2013 guidance. This guidance will evolve as we learn from projects in development and will be issued in a number of releases through 2025 and beyond.

RAPID and Ofwat proposes that the guidance forms part of a wider contractual framework for bulk supply transfers which arise from SROs. This allows us to introduce other documents into the contractual framework that, although not part of the BSA, will form part of a broader contractual framework ecosystem.

Rather than waiting until we have concluded all policy issues and then publish one guidance document, we propose publishing a first release of the guidance (Release 1.0) in the latter half of 2025. We will follow this with further releases as policy is developed. We will ensure that these policies have been socialised with industry through forums, such as the Regulatory and Commercial (R&C) Steering Group, and/or via other mechanisms such as consultations.

The difference between BSAs in the context of SROs is that the agreement entered into between the relevant companies includes agreement for the development of infrastructure in order to facilitate supply. Historically, BSAs have only dealt with the supply rather than the development of infrastructure.

The scope of the design and operational requirements of the infrastructure, and the tender for the CAP or IP, will be informed by the requirements of the BSAs. Therefore, there must be alignment between the content of a BSA and the design and operational specifications under any CAP or IP agreement.

It is clear that there is a need for Ofwat to give more direction and guidance to companies building and operating strategic water infrastructure assets. We therefore propose the provision of additional guidance for strategic water infrastructure assets. Additional guidance will sit alongside the existing BSA guidance⁹.

Proposed framework

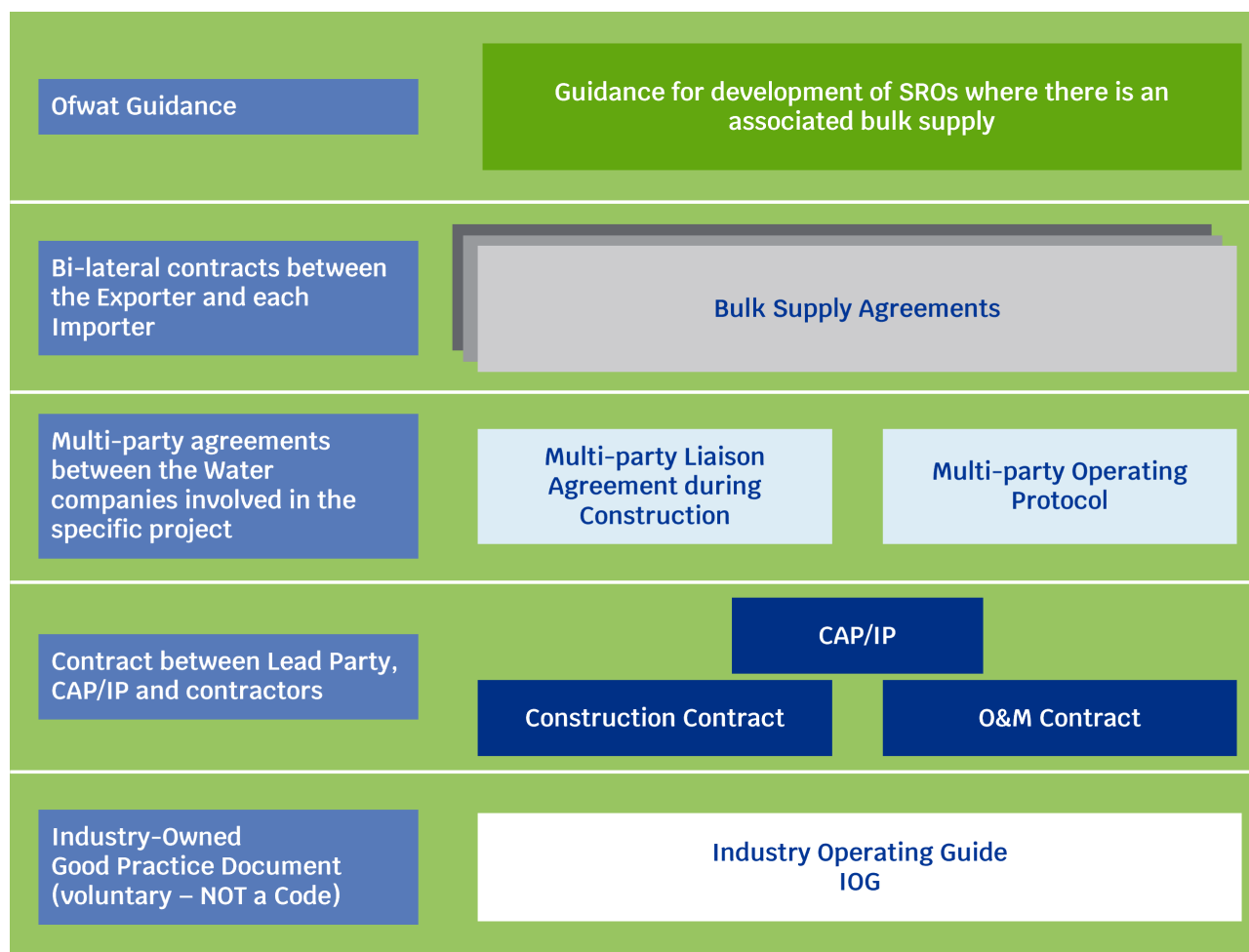
Although the BSA is a key document, it will sit alongside other key documents. A BSA will only change under its own terms or if the parties refer a dispute over terms to Ofwat for determination under section 40A of the Water Industry Act 1991.

Change provisions in a BSA are likely to be limited and in most instances changes to the contract will require the consent of both parties. This means that some issues, which may require more fluidity, may be better sitting outside the BSA. This structured approach will allow Ofwat and the industry to have constructive conversations, targeting the most appropriate place to document relevant regulations, standards, and recommendations.

Figure 2 below provides an illustration of the proposed framework.

⁹ [Negotiating bulk supplies](#) – Ofwat – August 2013

Figure 2: Proposed Contractual Framework



Layers in the framework

This framework is not a hierarchy. Each layer is independent, but will be inter-linked through referencing, or being informed by another layer. The layers are:

- **Ofwat Guidance for SROs where there is an associated bulk supply water transfer**

This guidance will contain principles and issues that Ofwat considers important and will be aimed at strategic water infrastructure projects that require a Bulk Supply Agreement.

- **Bilateral contract: Bulk Supply Agreement**

This is the contract between two parties: the Exporter and the Importer. It has two purposes:

- It is a 'supply' contract which describes the commodity (water) and service the Exporter will deliver to the Importer in terms of metrics such as volume per day, supply rate, water quality, service availability etc.
- As the supply is facilitated by the provision of infrastructure, it must be in place prior to the procurement of a third party that will deliver the infrastructure and also regulates the relationship between the parties from the outset of the project dealing with things like the allocation of costs of the infrastructure and the supply, and the parties' governance arrangements.

- **Multi-party agreements: construction and operations**

Historically, most supply contracts were for existing surplus water and did not include new shared infrastructure. What distinguishes new supply contracts is the need for new infrastructure, to meet the needs of multiple parties and paid for by multiple parties. This makes these BSAs significantly more complex.

Recognising that BSAs are bilateral agreements, for projects where there are more than two importers, there will also need to be a governance or liaison agreement that sets out the roles and responsibilities of all the parties; and establishes the forums and mechanisms for ongoing engagement and, where necessary, approvals.

We believe it may be necessary to set-up separate multi-party liaison agreements that describe the governance during the construction and operations of a multi-party project. These agreements require careful attention to ensure that any changes to construction or operating protocols can be absorbed without significant change to a BSA, which must be committed to prior to construction. This is a policy area that will be developed, on which we will engage with the water sector, and it may feature in Release 1.0 of the Ofwat guidance. This concept is discussed further in Section 3.3.2.

- **Contracts: CAP/IP, construction and operations**

These contracts will cover the main construction and the operations phases. These contracts are not discussed further in this document as they are covered in other Ofwat guidance on the delivery of DPC and SIPR projects.

- **Industry-owned document: Industry Operating Guide (IOG)**

This industry-owned document was proposed to encourage standardisation but without introducing a statutory code. The intention is to promote water companies and other entities involved in the SRO's with associated bulk supplies to work together and develop best-practice standards in the operational phase of a project. Concepts such as common definitions, operating models, protocols, performance parameters etc. could be developed. This is discussed further in Section 3.4.2.

3.2 Standard bulk supply agreement provisions

The consultation recognised one of the key challenges in developing new water infrastructure solutions is ensuring consistency and clarity in BSAs. While these agreements govern water transfers between companies, historically they have varied significantly in structure and term. The consultation identified the potential for standardised provisions to reduce transaction costs, enhance investor confidence, and improve overall service delivery.

Balancing flexibility and uniformity are important, while standardisation can streamline negotiation and create a more predictable investment environment, some stakeholders have expressed concerns about overly rigid contracts that may not suit the unique characteristics of different water transfers.

Appendix 1 of the consultation provided a draft framework for a standardised BSA, which set out a range of provisions for inclusion and on which we sought feedback.

In the consultation we asked:.

Q3.3. Which contract provisions do you believe should be standard to bulk supply agreements?

Q3.4. Please provide views on how to best achieve standardised provisions.

3.2.1 Consultation responses

Most respondents supported the need for standardised provisions in BSAs to improve consistency and efficiency. However, there was also recognition of the need for flexibility, given the unique characteristics of each strategic water resource solution. Some respondents proposed additional provisions such as third-party use, dispute resolution, and frameworks for performance monitoring.

The responses suggests that standardised provisions should be developed collaboratively through an industry working group. While standardisation is important, flexibility should be maintained to accommodate project-specific factors such as evolving market conditions.

Most respondents agreed that the areas identified in Appendix 1 were a useful reference point for the development of BSAs, and that they broadly aligned with the contract clauses that appointees were expecting to adopt for future strategic water resource solutions.

3.2.2 Discussion, decisions and next steps

Ofwat is progressing with a standardised CAP Agreement, which is the Agreement between a water company delivering a project and the Competitively Appointed Provider (CAP) delivering the project under Ofwat's Direct Procurement for Customers (DPC) initiative. This will have standard text and clauses, that reflect guidance issued by Ofwat, setting out the expected risk allocation for project agreements. The standardised CAP Agreement has also been able to draw lessons from two front runner projects being delivered under Ofwat's DPC initiative.

We consider that a standardised BSA for SRO's with associated bulk supplies will be useful but that it is too early for its development and standardisation. Instead, the focus will be on developing guidance. We will provide general guidance or policy on certain issues, and in some cases, we may also recommend specific contractual text.

3.3 Operation of bulk supply transfers during drought or other operational events

Droughts and operational challenges raise the question about how to fairly allocate water in times of scarcity. Bulk Supply Agreements need to address this issue. The consultation (and earlier RAPID consultations) introduced the concept of a 'fair shares' approach, which ensures that both exporting and importing companies' customers receive equitable service levels during periods of stress.

Under this approach, an importer should continue receiving its contracted supply unless doing so would leave the exporter's own customers with a lower level of service. If shortages were to occur, reductions would need to be managed equitably, and exporters may be required to compensate importers for any failure to supply contracted volumes.

The consultation set out proposed high-level principles for the operation of a 'fair shares' approach and explored different governance mechanisms to ensure that the approach could be effectively implemented and ensure that real time decisions could be made during crisis situations. The governance options proposed were:

- Basic contractual arrangement- a clear and objective method for determining the defined adjustments, for example this would be a formula for calculating the adjustment.
- Enhanced governance- a clear set of principles and an established governance panel with representatives from all parties to the agreement meeting regularly when the water availability position starts to change.
- System operator – an independent third party who will make the final allocation of water based on principles set out in the contract.

In the consultation we asked:.

Q3.5: Do the high-level principles align with the objectives of this policy?
Q3.6. Do you think it is possible to include an objective method in bulk supply agreements for calculating a fair shares adjustment in times of drought or other operational events?
Q3.7. Do you have any comments on whether an enhanced governance model coupled with a dispute resolution procedure could work? Or whether a system operator model may have advantages?

3.3.1 Consultation responses

Most respondents broadly agreed with the proposed high-level principles but highlighted challenges in practical implementation. Some noted that each solution is unique, making a single objective method difficult.

Several respondents supported an enhanced governance model, while other suggested that a system operator model could be useful in specific cases involving complex, multi-party transfers. Respondents agreed that the process needed to be clear, objective, and representative of the interest of all parties involved in the BSA.

Respondents mostly agreed with the use of enhanced governance options for implementing the fair shares approach. The preferred option was the enhanced governance model, as some matters require a joined-up approach that goes beyond the supply area of a single water company at times when water supply systems are under stress. The enhanced governance model was deemed to be an effective model not only for Fair Shares, but also for setting operational principles for bulk supply projects as a whole.

3.3.2 Discussion, decisions, and next steps

As discussed in Section 3.1.2, we believe that for multi-party projects (where there is more than one importer) there is a need for multi-party agreements that will sit alongside the BSA. In the construction period, this could take the form of a Liaison or Governance Agreement and in the operational period, we are proposing a Multi-Party Operating Protocol (M-POP), which will describe the principles upon which the asset will operate during normal and stress (fair shares) conditions. There may also need to be an Operational Agreement, depending on the contractual status of the M-POP.

The M-POP is not intended to allow all parties day-to-day involvement in the operations of the asset, rather it contains the governance structures and principles. We believe this proposal is in the spirit of the 'Enhanced Governance Model' described in our consultation.

We propose consulting on these issues before issuing release 1.0 of the Ofwat guidance, which will describe the specific content Ofwat considers important for these agreements. However, our current view is that as a minimum the following items (1-5) should be included in the M-POP.

1. Operational model – roles and responsibilities

Parties would be expected to agree roles and responsibilities. Some key roles that we would expect to see in the Operational Model are:

- Operator: the entity responsible for day-to-day operations
- Planner: the entity responsible for maintaining a view of the asset and determining if any proposed changes or enhancements can be accommodated and at what cost.
- Stakeholders: the parties, including the Exporter who will have a say in how the asset is developed and operated.
- Emergency Governance: The parties that have power to make emergency operational and planning decisions. This may be a set of delegated persons or a board/panel that is convened when needed.

2. Change and governance model

The M-POP must contain a Change and Governance Model which documents how and what Stakeholders can influence. It should contain at least:

- The Stakeholder initiated change request process, how they are proposed, agreed and funded.
- The Operator and Planner initiated change request process, how they are proposed, agreed and funded.
- The appeal route for parties should disagreements arise.

3. Operations and maintenance strategy

If the asset is a reservoir or a complex system of recycling works, rivers and reservoirs, the strategy to fill and discharge at the agreed water flow rates, maintenance of assets and water quality controls will be important to Stakeholders. A comprehensive strategy should be documented and agreed by all parties.

It is important that all parties understand the definitions of the types of maintenance such as scheduled, planned and unplanned. These definitions are key to determining if a

degradation in the water supply service would qualify for compensation. Ofwat encourages the industry to agree a standard set of definitions that could reside in the Industry Operating Guide.

4. Incident management and communications

In a multi-party operating scenario, it is important that incidents are managed efficiently. This is partly delivered by the incident management process, but a cross-party communication plan is also vital, especially in water stress conditions. Ofwat expects the Operator to issue early warnings to Stakeholders if environmental or other metrics indicate that a water stress scenario is probable.

We encourage the water industry to develop clear definitions of stress scenarios and best practice protocols for operations during these conditions. The Industry Operating Guide could be an ideal place to develop and document definitions and best practice protocols.

5. Post incident investigations and reporting

Following any incident, be it a fault or a managed degradation because of a water stress scenario, Ofwat would expect a robust investigation and reporting process to be part of the M-POP documentation.

3.3.3 Fair Shares

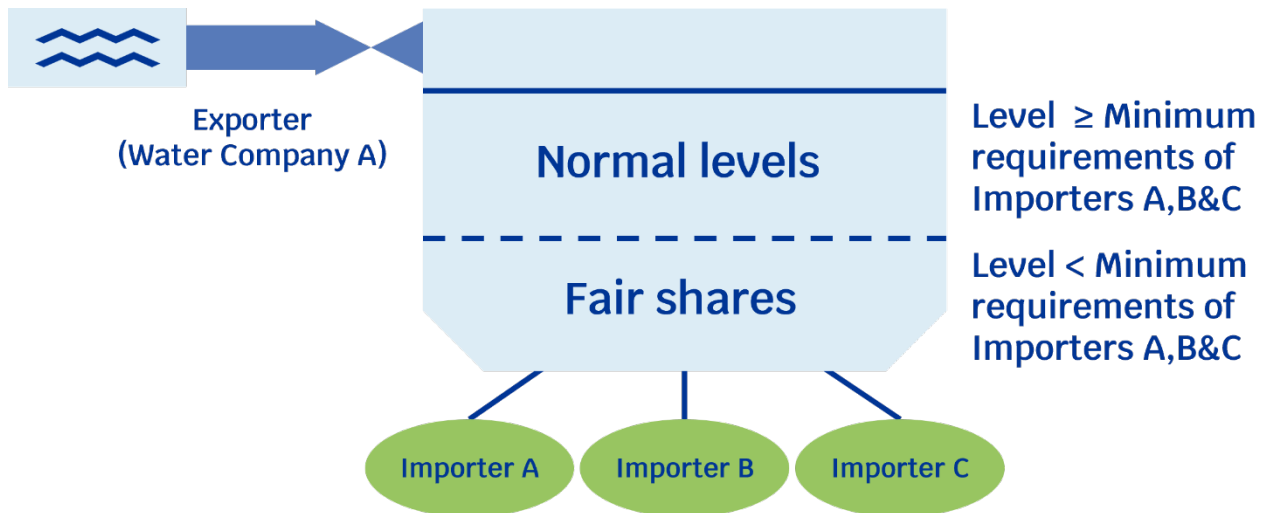
The issue of 'Fair Shares' has been keenly discussed, and many stakeholders have an interest in this subject. Fair shares refers to the situation where there is not enough water to serve the minimum requirements of all stakeholders.

The allocation of water in times of extreme stress, where multiple parties have need of the water, is a complex and important issue. The BSA should set out both normal and minimum requirements.

The consultation discussed the contractual principles which a bulk supply agreement might include to agree how a defined adjustment to the volume of water being exported could be determined under a fair shares arrangement. It also sought views on the feasibility of a single formula for calculating the defined adjustment.

In the diagram below, a Fair Shares scenario is reached when the asset cannot fulfil the minimum requirements of all Importers.

Figure 3: Fair shares



All customers connected to an asset must be treated equally and fairly. This is especially important in a scenario where water scarcity has become an issue (Fair Shares scenario). In the consultation we proposed that when a Fair Shares scenario is reached, the asset must be operated based on *need*, rather than a prescribed formula. In other words, the drought position of all connected water companies must be monitored, and in a Fair Shares scenario the Operator must share the water according to which party needs it most, at that point in time. However, the assumption that the asset can be operated based on need, implies that there is a way of measuring it.

Measuring 'need'

Each water company has their own drought plans. These plans outline how water companies will manage water supplies during a period of prolonged dry weather or drought, to maintain a secure water supply while minimising environmental impacts.

The plans define what environmental or operational scenarios constitute a certain drought position or level, and what actions the water company will take because of that drought position / level.

When different water companies trade water via an asset, such as a reservoir, they are making a connection across operating boundaries. However, those water companies' drought plans may not align. The Operator will need to determine which connected water company is in most need at any given time.

We continue to develop our thinking on this issue, but believe that the Operator will need a way to normalise or map each water company's drought levels onto a single common merit

order. This does not mean that each company must change their drought plans/levels, rather they must find where their levels most align with those defined by the asset.

We consider that the Exporter should also be included in the merit order. If its position is worse, and worsening, relative to connected Importers, it may decide to stop or suspend flow into an asset until its position stabilises.

Whatever method is chosen to measure need, the Operator should monitor it during both stress, and normal conditions. The latter is an important mitigation which ensures that if the rare occurrence of a Fair Share scenario is reached, there will already be a comprehensive plan in place and communicated to all Stakeholders.

In summary, we consider a Fair Shares scenario should be an extremely rare event. It would not happen overnight, which gives Stakeholders time to plan and organise using the following tools and arrangements:

- Continuous monitoring, by the Operator, of the merit order of connected parties
- Arrangements and protocols agreed in the M-POP, for both normal and stress conditions
- The mobilisation of the Emergency governance if required, to make critical or strategic decisions.

We recognise that further discussion is required with water companies as to how an Operator could measure need. This issue will be developed further over the coming months so that detailed policy can be included in Release 1.0 of the Ofwat guidance.

3.4 Guidance or statutory code for bulk supply agreement framework

The consultation posed the question on whether future BSAs (not just those required for SRO projects in the RAPID programme) should be governed by a statutory code. The consultation leaned towards guidance, allowing for flexibility while ensuring regulatory oversight. However, there was recognition that a statutory code could provide improve consistency across agreements and provide a stronger route for regulatory compliance and enforcement. We also sought views on how any statutory code might work alongside bulk supply agreements developed under previous non-statutory guidance.

In the consultation we asked:

Q3.8 What do you think about the longer-term planning for and development of a statutory code being wider than RAPID projects?
--

Q3.9. In developing a statutory code, what might we need to consider to avoid any legacy issues resulting from bulk supply agreements considered under non-statutory guidance?

3.4.1 Consultation responses

There were mixed views on the need for a statutory code. Some respondents felt that guidance should be used initially, with a decision on a statutory code being made later based on market-tested impacts. Others supported a statutory code for standardisation but highlighted the need to balance flexibility and enforceability.

3.4.2 Discussion, decisions and next steps

Standardisation leads to lower costs by bringing certainty and repeatability and can assist major projects being delivered efficiently and effectively. As a minimum the industry needs to use a common set of definitions for the projects currently progressing through Ofwat assessments. Ultimately, it is desirable to standardise as many concepts and issues as possible, such as best practice operating protocols, water supply characteristics, performance metrics methodologies, and management of design or operational change. In some sectors statutory codes have fulfilled this role, but in other sectors voluntary standards have played a similar role.

Overall, from both consultation responses and following engagement and additional feedback from water companies, there has been recognition of the benefits of standardisation, but no support for introducing a statutory code at this time.

This aligns with the proposal in the consultation that guidance rather than a statutory code should be used for the short to medium term. However, we have not ruled out the development of a statutory code in the longer term.

We also consider that a voluntary Industry Operating Guide may assist with greater standardisation. Water companies and other parties, such as design and operations companies, will be best placed to mobilise an industry forum to start this work. It is in the interest of water companies, and those involved in the design, build and operations of major projects, to work together to agree common standards as soon as possible so that we minimise unnecessary divergence.

4. Charging and Water Trades

In the 2023 consultation, we outlined our views on how charging would work within the BSA and BSA guidance. We emphasised the need for charges to reflect and allow for the recovery of costs associated with bulk supply provision, as well as incentives to encourage both exporters and importers to commit to strategic trades.

We sought feedback on our proposed charging model, method for calculating economic profit, incentivising availability and compensation for failure to supply, and our approach to guidance for charging.

In our September 2024 summary of responses document, we explained that our next steps would be to take on board feedback on the proposed charging model and work to develop a final model in discussion with consultation respondents.

Below we summarise how our thinking has evolved in light of responses, further work and discussion.

4.1 Proposed charging model

The charging model as proposed in the consultation comprised of a fixed charge, volumetric charge, economic profit, availability incentive, compensation for non-delivery and a re-balancing charge. In the consultation we asked:

Q4.1. Are any other charging elements needed? Please explain your answer.

4.1.1 Consultation responses

Some respondents agreed with our charging proposals, with several indicating that no additional elements were necessary. However, other respondents felt that the model required flexibility to accommodate bespoke circumstances.

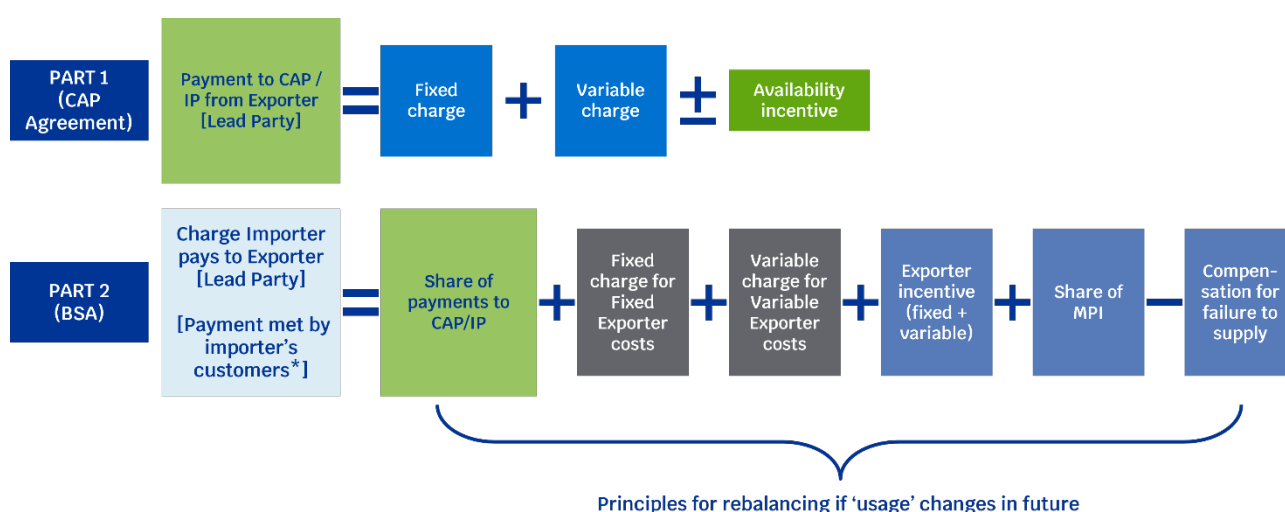
Specific points were raised regarding the need to consider losses in transfers, the role of system operators and interactions with price controls. Respondents requested further guidance on the necessity of an availability incentive in addition to economic profit, the scope of the 're-balancing' charge, and the responsibilities of each party. Clarity was also sought on the payment of liquidated damages due to construction delays. Additionally, there was a query on whether the model needed adaptation for SIPR, given that the charging model assumed a fixed revenue stream, which is applicable for DPC but not for SIPR. For SIPR

it is likely that there will be price resetting post construction in line with our regular price reviews.

4.1.2 Discussion, decisions and next steps

We have continued to develop our thinking on the charging model and have clarified the components and how they fit together. Our revised charging model is set out below in Figure 4.

Figure 4: Components of revised charging model



This includes a new element in part 2 of Figure 4: a share of the Major Projects Incentive ("MPI"). The MPI was introduced in PR24¹⁰ and covers both Ofwat's DPC stage process and RAPID's gated process. This regime will more clearly link reward to successful delivery, clarify the application of the incentive to SIPR projects, and clarify who will receive the rewards and incur penalties.

We re-name the economic profit element as the "exporter incentive" (in part 2). This is to clarify its purpose and demonstrate the potential for adjusting charges to reflect usage differences as a rebalancing of each component rather than an additional component. (We discuss the rationale for our change in terminology in section 4.2 below.)

We reconsidered the inclusion of the importer incentive in the model. Initially introduced to encourage potential importers to undertake discretionary trades and optimise available resources. However, this purpose does not align well with the SROs, which are being developed to create new resources to meet urgent needs for the importer and have been validated through the WRMP process as providing the best way for the importer to meet their

¹⁰ [PR24 final determinations: Major Projects Development and Delivery – Ofwat – February 2025](#)

needs. These SROs also receive significant regulatory support through RAPID. Therefore, we believe the rationale for the importer incentive is weak in the context of RAPID SROs and we have removed it. By removing the importer incentive, we can reduce costs for importing customers without compromising the resilience they receive.

The fixed and variable charges (in part 1), recover the costs of the CAP or IP under the CAP Agreement (or IP equivalent) initially from the Lead Party. Part 2 then shows that in the BSA a proportion of those charges are passed on by the Lead Party to each importer, and additional fixed and variable charges recover the Lead Party's own costs from each importer (who in turn recovers the costs from its customers through its price control).

In terms of the CAP or IP charges (in part 1), our position remains as in the consultation. The variable charge should reflect any variable costs that the CAP/IP incurs (i.e. costs that vary with the volume of water). These may be low or zero if the CAP/IP has limited or no operational role. The fixed charge reflects all fixed costs, including capital costs (including interest and profit for the CAP/IP) and fixed operating and maintenance costs where relevant. Both charges will likely include indexation and may be subject to periodic resets.

The allocation of the CAP/IP charge from the Lead Party to the Importers requires careful consideration given its magnitude. Companies will need to consider the drivers of the costs of the SRO and how each beneficiary of the water contributes to these costs. If there are benefits from the SRO beyond water supply, then these should be reflected.

For the recovery of costs incurred directly by the Lead Party, we envisage separate fixed and variable charges in the BSA. These should reflect incremental costs that can be identified explicitly – for example incremental capital costs reflected in enhancement allowances in the Lead Party's price control, so these are ultimately paid by the customers who benefit. In line with our previous consultation and responses, we do not consider that an approach based on average wholesale charges is appropriate.

The fixed charges may also need to reflect reallocations of development funding if the initial allocation of costs to different companies' customers does not reflect the ultimate beneficiaries of the SRO. We would expect this reallocation, if needed, to be a transfer without any additional returns or mark up.

In terms of re-balancing charges, we have clarified this in the new charging model. Year-to-year variations in water taken by each importer should not impact the fixed charges but will be reflected in the overall variable payments. When a change in the volume of water imported is sought, reallocation of fixed charges is likely to be appropriate.

Given the wide range of future possibilities, including the identification of new importers or sources and reallocation among existing importers, it is not practical to prescribe precise adjustments at this time. We acknowledge that reallocation may be prompted by changes to

WRMPs; however, we do not believe that adjustments can be made mechanistically based on new WRMPs alone. There is an established process to ensure necessary adjustments: if the parties to the BSA cannot reach an agreement, they should refer the matter to Ofwat for determination. In making a decision, Ofwat would consider existing commitments and the importance of new importers contributing to development costs to prevent free rider issues.

Regarding other issues raised in responses, we would welcome further case specific information on charging from water companies to clarify concerns. On the following points however, we would:

- Expect charges to be based on an identified supply point, reflecting losses in water volumes occurring during the transfer up to that supply point.
- anticipate that the Lead Party would operate the SRO system; however, there should be further discussion with Ofwat if alternative models are proposed for a particular SRO.
- not see a connection between the availability incentive on the CAP or IP and the economic profit or exporter incentive paid to the Lead Party.

Issues relating to delays in construction will be consulted on as part of Ofwat's development of BSA guidance.

4.2 Economic profit (now referred to as Exporter Incentive)

To encourage more bulk water trades between water companies and to overcome both financial and non-financial barriers evidenced through experience over recent years. Ofwat introduced an incentive for water companies in PR24¹¹. Exporters (in many cases the Lead Party for a SRO) are allowed to charge a premium on the expected costs, with the exporting company retaining half and the other half flowing to the exporters' customers.

In the consultation, RAPID set out a proposed approach to how the value of the incentive would be calculated and we referred to the value of the incentive as "economic profit". We asked:

Q4.2. Do you agree with the proposed approach to calculate economic profit?

Our engagement with water companies during the consultation identified that the term "economic profit" had led to a degree of confusion. Therefore, we now refer to "exporter incentive" instead of "economic profit" to better reflect the motivation for exporters to engage in bulk water trades, and aligning the terminology with the intended policy objectives.

¹¹ [PR24 Methodology – Appendix 2 – Water Trading Incentive, July 2022](#)

4.2.1 Consultation responses

A majority of respondents disagreed with our proposals, while some agreed fully or with some elements or required further information on the consultation proposals. Notably, all respondents disagreeing were from the water sector. Among those that disagreed, many raised issues with the benchmarking approach and the choice to benchmark against the upper quartile costs from WRMPs.

Another area of concern, mainly from water companies, was that risks would not be sufficiently captured by economic profit. One company suggested that, due to the additional risks taken on by the exporter, several factors should be considered for the exporter to be appropriately remunerated. These included: increased return to exporters; lower damages or limited damages relative to return; regulatory re-openers for exporters; risk allowances held by the exporter with out/under-performance mechanisms including sharing with customers; regulatory incentives/penalties; and licence amendments

Some water companies also suggested that a percentage uplift on the cost of capital may be a better method to set the level of economic profit. Several water companies also suggested that they disagreed with paying back the customer's share of development expenditure first, before economic profit was then shared. Some respondents felt that splitting economic profit between fixed and volumetric charges was a positive idea.

4.2.2 Discussion, decisions and next steps

We have undertaken further analysis, including some illustrative modelling, to further inform our approach to the economic profit as set out in the consultation and now referred to as "exporter incentive". As part of our engagement with companies we have request that they provide quantitative analysis to RAPID, including their own financial and charging models, to allow more specific consideration of the appropriate level of exporter incentives.

We remain of the view that an uplift on the cost of capital is not appropriate. Since the consultation, several schemes have seen their cost estimates increase, which would lead to higher rewards for worse value outcomes for customers. Companies have also noted that their own capital value associated with the SRO (to which the cost of capital is applied) may be relatively limited, so this approach may not be particularly useful in providing a reasonable risk-return balance.

Our illustrative modelling considers an exporter incentive set on a £ per Ml/d basis. We consider the value this could provide to a Lead Party/exporter, alongside the Major Projects Incentive set in PR24 and the return through the WACC (weighted average cost of capital) on their own assets associated with the bulk supply. This can be compared to the daily compensation figure that the exporter may need to pay if they are unable to supply to gauge

the balance of risks and returns. Our initial analysis suggests that the exporter incentive alone will cover a few days of non-supply per year and together with the other sources this increases the number of days. We have requested information from companies on the scale of risks (in terms of the potential frequency of non-supply) for each SRO.

We have considered the split of exporter incentives between a fixed element based on the capacity of the project and a variable element based on the volume of water actually taken in a given year. In principle we see benefit in linking the incentive to exports actually delivered, but recognise that there is considerable potential for this to vary over time and across schemes. We await further information from companies on potential usage scenarios before reaching a firmer position.

We expect that the exporter incentive would be payable where the exporter is delivering broadly as expected under the BSA, so its payment would be suspended under certain conditions.

4.3 Cost benchmarking

In the consultation, we proposed basing the level of economic profit (exporter incentive) on a cost benchmark, specifically one which reflects the lower quartile cost from the sample of all schemes of a particular type included in the WRMPs. This gives a cost benchmark to which we would apply a percentage uplift to calculate total exporter incentive.

To establish the cost benchmark, we based our analysis on all available data and updates from the final WRMP tables submitted by companies for each SRO. Using WRMP data we have been able to generate the updated £m/MI/d (megalitres per day) savings calculated using the methodology presented in the consultation document. Gains in WAFU (water available for use) (benefits MI/d) for each SRO was extracted from Table 4 of the WRMP tables, while total capex (£m) for each SRO taken from Table 5a from the WRMP tables. We then divided the total capex by the benefits to get the £m/MI/d for each SRO. Additionally, we calculated the average £m/MI/d for each option type (preferred and preferred/feasible) to compare the SROs against these figures.

Outliers were removed from the dataset (5% from each end of the data set) using the interquartile range (IQR) method whereby the upper and lower quartiles are calculated, as well as the IQR, and then all figures that fall out of the range are removed. We were then able to calculate a median and upper quartile from the remaining data, with the lower quartile used as the benchmark.

4.3.1 Consultation responses

A number of responses to the benchmarking approach were critical of the approach – notably on the robustness of the WRMP data, and RAPID not having considered regional differences in cost.

4.3.2 Discussion, decision and next steps

We remain of the view that the WRMPs contain valuable information on costs and potential risks associated with major projects. Therefore, we consider it would be prudent to utilise this information. Having evaluated the objections, we propose retaining benchmarking as a valid tool to cross-check the scale of incentives. Schemes with costs exceeding the benchmark will receive a smaller incentive as a percentage of costs.

To address concerns regarding the suitability of the WRMP data, sensitivity analysis of the exporter incentive estimates could be undertaken, considering regional cost differences and varying risk assumptions. This would provide a range of cost estimates reflecting different risk allocations, environmental considerations, and regional cost variations, rather than relying solely on the lower quartile of the most efficient projects. This approach, based on the cost benchmarking described in the consultation paper, allows for variation in cost estimates to account for the specific features of each project.

One of the responses argued that the use of the lower quartile in benchmarking meant that the calculation of economic profit was based on projects that had already been approved. Consequently, this introduced a selection bias. We consider this should not be a major issue, since the WRMP data is the best source of information available. It therefore makes sense to benchmark costs using data from projects that are likely to proceed (preferred and feasible), rather than those that have been ruled out.

Regarding the question of consistency with the proposals set out in Ofwat's water trading incentives consultation published in July 2022¹², we believe that RAPID's consultation document clearly indicated that the proposed benchmarking approach aims to provide a proxy estimate given the difficulty in estimating the next best alternative option.

4.4 Availability and compensation

In the consultation we proposed that the CAP or IP would be subject to an availability incentive to make the asset they are responsible for available for use, and that the exporter would also be subject to compensation if the CAP or IP failed to supply water up to the

¹² [PR24 Methodology – Appendix 2 – Water Trading Incentive, July 2022](#)

contracted volume sought by the importer. We suggested the energy sector Offshore transmission owner (OFTO) availability incentive could be a starting point for the design of both an availability incentive and compensation approach for the SROs.

Q4.3. Do you agree that the best way to incentivise the infrastructure provider is to set an availability incentive? Do you think the OFTO model could be applied, if not are there other models which should be considered?
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Q4.4. Do you agree that compensation should apply both for fair shares and other failure to supply? What factors should be considered in setting the level of compensation?

Q4.5. Do you agree that seasonality and ratchets depending on the scenario should be developed further? Should compensation be lower if fair shares adjustments are made?

4.4.1 Consultation responses

Most respondents agreed with setting an availability incentive, as it was felt that it could drive the right design behaviours, as well as being more outcome and customer focused. Respondents highlighted that availability incentives have been successful in other sectors in the past.

However, respondents noted that the incentive may be scheme specific, as different solutions would have different characteristics and requirements, and the incentive may not be appropriate for all RAPID solutions.

Almost all respondents agreed to some degree with setting compensation either for fair shares or other failure to supply or both.

Many respondents also supported the further development of seasonality and ratchets, whilst those who disagreed with this approach did so as they felt the proposal was already complex or that seasonality was a poor proxy for water availability.

A common theme emerging from the responses was the need to consider the individual circumstances of each solution.

4.4.2 Discussion, decisions and next steps

We remain of the view, in line with most respondents, that availability incentives and compensation for non-supply are important in driving the right behaviours. We consider the OFTO incentive provides a useful benchmark, including the use of caps to limit risk.

We recognise that the particularities of each SRO differ and that each project will need to develop its own proposals. We expect this to result in meaningful incentives and to focus on outcomes rather than constraining innovation in maintenance for example.

Where availability or supply performance is poor in a period such that liability caps are hit, we expect that additional contractual provisions would apply and ultimately regulatory sanction may be needed. These are considered in our work on developing BSA guidance as discussed in chapter 3.

4.5 Guidance or statutory rules on charging

In the consultation we discussed whether the approach to BSA charging should be set out in Ofwat guidance or in statutory rules. We asked: Q4.6. Do you agree with our approach to guidance / rules and charging?

We explained that Ofwat has powers under section 40E of the Water Industry Act 1991, to issue rules about charges that may be imposed by a water undertaker under a bulk supply agreement. A failure to comply with rules about charges could lead to Ofwat issuing a direction to comply and a failure to comply could lead to enforcement action against the relevant water company. To date, Ofwat has relied on non-statutory guidance rather than charging rules for bulk supply charges.

We discussed in the consultation that we had been considering whether to issue rules as we were concerned that guidance may not give sufficient protection to the interests of customers, as each water company may give primary weight in negotiations to the interests of its shareholders, and the interests of customers and shareholders may not align.

However, we proposed progressing by including charging in guidance, and considering the inclusion of some aspects of charging (as statutory rules) in the first phase of our work on considering the use of a bulk supply agreement code (discussed above in section 3.4).

4.5.1 Consultation responses

Most respondents agreed with the proposed approach that Ofwat should develop guidance initially and then the option for charging rules in the longer term alongside a code for bulk supply agreements. Respondents considered that this would enable the incorporation of lessons learned from initial schemes and would also be helpful in determining the optimal charging model and protecting customer interests.

4.5.2 Discussion, decisions and next steps

RAPID and Ofwat continue to develop principles for charging on the working assumption that they will initially be reflected in guidance and companies will need to explain any deviations from the guidance in the relevant gate and stage submissions. We anticipate however, that Ofwat is likely to move to bulk supply charging rules in the near future.

5. Next steps

Having progressed the commercial arrangement work to this stage, RAPID is now formally transferring this workstream to Ofwat to finalise these policies and take forward to implementation.

Ofwat will undertake further policy consultations on draft guidance and publish final guidance documents. Ofwat has established a specific Major Projects website¹³ through which it will provide regular updates and guidance.

RAPID encourages water companies and interested stakeholders to engage directly with Ofwat to discuss any elements of the policy areas covered in this policy outcome document.

RAPID recognises the need for continued visibility, transparency and engagement with stakeholders, and Ofwat will lead on this engagement with the water sector going forward. Engagement will be through the Regulatory and Commercial (R&C) Steering Group (which will be a joint RAPID and Ofwat forum) and the All [Water] Company Working Group. Ofwat will also undertake bilateral engagement with the investor and supply chain sectors; and Ofwat will attend external events to enable information sharing.

RAPID will continue to focus on work with partner regulators on reducing barriers within other cross-regulatory issues such as environmental regulation.

¹³ [Ofwat website – Major Projects](#)

A1 Glossary of terms

Term	Definition
Bulk supply agreement (BSA)	A bilateral contract between an exporter and an importer which sets out the terms and conditions of a bulk supply service, including price.
Competitively appointed provider (CAP)	The successful bidders of the DPC process and will be responsible for designing, building, financing and potentially operating and/or maintaining the infrastructure.
Direct Procurement for Customers (DPC)	The process whereby companies put major infrastructure projects out to competitive tender for delivery by third parties.
Emergency governance	The parties that have power to make emergency operational and planning decisions for the strategic water infrastructure asset. This may be a set of delegated persons or a board/panel that is convened when needed.
Exporter	The water company who is exporting the bulk supply of water transferred to another appointed company.
Exporter incentive	Previously referred to as Economic Profit. In water trading, exporter incentive is the excess amount charged by exporters over expected costs. Half the excess is retained by the exporting company, and the other half is given to the exporters' customers. This incentivises exporters and compensates customers for the opportunity cost and any development costs they may have funded.
Fair shares	The allocation of water in times of extreme stress, where multiple parties are contracted for the bulk supply water.
Fixed charge	In the context of the BSA charging model, fixed costs are the costs that do not vary with the volume of water supplied. These costs are incurred by the exporter regardless of the amount of water supplied and include expenses such as infrastructure development, maintenance, and administrative costs. Importers cannot avoid these fixed costs as long as water is made available, and these charges are likely to be index-linked.
Infrastructure provider	The successful bidder for a SIPR project who is responsible for designing, building, financing, and potentially operating and/or maintaining the infrastructure. Ofwat may issue an infrastructure provider with a project licence.
Importer	The water company who is importing the bulk supply of water transferred from another appointed company.
Importer Incentive	The importer incentive was designed to ensure that companies importing water received financial benefits for participating in water trades. The incentive, initially introduced to encourage discretionary trades and optimise resources, was reconsidered and removed because it was deemed unnecessary in the context of RAPID SROs, which provide better solutions for importers' needs. This decision was made to reduce costs for importing customers without compromising their resilience.
Lead Party	The water company that plans and develops the relevant infrastructure that facilitates a multi-water company supply to tender stage. It delivers this infrastructure both on behalf of itself and/ or the other water companies who will benefit from the supply (i.e. the exporters and importers).
Maintenance contractor	The entity responsible for maintaining the strategic water infrastructure asset.
Major Projects incentive	Major projects incentive is a financial reward-penalty mechanism provided to encourage the development and delivery of large infrastructure projects in the water sector. It is a single penalty regime covering both DPC stages and

	RAPID gates, introduced to improve consistency across projects. This regime links rewards to successful delivery and applies to SIPR schemes as well, with penalties phased across stages and capped at 30% of development costs. Rewards are partially earned upon successful tender completion and subsequent delivery.
NAVs	New appointments and variations referring to new, small water companies, also known as New Appointees.
Non-lead party	The other water companies involved in the SRO, usually the importers of the bulk supply water.
Offshore transmissions owner (OFTO)	In the energy sector, OFTOs design, build, operate and maintain the transmission assets; or others build the transmission assets and then transfer them to OFTOs at construction completion.
Operator	The entity responsible for day-to-day operations/delivery of the bulk supply service defined in the BSA.
Planner	The entity responsible for maintaining a view of the strategic water infrastructure asset and determining if any proposed changes or enhancements can be accommodated and at what cost.
Price Review 2024 (PR24)	The price control with Final Determinations issued in December 2024 covering the period 1 April 2025 to 31 March 2030.
Stakeholders (of the strategic water infrastructure asset)	The parties who will have a say in how the asset is planned and operated. Note that this cohort may also include the Exporter.
Strategic Water Infrastructure	Major infrastructure projects which have either: - a shared benefit between two or more water companies (with one water company using the infrastructure to facilitate a supply to itself and a third-party water company); or - a sole benefit to a third-party water company other than the water company delivering the infrastructure and/or in whose network it is based (with the benefit realised by way of a bulk supply).
Specified Infrastructure Projects Regulations (SIPR)	The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013. The Secretary of State or Ofwat may specify projects for delivery under the Regulations if: - the projects are of a size or complexity that threatens the incumbent undertaker's ability to provide services for its customers; and - specifying the infrastructure project is likely to result in better value for money than would be the case if the infrastructure project were not specified.
Statutory codes and rules	The Water Industry Act 1991 allows Ofwat to make and subsequently revise statutory codes and rules including in relation to Bulk Supply Agreements.
Strategic Resource Option (SRO)	Major water infrastructure projects being developed to address future water supply deficits and drought resilience challenges. Many of the proposed solutions are regional schemes and multi-party in nature.
Value for Money (VfM)	A key regulatory principle ensuring that water companies deliver services that achieve the best balance of cost, quality, and outcomes for customers, the environment, and society. Ofwat assesses VfM by evaluating whether investments and operations provide long-term benefits efficiently and equitably.
Volumetric charge	A variable charge based on the opex allowance. The charge is paid depending on the usage of the asset.
WAFU (Water Available For Use)	The volume of water a company can supply to customers, accounting for losses and operational use, but excluding most imports and exports. Used in assessing supply security.

Water company	A licensed company which has statutory powers and duties to supply water and/ or sewerage services to premises within an appointed geographical area under the Water Industry Act 1991.
Water Resource Management Plans (WRMP)	These plans set out how water companies (in England and Wales) intend to achieve a secure supply of wholesome water for customers and a protected and enhanced environment both now and in the long term.
Weighted average cost of capital (WACC)	WACC is calculated as the cost of equity multiplied by the percentage of equity assumed for the notional company plus the cost of debt multiplied by the percentage of debt assumed for the notional company. It represents the allowed return for the providers of equity and debt finance.



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