

AffinityWater

Water trading incentive compliance

Blind year reconciliation 2024/25

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Introduction to the water trading incentive compliance document

The Water Trading Incentive encourages companies to trade water subject to publishing an Ofwat-approved trading and procurement code encompassing 3 requirements and 12 principles. The Affinity Water [Trading and Procurement Code](#) was published in August 2018. This compliance document meets a requirement of the code in demonstrating that Affinity Water has complied with the requirements and principles detailed in the code in conducting water trades. The PR19 water trading incentive model has been updated as part of the Blind Year Reconciliation (BYR) process. The model includes water trades with related costs undertaken between 2020/21 and 2024/25, including the actual costs for the blind year 2024-25.

Two new qualifying water trades have been subsequently instigated during the period 2020-25 that meet all the requirements and principles detailed in the code. Both are imports from Thames Water, firstly Cockfosters facilitating the construction of HS2, and the other, Perivale compensating for a temporary loss of abstraction resulting from the construction of HS2.

Thames to Cockfoster Import

We agreed to supply HS2 up to 5Ml/d of construction (non-domestic) water to facilitate the construction of the HS2 railway, in particular the Chiltern and Northolt tunnels, as set out in our Water Resource Management Plan (WRMP). This required us to create a new import between Thames Water and Affinity Water at Cockfosters, managed by a Bulk Supply Agreement.

The Bulk Supply Agreement allows Affinity Water to transfer up to 5Ml/d of water from Thames Water to meet the HS2 water demand for construction. The Cockfosters import enters our Water Resource Zone 4 (Arkley) and effectively displaces up to 5Ml/d so that HS2 can connect to the local network and receive the same volume from our Water Resource Zone 1.

Bulk water supplies under the agreement commenced on 1st January 2022 which is in place for 5 years. Enabling the supply required modifications to the Thames Water treated water reservoir at Cockfosters, the installation of a 400mm link main between Thames Water's site and Affinity Water's site at Cockfosters, the installation of a chlorination plant at Affinity Water's site to reduce the risk of taste and odour complaints due to the different chlorination method between the 2 companies, the installation of a transfer station at Affinity Water's site and the installation of 5.2km of 350mm trunk main to introduce the import in Affinity Water's network in its Arkley zone.

All costs relate to activities categorised under the Network Plus price controls as they relate to water treatment and distribution only, and not abstraction. The allocation of

the incentive for this import comes under Trade type 3: Treated to distribution network consistent with the methodology set out on Ofwat's website p.55-57 <https://www.ofwat.gov.uk/wp-content/uploads/2017/12/Appendix-5-Water-resources-FM.pdf>.

Thames to Perivale Import

The construction of the HS2 railway caused the temporary cessation of abstraction at Affinity Water's Blackford Water Treatment Works (20MI/d peak deployable output). This temporary cessation is associated with transient turbidity increases from the Tunnel Boring Machine (TBM) and/or pilling for the Colne valley viaduct as the HS2 route passes near the Blackford Group of sources. This temporary loss of deployable output has been compensated in part by the creation of a new import from Thames Water at Perivale (10MI/d), managed by a Bulk Supply Agreement. The remaining 10MI/d volume was sourced from Affinity Water's existing groundwater sources (Batchworth, The Grove & West Hyde) through temporary uplift of peak licensed volumes.

The Bulk Supply Agreement at Perivale allows Affinity Water to transfer up to 10MI/d of water from Thames Water to partially mitigate for the loss of deployable output from Blackford source during the construction of HS2. Bulk water supplies under the agreement, which is in place for 10 years, commenced on 1st May 2021. Enabling the supply required the installation of a new transfer station at Affinity Water's site with associated interconnecting pipework.

All costs relate to activities categorised under the Network Plus price controls as they relate to water treatment and distribution only. The allocation of the incentive for this import comes under Trade type 3: Treated to distribution network consistent with the methodology set out on Ofwat's website p.55-57 <https://www.ofwat.gov.uk/wp-content/uploads/2017/12/Appendix-5-Water-resources-FM.pdf>.

PR19 Water trading incentive

The costs detailed in Table 1 below were included in the water trading incentive model; labour £0.011m, power £0.244m, water import £2.219m, and project costs £19.910m. The total costs for Perivale were £5.031m and for Cockfosters £17.353m.

Based on the 5% import incentive rate, discount rate of 2.92% and 0.1% cap rate of allowed revenue per year, we propose an import incentive of £0.856m in 2017/18 prices.

Table 1. PR19 Water Trading Incentive Model Cost Summary

Import	Costs £m 2017/18p				
	Labour	Power	Thames invoices	Project costs	Total costs
Perivale	0.004	0.082	1.322	3.623	5.031
Cockfosters	0.007	0.162	0.897	16.287	17.353
Total	0.011	0.244	2.219	19.910	22.384

Compliance with Trading and Procurement Code

The Cockfosters and Perivale imports to Affinity Water from Thames Water both comply with the 3 requirements and 12 principles set out in the Affinity Water Trading and Procurement Code. The sections listed below refer to sections within the Trading and Procurement Code:

<https://www.affinitywater.co.uk/docs/corporate/plans/appendix-5-trading-and-procurement-code-and-bid-assessment-framework.pdf>

Compliance with the 3 mandatory requirements in *Section 4 Qualifying Trades* of the Trading and Procurement Code is set out below:

Section 4.1 Agreement of trade in July 2013 or later (Requirement 1):

The Thames Water to Cockfosters import bulk supply agreements was concluded on 29th August 2024, and the import to Perivale was agreed on 12th March 2024. As noted above, the supplies were operating from 2021 and 2022 onwards respectively, whilst contractual negotiations were still underway. The dates at which operations commenced and agreements struck mean that this requirement has been met.

Section 4.2 The trade must be or have been operating between April 2015 and March 2025 (Requirement 2):

As the Thames Water to Cockfosters import operated from April 2021 to June 2024, and the Perivale import has been in operation since April 2021, this requirement has been met.

Section 4.3 Trades to be between unrelated parties (Requirement 3):

Both import trades are from Thames Water to Affinity Water and they are unrelated, independent companies.

Compliance with the 12 principles in *Section 3 Principles of the Code* of the Trading and Procurement Code for an import to qualify for incentive payment are set out below:

Section 3.1.1 Non-discriminatory procurement (Ofwat Principle 1):

We are committed to undertaking new trading discussions on a non-discriminatory basis.

An assessment of all possible import options was undertaken by Affinity Water in early AMP7, to accommodate both the replacement of the 20Ml/d volume (loss of Blackford source deployable output) and also the water demand for HS2 (5Ml/d). All existing imports from other water companies were assessed as already fully utilised or already accounted for in our water resources plan. We therefore sought new import volumes and the only options available were from Thames Water via establishing new connections (Perivale and Cockfosters).

Section 3.1.2 Economic purchasing (Ofwat Principle 2):

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

In contracting for the provision of water resources, as detailed under Ofwat Principle 1 above, an assessment of all possible import options was carried out in early AMP7. This resulted in identifying the only option to secure the necessary volumes of water to compensate for HS2 to be the establishment of new import connections from Thames at Cockfosters and Perivale.

Section 3.1.3 Use of competitive processes (Ofwat Principle 3):

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

In contracting for the provision of water resources, as detailed under Ofwat Principle 1 above, an assessment of all possible import options was carried out in early AMP7. This resulted in identifying the only option to secure the necessary volumes of water to compensate for HS2 to be the establishment of new import connections from Thames at Cockfosters and Perivale.

Section 3.3.1 Contract lengths (Ofwat Principle 4):

Affinity Water will ensure that the duration of its agreements for trading water are reasonable taking into account our need to have certainty regarding the resource available to us and the requirements of our trading partners who may have made significant investment to enable a trade to take place and may have their own statutory duties to meet.

Both agreements are in place as a result of the HS2 construction work and its impact on Affinity Water (both as additional demand for construction and loss of deployable output during construction). The duration of each agreement has been negotiated with due consideration of the duration of the construction work. Both agreements have termination provisions that could be initiated ahead of the fixed term by either party with appropriate notice periods.

Section 3.3.2 Transparency (Ofwat Principle 5):

Affinity Water is committed to effective provision of information to demonstrate compliance with the provisions of its Code. We will publish a short summary document for each new water trade we make to demonstrate how each trade meets the requirements of our Code. We will also arrange annual external assurance of Code compliance and will provide the results to our Audit Committee and to Ofwat

The Cockfosters and Perivale bulk supply agreements were discussed at Affinity Water's HS2/Strategic Programme Board, reviewed by legal and signed off by a Director.

The HS2 governance process for awarding infrastructure projects works at two levels, internally first and then externally. Internally a work order proposal or a change request is submitted to the Affinity Water Programme Board, and once approved the same is submitted to HS2 to go to their own Board for approval.

An external audit was organised for 4 June 2025. The audit reviewed the process followed to complete the Water Trading Incentive model in deriving the incentive being claimed and compliance with Ofwat's methodology. The results were provided to the Audit Committee on 24 June 2025 and submitted to Ofwat on 15 July 2025.

This short summary document was published on our website on 15 July 2025.

Section 3.3.3 Link to WRMP (Ofwat Principle 6):

Affinity Water adopts a single approach to agreeing water trading arrangements and selecting options under its WRMP.

Our approach to agreeing these water trading arrangements and their interaction with our WRMP is set out below. In our final WRMP19 (paragraph 3.3.37, page 38), we stated:

"The water demand for HS2 is considered temporary in nature (i.e. within AMP7), hence is dealt with outside of the WRMP and will be developed separately by HS2. Measures will be in place to ensure that our assets are protected from HS2 works during construction and are designed to cover peak demand periods."

Section 3.3.4 Environment and Economic rationality (Ofwat Principle 7):

Affinity Water is committed to ensuring that any trades involve economically and environmentally rational flows.

There is no obligation on Affinity Water to supply HS2 using Cockfosters. It can supply it from its own sources if available and economical, which allows for optimisation of the water supply.

Perivale import has been created to partially compensate for the loss of Blackford WTW as a result of HS2 construction work. The import only accounts for up to

10ML//D of the 20ML//D peak abstraction licence at Blackford, with the remainder made up from emergency provisions in the abstraction licences of other existing groundwater sources in the same WRZ that have been negotiated with the Environment Agency.

Section 3.3.5 No artificial ending of trades (Ofwat Principle 8):

Affinity Water will not artificially end and restart trades to take advantage of changes in incentive arrangements.

Both import trades have been in place continuously since they were initially agreed and so comply with the principle that trades are not artificially ended and started to take advantage of changes in incentive arrangements.

Section 3.2.1 Correct Assessment of costs (Ofwat Principle 9) :

This principle relates to exports only and so does not apply to the Affinity Water import trades.

Section 3.3.6 Appropriate allocation of incentives (Ofwat Principle 10):

Affinity Water will allocate any incentive payment that it receives to the relevant price control in accordance with the guidelines set out in Ofwat's Final Methodology for the Price Review.

All costs that have been incurred under both the Cockfosters and Perivale imports relate to activities categorised under the Network Plus price controls as they relate to water treatment and distribution only, and not abstraction.

The allocation of the incentive for both imports come under Trade type 3: Treated to distribution network consistent with the methodology set out on Ofwat's website p.55-57 <https://www.ofwat.gov.uk/wp-content/uploads/2017/12/Appendix-5-Water-resources-FM.pdf>

Section 3.3.7 Consistency with the company's bid assessment framework (Ofwat Principle 11):

This Code is consistent with and complements our Bid Assessment Framework, which will be published no later than 3 September 2018.

This Code is consistent with and complements our Bid Assessment Framework (https://www.affinitywater.co.uk/docs/corporate/2020/BAF-Nov2020-TrackedChange-Version_final.pdf) which will be updated in the autumn of 2025 to be in accordance with the WRMP24.

Section 3.3.8 Evidence of assurance processes (Ofwat Principle 12):

We understand the need for robust assurance processes for the agreement of water trade arrangements to ensure decisions have a sound and objective basis and in particular take into account the long-term nature of water trading and supply-demand balances.

As outlined in point 5, this document contains a summary of both import trades undertaken by Affinity Water and demonstrates compliance with the Trading and

Procurement Code and outlines the processes followed during the trade negotiations.

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Glossary

Term	Description
Abstraction	The process of removing water from the natural environment.
Allowed revenue	The maximum amount of money a water company is allowed to collect from its customers through their water bills.
AMP7	The seventh Asset Management Period, a five-year investment cycle (2020-2025) for the UK water industry.
Bid Assessment Framework	A structured process that water companies use to evaluate bids from third parties for water-related services with the aim to create a competitive market for those services.
Blind Year Reconciliation (BYR)	Process where water companies adjust their price controls to reflect their actual performance in the final year of a price control period, compared to the initial forecasts used in setting those price controls.
Bulk-supply agreement	An agreement that sets out the terms and conditions between one appointed water company and another regarding the import or export of water.
Cockfosters	A new water import developed from Thames Water to Affinity Water.

Deployable output	The maximum amount of water a water company can reliably supply from its resources.
Discount rate	The interest rate used to calculate the present value of future cash flows.
Environment Agency	A non-departmental public body in England and Wales responsible for protecting and improving the environment.
High Speed Two (HS2)	A high-speed railway network in the UK, designed to connect London, Birmingham, and potentially the North of England.
Ml/d	Million litres per day.
Network Plus price control	Activities which include core water and wastewater network operations.
Ofwat	The economic regulator for the water and sewerage sectors in England and Wales.
Perivale	A new water import developed from Thames Water to Affinity Water.
Price Control 2019 (PR19)	Refers to the 2019 Price Control for companies in England and Wales conducted by Ofwat for the period 2020-2025. The Price Control sets the framework for how much water companies can charge their customers and what they must deliver in terms of service and environmental performance.
Trade type 3	Transfer of potable water between network plus water assets of the exporter and importer.
Trading and procurement code	A set of rules and guidelines that govern how water companies interact and trade with each other and with third parties regarding water resources.

Transient turbidity	A temporary increase in the cloudiness or haziness of a fluid, caused by suspended particles.
Water import	When one company buys water from another or a third party instead of developing its own resources.
Water Resources Management Plan 2019(WRMP19)	A statutory plan which water companies use to plan ahead and manage their water resources. WRMP19 refers to the period 2020-2025.
Water Resource Zone (WRZ)	A geographical area where water supply and demand are largely managed as a single, self-contained unit.
Water Resource Zone 1	Affinity WRZ 1 (Central) is also known as Misbourne
Water Resource Zone 4	Affinity WRZ 4 (Central) is also known as Pinn.
Water Trade	An agreement between a water undertaker and another water undertaker to transfer water between them.
Water trading incentive	A financial mechanism designed to encourage the trading of water between different users.