

Consultation responses

Water undertakers' new conditions of appointment and licence conditions for water supply licensees, consultation paper, December 2004

MD 205 – Modification to new condition R, June 2005

Summary of responses and final regulatory impact assessment

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Appendix 1 – Respondents to the consultation on new conditions of appointment/licence conditions for water supply licensees (December 2004)

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1. Introduction

From 1 December 2005, non-household customers who are likely to use at least 50 megalitres (Ml) of water a year at eligible premises will have the option of switching from their current water undertaker¹ to a licensed water supplier (licensee). Licensees will be able to supply water to eligible premises by purchasing a wholesale supply of water from a water undertaker (a wholesale supply), or by introducing water into a water undertaker's supply, or by a combination of both. Water undertakers must provide access to licensees on terms that comply with the licensing provisions of the Water Industry Act 1991 (WIA91)² and our guidance on access codes.

The WIA91 provides for the Secretary of State, in consultation with the National Assembly for Wales (the Assembly), to determine licence conditions and for Ofwat to make the necessary changes to water undertakers' conditions of appointment. In practice the Department for Environment, Food and Rural Affairs (Defra), the Assembly and Ofwat have worked together on both.

The proposed modifications to the water undertakers' conditions of appointment and the standard conditions of Water Supply Licences are necessary to implement the new water supply licensing (WSL) regime. In preparing these, the aim has been to avoid creating a regime which is too bureaucratic. We do not want to stifle competition with too much regulation. At the same time, we are also mindful of the Government's wider objectives as set out in the July 2002 consultation paper³.

In December 2004, we consulted on our proposed amendments to water undertakers' new conditions of appointment and licence conditions for water supply licensees⁴ (December 2004 consultation). This was a joint consultation carried out in conjunction with Defra and the Assembly. Questions 1 - 5 of the December 2004 consultation related to water undertakers' conditions of appointment, questions 6 - 18 related to licence conditions for water supply licensees and questions 19 - 22 related to the regulatory impact assessment. Section 2 of this paper summarises the responses we received to the section of the December 2004 consultation about water undertakers' conditions of appointment A - S (in particular, questions 1 - 5). Section 2 also explains how we are taking account of those responses in the final conditions⁵.

In June 2005, we issued MD 205⁶, which explained that we had been advised that the wording of section 66D(4) WIA91 and condition R (2)(a) was not wide enough to cover matters of pure process and that those parts of the access code guidance were non-statutory (June 2005 consultation). In the June 2005 consultation, we proposed

¹ The term 'water undertaker' means a company appointed under the Water Industry Act 1991 (WIA91) to provide water services to a defined geographical area.

² In this paper, references to the WIA91 refer to the WIA91 as amended by the Water Act 2003.

³ 'Extending opportunities for competition in the water industry in England and Wales, consultation paper, July 2002.

⁴ WSL 05/04 'Water Act 2003: Water supply licensing: New conditions of appointment/licence conditions for water supply licensees, Policy proposals on exceptions regulations and exemptions (21 December 2004).

⁵ Defra have published a separate responses document for questions 6-18 as those questions related to the Water Supply Licence and standard licence conditions (SLC's).

⁶ Modification to new licence condition R – consultation, 30 June 2005.

amending condition R to require water undertakers to comply with the non-statutory parts of the guidance, for example the process (including timescales) for responding to applications for access from licensees. We asked for views on those proposals. Section 3 of this paper summarises the responses we received to the June 2005 consultation.

There is a final regulatory impact assessment in section 4 of this paper. This section summarises the comments we received to the partial RIA of the December 2004 consultation paper (questions 19 - 22).

If you wish to discuss any aspect of this paper, please contact Irene Marnell on 0121 625 1408 or e-mail irene.marnell@ofwat.gsi.gov.uk.

2. Responses to the December 2004 consultation

2.1 Summary

We received responses from 19 stakeholders, including 13 water undertakers operating in England and Wales, Drinking Water Inspectorate (DWI), WaterVoice⁷, Water UK and one potential licensee. A list of respondents is at appendix 1 and copies of all replies have been placed in our library.

We have carefully considered all points raised by respondents to the consultation. We have summarised the responses to each question and set out how we will address the points in the paragraphs headed 'Our conclusions'.

Only condition A, and proposed conditions R and S, had specific questions relating to them in the consultation paper and they attracted the largest number of comments. Comments on the other conditions were often included within respondents' general submissions.

2.2 Key points raised in the responses to the consultation

This section summarises the key points that were made in reply to the consultation and explains our response to these issues.

a) Conditions A – Q

There was a general consensus to our proposals that these conditions do not need to be modified.

b) Costs to ineligible customers

There was a general consensus that ineligible customers should not subsidise the cost of the WSL regime. WaterVoice was concerned about the potential impact of the regime on ineligible customers and wanted clarification on how certain conditions would ensure that customers are not disadvantaged by higher prices. We have provided explanations to address those concerns under the relevant conditions.

c) Provision of information to licensees

Some water undertakers noted that the provision of information obligations should be matched by obligations on licensees to do the same. The information provisions in condition R have been aligned as far as possible, while reflecting the different positions of the water undertaker and the licensee and the different obligations imposed on each.

d) Confidentiality of information

⁷ From 1 October 2005, WaterVoice will be replaced by Consumer Council for Water (to be known as CCWater).

Respondents expressed a variety of views on this subject. Some respondents thought that the access agreement was the best place for the confidentiality agreement, others said that confidentiality should be covered in the condition. We believe that the confidentiality provisions in the conditions of appointment and the standard conditions of water supply licences, and those in the agreement as required by the access code guidance are complementary. We have explained this in more detail in the condition R section of this response paper.

e) Transfer protocol and debt blocking

Most respondents agreed that debt blocking should be included in condition S (and the corresponding SLC). Respondents are generally agreed that condition S, which covers the customer transfer protocol (CTP), achieves the right balance between ensuring that the system works and allowing the industry to retain ownership of the protocol.

2.3 Responses to conditions A - R

This section summarises the issues raised for each condition and explains our conclusions to those responses.

CONDITION A: INTERPRETATION AND CONSTRUCTION

Policy overview

This condition explains the terms and expressions used in the Instrument of Appointment. We did not propose to amend this condition.

Q1. Do you agree that there are no conditions or terms that need to be modified or added? If not, tell us which ones should be changed and how you would do so.

All respondents agreed that there were no terms that needed to be modified or added. One water undertaker suggested that a review should take place 12 months after the start of the new competition framework. This should be used to ensure that existing terms and definitions were appropriate. A stakeholder questioned whether we had intentionally defined a licensee as a 'non customer' for condition J (Levels of service and Target reports). This is addressed below under condition J.

Our conclusions

The comment relating to the definition of licensee as a 'non customer' is addressed below under condition J. No modification of condition A is needed.

Status: unchanged

CONDITION B: CHARGES

Policy overview

This condition allows us to limit the average increases in the standard charges made by the water undertakers to the change in the retail price index over the previous year, plus an adjustment factor, called K. It provides for a review of all K factors by us at five-yearly intervals. Condition B also requires each water undertaker to produce an annual Principal Statement confirming that its tariffs are in line with its price limits.

Condition B also sets out the circumstances under which we (and the water undertaker) can request an interim determination to adjust price limits between price reviews.

Respondents' views

WaterVoice was concerned about the potential impact of the regime upon ineligible customers. They suggested a water undertaker might lose revenue as a result of large users switching to a new supplier, and that Ofwat might make an interim determination of K if the water undertaker makes a claim for compensation under the 'substantial effects' clause in condition B. They wanted to know how we will use condition B to ensure that customers are not disadvantaged by higher prices if Ofwat does this.

Our conclusions

We do not consider that the competition regime will give rise to any substantial effect claims for an interim determination of K. The costs principle (see section 66E WIA91) aims to achieve a broadly financially neutral effect on water undertakers from customers switching suppliers. Other general support costs incurred by water undertakers are likely to be small. A substantial effect claim is not valid where the loss of revenue or detriment comes as a consequence of management action or inaction. Loss of customers to a competitor would not be valid grounds for a claim. No modifications to this condition are needed.

Status: unchanged

CONDITION C: INFRASTRUCTURE CHARGES

Policy overview

This condition limits the amount and rate of increase in a water undertaker's charges for the 'first time' provision of a water supply or sewerage service for domestic purposes. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

Most respondents did not comment on this condition. One stakeholder suggested that infrastructure charges should be determined on a site-specific basis and not on a cost per plot. This would be a fairer system if water supply licensing ever became applicable to residential developments and it would alleviate the problem of 'double accounting' on those charges and reinforcement costs.

Our conclusions

The methodology for calculating infrastructure charges is not part of this WSL consultation.

Status: unchanged

CONDITION D: CHARGES SCHEME

Policy overview

This condition requires water undertakers to fix and publish charges for water and sewerage services and for infrastructure. This is done via a charges scheme, which is submitted to us on an annual basis. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

We have consulted with WaterVoice Committees on the approval of charges schemes since 2001. WaterVoice would like this arrangement to be formalised via an amendment to condition D.

Our conclusions

Ofwat will continue to interact with WaterVoice (CCWater) in the same way as it currently does regarding the approval of charges schemes. Formalising these arrangements via an amendment to condition D is not an issue for this WSL consultation.

Status: unchanged

CONDITION E: PROHIBITION ON UNDUE DISCRIMINATION AND UNDUE PREFERENCE AND INFORMATION ON CHARGES

Policy overview

This condition applies to certain charges a water undertaker may levy for water supply and sewerage services. It imposes a duty to ensure that no undue preference is shown to, and that there is no undue discrimination against, any class of customers or potential customers in respect of standard charges. And there is a similar duty to ensure that that no undue preference is shown to, and that there is no undue discrimination against, any customer or potential customer in respect of charges fixed by agreement.

Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

WaterVoice wanted us to be aware of the possibility of water undertakers making changes to their large user tariffs within the tariff basket to offset the loss of revenue from customers switching suppliers. WaterVoice thought this could particularly apply to businesses sited at 'common management co-located premises' where, for example, a water undertaker's basis for charging businesses on industrial parks may differ from that which will apply under the eligibility criteria for premises within the competitive framework. WaterVoice also said that we should ensure that ineligible customers did not end up covering any high infrastructure costs left behind by those who switch suppliers.

Our conclusions

The costs principle should ensure that water undertakers incur no net financial loss as a result of losing customers to a licensee, so they should not need to increase charges to other customers.

We would not expect tariff basket customers to be eligible for competition (except perhaps in Wales where the tariff basket threshold is currently above the WSL eligibility threshold). In any event, there are likely to be few such customers and the potential adverse effects on other tariff basket customers is likely to be very small.

The costs principle also ensures that ineligible customers will not end up covering any high infrastructure costs left behind by those who switch suppliers. Access prices are calculated partly by subtracting from water undertakers' relevant retail prices any costs that can be avoided, reduced or are recoverable in some other way. So access charges will compensate water undertakers for the contribution that the switching customer would otherwise have made to any unavoidable costs.

Status: unchanged

CONDITION F: ACCOUNTS AND ACCOUNTING INFORMATION

Policy overview

This condition places a duty on water undertakers to provide accounting and other financial information. It also contains certain financial ring-fencing provisions, such as those prohibiting cross-subsidy between Appointed and Non-Appointed Businesses to ensure that all activities are on arm's-length terms. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

A potential licensee thought this condition should be modified so that water undertakers produce and maintain separate costs for activities subject to the new competitive regime. June returns should collect this information so that benchmarks are available to help compare different water undertakers' access prices. The respondent commented that this work would be invaluable to us in carrying out our duties and would enable a robust assessment of different customer groups to prepare for lower thresholds in three years.

Our conclusions

It is important to clarify that the licensing framework, including the eligibility threshold, will be reviewed within three years of the start of the regime. This does not necessarily mean that the threshold will be lowered in three years. The reviews will be co-ordinated by Defra. The timing of the review will depend on when the regulators have sufficient information to undertake it.

We are considering the approach that should be taken in relation to cost disaggregation. We do not consider that an amendment is needed to condition F to ensure that undertakers produce and maintain separate costs for activities subject to the new competitive regime. There will be appropriate amendments to the June return reporting requirements that will enable us to collate the relevant information.

Status: unchanged

CONDITION G: CODE OF PRACTICE FOR CUSTOMERS AND RELATIONS WITH OFWAT

Policy overview

This condition requires the water undertaker to prepare a code of practice for us that describes the services and charges to household customers, the arrangements for bill paying and complaint handling, matters relating to water meters and what to do in an emergency. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

No modification of this condition is needed.

Status: unchanged

CONDITION H: CODE OF PRACTICE AND PROCEDURE ON DISCONNECTION

Policy overview

Each water undertaker has a code of practice on debt, which is submitted to us for approval and gives guidance to household customers who have difficulty in paying their bills. The Water Industry Act 1999 amended the WIA91 to prevent the disconnection of household customers. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

No modification of this condition is needed.

Status: unchanged

CONDITION I: CODE OF PRACTICE AND PROCEDURE ON LEAKAGE

Policy overview

This condition requires water undertakers to prepare a code of practice for us about the process for recalculating charges for household customers on a metered supply where there is an unidentified leak. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

No modification of this condition is needed.

Status: unchanged

CONDITION J: LEVELS OF SERVICE INFORMATION AND SERVICE TARGETS

Policy overview

Water undertakers are required to maintain an efficient and economical system of water supply. They are required to provide us with an annual report setting out their performance against nine service standards (known as the DG indicators). The nine service targets are specified by the Secretary of State, but can be modified by us in respect of individual water undertakers after consultation with the water undertaker in question. This enables us to compare each water undertaker's performance with the rest of the industry. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

One stakeholder questioned whether we had intentionally defined a licensee as a 'non customer' for condition J.

Our conclusions

The levels of service provided by undertakers to licensees will be case-specific. Undertakers and licensees can negotiate and agree the level of service that is appropriate for particular access agreements. We do not expect water undertakers to report on any levels of service that they negotiate with licensees.

Status: unchanged

CONDITION K: RING FENCING, DISPOSAL AND CHANGE OF USE OF PROTECTED LAND

Policy overview

This condition ensures that water undertakers retain sufficient rights and assets to enable a special administrator to manage the business to achieve the purposes of a special administration order. It also ensures that the best price is achieved from land disposals so as to secure benefits for customers from the proceeds. Our view was that this condition will be unaffected by the licensing provisions and does not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

No modification of this condition is needed.

Status: unchanged

CONDITION L: UNDERGROUND ASSET MANAGEMENT PLANS

Policy overview

This condition requires water undertakers to produce an underground asset management plan to show that it is maintaining and developing its underground assets as necessary to fulfil its legal obligations. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

The House Builders Federation commented that transparency of information had always been a problem for its members and welcomed ways to make water undertakers more accountable.

Our conclusions

The matter raised does not relate to the WSL consultation.

Status: unchanged

CONDITION M: PROVISION OF INFORMATION TO OFWAT

Policy overview

This condition requires the water undertakers to provide us with the information required to carry out our functions under the WIA91. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

In February 2004, we consulted on our policy proposals to modify water undertakers' existing conditions of appointment and develop licence conditions for water supply licencees⁸. In its response to that consultation WaterVoice suggested there should be a licence condition for undertakers and licensees that reflected the provisions in sections 27H and 27K WIA91 to provide information to CCWater. In our summary of responses to SLC 8 (provision of information to Ofwat)⁹, we concluded that the WIA91 gave sufficient powers to CCWater to require the information it needs from licensees to carry out its functions and there was no need to replicate these powers in a licence condition. WaterVoice asked whether this conclusion relates to condition M as well.

Our conclusions

Section 27H and 27K WIA91 will give CCWater sufficient powers to require undertakers to supply information to it. We do not consider that any amendment is needed to condition M.

Status: unchanged

CONDITION N: FEES

Policy overview

This condition gives us the power to levy annual fees on water undertakers to cover our running costs. Fees include the costs involved in undertaking price reviews and Competition Commission references. The fees are payable to Government (into the Consolidated Fund). Our costs are met from the Treasury. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

In our December 2004 consultation paper we explained that licensees will pay an annual licence fee to the Secretary of State. We set out two proposals in our consultation for calculating these fees.

⁸ WSL 01/04 'Water Act 2003: Water Supply Licensing. Consultation on policy proposals to modify water undertakers' existing conditions of appointment and develop licence conditions for water supply licensees' (26 February 2004).

⁹ Responses to the February 2004 policy consultation were summarised in our December 2004 consultation paper.

1. To separate CCWater's and our WSL costs from other costs of competition, regulation (in the case of Ofwat) and other matters. Ofwat would then recover these solely from licensees on a proportionate basis; or
2. To use WSL costs in the same calculation that exists under condition N, so that WSL costs are not separated from the other costs incurred by us or CCWater. Under this approach, each water company (water undertaker or licensee) would pay a proportion of the total cost incurred, weighted by their turnover (or in the case of licensees without customers, a basic fixed fee only).

We asked for views on which approach was the most appropriate and balanced way of recovering costs from licensees¹⁰ and asked what respondents thought about option 2¹¹.

The one potential licensee that responded to this question supported option 2 as it would impose less of a burden on new entrants. Water undertakers generally favoured the option 1 approach, as it is consistent with the principle that in general ineligible customers should not bear the costs of regulating the new regime.

WaterVoice noted that it would not be practical for CCWater to separate its costs associated with water supply licensees from the costs of its other functions and therefore supported option 2.

We appreciate that all eligible customers will benefit (either indirectly or directly) from the WSL regime. For example, eligible customers will have the benefit of choosing whether or not they wish to switch water supplier. If they choose to switch it will be because an alternative supplier may provide them with better price and/or non-price terms than their existing water supplier. All customers, eligible and ineligible, including those who choose not to switch, may indirectly benefit from improvements in service levels and prices that competition seeks to achieve. However these indirect benefits are most likely to accrue to the class of eligible customers in the short term.

We therefore agree that ineligible customers should not subsidise the cost through water undertakers' appointment fees.

All eligible customers will benefit from the WSL regime, whether or not they switch, and should therefore pay a proportion of WSL related costs. However, recovery of costs from licensees alone (option 1 above) would not reflect this.

We have therefore agreed with Defra and the Assembly that CCWater's and our WSL related costs should be recovered from both undertakers and licensees, based partly on the number of eligible customers they have.

There may be some suppliers who hold a licence but do not yet have customers to supply. A weighting mechanism based only on turnover would mean that some licensees would not be charged even though they may lead us and CCWater to incur costs. Licensees will therefore pay a fixed fee and a variable fee.

¹⁰ Q14 in the December 2004 consultation paper.

¹¹ Q15 in the December 2004 consultation paper.

Water undertakers will pay only a variable fee. The allocation of this variable fee would be based on the revenue received from eligible customers only. As customers switch, licensees' variable fees would increase as they gained customers and water undertakers' fees would fall. The fixed fee paid by licensees will be the same, regardless of how many customers it acquires.

Any subsequent changes to condition N to implement this approach will be undertaken as part of a separate consultation.

Status: We will consult on proposals to change condition N separately.

CONDITION O: CIRCUMSTANCES IN WHICH A REPLACEMENT APPOINTMENT MAY BE MADE

Policy overview

Instruments of Appointment were granted from 1 September 1989. Generally, a water undertaker can be replaced only after 25 years' notice of termination from the Secretary of State. This condition permits other changes by agreement or to cover inset appointments. Our view was that it would be unaffected by the licensing provisions and did not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

No modification of this condition is needed.

Status: unchanged

CONDITION P: UNDERTAKING FROM A HOLDING COMPANY

Policy overview

This condition applies to water undertakers that are part of a multi-utility or other large commercial group. Essentially, the parent company gives an assurance to the water undertaker that the other group members will provide it with the information needed to meet its conditions of appointment, and refrain from actions which would cause it to breach these or relevant legislation. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

There were no comments from respondents on this condition.

Our conclusions

No modification of this condition is needed.

Status: unchanged

CONDITION Q: INTERRUPTIONS TO SUPPLY BECAUSE OF DROUGHT

Policy overview

This condition requires water undertakers to pay compensation to business and household customers if their supply is interrupted or cut off under the authority of a drought order. Our view was that this condition would be unaffected by the licensing provisions and did not require modification. We explained that compensation payments between licensees and their customers should be dealt with through contractual arrangements.

Respondents' views

One water undertaker noted that it would be difficult for water undertakers to calculate an increase in access charges that reflects the provision of a higher service level and compensation where this is not delivered. The respondent suggested that arrangements equivalent to the guaranteed standards scheme should be defined within the access agreement.

Our conclusions

We do not agree that we need formal arrangements governing payment of compensation similar to the guaranteed standards scheme. It would not be possible to prescribe all the possible variations of service that a licensee might agree with a water undertaker, the circumstances in which payment should be made and the level of compensation.

Status: unchanged

CONDITION R: PROVISION OF COMMON CARRIAGE AND WHOLESALE SERVICES

Policy overview

We proposed this new condition in our February 2004 paper to support the duties placed on water undertakers by sections 66A-66C WIA91 with regard to the provision of access to licensees on reasonable terms. Condition R should ensure that water undertakers:

- each produce, publish and update as necessary a code for access (including prices) in compliance with the access code guidance;
- do not unfairly discriminate between licensees (or their customers) and their other customers; and
- do not (nor their associates) obtain an unfair commercial advantage as a result of their activities under this condition.

As a result of the responses received to that consultation, and in particular the comments in relation to provision of information and confidentiality of information, we

amended the proposed condition R and published it as part of our December 2004 document.

Q2. Do respondents think that the condition should include provisions requiring the water undertaker to provide information to licensees? If so, what types of information do you think this would be required for?

Respondents' views

This question prompted a substantial volume of responses. Respondents generally agreed with the suggested provision, but with caveats.

The following responses were received:

- A potential licensee supported the proposed condition but thought it should go further. Water undertakers should have a duty to disclose any potential cross-border supply arrangements so water undertakers and their associates do not have an unfair advantage. Details of eligible customers should also be disclosed so that a fair market opportunity arises for all participants.
- One water undertaker noted that references to the issue of connectivity and the direction of water flow¹² may need to be revised.
- Some water undertakers said that requirements for undertakers to provide information should be matched by obligations on licensees to do the same. These provisions should be equal and symmetrical.
- A water undertaker thought that paragraph R9(7) (now renumbered as paragraph 8(7)) would be onerous and unduly costly for undertakers. The respondent suggested that licensees should only be informed of actual or potential incidents if they are likely to be affected by them.
- One water undertaker thought that the information requirements in paragraph R9 (now paragraph R8) were too wide. The respondent said that this requirement would be better placed in access codes. Another water undertaker said that the type(s) of information provided to licensees should be governed by the terms of the access agreement. There was also a comment that the requirement that an appointee should not seek more information than it needs¹³ is unnecessary.
- WaterVoice said that the definition of 'special needs consumer' is inaccurate and requires more clarification.
- One water undertaker said that we should decide what constitutes a 'reasonable' request for information¹⁴. If a request falls outside of this definition, the water undertaker should be able to recover costs incurred in considering the disclosure of this information.
- One water undertaker would also like to have the right to charge an administration fee for providing paper copies of access codes.

¹² Paragraph R7 of the draft condition in our December 2004 consultation.

¹³ Paragraph R10 of the draft condition in our December 2004 consultation (paragraph R9 of the final condition).

¹⁴ Paragraph R9(1) of the draft condition in our December 2004 consultation (paragraph R8(1) of the final condition).

- One water undertaker said that requiring access codes to be updated annually could be both unnecessary and unduly costly for smaller water undertakers in particular.

Our conclusions

Respondents provided a wide variety of useful comments to this question. Some suggestions were not suitable for the regime as it currently stands, but others have led to changes in the drafting of this condition.

We do not consider that the condition needs to include a provision to ensure that water undertakers or their associates disclose information (such as cross border supply arrangements) to prevent water undertakers gaining an unfair commercial advantage. The condition as it stands is sufficient to protect competitors from unfair competitive activity.

Following further discussions, we have deleted text relating to the consequences of a combined supply agreement or determination of a permanent change in the direction of water flow in a supply system¹⁵. This reflects our revised interpretation of the relevant provisions of the new regime relating to common carriage arrangements (for example, sections 17A(5), 66B(1) and 66C(1) WIA91).

As far as possible, we have sought to ensure that text relating to confidentiality¹⁶ is symmetrical with SLC 5, which covers the same issues for licensees, while reflecting the different positions of the undertaker and the licensee and the different obligations imposed on them.

Following discussion, we agree that text relating to the requirement for water undertakers to inform licensees of incidents which may affect their supplies should be revised to include a test of adverse (actual or likely) effect¹⁷. We also propose that an undertaker should only be obliged to inform a licensee of an actual or potential incident only if and to the extent that the supply being made by the licensee is or is likely to be affected by that actual or potential incident.

We have considered the information requirements in paragraph R9 (now R8). These requirements should be contained within a licence condition because the access code and access agreement do not provide the same strength of protection.

The definition of a special needs consumer has been amended and the list of qualifying medical conditions has been taken out. After discussions with Defra, it was decided that this condition should only cover people whose lives might be endangered without a supply of water being constantly available. The list in the proposed condition did not provide for this, but referred to customers who qualify for financial assistance for a measured water supply under the Vulnerable Groups Regulations. The Vulnerable Groups Regulations do not apply to eligible customers,

¹⁵ Paragraph R7 of the draft condition in our December 2004 consultation.

¹⁶ Paragraph R8 of the draft condition in our December 2004 consultation (paragraph R7 of the final condition).

¹⁷ Paragraph R9(7) of the draft condition in our December 2004 consultation (now paragraph R8(7) of the final condition).

which will be large industrial and commercial users that do not qualify for financial assistance on their water bills.

We have used the term 'special consumer' to cover consumers who require water urgently on medical or other grounds. The condition provides for us to consult on and determine which persons or classes of persons should be regarded as being special consumers. The revised definition also provides for the licensee and water undertaker to agree that a person or a member of a class of persons is a special consumer for the purpose of this condition.

We propose to retain the text requiring undertakers to seek no more information than is necessary for the purposes specified¹⁸. Without it, there would be no sanction against an undertaker being obstructive by making superfluous requests for information from a licensee. The text should also reduce the number of requests for determination that we receive on this issue. We intend that the obligations on undertakers and licensees to provide information to the other party will be aligned wherever necessary.

Access codes should be reviewed at least every year and updated whenever necessary. It is particularly important for new entrants that they have access to the most up to date information. The condition also specifies circumstances where the water undertaker is required to revise its access code.

Q3. Do respondents think that the confidentiality provisions are required in access agreements as well as in condition of appointment R and standard licence condition 5?

Respondents to this question generally agreed with the principle of confidentiality provisions, but had differing views on what provisions were required.

The following responses were received:

- One licensee suggested that licence conditions should include confidentiality provisions. This would mean that there was no need for multiple legal agreements between all the different participants in the market.
- Similarly, one water undertaker believed that confidentiality provisions should be included within licence conditions and were not necessary within access agreements. If there were special circumstances that require particular provisions, then these should be included in a specific access agreement between the parties.
- Two water undertakers said that confidentiality agreements should be negotiated by the undertaker and licensee, rather than being forced on parties through a licence condition. If confidentiality provisions are wanted, they should be included within access agreements.
- Another water undertaker said that as confidentiality should already be covered in the access code, it should be also included in the access agreement. Another water undertaker agreed it was necessary for confidentiality to be included in

¹⁸ Paragraph R10 of the draft condition in our December 2004 consultation (paragraph R9 of the final condition).

access agreements saying that the provisions were likely to be much more detailed than those found in licence conditions. They also supported the idea of standardising provisions on this matter across the industry.

- A water undertaker supported the idea of an industry-developed standard code on confidentiality. They also said that any agreement should have due regard for the sewerage undertaker for the relevant area.
- A water undertaker said that both access agreements and licence conditions should cover confidentiality. This way, it can be enforced between the parties without referring the matter to us.
- WaterVoice agreed that both access agreements and licence conditions should cover confidentiality. WaterVoice said that a standardised approach would help avoid delays and obviate the need for new entrants to seek legal advice on the text of the confidentiality agreement for every application.

Our conclusions

Respondents expressed a variety of views on this subject. We believe that the confidentiality provisions in the conditions of appointment and SLCs, and those in the agreement required by the access code guidance, are complementary. The provisions in the conditions ensure that any information exchanged before the specific confidentiality agreement is made is protected, including for example, information on the identity of the customer and premises which the licensee is seeking to supply. At the same time it is not possible for us to anticipate every different situation which may be the subject of an access agreement, so we believe that specific agreements are also necessary.

For these reasons, we have not changed paragraph R8(1) (now R7(1)) which provides that whenever an appointee is:

- (a) negotiating with a licensee the period for which and terms and conditions on which it might discharge any of its duties under section 66A to 66C WIA91; or
- (b) discharging any of those duties

it shall ensure that legally enforceable terms exist about the confidentiality of information provided to or by it for those purposes.

That paragraph ensures that we can take enforcement action if confidentiality is breached, but the specifics are left to parties to decide in access agreements. Paragraph R8(2) (now R7(2)) has been aligned with SLC 2(2). We welcome ongoing work by stakeholders in producing a standard confidentiality agreement.

Additional issues

We have made a small change to paragraph R5 (b) to ensure the wording is consistent with that in condition F.

We have modified condition R for Albion Water Ltd (Albion Water) and Cholderton & District Water Company Ltd (Cholderton Water) commensurate with their size and circumstances.

Albion Water is a water undertaker but does not have a supply system. While that situation continues, the provisions of sections 66A to 66C will not be relevant to it.

For that reason, Albion Water will not be required to comply with paragraphs 1-9 of condition R for as long as it does not have a supply system. It will not be required to publish an access code or indicative prices. The condition for Albion Water will require it to inform Ofwat if its circumstances change.

Similarly, Cholderton Water is a very small water undertaker that has no eligible premises in its water supply area. While that situation continues, the provisions of sections 66A and 66B will not be relevant to it. In those circumstances, we consider it reasonable and proportionate not to require Cholderton Water to publish an access code or indicative prices. However, it may be contacted by a licensed water supplier for a secondary supply under 66C WIA91. If Cholderton Water receives any requests for secondary supplies, it will be required to tell us. We will then specify (by notice) what we expect Cholderton Water to do.

We would adopt a similar approach to any new water undertaker in comparable circumstances.

Condition S: The customer transfer protocol

Policy overview

In order to ensure a smooth transfer when customers switch suppliers a CTP will be needed.

This will guide water undertakers and licensees on the steps that need to be followed during a change of supplier by a customer such as:

- the stages involved;
- the responsibilities of the relevant parties;
- notification details; and
- timing issues.

We proposed this new condition, which would require water undertakers to abide by the terms of the transfer protocol once it was created. Following its implementation, we suggested that water undertakers could propose amendments to us. We would have the power to veto proposed changes if necessary. We proposed that, following its implementation, water undertakers or licensees would therefore not have the power to amend the CTP without our consent and the involvement of water undertakers and of licensed water suppliers.

In our December 2004 consultation we explained that the draft condition included a provision allowing a licensee or water undertaker to object to a customer transfer where they are the old supplier. The reasons that a customer transfer might be blocked are explained in the draft CTP (which will be issued later this year). However, we considered that debt blocking merited being in a standard condition. Debt-blocking provisions prevent customers moving suppliers to avoid paying a debt and causing difficulties to a creditor supplier.

Q4: Do you agree that debt blocking should be included in this licence condition?

Respondents' views

There was almost complete agreement among respondents to this question that debt blocking should be included as a licence condition. Ten water undertakers supported this move. WaterVoice also supported this, but suggested that there should be guidelines so that debt is looked at in the context of overall payment history. However a potential licensee disagreed with the proposal; it thought that debt could be adequately covered through the CTP. Additionally, a stakeholder thought that the condition as worded did not allow for a debt to be written off (for example to get rid of a troublesome customer).

Our conclusions

We agree that debt blocking is an important issue which should be included in a condition of appointment. We do not think guidelines on debt in the context of payment history are necessary. Stakeholders will be able to propose changes through the CTP forum if, in practice, such guidelines on debt are needed. Further details about the procedure for the CTP forum will be provided in the CTP. The CTP will also highlight which stakeholders will be able to propose changes.

There is nothing in the condition to prevent a supplier writing off debt. Old suppliers may suspend a transfer due to outstanding debt, but there is no obligation on them to do so.

We do not propose to change paragraph S5 of this condition.

Q5. Do you think that this achieves the right balance between ensuring the system works and allows the industry to retain ownership of the protocol?

Respondents' views

Respondents were generally in agreement with the balance that has been struck.

These additional comments were received:

- Two water undertakers made the point that it was difficult to answer this question with any certainty, as they had not operated a system like this before.
- A water undertaker thought that condition S should be clarified so it is clear that responsibility for implementing the CTP lies with the water undertaker.
- WaterVoice suggested that customers should have the chance to express their view on any change to the CTP that may affect them. They also wanted consideration as to who will have powers of resolution in the event of a dispute over an amendment proposed by us.
- A stakeholder was concerned that because we will have both the power to veto and propose changes, we could veto any objections to a change it proposed.
- Some water undertakers proposed that Ofwat should play a key/leading role at the CTP forum meetings.

Our conclusions

We appreciate that there is some uncertainty as to exactly how the CTP will work in practice. The intention is that the CTP forum will meet on a regular basis. The CTP will provide more detail about the forum and CCWater's role.

Responsibility for implementing the CTP lies with both the water undertaker and the licensee. We think that this condition, and corresponding SLC 6 for licensees, is clear enough in setting out the obligations on each party.

We will have the power of veto over proposed changes, but will not be able to force through changes that we propose. This is set out in paragraph S4(b)(iii) of the condition.

Following comments from respondents and discussions with Defra, we have made two changes to the wording of paragraph S4. These will not change the policy, but instead add clarity. Paragraph S4(b)(i) has been amended to make clear that in addition to allowing us to propose amendments, the CTP will include provisions for other persons to propose amendments. The CTP will include provision for water undertakers and licensees to propose amendments (subject to certain conditions). Some respondents found the wording in paragraph S4(b)(iii) a little unclear. We have therefore changed S4(b)(iii) to make it clear that if there are disagreements as to whether any amendment to the protocol which has been proposed other than by us should be made, we have the power to determine whether or not an amendment should be made. In all cases, no amendment can be made without our agreement.

Additional issues

We have reviewed the application of condition S to Albion Water and Cholderton Water, to have regard to their size and circumstances. Subject to the comments below, we will not serve the CTP on Albion Water and Cholderton Water while their circumstances remain as they are now, unless they request us to do so. Their circumstances are:

- Albion Water is an undertaker that does not have a supply system. Because Albion Water does not have a supply system, its customer (assuming it was an eligible customer) could not transfer to a licensee.
- Cholderton Water is a very small water undertaker that has no eligible premises in its water supply area.

We would adopt a similar approach to any new water undertaker in comparable circumstances.

3. Responses to the June 2005 consultation

3.1 Summary

We received responses from 18 stakeholders, including 15 water undertakers, Water UK, WaterVoice and Halcrow, but none from potential licensees. The respondents are listed in appendix 2. The responses from WaterVoice and two other respondents supported our proposal. Most water undertakers raised concerns about the proposals and the main points of concern are summarised below.

3.2 Responses to MD 205 consultation – condition R

1) Several water undertakers felt that the proposals go beyond what Parliament intended

The following comments were received:

- Water undertakers commented that we are only empowered to make such changes to conditions of appointment as are necessary or expedient to accommodate the new statutory regime. They commented that it was unlikely that Parliament intended to empower us to issue enforceable guidance beyond that provided under primary legislation.
- One water undertaker commented that it was not appropriate for non-statutory guidance to be enforced through the mechanism of the conditions of appointment. If it is necessary to have specific enforcement powers rather than issue guidance, this should be through a statutory mechanism rather than indirect powers through the conditions of appointment.
- Another water undertaker felt that it was not appropriate for perceived limitations in legislation to be corrected via a regulator's amendment to undertakers' conditions of appointment rather than by changes to the legislation.

Our conclusions

We note the comments about our giving enforceable non-statutory guidance in addition to the guidance that we are specifically empowered and obliged to give under the WIA91.

However, we have specific powers under paragraph 4(1) of Schedule 4 of the WA03 to modify the conditions of appointment where we consider it necessary or expedient to do so in consequence of the introduction of the water supply licensing regime. We consider that it is both necessary and expedient to include the proposed provisions in the new condition R in order to implement that regime (and thereby give effect to Parliament's intentions to implement the water supply licensing regime). It is clear that, in enacting paragraph 4(1) of Schedule 4, Parliament intended us to have the power to impose on undertakers, through modifications to the conditions of appointment, obligations beyond those specifically prescribed in the WIA91. This would ensure that the new regime was implemented effectively. By way of example,

the development of access codes and the CTP (which are contained in conditions R and S) were not specified in the legislation. Water undertakers have, however, supported the work in these areas and have not raised any concerns that such matters are inappropriate or that our modification of the conditions of appointment in respect of those matters is in some way beyond our powers.

Furthermore, as explained in MD 205, our original consultations on proposed condition R (December 2004) and the draft access code guidance (October 2004) made no distinction between statutory and non-statutory guidance. None of the responses to either consultation contended that it was unnecessary or inappropriate or beyond its powers for Ofwat to be able to require compliance with and to enforce the procedural parts of the access code guidance.

We have carefully reviewed our approach in the light of the responses. We still consider that WIA91 gives us the power to make the proposed changes and that the proposed changes are necessary and expedient to implement the water supply licensing regime. Our proposed amendment to condition R promotes certainty and provides further clarity in the operation of the WSL regime.

2) Some water undertakers were concerned that the proposals appear to significantly increase their exposure to the possibility of enforcement action and the imposition of financial penalties and that this may have adverse consequences

The following comments were received:

- Water undertakers were concerned that the proposal could result in our issuing enforcement orders or imposing financial penalties inappropriately. One water undertaker noted that there are no statutory 'guiding principles' for procedural matters to protect undertakers from over-zealous regulation.
- One water undertaker also commented that the threat of an enforcement order may put water undertakers under unreasonable pressure to accept terms and conditions that they would not otherwise agree to.
- Three water undertakers commented that the proposals would affect the financeability of water undertakers because, for example, bank covenants require compliance with conditions of appointment. They argue that failure to comply with the guidance would be a breach of conditions of appointment and hence a breach of covenant, which would affect their ability to raise capital.

Our conclusions

We will apply our powers appropriately and consistently. Section 19 WIA91 (exceptions on our duty to enforce) continues to apply to all conditions of appointment. If we exercise our powers to issue enforcement orders and to impose financial penalties, we will do so in a transparent and open manner. Water undertakers will generally have the opportunity to address their behaviour before we take enforcement action or impose financial penalties.

If we do proceed to issue an enforcement order or to impose financial penalties, we will take into account relevant considerations, we will deal with evidence in a balanced manner and water undertakers will be given opportunities to comment on our draft decisions.

The process set out in the access code guidance is neither inflexible nor onerous and was agreed after extensive discussion by stakeholders in an industry advisory group. In the light of this and the checks and balances outlined above, we think it is unlikely that any water undertaker will be in a position where its financing is put at risk from its actions in dealing with potential licensees, as long as it acts reasonably and within the legislation, its conditions of appointment and our guidance.

3) Water undertakers commented that there are alternative ways of making them comply with non-statutory guidance

The following comments were received:

- Several water undertakers commented that the industry has shown that it is capable of complying with non-statutory requirements, for example the submission of June returns, development of access codes under the Competition Act 1998 and development of self-lay codes of practice.
- One undertaker said we should continue with the existing approach of investigating and naming those who do not comply with the process set out in the access code guidance.

Our conclusions

We note the comments relating to the submission of June returns. However, these submissions are underpinned by obligations in condition M to provide information to Ofwat. Furthermore, this compliance with June return guidance for the purpose of regulating each water undertaker is different to compliance with guidance on working with potential competitors. Delay is a recognised tool used by monopolists seeking to resist competitors. We consider that the changes to condition R will encourage water undertakers, in their relations with licensees, to focus on the requirements of the new regime and will strengthen the development of the market. Undertakers will be encouraged via condition R to seek to agree terms with licensees rather than rely on determination of terms by Ofwat. And if water undertakers are ready and willing to comply with the access code guidance, this proposal, with the flexibility in the access code guidance and the existing protection given to undertakers in the enforcement provisions of WIA91, does not place an additional burden on them.

4) Water undertakers stated that the proposals create problems in relation to revising the access codes and the guidance

The following additional comments were received:

- Water undertakers commented that adequate time should be allowed for effecting changes to access codes as a result of changes to our guidance and said that parties to commercial arrangements require certainty, particularly in

relation to costs and charges. One undertaker suggested revising condition R 3(2) to read ‘the Appointee shall revise its access code to conform to the revised guidance **within the timescales set out by the Authority**’ (the suggested new text is in **bold**).

- One water undertaker said that an access code could not be altered until the guidance has been altered, even if a change is beneficial to the new entrants.
- Two water undertakers said the regime and the access code guidance are untested; one added that the access code guidance might be legally challenged and that it cannot accept that all of the detail in it is binding. Another water undertaker said that we need to have the flexibility to amend our guidance on process in the light of experience.
- One respondent was concerned about the reference to ‘...any of those possible applications’. It commented that this appeared to have a greater and more extreme emphasis than before and required water undertakers to develop an all-inclusive series of methodologies for dealing with any possible type of application, which may be onerous and unnecessary.

Our conclusions

We agree that water undertakers will need time to revise their access codes following a change to our guidance and we will not impose onerous requirements on them to do so. We accept the amendment proposed above and have added the words “**within the timescales set out by the Authority**” to the text relating to these requirements¹⁹.

Water undertakers are not prohibited from changing their access codes; condition R²⁰ allows them to revise their codes at any time, as long as they continue to comply with the access code guidance. The guidance is written specifically to provide undertakers with flexibility to manage applications for combined and wholesale supplies in accordance with their own circumstances. If a water undertaker identifies an improvement to its code that is not in our guidance, we may amend our guidance accordingly, if such an improvement could suitably be applied to all water undertakers.

We agree that the regime will evolve over time and look forward to any improvements that experience may identify. We will, with help from stakeholders, review our access code guidance as the regime progresses. The proposed change to condition R does not affect our ability to amend our guidance.

5) Several water undertakers were concerned that the proposals amount to ‘regulatory creep’ and did not comply with the principles of the Better Regulation Task Force or the Government’s desire to reduce regulation by 25%

¹⁹ Paragraph 3(2) of the final condition.

²⁰ Paragraph 3(1)(b) of the final condition.

Our conclusions

The WA03 gives us wide powers to make determinations. For example, if a licensee and a water undertaker are not able to agree the terms and conditions of an access agreement, we may determine them, in a case referred to us by the licensee (see section 66D(2)(b) WIA91). If the terms and conditions determined by us are acceptable to the licensee, they become binding on the undertaker straight away. For example, we may also determine whether a water undertaker's refusal to give access is reasonable. That regulatory power goes well beyond anything we are proposing by the amendment to condition R. However, what we could achieve through making determinations would only address specific disputes. It would not address poor process or the failure of water undertakers to follow timeframes in the guidance.

If we make the non-statutory parts of the access code guidance binding through a condition of appointment, we consider this would achieve more and be less burdensome (from a regulatory perspective) for all parties than our becoming involved in every negotiation for every access agreement. As we have already described above in section 3, the proposed changes to condition R are intended to place the emphasis on consensus not compulsion, thereby reducing our involvement in the making of access agreements through the determinations procedure, to clarify our requirements and to implement the water supply licensing regime in an expedient manner.

4. Final regulatory impact assessment

4.1 Purpose and intended effect of the policy and its timing

This paper forms part of the framework for implementing the licensing provisions of the WIA91. The licensing provisions provide a specific framework for 'access' to water undertakers' supply systems (combined and retail/wholesale supply competition) within the water industry of England and Wales.

In February 2004 we consulted on our policy proposals²¹ to modify water undertakers' Instruments of Appointment and develop licence conditions for Water Supply Licences. We consulted further in December 2004 on the legal text of the proposed modifications to water undertakers' conditions of appointment and the SLCs. These will be determined this summer. Prospective suppliers were able to apply for a Water Supply Licence from 1 August 2005, with the overall regime due to commence on 1 December 2005.

In order to protect water quality and to promote competition, there need to be rules and procedures to govern how water undertakers will provide access to their supply systems. Although relevant standards have to be met, these rules should not be so burdensome on water undertakers and licensees that they deter competition. In addition, they must not create unnecessary risks in other areas, such as public health.

There will need to be an access agreement between the licensee and the water undertaker to govern arrangements between the two parties. Section 66D(4) WIA91 requires us to publish guidance in accordance with which the terms and conditions of such agreements shall be made. We published a consultation on our access code guidance in October 2004²². The final access code guidance was published on 24 June 2005.

We need to strike a balance between the issues that are governed by an access agreement and the obligations we need to impose on water undertakers and licensees by means of conditions of appointment and SLCs respectively.

Due to the complex nature of this regulatory regime, and the difficulty in predicting how a competitive market will develop and behave, the assessment of costs and benefits included in this regulatory impact assessment (RIA) is mainly qualitative. Although there will be a degree of fixed costs associated with the start up of competition, we expect that the scale of these will be limited because of the size of the initial market. Having said this, it is possible that the costs of implementing the new regime will be higher in the initial stages before the parties involved have established policies and procedures. Over the longer term, however, we expect that

²¹ 'Water Act 2003: Water supply licensing. Water undertakers' new conditions of appointment, Licence conditions for water supply licensees. Consultation paper, (February 2004).

²² 'Water Act 2003: Water supply licensing. Access code guidance consultation paper' (15 October 2004).

the extent and magnitude of costs and benefits will depend more on the number of new entrants and the level of competitive activity in the market.

The focus of this RIA shows how the new licensing provisions are best reflected in the water undertakers' conditions of appointment. It looks at the likely costs and benefits to water undertakers, licensees and other stakeholders, of following the approach that is set out. The wider regulatory impact of the extension of competition in the water industry was dealt with in the RIA to the Government consultation paper 'Extending opportunities for competition in the water industry in England and Wales' (July 2002).

Our December 2004 consultation contained a partial RIA and we asked the following questions:

Q19. Do you consider that our analysis of the benefits and costs of the approach we have taken in the consultation is complete? If not, please explain why.

Q20. What other benefits or costs do you feel should be included? If possible, please quantify these.

Q21. Are our assumptions about who will be affected reasonable?

Q22. Have we over or under estimated the effects on those identified?

Respondents' views

The majority of respondents to the consultation chose not to answer these questions. Where they commented, it was often one response to cover the RIA as a whole. Respondents were supportive of the options we chose in the partial RIA, but wanted greater consideration of costs that may be incurred by ineligible customers, CCWater, DWI and the Environment Agency.

Our conclusions

We agree with the suggestion that there should be wider consideration of potential costs incurred by the parties mentioned above. We have amended the RIA to include this. Conditions of appointment R and S do not impose any costs on the Environment Agency.

4.2 Options and Rationale

The WA03 allows us to modify conditions of appointment where it considers it necessary or expedient to do so in consequence of the amendments to the WIA91 made by schedules 4 and 8. We have sought to attain a suitable balance between what is specified by them and what is contained in our guidance on access terms and conditions. The three options we have identified for the modification of the conditions are:

- **Option 1:** do nothing – make no changes to water undertakers’ conditions of appointment. There is no statutory requirement for us to modify water undertakers’ conditions of appointment;
- **Option 2:** make minimal changes to water undertakers’ conditions of appointment; and
- **Option 3:** modify conditions of appointment to ensure that all or most new competition arrangements between water undertaker and licensee are covered by means of a condition of appointment.

Option 1

If we made no changes to water undertakers’ conditions of appointment, it is likely that regulatory uncertainty would increase. For example, the WIA91 requires our guidance to be followed on access codes and prices. Unless a water undertaker is obliged to publish its code, however, we will not know whether one has been produced, nor if any work to calculate access prices has been carried out in advance of being approached by a licensee.

Without published access codes, there would also be uncertainty for prospective suppliers, as they would have difficulty assessing the costs and benefits of applying for a Water Supply Licence. There may not be information available setting out the terms on which they could enter into agreement with a water undertaker.

The access agreement between a licensee and a water undertaker will be case-specific and depend on the individual circumstances. However, it is important that a water undertaker has in place an access code, the principles of which can then be put into an access agreement that is tailored to meet the licensee’s situation.

Similarly, without appropriate changes to conditions of appointment, there would be no obligation on water undertakers to plan in advance and ensure they have systems and procedures in place to ensure the smooth transfer of a customer to another supplier. This would have detrimental effects on competition since it would not ensure a level playing field.

If there are no clear duties set out in water undertakers’ conditions of appointment to complement the licensing provisions of the WIA91, prospective suppliers may be deterred from entering the competitive market. In order for water undertakers to be able to plan future activities effectively, they need to know exactly what is expected of them under the new licensing provisions.

This option would make it more difficult for us to promote competition. It is likely that we would become more involved in disputes than it could otherwise have been (for example regarding customer transfer issues where there would be inconsistencies in approach taken by water undertakers).

Option 2

This option will increase regulatory certainty and will create clarity to ensure that water undertakers are aware of what is expected of them to make the regime work.

There will also be clarity for licensees about the duties of water undertakers and how they affect any agreements entered into between the two parties.

This option will enable the water undertaker to plan effectively to implement the licensing provisions, including developing their internal policies and procedures where necessary.

We believe this option will produce the right balance of clarity and flexibility.

Putting only the most appropriate requirements in conditions of appointment leaves water undertakers with some flexibility to deal with other contractual and customer specific issues in an access agreement. Subject to compliance with the requirements of our statutory guidance, this has the advantage that water undertakers and licensees will have discretion to decide what works best for them. This would reduce the need for regulatory intervention that might otherwise arise if there was little flexibility in the terms, and licensees consequently felt that water undertakers were preventing market entry. However, in allowing greater flexibility there will need to be a balance to ensure that parties do not have so much discretion that they have difficulty in agreeing terms and call on regulatory intervention.

The access agreement between a water undertaker and licensee will govern case specific issues such as how the parties intend to deal with customer queries and complaints, emergency procedures and contacts, certain water quality issues, billing and debt collection. Our guidance on access terms (including prices) will guide water undertakers and licensees as to what issues should be considered when drawing up access agreements. If these terms were contained in conditions of appointment, it would be more difficult and costly to modify a condition every time a change was required.

Option 2 is the preferred option that guides our approach in this responses paper, as it creates the least regulatory uncertainty for water undertakers and has the least impact on costs.

Option 3

This option would mean that almost all issues that could be dealt with through an access agreement would instead be dealt with in conditions of appointment.

Water undertakers and licensees would know exactly what was expected of them, since everything would be specified. However, this might create unnecessary burdens and cost. For example, if all issues were listed in conditions of appointment, then a water undertaker would be more likely to have to ensure they were covered in every agreement entered into, regardless of the circumstances. It would be costly for a water undertaker to comply with its conditions of appointment if it was not essential for the agreement in question. If the water undertaker did not do this, it could be in breach of a condition.

Option 3 is more prescriptive with limited flexibility for water undertakers to tailor their agreements with licensees to reflect case specifics. In regulatory terms, if we wanted to change any aspect of supply arrangements, it would be far more difficult to make

changes to conditions of appointment than it would be to change our guidance on access agreements.

Under this option, we would incur greater costs of regulating and monitoring water undertakers' policies, and ultimately prices could rise for customers. In any event, the WIA91 envisages a balance between modifications to water undertakers' appointment conditions and guidance on access terms and conditions.

4.3 Summary of costs and benefits to support Option 2

This section provides a summary of the costs and benefits already identified in this RIA associated with the adoption of Option 2 in this responses paper related to conditions of appointment.

4.3.1 Benefits

Benefits to water undertakers

- It enables water undertakers to plan policies to implement the licensing provisions more effectively.
- It reduces uncertainties for water undertakers, by clearly setting out key duties that should be complied with.
- It will enable water undertakers to reduce some costs in the long term, as they will be aware of their obligations prior to agreeing any terms of access.
- It provides clarity to those interested in entering the competitive market.

Benefits to customers

As the approach allows some flexibility to water undertakers and licensees to secure customer specific arrangements, customers' needs can be better accommodated. Licensees might see the existence of too many prescriptive licence conditions as a barrier to entry, thus reducing the number of new suppliers that customers can choose from.

Benefits to Ofwat

- Our proposed approach improves the transparency of regulation.
- It allows us to maintain some control over water undertakers' activities without being too prescriptive.
- It reduces the risks that water undertakers, licensees and customers would otherwise face if we adopted a 'hands-off' approach.

4.3.2 Costs

Costs to Ofwat

We expect that there will be some increased costs to administer the new obligations we are proposing for water undertakers. Although these costs are difficult to quantify at this stage, they will, for example, relate to assessing and analysing information

provided by the water undertaker. This will be requested to enable us to fulfil its functions under the WIA91. There will also be costs involved when we have to take enforcement action if conditions of appointment are breached.

Section 17G WIA91 allows for payment of a licence fee when a Water Supply Licence is granted, and/or payments while that licence is in force. Any net increases in our expenditure arising from the proposals on competition will be recovered from the fees paid by water undertakers and licensees.

The new WSL regime will create additional regulatory functions for us. These will include the enforcement of:

- water undertakers' obligation to provide access and wholesale supplies, including pricing; and
- licensees' obligations to co-operate with water undertakers and us.

Greater competition will increase the complexity of our regulatory activities. However, as our experience of dealing with competition-related queries and making determinations develops, the time taken to process them could reduce, and our costs for this area of work decrease.

Costs to water undertakers

There will be minimal costs for water undertakers to implement the proposals we have outlined in the consultation paper. As an example, a water undertaker will incur costs in revising its access code as well as publishing the code and keeping it under review. There may also be costs involved in complying with an aspect of the transfer protocol, such as ensuring they have procedures in place to ensure the smooth transfer of a customer.

Costs to ineligible customers

The direct costs incurred by undertakers associated with access applications will be recoverable from the licensees making those applications. Water undertakers' general costs associated with the competition regime, such as those incurred in reviewing and publishing its access code, are likely to be small and will be recovered from licensees or allowed for in price limits as appropriate.

Costs to Drinking Water Inspectorate (DWI)

There may be an increase in costs to DWI because they might be involved in disputes on water quality aspects of the feasibility studies carried on by the undertaker when a combined licensee makes an application for introducing water to the water undertaker's supply system. DWI will also continue to monitor closely the quality of the water supplied to all customers and will investigate any reports of real or perceived changes associated with the new regime. The impact of the new regime on DWI's resources has already been taken into account. DWI's operating costs are currently met by its sponsoring department, Defra.

Costs to the Consumer Council for Water

Although CCWater has no powers to administer the new regime or resolve disputes, its remit is to represent all customers, eligible or otherwise. It may incur a small amount of extra cost as a result of customer queries and complaints regarding the new regime.

Appendix 1 - Respondents to the consultation on new conditions of appointment/licence conditions for water supply licensees (December 2004)

Potential licensees

Aquavitae

Water undertakers

Anglian Water
Bournemouth & West Hampshire Water
Bristol Water
Dŵr Cymru/Welsh Water
Folkestone & Dover Water
Northumbrian Water
Portsmouth Water
Severn Trent
South East Water
Thames Water
United Utilities
Wessex Water
Yorkshire Water

Other stakeholders

Drinking Water Inspectorate
House Builders Federation (now known as the Home Builders Federation)
Linkwork Ltd (Barry Watson)
Water UK
WaterVoice

Appendix 2 – Respondents to the consultation on modification to new licence condition R (30 June 2005)

Water undertakers

Anglian Water
Bournemouth & West Hampshire Water
Bristol Water
Dŵr Cymru/Welsh Water
Folkestone & Dover Water
Mid Kent Water
Portsmouth Water
Severn Trent Water
South East Water
South Staffordshire Water
South West Water
Thames Water
Three Valleys Water
United Utilities Water
Wessex Water

Other stakeholders

Water UK
WaterVoice
Halcrow

Appendix 3 – Glossary of terms

There follows a brief description of some of the terms used in the WSL regime. Readers should refer to WIA91 for precise statutory meanings.

Access: The wholesale supply of water by a water undertaker to a licensee for the purpose of making a retail supply of water to the premises of the licensee's customer; and the introduction of water by the licensee into a water undertaker's supply system for that purpose.

Access agreement: An agreement between a water undertaker and a licensee for access by a licensee to a water undertaker's supply system pursuant to a Retail Authorisation and/or Supplementary Authorisation.

Access code: A water undertaker's document that sets out all principal aspects of access to its supply system and the terms and conditions on which it will grant access to its supply system by a licensee. The access code comprises the standard terms and conditions common to all water undertakers and the terms and conditions specific to that water undertaker.

Access terms: The terms under which a water undertaker and a licensee agree access to the water undertaker's supply system.

Appointee: A company that holds an appointment to provide water and sewerage services in a geographic area.

ARROW costs: Expenses that can be Avoided or Reduced, or any amount that is Recoverable in some Other Way (other than from other customers of the water undertaker) (see section 66E(3) WIA91).

The Assembly: The National Assembly for Wales.

CCWater: The Consumer Council for Water (also known as WaterVoice).

Charges scheme: Each company is required to publish this document under condition of appointment D. It sets out the company's charges for water and sewerage services and the terms and conditions of those charges. Most charges, including all standard charges, must be approved by Ofwat.

Costs principle: As defined in section 66E WIA91.

Defra: Department for Environment, Food and Rural Affairs.

DWI: Drinking Water Inspectorate.

Eligible premises: Premises that satisfy the eligibility requirements in section 17A(3) WIA91. Each of the following three requirements must be satisfied in relation to each of the premises in order for a customer's premises to be eligible.

- The customer's premises must not be 'household premises' (as defined in section 17C WIA91).
- When the licensee first enters into an undertaking with a customer to give the supply, the total quantity of water estimated to be supplied to the premises annually by the licensee must be not less than 50 Megalitres (the "threshold requirement", section 17D WIA91).
- The premises may only be supplied by one licensee (but may also be supplied by one or more water undertakers).

Guaranteed standard scheme (GSS): A scheme that lays down the minimum guaranteed standards of service that water companies have to deliver. Water companies have to pay compensation to customers if they fail to meet these standards.

Interim determination: Condition of appointment B allows the Director to make adjustments to a price limit in any year for certain relevant items. Relevant items are either relevant changes in circumstances (RCCs) (which are defined in the Instrument of Appointment) or notified items (see definition).

June return: Water companies' annual report to Ofwat detailing progress on a number of measures of performance. It provides the majority of information Ofwat needs to monitor companies' progress and compare performance. Some of the information is commercial and in confidence but the majority is placed in the Ofwat library and published on a CD-ROM.

Licensee: A company holding either a Retail Licence or a Combined Licence; also referred to as a licensed water supplier.

Standard licence conditions of water supply licences (SLCs): The standard terms and conditions of Water Supply Licences determined and published by the Secretary of State (for the Environment Food and Rural Affairs) pursuant to section 17H WIA91.

Tariff basket: The basket of charges to which the annual regulatory price limits apply, comprising: charges for unmeasured water supply; charges for measured supply; charges for unmeasured sewerage services; charges for measured sewerage services and charges for reception, treatment and disposal of trade effluent. Within the overall price limit, basket items may increase or decrease by different amounts and percentages. However, the average change in the basket of charges must not exceed the price limit.

Vulnerable Groups Regulations: The Water Industry (Charges) Vulnerable Groups Regulations 1999 (SI 1999/3441) (as amended) came into force in 2000. The Vulnerable Groups Regulations state the nature of the assistance to be provided to a prescribed class of persons (vulnerable groups) who are eligible to apply for assistance with water and sewerage charges. The Regulations apply only to water companies covering areas wholly or mainly in England.

Water Supply Licence: A licence granted to a company giving it the Retail Authorisation, or both the Retail Authorisation and the Supplementary Authorisation.

Water undertaker: A company appointed under the WIA91 to provide water services to a defined geographic area and which owns the supply system and other infrastructure.

WIA91: The Water Industry Act 1991 (as amended by the Water Act 2003).