

# **WATER ACT 2003 WATER SUPPLY LICENSING IMPLEMENTATION PROCESS INFORMATION PAPER**

## **1 INTRODUCTION**

### **1.1 Background**

The Water Act 2003 (the Act) extends the opportunity for competition in the water industry. From autumn 2005 customers who consume 50 Megalitres or more per annum will be able to purchase water from either their existing water undertaker<sup>1</sup> or from a water supply licensee. This is an ambitious project and will require the industry and Ofwat to work together to ensure that an effective regime is delivered on schedule.

Extending competition will increase customer choice and should lead to keener prices, innovation and the provision of new and improved services for customers. The proposals in the Act are set within the Government's wider objectives, which are to

- Protect public health, and ensure that the industry continues to deliver a safe and secure water supply.
- Protect and improve the environment.
- Meet the Government's social goals including affordability of water supplies.
- Safeguard services to customers.

The Act received Royal Assent on 20 November 2003. Among other things, it amends the Water Industry Act 1991 (WIA91) by providing a specific framework for 'access'<sup>2</sup> to the public distribution network (common carriage<sup>3</sup> and retail/wholesale supply<sup>4</sup> competition) within the England and Wales water industry. The relevant provisions within the Act were included in the light of responses received to the Government's public consultation: 'Extending Opportunities for Competition in the Water Industry in England and Wales' (July 2002). Annex 1 explains the relevant provisions of the Act.

The Act provides a basic legislative framework for the new regime. The Act also provides for the issuing of Statutory Instruments, other secondary legislation and statutory guidance on specific matters. For example, the Act requires Ofwat to produce statutory guidance that will enable parties to implement the new regime more effectively.

### **1.2 Purpose of the Paper**

The purpose of this document is to set out Ofwat's thinking on the mechanisms needed to deliver the new competitive regime, and to invite you to a workshop on the implementation process. It also invites nominations for membership of the various sponsor and advisory groups involved in the process.

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<sup>1</sup> Undertaker: A company appointed under the Water Industry Act 1991 to provide water and/or sewerage services to a defined geographical area.

<sup>2</sup> The term 'access' refers to common carriage and wholesale supplies.

<sup>3</sup> Common Carriage: The conveyance of water through the public distribution network by a water undertaker on behalf of a licensee to supply the licensee's customer.

<sup>4</sup> Retail: The supply of water, purchased wholesale from the water undertaker, to the licensee's customer.

# Water Supply Licensing Implementation Process – Information Paper

## 1.3 Proposed Groups

We propose to set up

- A sponsor group with representatives from all industry stakeholders, to assist with ensuring the successful delivery, by autumn 2005, of the new competition regime as described in the Act.
- Two advisory groups, with representatives from all industry stakeholders, to assist and advise Ofwat, the Department for Environment, Food and Rural Affairs (Defra) and the Welsh Assembly Government, as appropriate, as they prepare the relevant secondary legislation and guidance.
- A regulators' group involving Defra, Ofwat, the Drinking Water Inspectorate (DWI), the Environment Agency (EA) and Welsh Assembly Government, to co-ordinate the various activities of each organisation.

These proposals are expanded on in Chapter 4 below.

## 1.4 Regulatory Impact Assessment

The competition framework was subject to a regulatory impact assessment prior to the Water Bill being brought before Parliament in February 2003. Copies of this are published on the Defra website [www.defra.gov.uk](http://www.defra.gov.uk). Where relevant, consultations on individual regulations and guidance produced as a result of the implementation process will be accompanied by specific regulatory impact assessments.

## 1.5 Structure of the Paper

The rest of this paper is structured as follows.

- **Chapter 2** invites stakeholders to a workshop and invites nominations for the industry groups.
- **Chapter 3** provides an overview of the main areas of work and sets out the timetable for developing the competition framework.
- **Chapter 4** outlines the responsibilities, scope and membership of the sponsor, advisory and regulators groups.
- **Annex 1** explains the main provisions for water supply competition within the Act.
- **Annex 2** sets out the proposed terms of reference for the groups.

# Water Supply Licensing Implementation Process – Information Paper

## 2. WORKSHOPS AND NOMINATIONS

The chapter invites stakeholders to a workshop and invites nominations for the industry groups.

### 2.1 Workshop

Ofwat will hold a workshop for relevant stakeholders on Monday 12 January 2004, to discuss with them the proposals set out in this paper. This is an opportunity to put forward your views. We welcome comments on the following:

- membership of the sponsor group and advisory groups;
- selection of group members;
- roles and responsibilities of the sponsor group and the advisory groups; and
- allocation of tasks between the advisory groups.

Relevant stakeholders interested in attending this workshop should contact Ofwat Competition Policy Team by Monday 22 December 2003. Contact details are given in 2.3 below. Please note that we may need to restrict attendance to a maximum of two people per relevant organisation. You may also wish to provide written comments on the above issues at the same time. In responding to this invitation please provide:

- the name of the person(s) interested in attending;
- contact details (including email address);
- organisation/company represented;
- business activity of organisation/company; and
- stakeholder constituency represented.

### 2.2 Membership Nominations

For practical reasons, it is impossible for every individual stakeholder to participate in every group. Therefore, although individuals are entitled to nominate themselves Ofwat would prefer that, where a body exists to represent the interests of a particular stakeholder constituency, members of that body should agree whom they wish to represent them on a particular group, before forwarding nominations to us. Where a representative body does not exist, for example in the case of potential licensees, or where a stakeholder is not a member of a representative body, we welcome individual nominations. However, we will not allow representation to be unbalanced by too many representatives from one stakeholder constituency. We will aim to have a balanced set of views. If there are too many nominations, we will select the representatives.

Further details on the groups are outlined in Chapter 4 and Annex 2.

## Water Supply Licensing Implementation Process – Information Paper

Membership nominations must be made in writing, and lodged with Ofwat's Competition Policy Team by 5pm on Friday 2 January 2004, contact details for which are given in 2.3 below. The nomination should include:

- the name of the nominee;
- contact details (including email address);
- organisation/company represented;
- business activity of organisation/company;
- constituency represented; and
- sponsor or advisory group in which nominee wishes to participate.

Ofwat will announce its preliminary decisions on group membership at the workshop on Monday 12 January 2004. This will enable you to raise any issues about membership at the workshop. We will announce the final composition of the groups shortly after the workshop.

### 2.3 Contact Details

If you are interested in attending the workshop in January 2004 or wish to be considered for membership of the sponsor or advisory groups, please contact Ofwat at the address given below.

Graham Craig  
Competition Policy Team  
Office of Water Services  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Or by fax to: 0121 625 1379

Or by email to: [Graham.Craig@Ofwat.gsi.gov.uk](mailto:Graham.Craig@Ofwat.gsi.gov.uk).

## Water Supply Licensing Implementation Process – Information Paper

### 3 DEVELOPMENT FRAMEWORK AND TIMETABLE

This chapter sets out the main areas of work which need to be undertaken and the timetable for developing the new regime.

#### 3.1 Secondary Legislation and Guidance

Ofwat and Defra/Welsh Assembly Government believe that implementing the new regime will be helped by the active participation of stakeholders giving advice on practical issues and sharing industry and market knowledge with decision-makers. Prior to the inaugural meetings of these groups, Ofwat will produce a series of draft guidance notes and statutory instrument policy discussion papers that will form the basis of the new regime. These papers will form a basis for discussion and will also highlight the main issues to be considered by the advisory groups.

The division of work between the two industry advisory groups is as follows.

	<b>Access Terms Group</b>	<b>Licence Application &amp; Eligibility Group</b>
Statutory Instruments	Exemptions & exceptions	Licence application process Household/non-household New customer exemptions
Ofwat Guidance	Access terms and charges Strategic supplies	Licence application process Eligibility of customers, (extent of premises & estimating quantities of water) Customer transfer protocol

#### 3.2 Timetable

The timetable below outlines the key events in the implementation process. The industry advisory groups will develop specific milestone dates.

<b>Date</b>	<b>Activity</b>
<b>Autumn 03</b>	Water Act 2003 received Royal Assent on 20 November 2003
	Ofwat publishes information paper
<b>Winter 03 to Spring 04</b>	Ofwat hosts implementation workshop
	Ofwat, Defra and the Welsh Assembly Government consult on licence conditions and conditions of appointment policy
	Ofwat, Defra and the Welsh Assembly Government present discussion papers to advisory groups
	Inaugural meetings of industry advisory groups
<b>Spring 04 to Autumn 04</b>	Industry advisory groups produce policy documents
<b>Winter 04 to Spring 05</b>	Ofwat, Defra and the Welsh Assembly Government consult on legal text of licence conditions and conditions of appointment.
	Defra and the Welsh Assembly Government consult on legal text of Statutory Instruments
	Ofwat consults on draft guidance notes
	Ofwat publishes final guidance on access terms & charges

## Water Supply Licensing Implementation Process – Information Paper

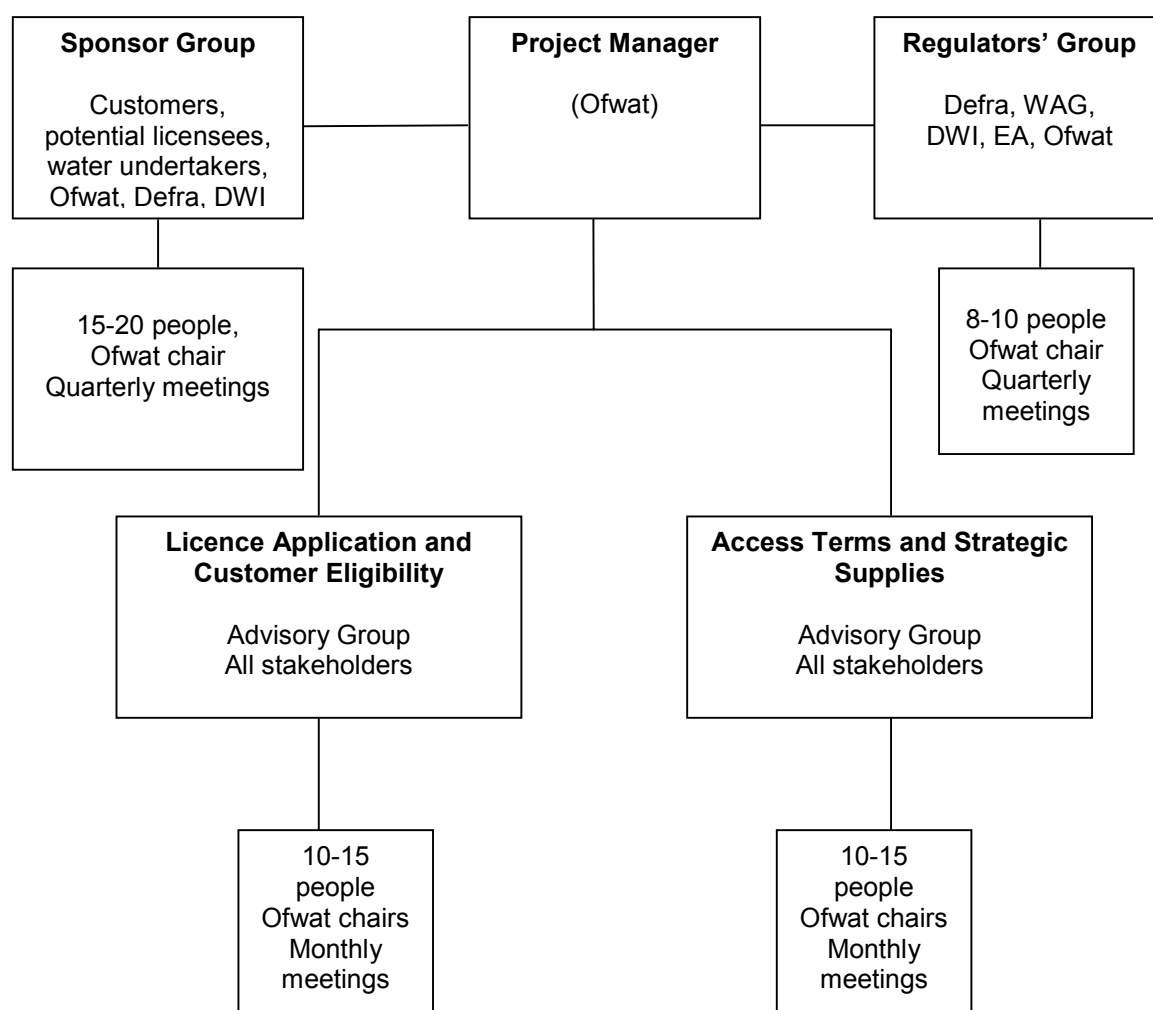
<b>Spring 05 to Summer 05</b>	Water undertakers publish access terms & charges
	Ofwat publishes final guidance notes
<b>Summer 05</b>	Applications for first water supply licences
	Final standard licence conditions and conditions of appointment published by Defra and Ofwat
<b>Autumn 05</b>	Licensed water supply regime commences
	Ofwat grants first water supply licences

## Water Supply Licensing Implementation Process – Information Paper

### 4. INDUSTRY AND REGULATORS' GROUPS

This chapter describes Ofwat's proposals to establish a sponsor group, regulators' group and two industry advisory groups to assist with the development of the new competition framework. The proposed terms of reference for these groups are set out in annex 2.

The chart below outlines the structure and inter-relationships of the groups.



#### 4.1 Overview of Groups

The groups are intended to assist and advise Ofwat and Defra/Welsh Assembly Government in developing the detailed guidance and secondary legislation necessary to implement the new competition regime. They will provide expert forums for robust and focused discussions, involving all stakeholders. This process should ensure that the guidance and mechanisms will be endorsed by the industry as practical, relevant and 'fit for purpose' and that all issues are addressed prior to implementation.

Ofwat and Defra/Welsh Assembly Government will take careful note of this advice when implementing the regime. However, the Government's broader policy framework, its objectives and the legislation must govern final policy decisions.

## **Water Supply Licensing Implementation Process – Information Paper**

### **4.2 Industry Sponsor Group**

The sponsor group will assist with ensuring the successful delivery, by autumn 2005, of the new competition regime as described in the Act. In doing this the sponsor group will assist with ensuring that each advisory group achieves its milestones, that there is consistency between the groups, and it will seek to address differences of view between stakeholders within the groups.

Members of this group should be at a senior level within their particular stakeholder constituency. This will strengthen the facilitating role of the group. We expect the group to meet every three months at Ofwat headquarters in Birmingham. Progress reports presented to the sponsor group will also be published on the Ofwat website so that the public is informed of progress.

### **4.3 Industry Advisory Groups**

The two industry advisory groups will advise on the development of the new competition regime. One group will cover each of the following areas.

- Access (common carriage and wholesale) terms and charges and strategic supplies;
- Licence application process and customer eligibility.

The advisory groups will meet monthly at Ofwat headquarters in Birmingham. We expect the groups to meet for approximately ten months, beginning in February 2004. We envisage that members will continue to work between each meeting, reviewing and commenting on papers that will be sent to them, or considering issues that might arise during the meetings.

As the period during which the groups are active draws to a close, Ofwat will review the operation of each of the groups, and decide whether it would be appropriate to continue them, either in their existing state or perhaps as a single body to advise on further developments.

### **4.4 Regulators' Group**

Implementing the new regime will involve a number of regulatory bodies and departments, not just Ofwat. Co-ordination of the various actions each must take is therefore crucial. Ofwat proposes to establish a regulators' group drawn from Ofwat, Defra, Welsh Assembly Government, DWI and EA that will meet every three months.

The group will co-ordinate the work of the various regulators including the preparation of any regulations that need to be adopted by the Secretary of State in England and the National Assembly for Wales.

## Water Supply Licensing Implementation Process – Information Paper

### ANNEX 1 - OVERVIEW OF WATER ACT 2003 PROVISIONS

This annex explains the main provisions of the Act that relate to water supply competition.

#### WATER SUPPLY LICENSING

The Act permits access to a water undertaker's network for a licensed water supplier for the purpose of supplying eligible customers. This will require prospective suppliers to obtain a water supply licence in order to compete with water undertakers in the supply of water through the public distribution network. Prospective suppliers can either apply for a

- 'Retail' licence, which entitles the holder to purchase water from a water undertaker ('a wholesale supply') and to retail it to the eligible customer.

Or

- 'Combined' licence which enables the holder to input water into a water undertaker's distribution network and to retail that water to an eligible customer.

There are approximately 2,300 eligible customers spending in total about £200m on water each year (2002 figures). Eligible customers are defined in the Act as non-households whose annual consumption at each relevant single premises is likely to be not less than the defined eligibility threshold, currently set at 50 Megalitres. Aggregation of volumes at different premises in order to meet the threshold is not allowed. The Government will review the competition framework, including the eligibility threshold, within three years of the regime commencing.

As well as the primary legislative framework for competition, the Act provides for the making of secondary legislation (Statutory Instruments including Regulations). Ofwat and Defra/Welsh Assembly Government will be involved in developing this secondary legislation, which will cover the following aspects of the new regime.

- Licence application process, new section 17F(1)-(5).
- Definition of household and non-household premises, new section 17C(3).
- New customer exemptions, new section 17D(7).
- Exemptions & exceptions, (the treatment of existing common carriage and wholesale supply arrangements, if any, caught by the prohibitions in the Act), new sections 66I-L.
- Certain matters relating to modification of licences, new sections 17J(6) and 17Q(9).
- Designation of treatment works, new section 17B(6) & 66B(8).
- Prescription of requirements relating to water fittings regulations, new sections 66A(6), 66B(6) and 66C(6).

Ofwat must also issue statutory guidance on the following.

- Access terms and charges, new section 66D(4).
- Eligibility of customers, including estimating quantities of water, new section 17D(3).
- The extent of a single premises, new section 17A(9).

In addition Ofwat will issue non-statutory guidance on the following.

## **Water Supply Licensing Implementation Process – Information Paper**

- Customer transfer protocol.
- Strategic supplies, new sections 66G-H.
- Licence application process, new section 17F.

The DWI has been granted extended powers under the Act to audit water supply licensees as well as undertakers in respect of sections 68, 69 and 79 of the WIA91. The offence of supplying water unfit for human consumption under section 70 of the WIA91 has also been extended to enable the DWI to prosecute undertakers, licensees and their contractors in the event of such incidents. The DWI will play an important role in the licensing process to ensure applicants for the combined authorisation are technically competent.

The EA continues to be responsible for regulating access to water resources, including managing the abstraction-licensing regime. The EA or Defra, as appropriate, has overall responsibility for water resource and drought planning in England and Wales.

Under the Act, a Consumer Council for Water (CCW), independent of Ofwat, will replace the present WaterVoice arrangements. Its function will be to represent and protect the interests of all customers. The CCW will represent the interests of both eligible and ineligible customers under the new competitive regime.

Water undertakers will remain vertically integrated companies, with responsibility for all elements in the water supply chain. They must however provide access to licensees under terms that comply with the Act and with subsequent guidance. For example, charges must comply with the costs principle established by new section 66E of the Act. Water undertakers and licensees will be required to reach individual agreements on terms that comply with the Act. Water undertakers will have a duty to provide access, subject to certain conditions. For example, the duties do not apply if they would put at risk the water undertaker's ability to fulfil its existing or future obligations, or where complying would contravene the Water Supply (Water Fittings) Regulations, or where providing access would require the water undertaker to incur unreasonable expenditure in carrying out these works.

Ofwat will have the power to make determinations to resolve disputes between water undertakers and licensees, on matters such as access terms and charges and whether a customer is eligible. In making determinations, Ofwat will refer to the appropriate legislation and published guidance decisions will be binding. Ofwat will consult the DWI where water quality issues are involved. It would be prudent for both parties to attempt to resolve disputes between themselves, before asking for our help. We intend to issue clear guidance to minimise the need for determinations.

### **LICENCE CONDITIONS AND WATER UNDERTAKERS' APPOINTMENTS**

Under the current regime, water undertakers operate according to their instruments of appointment. This will continue to be the case under the new competition regime, although there will be some modifications to existing conditions of appointment.

Changes to water undertakers' conditions of appointment are normally made by Ofwat, with the water undertakers' agreement; or following reference by Ofwat to the Competition Commission on public interest grounds. However, the Act provides for modifications to be made to these conditions of appointment, where necessary, or

## **Water Supply Licensing Implementation Process – Information Paper**

expedient, to implement the competition proposals in the Act, without reference to the Competition Commission (paragraph 4 schedule 4 and section 103).

Licensees will have a water supply licence, which will be of a different construction to water undertakers' instruments of appointment. These licences will have standard terms and conditions that will govern how licensees operate, together with specific individual conditions where appropriate.

A policy document on the proposed standard licence conditions for licensees and proposed modifications to water undertakers' conditions of appointment will be published for consultation in early 2004. It is at this stage of the process that respondents will be able to influence relevant policy as regards standard licence conditions for licensees and proposed modifications to water undertakers' conditions of appointment.

The draft legal text of both documents incorporating responses to the policy consultation will be issued for consultation in winter 2004. Final standard licence conditions and conditions of appointment will be published in summer 2005. At the same time, prospective licensees will be able to begin applying for a water supply licence, with the overall regime due to commence in autumn 2005.

# Water Supply Licensing Implementation Process – Information Paper

## ANNEX 2 - TERMS OF REFERENCE

This annex outlines the proposed terms of reference for the groups.

### WATER SUPPLY LICENSING SPONSOR GROUP

#### Aim of the Group

To assist with ensuring the successful delivery of the new competition regime as described in the Act, by autumn 2005. In doing this it will assist with ensuring that each group achieves its milestones, there is consistency between the groups, and it will seek to address differences of view between stakeholders within the groups. This will ensure that:

- the project is delivered on time and is successful;
- the delivered project meets the needs and objectives of the various stakeholders as far as is legally possible;
- all stakeholders have an opportunity to have their views heard and given due consideration;
- the activities of the advisory groups are co-ordinated; and
- all stakeholders have a global view of the project and their role within it.

#### Membership

The group should consist of approximately 15-20 individuals. Members will be selected according to their expertise and practical experience and its relevance to the issues for discussion. They will represent the following stakeholder constituencies:

- water undertakers;
- WaterVoice and eligible Customers;
- potential licensees; and
- Government, including Defra, Welsh Assembly Government, DWI and Ofwat.

#### Work of the Group

The group will act as an observing body, to assist with ensuring that the advisory groups and other project stakeholders are acting in a manner that will ensure the successful implementation of a water supply competition regime in autumn 2005. To this end, the group may need to address specific implementation issues from time to time.

#### Administration

The group will meet every three months at Ofwat's headquarters in Birmingham. Ofwat will chair and act as the secretariat to the group. We will also prepare papers.

### ACCESS TERMS AND STRATEGIC SUPPLIES ADVISORY GROUP

#### Aim of the Group

To assist with ensuring the successful delivery of the new competition regime as described in the Act, by autumn 2005. To assist and advise Ofwat and Defra/Welsh Assembly Government in developing the detailed guidance on access terms and charges and strategic supplies, and secondary legislation relating to exemptions and exceptions.

#### Membership

The group should consist of approximately 10-15 individuals. Members will be selected according to their expertise and practical experience and its relevance to the issues for discussion. They will represent the following stakeholder constituencies:

- water undertakers;
- eligible customers;
- potential licensees; and
- Government including relevant regulators.

#### Work of the Group

The group will provide expert advice on the issues listed below and any others it believes to be relevant. The group will produce detailed proposals on each of these issues. It is envisaged that the group will spend the majority of its time considering access terms and charges.

Ofwat and Defra/Welsh Assembly Government will take careful note of this advice when implementing the regime. However, the Government's broader framework, its objectives and the legislation must govern final policy decisions.

#### • Access Terms and Charges: Ofwat Guidance

- How the access code will address issues such as exchange of information including timeframes, maintenance of water quality, balancing inputs and outputs, dispute resolution, network security and emergency arrangements.
- The process for determining whether licensee requests would impose unreasonable costs on the water undertaker or put at risk its ability to meet existing and future obligations.
- Ensure that access charging methodology complies with the costs principle (section 66E) established by the Act.
- Charging methodology issues such as use of average accounting costs or long run marginal costs (LRMC), actual cost allocation and estimation, stability of LRMC estimates over time, split in total charges between those based on capacity and those based on consumption, how to calculate avoidable costs.
- Definition of retail cost items for calculating wholesale charges.
- How to ensure wholesale and access charges respond to changes in the level of retail charges and/or avoidable costs.

## **Water Supply Licensing Implementation Process – Information Paper**

- **Exemptions and Exceptions: Statutory Instrument**
- Treatment of existing common carriage and other arrangements and whether exemptions or exceptions will need to be made.
- **Designation of Strategic Supplies: Ofwat Guidance**
- Determine criteria for assessing strategic supplies.
- Establish process and reasonable time scales.
- Possible impact on customers.

### **Administration**

The group will meet monthly at Ofwat's headquarters in Birmingham. It is expected to meet for approximately ten months, beginning in February 2004. Members of the group will continue to work between meetings, reviewing and commenting on papers and considering issues. Ofwat will chair the meetings and act as the secretariat to the group. We will also prepare initial policy papers.

# Water Supply Licensing Implementation Process – Information Paper

## LICENCE APPLICATION AND CUSTOMER ELIGIBILITY ADVISORY GROUP

### Aim of the Group

To assist with ensuring the successful delivery of the new competition regime as described in the Act, by autumn 2005. To assist and advise Ofwat and Defra/Welsh Assembly Government in developing the detailed guidance and secondary legislation relating to the licence application process and the eligibility of customers.

### Membership

The group should consist of approximately 10-15 individuals. Members will be selected according to their expertise and practical experience and its relevance to the issues for discussion. They will represent the following stakeholder constituencies:

- water undertakers;
- eligible customers;
- potential licensees; and
- Government including relevant regulators.

### Work of the Group

The group will provide expert advice on the issues listed below and any others it believes to be relevant. The group will produce detailed proposals on each of these issues. It is envisaged that the group will spend the majority of its time considering the licence application process and eligibility issues.

Ofwat and Defra/Welsh Assembly Government will take careful note of this advice when implementing the regime. However, the Government's broader framework, its objectives and the legislation must govern final policy decisions.

#### • **Licence Application Process: Statutory Instrument & Ofwat Guidance**

- Relationship of applicant with existing water undertakers.
- Application process and time scales.
- Areas and level of competency required (eg) management, financial, technical and operational skills.
- Assessment of competency levels.
- The role of Ofwat and other regulators in the assessment process.
- Differing requirements between retail and combined licence applicants.
- Licence variation process.
- Ongoing certification of adequacy.
- Licence termination and revocation.

#### • **Definition of Household & Non-Household: Statutory Instrument**

- Determination of principal usage in a multiple use premises.
- Treatment of premises in which the business carried out involves providing residential services, eg nursing homes, prisons.

## **Water Supply Licensing Implementation Process – Information Paper**

- **Definition of Relevant Premises and Estimated Quantity of Water: Ofwat Guidance**
- Definition of an individual premises with regard to issues such as multiple connections, sites split by transportation infrastructure, site boundaries, and sites with landlord/tenant relationships.
- Rules for measuring consumption with regard to use of past, present or future consumption, timeframes considered, and evidence accepted.
- Disputes procedures.
- Time scales for reasonable supply of data between parties.
- Ensuring that the premises definition and consumption estimation rules are consistent.
- **Customer Transfer Protocol: Ofwat Guidance**
- How the process will be administered.
- Actual process and time scales.
- Data requirements and means of transfer.
- **New Customer Exemptions: Statutory Instrument**
- Situations in which licensees will not be regarded as entering into an agreement with a new customer.

### **Administration**

The group will meet monthly at Ofwat's headquarters in Birmingham. It is expected to meet for approximately ten months, beginning in February 2004. Members of the group will continue to work between meetings, reviewing and commenting on papers and considering issues. Ofwat will chair and act as the secretariat to the group. We will also prepare initial policy papers.

## **Water Supply Licensing Implementation Process – Information Paper**

### **REGULATORS' GROUP**

#### **Aim of the Group**

To assist with ensuring the successful delivery of the new competition regime as described in the Act, by autumn 2005. To co-ordinate the activities of the various regulators so that their work is prepared and where appropriate submitted to the Secretary of State in England and the National Assembly for Wales. This will assist with ensuring effective co-ordination with respect to any regulations to be adopted by Secretary of State in England and the National Assembly for Wales so that prospective suppliers can begin applying for licences in summer 2005, before the competitive regime commences in autumn 2005.

#### **Membership**

The group should consist of approximately 10-15 individuals. Members represent all relevant regulators and Government departments, Defra, Ofwat, DWI, EA, and Welsh Assembly Government.

#### **Work of the Group**

The group will assist with co-ordinating the work of the various regulators with respect to any regulations to be adopted by Secretary of State in England and the National Assembly for Wales.

The group will assist with ensuring that Ofwat publishes suitable guidance in support of the Act and that the various regulators provide robust advice to the Secretary of State in England and the National Assembly for Wales with a view to ensuring the associated Statutory Instruments are prepared and adopted. Ofwat and the DWI must also agree the various roles they will play in the licence application process.

#### **Administration**

The group will meet in London every three months throughout the implementation period. Ofwat will arrange and chair the meetings and act as the secretariat.