



WATER ACT 2003
WATER SUPPLY LICENSING

Guidance on eligibility

Consultation responses and RIA

November 2005

Guidance on eligibility – eligibility, licensing, customer transfer protocol and strategic supplies consultation

Summary of responses and final regulatory impact assessment

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1. Introduction

In October 2004 we consulted on our draft guidance on eligibility¹.

From 1 December 2005, non-household customers who are likely to be supplied with at least 50 megalitres (Ml) of water a year at eligible premises will have the option of transferring from their existing water undertaker to an alternative water supply licensee (referred to in this paper as a 'licensee'). Licensees will be able to compete by purchasing a wholesale supply of water from an existing water undertaker and retailing it to a customer (a retail supply), or by introducing water into a water undertaker's supply system and selling it to a customer (a combined supply). Water undertakers must provide access to licensees on terms that comply with the licensing provisions of the Water Industry Act 1991² (WIA91) and our guidance on access codes.

Section 17A(3) WIA91 sets out the requirements that must be satisfied for a set of premises to be eligible to be supplied by a licensee. Our draft guidance on eligibility explained how to assess whether premises are eligible. It included information on what constitutes a single set of premises, the definition of 'non-household' premises, and how to measure the supply volumes of water to calculate whether the threshold requirement is met.

We asked for views on our proposed guidance on eligibility. In particular, we wanted to know if our proposals were practicable or were likely to cause problems, and if so, what these problems were, and how they might be addressed.

This paper summarises the consultation responses that we received on eligibility and explains how we took account of them in the final guidance. If you wish to discuss any aspect of this paper, please contact Christina Chadwick on 0121 625 3652 or e-mail christina.chadwick@ofwat.gsi.gov.uk.

¹ Water Act 2003: Water Supply Licensing. Eligibility, licensing, customer transfer protocol and strategic supplies (October 2004).

² In this summary, references to WIA91 refer to WIA91 as amended by Water Act 2003 (WA03). The principal water supply licensing amendments have effect from 1 December 2005 (see the Water Act 2003 [Commencement No.5, Transitional Provisions and Savings] Order 2005 [SI 2005/2714 (C.109)]).

2. Responses to the consultation

2.1 Summary

We received responses from 34 stakeholders including 17 statutory water undertakers operating in England and Wales, Drinking Water Inspectorate (DWI), Water UK, WaterVoice³ and four potential new licensees. Bristol Water, Folkestone & Dover Water Services, Portsmouth Water, Scottish Water, Sutton & East Surrey Water and Tendring Hundred Water Services confirmed their support of the response submitted by Water UK, rather than providing individual responses to the consultation. A list of respondents is in appendix 1, and copies of all replies are available to read in our library.

Generally, respondents agreed with the guidance on eligibility and several provided additional comments for consideration. The section below summarises the key points that were made in reply to the consultation and explains our response to these issues. We have then summarised individual responses to each of our questions and set out how we have addressed the points in the sections headed 'Our conclusions'.

2.2 Key points raised in the responses to the consultation

a) Legal responsibility for eligibility assessment

Several respondents expressed concern that it is unclear that licensees rather than water undertakers have the legal responsibility to ensure that the premises of customers they supply are eligible. We have explained in the final guidance that in all cases and for all aspects of eligibility, it is the licensee rather than the water undertaker that must ensure that the premises of a potential customer are eligible.

b) Additional examples of premises

Respondents generally felt that the guidance would benefit from more examples of premises. We have compiled a list of the examples of premises that respondents suggested together with our conclusion on eligibility in an additional appendix.

c) Definitions of a single set of premises

Respondents suggested that the term 'single customer' in the guidance and the examples of 'common occupation co-located premises' in appendix 2 should be clarified. We have explained 'single customer' as a single customer that occupies the premises and is liable for water bills in respect of those premises. The text in appendix 2⁴ has been expanded to clearly distinguish between examples one and two of 'common occupation co-located premises'.

³ WaterVoice, the water customers' watchdog, provided comments on the eligibility guidance before it was succeeded by Consumer Council for Water (CCWater) on 1 October 2005. CCWater represents customers' interests in respect of price, service and value for money; it also investigates complaints from customers about their water companies.

⁴ Appendix 2 is now appendix 1 in the final guidance on eligibility.

d) Household and non-household list

Respondents generally felt that the list of premises designated as household and non-household should be amended. In the light of the responses, we have added several premises to the non-household list, removed the principal use examples and explained how the list can be utilised for mixed-use assessment.

e) Assessment of mixed-use premises

Respondents have expressed concern regarding the difficulty of accurately assessing household and non-household splits in the consumption of water on mixed-use premises. We have explained that water use might be measured by analysing historical bills or by fitting separate meters at an additional cost.

f) Consistency on leakage

Several respondents highlighted that the proposed guidance inaccurately referred to the access code guidance as explaining leakage in more detail. We have amended both sets of guidance for consistency.

g) Publication of determinations

It was suggested that we publish determinations on eligibility. The determinations procedure⁵ can be referred to for guidance on obtaining a determination. We propose to publish the results of determinations and have added text to the guidance on eligibility accordingly.

h) General comments on the guidance on eligibility

Respondents made a variety of comments, raising issues that they felt needed consideration or did not think that the guidance had covered. Where relevant, we have addressed these points in our final guidance on eligibility or in this summary. Full copies of replies to the consultation are available to read in our library.

2.3 Concurrent consultations

In 2004 we consulted on the following water supply licensing issues.

- Water undertakers' new conditions of appointment and potential licensees' Water Supply Licence conditions.
- Policy proposals on exceptions regulations and exemptions.
- Access code guidance.

We have reviewed the responses to all the consultations for links and related issues. We have also reviewed our final guidance to make sure it is consistent. In addition, drafts of our final guidance documents have been reviewed and commented on by

⁵ Water Act 2003: Procedure for handling water supply licensing determinations.

the Technical Advisory Group⁶ (TAG). After these documents are published, we will monitor how the market develops and consider if we need to revise them.

2.4 Responses to individual questions

2.4.1 Premises

Question 1: Do you agree that section 3.3.1⁷ above correctly identifies the types of premises that may be eligible under the WSL regime? If not, what definition of premises would you suggest and why?

Most respondents agreed that we have correctly identified eligible premises. Some respondents went on to give examples of types of premises where greater clarity is required.

The following comments were received.

- One water undertaker highlighted that the layout of premises may complicate the assessment of eligibility and questioned whether part of an eligible premises can be disaggregated from an ineligible part. Also, the relationship between the large user tariff definition and the eligibility definition was raised.
- The same water undertaker suggested that for premises to be eligible, customers' premises should have had a Water Regulation inspection carried out within the past six months.
- Another water undertaker stated that it must be clear that the list of eligible premises in the guidance is not exhaustive.
- One water undertaker commented that licensees should be able to pursue national contracts to supply all the sites of an organisation that exceed the 50MI/yr threshold, rather than having a contract for each individual site.
- WaterVoice were keen that we should assess the eligibility of 'unique' premises on a case-by-case basis, taking account of the Carbon Trading rules or the Gas Network Code.
- A stakeholder gave several examples of premises where clarification regarding common occupation co-located premises is needed. In particular, the stakeholder queried the definition of 'occupied by one customer' and asked if this means that one customer/business/local authority owns the premises or whether it implies that the water bills are all addressed and paid by the same account holder.

Our conclusions

We have carefully considered respondents' comments and have revised the section on premises and appendices in the guidance. We have added an explanation of how the list of premises in the appendix can be used to assess principal use and have clearly explained that premises must be considered as a whole, not disaggregated, when assessing principal use. We have also clarified that a single

⁶ Industry advisory group which was set up to advise us on the technical implementation of the water supply licensing policy.

⁷ Section 3.3.1 is now section 3.1 in the final guidance on eligibility.

customer must occupy the premises and be liable for water bills in respect of the premises.

We have previously considered the impact of the eligibility definition on the large user tariff and the TAG members have agreed that the definition is in line with the tariff. Therefore, we do not propose to change the final guidance on eligibility.

As an extension to the third condition under section 66A(3) WIA91, we have clarified in the final guidance that eligible premises must fully comply with the Water Fittings Regulations in response to the suggestion made by a water undertaker. However, we do not consider it necessary for customers to have had a Water Regulation inspection in the past six months in order to be eligible. Water undertakers should treat licensees' customers as they would treat their own customers in respect of Water Fittings Regulations.

The three types of premises described in the eligibility consultation paper are taken from the Department for Environment, Food and Rural Affairs (Defra) and the Welsh Assembly Government (the Assembly Government) joint public consultation on 'Extending Opportunities for Competition in the Water Industry in England and Wales' (July 2002). The respondents and we largely agree that the three types of premises cover those that will be eligible in the new water supply licensing (WSL) regime. However, we propose to review the three types of premises if additional types arise from eligibility determinations and we recognise that there may be unique cases to consider as highlighted by WaterVoice. We do not intend to follow precedents set by the Carbon Trading rules or the Gas Network Code as the definition of eligible premises is different to that in the water industry.

We note the point raised by one water undertaker on national contracts. The guidance does not seek to prevent a licensee from pursuing national contracts with a customer. However, where the licensee is an associated company it must not seek to compete in its related water undertaker's area of appointment, and every licensee must have an access agreement for each of the eligible premises it supplies.

Question 2: Do you agree that the examples in appendix 2⁸ are consistent with section 3.3.1⁹ of the guidance? Do you have other examples that are not represented above?

It was generally agreed that the examples were consistent. Some respondents did suggest that additional examples would be helpful and a water undertaker and stakeholders said that 'common occupation co-located premises' examples one and two in the appendix are confusing.

The following additional comments were received.

- One water undertaker commented that the examples in the appendix are simplistic when compared with actual premises. It wanted more examples of premises separated by transport infrastructure such as universities where

⁸ Appendix 2 is now appendix 1 in the final guidance on eligibility.

⁹ Section 3.3.1 is now section 3.1 in the final guidance on eligibility.

non-university buildings are found within the campus, and sites that are part of the same company, but diagonally split by a road.

- A water undertaker requested clarification on what would happen if a party within a 'common management co-located premises' wished to withdraw from the management company's supply agreement with a licensee and subsequently the remainder of the site supplied by the licensee fell below the 50MI/yr threshold.

Our conclusions

We note that the examples of premises in the guidance may be considered simplistic and have created an additional appendix which comprises examples of premises raised in the consultation responses with a conclusion on eligibility. This can be referred to when assessing eligibility.

We have explained in the guidance that if a customer sells part of its premises so that the original premises is split and is occupied by a different customer then the threshold requirement will have to be reassessed. If the threshold is below 50MI/yr then the premises would not be eligible to be supplied by a licensee.

Question 3: Do you agree that the list in appendix 3¹⁰ is correct for the purposes of water supply licensing? If not, what amendments would you suggest and why?

Approximately half of the respondents to this question were happy with the list. The remainder suggested additional premises to be included, or disagreed with the household/non-household designation of different types of premises.

We received the following additional comments.

- Several respondents suggested removing the principal use sub-heading from the appendix as it could cause confusion and there are more than the two specific examples that are listed.
- One water undertaker thought that the list was too long and prescriptive and suggested that a better approach would be to have a short list of household premises, or a concise definition of how a premises is defined as a home.
- A potential licensee thought the non-household list should be expanded to include airports and military bases. It questioned why barracks are classed as household when usage is often mixed, while a water undertaker supported this by suggesting that military bases should be considered in their entirety under the 80:20 principal use criteria. Another stakeholder suggested that barracks and university halls of residence should be categorised as non-household. This is because it doubted whether the occupants would consider these premises to be their homes, as they very often do not occupy the premises on a permanent all-year-round basis.
- Several water undertakers thought that prisons, hospices, boarding schools, charity premises and day care centres should be re-designated or fall under the principal use category. One of the water undertakers pointed out potential

¹⁰ Appendix 3 is now appendix 2 in the final guidance on eligibility.

conflict between the two lists, as some stately homes owned by the National Trust, for example, are still used as private residences.

- One water undertaker requested clarification of the disconnection policy for premises such as hotels, schools and casinos where caretakers and staff live as tenants or residents on the premises.
- A large majority of respondents suggested that university halls of residence and boarding schools should be included in the non-household list. Some respondents commented that there is conflict in defining boarding schools as non-household and university halls of residence as household.
- WaterVoice thought that, for clarity, references to 'mixed-use mobile home' should be changed to 'mixed-use mobile home site'.
- A stakeholder thought that some residential accommodation for the elderly should be classified as non-household, as they are similar to hotels or hospitals. Another stakeholder suggested that health accommodation should be non-household.
- One stakeholder commented that hospices and hostels for the homeless should be classified as household. This is because in both cases the premises are likely to be the sole residence for the people staying there. It also thought that the term 'charity premises' should be removed as it had too broad a definition that could include shops, institutions, schools and religious premises.
- One stakeholder wanted universities to be added to the non-household list and university halls of residence moved from household to non-household list. It was also concerned that universities could be adversely affected by the 'principal use' criteria. The main point made was that the residences only exist because of the universities themselves, and should be classified as non-household when rating the premises as a whole. It gave examples of universities that could be affected by the rule that no more than 20% of consumption on a site could be 'household' if the site as a whole was to be classified as non-household. Universities are also being encouraged to build more student accommodation on campus by the Higher Education Funding Council for England in order to reduce congestion and be more environmentally friendly. For many universities, this could push their 'household' consumption above the 20% limit.

Our conclusions

We have amended the list of premises designated as household and non-household in the light of the comments received and from further consideration of eligible premises. The list in the appendix is now household and non-household only and the principal use column has been removed to avoid confusion. Therefore, the suggested change from WaterVoice is no longer applicable.

Universities have been added to the non-household list, along with airports/airfields and military bases. However, university halls of residence remain as household and boarding schools as non-household in the list. This is because halls of residence can be separate from a university and classified as household alone, whereas dormitories are unlikely to be separate from a school as an independent premises.

We also note the concern that university premises could be affected by the 80:20 rule to assess principal use, however, we do not think it is necessary to amend our guidance. This is because the 80:20 rule was agreed by members of our WSL

advisory groups and is considered appropriate. But we recognise that the 80:20 rule might require amending in the future.

We have not revised our guidance to change the classification of prisons, hospices, boarding schools, charity premises and day care centres to household as we believe that these will not be classed as a person's home. Several respondents appeared to be confusing domestic use with household use. We have explained how the list can be used for mixed-use assessment to make this clear. We have expanded the definition regarding stately homes and charity premises to differentiate premises that are also private residence. However, we have not removed charity premises from the list as one respondent suggested, because other premises on the list cover the broad examples given.

Residential accommodation for the elderly, health workers' accommodation, hospices and hostels for the homeless remain unchanged. We regard these as having been correctly defined in the guidance.

The disconnection policy for premises with possible live-in staff such as hotels, schools and casinos has not been explained, as we believe that this is not an issue that affects eligibility. Disconnection is covered in the access code guidance.

2.4.2 Household and non-household

Question 4: Do you agree that the above criteria correctly identify the principal use of a set of premises that has both a household and non-household use? If not, what criteria would you suggest and why?

This question prompted a considerable volume of responses. Respondents generally agreed with the first criteria of principal use where the household part of premises is dependent on the non-household part. However, several respondents were unhappy with the 80:20 rule in the second criteria and its application, although they held different views about whether this ratio is too big or too small.

We received the following additional comments.

- A potential licensee thought that the 80% threshold for determining principal use is too high and suggested that 66% (two-thirds) could represent principal use just as easily.
- One water undertaker commented that the 20% household use threshold is an arbitrary figure, which is likely to be challenged and require frequent review. Another water undertaker believed that the 80% threshold is too low and should be set perhaps as high as 95%.
- Three water undertakers said that in many cases the household and non-household parts of premises are not separately metered, so determining eligibility could be difficult without the expense of installing individual meters. Another water undertaker agreed with the difficulty of assessment if a customer is not metered and requested greater clarity to ensure that the non-household use of water is not confused with domestic/non-domestic use.

- A stakeholder suggested an additional criterion where premises should still be considered eligible if the calculated non-household consumption is in excess of 50MI/yr, but the bulk use of non-household consumption is just less than 80%.
- WaterVoice thought that the number of premises deemed ineligible because of the principal use criteria should be monitored and the approach re-examined as part of the planned review of the regime.
- A stakeholder suggested that the definitions should be changed to domestic and non-domestic, as these are the terms used in the gas and electricity sectors.
- One stakeholder believed that if a customer's consumption has fallen below 50MI/yr it should still be able to switch licensees if the fall in consumption can be directly attributed to water efficiency.
- Following on from the previous question, the stakeholder stated that universities could be adversely affected by the 20% household usage rule as a result of efficiency measures encouraging them to build more student accommodation on the main site. It also disagreed with the fact that halls of residence are classed as household, but accommodation for hospital staff is classed as non-household, even though both types of accommodation are identical and can be on the same site as the establishment that they serve.

Our conclusions

We have not revised our criteria in the section on principal use as the 80:20 rule was agreed by members of our WSL advisory groups and is currently considered appropriate. However, we will monitor it and consider whether we might need to amend it in the future.

We note respondents' concerns about assessing non-household consumption on mixed-use premises. We have expanded this section in the final guidance to explain that the proportion of non-household consumption might be measured by analysing historical water bills. Alternatively, licensees might decide to fit separate meters in the household and non-household parts of premises (at their own expense).

We do not propose to change household and non-household terms to domestic and non-domestic as the WIA91 refers to eligibility with respect to household use. The term 'domestic' has a specific meaning in the water sector given by legislation, and premises can be non-household while using water for domestic purposes. This distinction is further explained in the guidance.

Also, we do not agree that a customer who has fallen beneath the 50MI/yr threshold due to water efficiency should be permitted to transfer to another licensee as this is unfair to customers with ineligible premises and might encourage wasting water in order to be eligible.

We along with the Environment Agency and DWI will monitor and develop the WSL regime. As WaterVoice have suggested, the principal use criteria may form part of that review.

2.4.3 Volume threshold

Question 5: Do you agree with the proposed circumstances in which a licensee will not be regarded as entering into an undertaking with a new customer?

Responses specifically related to the New Customer Exceptions Regulations are covered in a separate responses document by Defra and the Assembly Government¹¹. However, a number of respondents also commented on issues that are a matter for the guidance on eligibility.

The following comments were made.

- A potential licensee suggested that an efficient site that reduces consumption to below 50MI/yr and then subsequently buys a neighbouring plot of land should not be threatened with ineligibility and as such have no guaranteed supply from the water undertaker.
- A water undertaker believed that to have an equitable customer base of ineligible customers, an absolute floor for consumption should be applied. For example, an absolute floor of 40MI proven usage, so that if use was estimated to be 50MI and then fell by more than 10MI, then the customer would not meet the eligibility requirement.
- A water undertaker advised that it is not clear from the guidance what an “undertaking” means. It is concerned that the current interpretation leaves the parties in no man’s land as non-binding agreements on heads of terms are little more than an expression of interest which give the parties confidence to proceed with more detailed negotiations. The water undertaker requested a more precise definition with reference to legally binding arrangements evidenced by formal documentation.
- Another water undertaker agreed by saying that the current definition of an undertaking may lead to unnecessary confusion when it comes to determining threshold eligibility. It believed that disputes could arise where a customer’s supply drops below the threshold and a long period of time has elapsed before an access agreement with a water undertaker has either been made or been successful. It suggested that it would be simpler to relate the date of the licensee’s undertaking with the customer to the date that the licensee makes a formal application for access to a water undertaker’s network.
- Water UK advised that the Oxford Dictionary defines an undertaking as a pledge or promise. It therefore considered that the phrase contained in section 17D WIA91 “enter into an undertaking with a customer to give a supply” means entering into a binding contract to that effect, even if subject to later elaboration or modification.
- A respondent suggested that a customer should be allowed to switch to another licensee where the customer’s demand has fallen below the threshold due to actions of the licensee in promoting water efficiency. Alternatively, it said that the threshold should be reviewed downwards at the very earliest opportunity without waiting for three years.

¹¹ Water Act 2003: Water Supply Licensing Government Response to the Consultation on the New Customer Exception Regulations.

- WaterVoice supported this by stating that we will need to consider the long-term implications of water efficiency. This relates to a customer being able to remain with the licensee where consumption has dropped yet not being permitted to change to another licensee. It suggested that the consumption threshold should be reduced from 50MI/yr at the earliest opportunity, as it would not want customers with consumption just below the threshold to unduly waste water to meet the 50MI/yr threshold.

Our conclusions

We have considered the comment related to an efficient site that buys a neighbouring plot of land and believe that this arrangement should not result in a reduction of water consumption below the eligibility threshold, therefore we do not propose to modify the guidance.

We do not believe that there is a need for an absolute floor of consumption of 40MI as this may discourage water efficiency. If the estimated consumption figures provided are made by reference to historical meter readings or evidence of likely future demand in the case of a new customer this is sufficient.

We do not propose to amend the definition of an undertaking in the guidance. The definition is akin to an agreement under the Competition Act 1998 and we believe that 'undertaking' has a wider meaning than the word 'contract' or 'agreement' in ordinary contract law. In the guidance we interpret this to mean that an undertaking may be entered into once the principal commercial terms of an agreement have been agreed between commercial managers, but before the legally binding contracts have been finalised and signed.

A customer should not be allowed to switch to another licensee where the customer's demand has fallen below the threshold due to actions of the licensee in promoting water efficiency. This would be unfair to customers just below the eligibility threshold. However, along with the Environment Agency and DWI, we will monitor and develop the WSL regime to assist Defra with the review of the 50MI/yr threshold.

Question 6: Are there any circumstances in which a licensee will not be regarded as entering into an undertaking with a new customer, that are not covered above?

All responses received in relation to this question are covered in a separate New Customer Exception Regulations responses document by Defra and the Assembly Government.

Question 7: Do respondents believe that the draft new customer exceptions regulations in appendix 4 delivers the policy explained above?

All responses received in relation to this question are covered in a separate New Customer Exception Regulations responses document by Defra and the Assembly Government.

Question 8: Do you agree with the method for assessing volumes set out above? If not, what method would you suggest and why?

On the whole respondents agreed with our methods for assessing volumes, but suggested important caveats. These are listed below.

- Several respondents highlighted that the section on reservation and stand-by charges should be a general point as not all back-up supplies require a reservation charge nor would all premises that pay a reservation charge be unlikely to meet the threshold.
- A considerable proportion of respondents suggested that supplies to premises over the 50MI threshold must be metered, to accurately measure demand. Water UK believed that unmetered premises should not be permitted to change supplier.
- One water undertaker said that it is opposed to the idea that licensees should apply the same methods for estimating consumption as the incumbent water undertaker. It was concerned that the same facts could lead to different results from different water undertakers. To prevent this, it suggested that where volume forecasts are used as the basis for assessing eligibility, an audit should be carried out at the end of the first year of supply.
- A water undertaker requested clarity regarding to whom licensees will have to demonstrate that a customer's premises is eligible.
- A water undertaker asked for confirmation that reasonably incurred additional costs can be recovered from licensees in line with the cost principle. Another water undertaker stated that we might wish to use independent advice when determining eligibility issues, and questioned how these costs would be recovered.
- A water undertaker asked for predicted consumption of water to be checked against actual consumption and an absolute limit of 40MI/yr usage to be applied for eligibility to continue.
- One water undertaker was concerned that customers would only have to 'reasonably demonstrate' why their future consumption would be in excess of 50MI/yr if they wanted to switch suppliers and suggested that we should set out what is 'reasonable'.
- WaterVoice were concerned that with private supplies being excluded from the assessment of consumption, some businesses may temporarily change their supply in order to meet the threshold. For example, closing down a borehole to take water instead from the undertaker's supply system to meet the threshold. Having switched, the borehole could be brought back into use again.

Our conclusions

We have amended the guidance on reservation and standby charges to clarify that not all customers pay them and that not all of those customers who do may be ineligible.

We have also expanded the guidance to propose that licensees might decide to fit separate meters in household and non-household parts of premises. However, this is not mandatory and customers will still be permitted to change supplier where eligible premises do not have a water meter.

The access code guidance provides for licensees to inform water undertakers that a customer's premises is eligible when applying for an access agreement. It is a criminal offence for a licensee to supply ineligible premises; therefore the onus is on them all times to ensure that the premises they supply are eligible.

We have not changed the final guidance with regard to the suggestion that licensees should not apply the same methods for estimating consumption as the incumbent water undertaker. We believe that both parties should assess volumes in the same manner, but have expanded the guidance to clarify that volume can be assessed by reference to historical meter readings or evidence of likely future demand in the case of a new customer. Where future demand has been estimated, this must be justifiable (rather than just 'reasonably demonstrated' as in the proposed guidance), and therefore does not need confirmation of a lower limit of 40Ml/yr usage as suggested by a water undertaker.

The concern expressed by WaterVoice, that a customer may temporarily close down its borehole to take water from the supply system in order to meet the threshold, should be infrequent. This is because volume assessment based on historical meter readings should capture customers that are using private water supplies and as such have been below the 50Ml/yr threshold historically.

Finally, in relation to cost recovery, water undertakers' general costs associated with the WSL regime are likely to be small. Therefore, the costs of setting up and administering the new regime are not sufficiently material at present for water undertakers to seek to recover them from customers.

For the future, we accept the principle that water undertakers should be able to recover the reasonable, material costs of administering the new regime. Consequently, we will want to assess at future price reviews whether the additional base operating expenditure attributable to WSL is indeed reasonable. If we conclude that it is, we will then look carefully at how water undertakers plan to recover these costs. We consider that they should only recover such costs from customers who are eligible to switch supplier under the new regime. They should not recover these costs from the generality of customers, since most customers are only likely to benefit indirectly from the new regime.

2.4.4 General comments on guidance on eligibility

In addition to the answers to specific questions, respondents commented on several different areas relating to eligibility.

- Referring to rateable value, a potential licensee pointed out that this is an annual value, not a monthly value as we say in the paper.
- A water undertaker asked for a clearer explanation of the situations when a water undertaker does not have a duty to supply water to a licensee. They also wanted to see in the final regulatory impact assessment (RIA) how any increase of costs in the new WSL regime for us or Consumer Council for Water (CCWater) will be recouped.

- A water undertaker suggested that there should be an annual self-certification process for licensees in which they give an explanation and confirmation that a customer's premises remains eligible.
- One water undertaker thought that the sections dealing with 'common management co-located premises' in the guidance on eligibility and the section on 'third party retail supply' in the policy proposals on exceptions regulations and exemptions is contradictory in some areas.
- A stakeholder suggested that establishing whether there is an 80:20 split between non-household and household use on Ministry of Defence sites will be impracticable.
- Although the criteria for eligibility at present excludes households, another stakeholder requested that we lower the 50MI threshold in the future to enable new residential developments to be supplied by licensees.

Our conclusions

We have revised our final guidance to convey annual rateable value rather than monthly rateable value.

We note the comment on water undertakers' duties to supply water to licensees and have amended the guidance to explain the interim duty to supply under section 63AC WIA91. More detail can be found in the final guidance on strategic supplies.

The ongoing WSL regime costs incurred by us will be recovered from water undertakers and licensees via annual fees. We have revised our final RIA to cover the involvement of Consumer Council for Water (CCWater) in the regime and any associated costs.

We do not intend to require licensees to carry out an annual self-certification process for assessing eligibility of its customers' premises, as this would be overly burdensome. A customer can continue to be supplied by a licensee if consumption falls beneath the 50MI/yr threshold. However, the customer may not transfer to another licensee. Therefore, volume of water need only be assessed when a licensee first enters into an undertaking with a customer.

We note the concern regarding consistency between the guidance on eligibility and the policy proposals on exceptions regulations and exemptions consultation paper. We have reviewed all responses and guidance documents to ensure links and related issues are addressed.

In the light of the comment on eligibility assessments for Ministry of Defence sites where principal use applies, we do not think it is necessary to amend our guidance. This is because the 80:20 rule was agreed by members of our WSL advisory groups and is considered appropriate to capture premises with principal use that will be eligible under the new WSL regime. However, we recognise that the 80:20 rule might require amending in the future with experience.

In response to a stakeholder's request that we lower the 50MI threshold in the future, along with the Environment Agency and DWI, we will monitor and develop the WSL regime to assist Defra with the review of the 50MI/yr threshold.

3. Final regulatory impact assessment

3.1 Purpose and intended effect of the guidance on eligibility

Our consultation on the guidance on eligibility formed part of the framework for implementing the WSL provisions of the WIA91 as amended by WA03. Prospective suppliers were able to apply for a Water Supply Licence from 1 August 2005, with the overall regime starting on 1 December 2005.

In the partial regulatory impact assessment (RIA) we identified that 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.

Due to the complex nature of this regulatory regime and the difficulty in predicting how a competitive market will develop, the assessment of costs and benefits included in this final RIA are mainly qualitative. Although there will be a degree of fixed costs associated with the start up of competition through licensing, we expect that the scale of these will be limited because of the size of the initial market. Over the longer term, however, we expect that 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.

3.1.1 Responses to the partial regulatory impact assessment

We received 34 responses to the consultation and only a small proportion of the respondents commented on the draft RIA. Respondents generally agreed with our approach, including our preference for option 2.

Our assessment of the benefits and costs to the industry follows.

3.2 Options and rationale

Section 17A(9) WIA91 states that we may, with the approval of the Secretary of State after consulting the Assembly, issue guidance on the factors which are, or are not, to be taken into account in determining the extent of any premises for the purpose of being eligible to be supplied water by a licensee. Given this provision, we were unable to consider a 'do nothing' option. In the partial RIA, we identified and considered the two options below.

- **Option 1:** Issue broad guidance that sets out the basic requirements for eligibility and allows many cases to be considered on an individual basis.
- **Option 2:** Issue firm guidance with some flexibility to allow case specifics to be taken into account only where necessary.

3.3 Summary of benefits and costs to support the adoption of option 2

3.3.1 Benefits

Benefits to Ofwat

- Improves the transparency of regulation.
- Allows us to maintain the right level of involvement.
- Reduces the risks that water undertakers, licensees and customers would otherwise face if we adopted a broad, basic approach.
- As we expect the number of disputes to reduce over time, we will be required to invest less time (and hence incur less cost) in determinations.

Benefits to water undertakers and licensees

- Enables water undertakers and licensees to plan policies to implement the licensing provisions more effectively.
- Reduces uncertainties for water undertakers and licensees, by clearly setting out key principles that they should follow.
- Provides clarity to those interested in entering the competitive market.

Benefits to customers

As this approach allows some flexibility to water undertakers and licensee to secure customer-specific arrangements, customers' needs can be better accommodated than through inflexible guidance. Having inflexible guidance on eligibility might be seen as a barrier to entry by licensees, thus reducing the number of new suppliers that customers can choose from.

Benefits to us of less time and costs spent on determinations will also benefit customers through the reduction of water bills. Water bills will include our costs associated with the WSL regime.

3.3.2 Costs

Costs to Ofwat

It is likely that there will be some administrative costs. For example, we might receive more enquiries relating to the guidance on eligibility than expected.

We might incur costs from making determinations on eligibility. Although these are difficult to quantify until the start of the WSL regime, they will relate to assessing information. There will also be costs involved in instances where we have to take enforcement action if a licensee breaches its licence by supplying ineligible premises.

The new WSL regime will create additional regulatory functions for us. This will include monitoring the effectiveness of the guidance so that it allows as much

competition as possible to develop within the legislation and Government's wider objectives. It will also include considering the effect of new or unique circumstances on licensees' and water undertakers' obligations and updating the guidance to reflect these circumstances.

Costs to water undertakers

There will be minimal costs for water undertakers in implementing the policy set out in the guidance on eligibility. For example, a water undertaker might incur costs from seeking its own legal advice if it disagrees with a licensee, and with our guidance on eligibility and where they request a determination for eligibility.

Costs to licensees

Licensees are likely to face some costs when following the guidance, including assessing eligibility. We expect the costs to be similar to those which water undertakers are likely to incur.

Costs to ineligible customers

The costs incurred by water undertakers where they request a determination for eligibility will not be recoverable from their customers. Water undertakers' general costs associated with the WSL regime are likely to be small. Therefore, the costs of setting up and administering the new regime are not sufficiently material at present for water undertakers to seek to recover them from customers.

For the future, we accept the principle that water undertakers should be able to recover the reasonable, material costs of administering the new regime. Consequently, we will want to assess at future price reviews whether the additional base operating expenditure attributable to WSL is indeed reasonable. If we conclude that it is, we will then look carefully at how water undertakers plan to recover these costs. We consider that they should only recover such costs from customers who are eligible to switch supplier under the new regime. They should not recover these costs from the generality of customers, since most customers are only likely to benefit indirectly from the new regime.

Costs incurred by us will be recovered from water undertakers and licensees. However, as our experience of dealing with competition related queries and resolving disputes develops, the time taken to process them should reduce, and our costs should decrease.

Costs to Consumer Council for Water

CCWater has no powers to administer the new regime or resolve disputes that may arise from eligibility assessment. Therefore we do not expect CCWater to incur costs in this area.

Appendix 1: Eligibility, licensing, customer transfer protocol and strategic supplies consultation – list of respondents

Potential licensees

Aquavitae UK
C2C
Scottish Water
Waterlevel

Water undertakers

Anglian Water
Bournemouth & West Hampshire Water
Bristol Water
Dee Valley Water
Dŵr Cymru – Welsh Water
Folkestone & Dover Water Services
Northumbrian Water
Portsmouth Water
Severn Trent Water
South East Water
Sutton & East Surrey Water
Tendring Hundred Water Services
Thames Water
Three Valleys Water
United Utilities
Wessex Water
Yorkshire Water

Other stakeholders

Drinking Water Inspectorate (DWI)
EIC
Electralink
Gemserv
House Builders Federation
Local Authority and Government Utilities Resource (LAGUR)
Major Energy Users Council Limited
Mr Malcolm J Sutcliffe
The Chartered Institute of Purchasing and Supply (CIPS)
The Energy Consortium
University of West of England
Water UK
WaterVoice