



WATER ACT 2003
WATER SUPPLY LICENSING

**Policy proposals on exceptions
regulations and exemptions**

Consultation paper

December 2004

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1. Introduction

1.1 Purpose of the consultation

This consultation paper sets out our policy proposals and proposed legal draft for regulations establishing exceptions from the prohibition on the use of, and introductions of water into, a water undertaker's¹ supply system² to supply premises of customers introduced by sections 66I and 66J of the Water Industry Act 1991 (WIA91)³.

The Water Act 2003 (WA03) amends the WIA91 so as to permit a licensed water supplier (licensee) to have access⁴ to a water undertaker's supply system for the purpose of supplying water to customers' eligible premises. In some circumstances, water undertakers' duties to provide access do not apply. However, WIA91 also prohibits access to anyone that is not a licensee or, in some circumstances, another water undertaker⁵.

Sections 66I(3) and 66J(3) WIA91 allow the Secretary of State by regulations to specify further circumstances in which the prohibitions do not apply. These regulations will be used to except certain general activities that would otherwise be illegal. This includes situations where the prohibition had unintentionally caught a particular activity.

Under sections 66I(8) and 66J(9) WIA91 the function of making regulations are exercisable by the National Assembly for Wales (the Assembly) in relation to any supply system of a water undertaker whose area is wholly or mainly in Wales.

In addition, section 66K WIA91 provides that the Secretary of State may by order made by statutory instrument exempt specific persons or classes of person from the prohibitions set out above. Exemptions can apply to persons generally or to such extent as specified and can be unconditional or subject to specified conditions. Therefore, exemptions can be more finely tuned than exceptions. Under section 66L(7) WIA91 the function of granting exemptions is exercisable by the Assembly in relation to any supply system of a water undertaker whose area is wholly or mainly in Wales.

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 The term 'supply system' is defined in section 17B(5) WIA91 for the purposes of the new water supply licensing arrangements as the potable water mains and other pipes from below the water undertaker's treatment works up to its customer's premises, and any non-potable networks that are not connected to any potable system. Access to all other facilities (ie treatment works of a potable supply system and upstream of this) is outside this licensing regime.

³ In this paper, references to the WIA91 refer to the WIA91 as amended by WA03.

⁴ The term 'access' refers to combined supply (the conveyance of water through the public supply system by a water undertaker on behalf of a licensee to supply the licensee's customer) and retail supply (the supply of water, purchased wholesale from the water undertaker, to the licensee's customer).

⁵ See section 3 for more detailed explanations of the prohibitions introduced by sections 66I and 66J WIA91.

This consultation paper also sets out our proposed policy towards activities that are prohibited under the new water supply licensing (WSL) regime and the activities that we propose to exempt. It also includes for information the process for making and revoking or withdrawing an order to grant an exemption.

The other aspects of the WSL regime are covered in our consultation papers on 'Access code guidance', 'Licensing and eligibility' and 'Conditions of Water Supply Licences and modifications to water undertakers' conditions of appointment'.

1.2 Structure of the consultation

The paper is structured as follows:

- Section two provides an overview of the four water supply licensing consultation papers.
- Section three sets out our proposed policy on exceptions in the new WSL regime.
- Section four explains the procedure for granting, revoking and withdrawing exemptions.
- Appendix one sets out a list of prohibited activities under the WIA91 and the activities for which we propose to grant an exception.
- Appendix two contains the proposed draft Water Supply (Exceptions from Supply System Prohibitions) Regulations.

A regulatory impact assessment (RIA) has not been developed for this consultation for the draft exceptions regulations. This is because, rather than imposing regulatory burdens, the regulations remove restrictions imposed by the WIA91 in order to allow activities that would otherwise be prohibited.

Responses to this consultation will inform the drafting of final regulations which will be made by the Secretary of State and the Assembly, to be in place before the new WSL regime begins in autumn 2005.

1.3 Next steps

We invite your views on:

- all areas of the consultation paper, including the draft regulations;
- additional issues you think need to be considered, what these issues are and how they should be dealt with;
- whether our proposals are practical; and
- whether our proposals are likely to cause problems, what these problems might be and how they could be resolved.

We have also identified specific questions in the consultation paper. We welcome your views on these.

Please send your responses by **22 March 2005** to:

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Unless otherwise requested, all responses will be placed in our library and made available to the public.

2. Overview of water supply licensing consultation papers

This section outlines the new WSL regime and explains the links between the four consultation papers that Ofwat⁶, the Department for Environment, Food and Rural Affairs (Defra) and the Assembly have produced in autumn/winter 2004.

2.1 Water supply licensing regime

The WA03 amends the WIA91 to extend opportunities for competition within England and Wales. Among other things, it provides a specific framework for access to the public water supply systems of statutory water undertakers within England and Wales. The relevant provisions within the WIA91 were included in the light of responses received by Defra and the Assembly to their joint public consultation on 'Extending Opportunities for Competition in the Water Industry in England and Wales' (July 2002).

From autumn 2005, customers who are likely to be supplied with at least 50 Ml/yr in a set of premises will be able to purchase water from either their existing water undertaker or from a water supply licensee.

Extending opportunities for competition will increase customer choice. This should lead to keener prices, innovation and the provision of new and improved services for customers. The new provisions in the WIA91 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;
- to protect and improve the environment;
- to meet the Government's social goals including the affordability of water supplies; and
- to safeguard services to customers.

2.2 Water Supply Licences

The WIA91 permits access to a water undertaker's supply system by a licensee for the purpose of supplying a customer's eligible set of premises. Prospective suppliers will need to obtain a Water Supply Licence from Ofwat in order to compete with water undertakers in the supply of water through the water undertakers' supply systems. Prospective suppliers can either apply for:

- a 'retail' Water Supply Licence, which entitles the holder to purchase a supply of water from a water undertaker and to retail it to a customer's eligible set of premises; or

⁶ Under the Water Industry Act 1991 (WIA91) as amended by the Water Act 2003 (WA03), the role of a single Director General of Water Services (the Director General) will be replaced with the Water Services Regulation Authority (the Authority) which will be run by a Board. In anticipation of this change, which is expected to take place in April 2006, Ofwat has already appointed an advisory board that includes independent non-executive advisory directors. For consistency and continuity, in this consultation, Ofwat means the Director General and the Authority.

- a 'combined' Water Supply Licence, which is a retail licence with a supplementary authorisation that enables the holder to introduce water into a water undertaker's supply system and to retail that water to a customer's eligible set of premises.

There are approximately 2,300 customers at eligible premises, spending in total about £210 million on water each year (2002 figures). Eligible premises are defined in the WIA91 as non-households where annual consumption is likely to be not less than the defined eligibility threshold, currently set at 50 Ml/yr. In addition, premises may be supplied by only one licensee at any time.

Along with the Environment Agency and Drinking Water Inspectorate (DWI), we will undertake a review of the licensing framework, including the 50 Ml/yr threshold, within three years of the start of the regime. The reviews will be co-ordinated by Defra. The timing of when that review will take place will depend on whether the regulators have enough information to undertake such a review in that timescale.

2.3 Legislative framework

As well as the primary legislative framework, the WIA91 provides for the making of secondary legislation, which Ofwat is developing in conjunction with Defra and the Assembly. Ofwat are required to issue statutory guidance and will also provide non-statutory guidance.

DWI has been granted extended powers under the WIA91 to regulate water supply licensees as well as water undertakers. The offence of supplying water unfit for human consumption under section 70 WIA91 has also been extended to enable DWI to prosecute water undertakers, licensees and their contractors in the event of such incidents. This change will be reflected in the Water Supply (Water Quality) Regulations. DWI will play an important role in the licensing process to ensure potential licensees are technically competent.

The Environment Agency continues to be responsible for regulating access to water resources, including managing the abstraction licensing regime. It assesses company drought and water resource plans on behalf of the Government, and will continue to have a role in assessment when these plans become statutory.

Under the WIA91, 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 customers at both eligible and ineligible premises under the new competitive regime.

Water undertakers will remain vertically integrated companies⁷, with responsibility for all elements in the water supply chain. Water undertakers must, however, provide access to licensees under terms that comply with the WIA91 and subsequent guidance. For example, access terms, including charges, must comply with the

⁷ Vertically integrated water undertakers operate at every level of the water services supply chain, ie ownership and/or control of the operation of abstractions, reservoirs, pumping stations, treatment works and/or all elements of the public distribution network.

costs principle⁸ set out in section 66E WIA91. Water undertakers and licensees will be required to reach individual agreements on terms that comply with the WIA91 and Ofwat's statutory guidance. Water undertakers will have a duty to provide access, subject to certain conditions. The duty to provide access does not apply if, in certain circumstances, access would put at risk the water undertaker's ability to fulfil certain of its existing or future obligations, where complying would contravene prescribed requirements of the Water Supply (Water Fittings) Regulations 1999, or where providing access would require the water undertaker to incur unreasonable expenditure in carrying out certain 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 set of premises is eligible. In making determinations, Ofwat will refer to the appropriate legislation and published guidance and its decisions will be binding. Ofwat will consult DWI where water quality issues are involved. Ofwat expects parties to attempt to resolve disputes between themselves, before asking it to intervene. Ofwat intends to issue clear guidance to minimise the need for determinations.

2.4 Licence and appointment conditions

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

Ofwat normally makes changes to water undertakers' conditions of appointment with the water undertakers' agreement or, without this, following a successful reference by Ofwat to the Competition Commission on public interest grounds. However, the WA03 provides for modifications to be made to conditions of appointment, where necessary or expedient to implement the licensing provisions in the WIA91, without the need to obtain water undertakers' agreement and without the need to make references to the Competition Commission (paragraph 4, schedule 4 WA03).

Licensees will operate according to a Water Supply Licence, which will be of different construction to water undertakers' Instruments of Appointment. Licences will have standard terms and conditions that will govern how licensees operate, together with specific individual conditions where appropriate. We do not currently envisage any need for specific conditions in licences.

Along with Defra and the Assembly, Ofwat consulted on the policy for proposed standard licence conditions for licensees and proposed modifications to water undertakers' conditions of appointment in February 2004⁹. A further consultation on the draft legal text of both types of conditions was published in December 2004, which summarised the responses to those policy proposals and explained how we have taken them forward.

⁸ The costs principle is explained in the access code guidance consultation.

⁹ '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).

2.5 Industry involvement in the development of the regime

In February 2004 Ofwat established a sponsor group, a regulators group and two industry advisory groups to assist with the development of the detailed guidance and secondary legislation necessary to implement the new WSL regime. These groups have helped Ofwat to develop guidance and mechanisms that are practical, relevant and 'fit for purpose', and to address major issues prior to implementation. The membership of the groups is outlined below.

Ofwat, Defra and the Assembly have taken careful note of the groups' discussions. However, the Government's broader policy framework, its objectives and the legislation govern the final policy decisions.

Figure 1 below outlines the structure and inter-relationships of the groups.

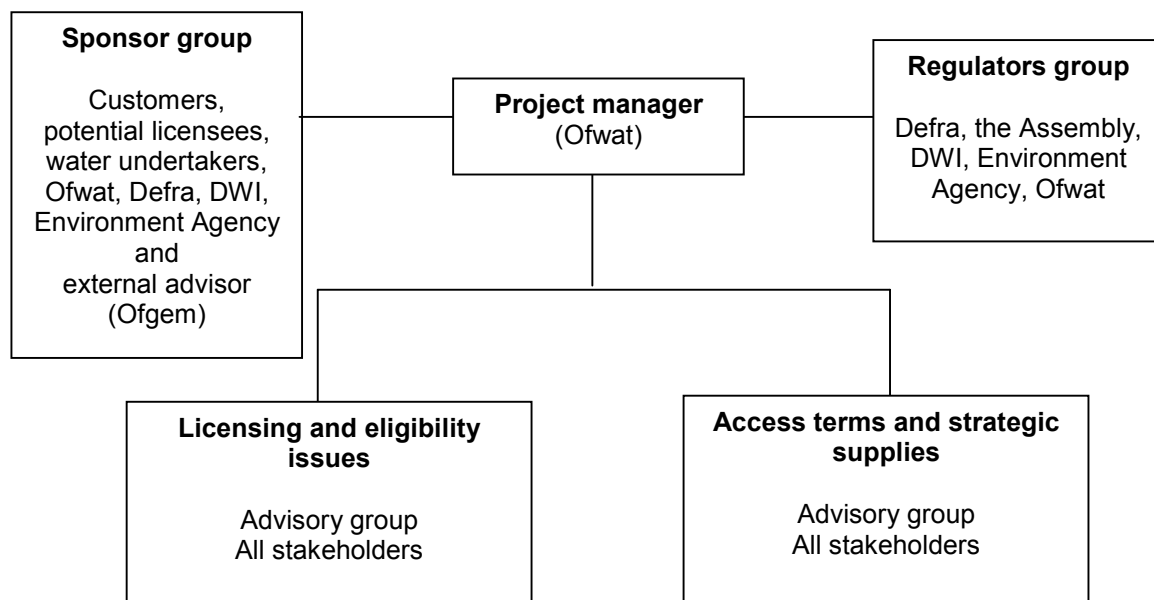


Figure 1: Structure and inter-relationship of the groups

2.5.1 Industry sponsor group

The sponsor group comprises members from a senior level within their particular stakeholder constituency. It has assisted with ensuring that each advisory group achieved its milestones, that there was consistency between the groups, and that differences of view between stakeholders within the groups were addressed. The group has met every three months.

The group has concluded its task of providing assistance to ensure the success of the advisory groups. However, it will continue to ensure that the project is on time and successful, and that it meets the needs of all stakeholders as far as is legally possible until the regime starts.

2.5.2 Industry advisory groups

The two industry advisory groups advised on the development of the new licensing regime. The groups met every month from February to September 2004 and discussed the following areas:

- access (combined and retail supply) price and non-price terms;
- strategic supplies;
- licensing and eligibility issues;
- customer transfer protocol; and
- exemptions and exceptions from the new prohibitions.

The groups' work in identifying and developing the main issues has largely been concluded. However, as announced in December 2003, Ofwat has reviewed the operation of the advisory groups, and decided it would be appropriate to create one new advisory group to take forward the technical implementation of the main policy areas, and where appropriate to continue to develop the policy. Part of the new group's work will be to consider issues that arise from the consultations. The group will retain its current level of technical expertise and, where necessary, enhance that with other members with particular skills. We have established a group of 16 members, some of whom will attend only when an issue relevant to them is discussed. The group membership is drawn from the existing group members.

2.5.3 Regulators group

This group co-ordinates the work of the various regulators including the preparation of any secondary legislation that needs to be made by the Secretary of State and the Assembly. This group comprises members from Ofwat, Defra, the Assembly, DWI and the Environment Agency, and meets every three months. It will continue to operate until the regime takes effect.

2.6 Timetable

Table 1 outlines the key events in the implementation process along with the timetable and the actual dates for events that have occurred.

Timetable	Activity	Date
Autumn 2003	Water Act 2003 received Royal Assent	20 November 2003
	Ofwat published information paper	5 December 2003
Winter 2003 to autumn 2004	Ofwat hosted first implementation workshop	12 January 2004
	Ofwat, Defra and the Assembly consulted on licence and appointment conditions policy (see www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/WSL0104)	27 February 2004
	Inaugural meetings of industry advisory groups	February 2004
	Ofwat, Defra and the Assembly produced policy documents and presented these as	February to September 2004

	discussion papers to advisory groups	
Autumn 2004 to spring 2005	Ofwat, Defra and the Assembly consult on: - Legal text of Statutory Instruments - Guidance notes ¹⁰	October 2004
	Ofwat hosts second implementation workshop	5 November 2004
	Ofwat, Defra and the Assembly consult on legal text of licence and appointment conditions	December 2004
	Ofwat, Defra and the Assembly consult on policy proposals on exceptions regulations and exemptions	December 2004
	Ofwat publishes final guidance on access terms and charges	
Spring 2005 to summer 2005	Water undertakers publish access terms and charges	
	Ofwat publishes final guidance notes	
Summer 2005	Final standard licence conditions and conditions of appointment determined by Defra and Ofwat	
	Applications for first Water Supply Licences	
Autumn 2005	Licensed water supply regime commences	
	Ofwat grants first Water Supply Licences	

Table 1: Timetable of key events and dates of the implementation process

2.7 Consultations

The four consultations for this autumn/winter 2004 are summarised below.

Access code guidance: This includes the terms under which water undertakers must provide access to licensees on terms which comply with the licensing provisions of the WIA91 and our access code guidance.

Licensing and eligibility guidance: This includes the following policy areas:

- **Guidance on eligibility** – outlines the requirements that must be satisfied for a set of premises to be eligible to be supplied by a licensee.
- **Guidance on application for a Water Supply Licence** – sets out the process for applying for a Water Supply Licence.
- **Customer transfer protocol** – sets out the process and procedures that water undertakers and licensees will need to follow when a customer switches supplier.
- **Strategic supplies** – sets out the circumstances under which we will determine whether one or more introductions of water constitute a supply of water that is strategic. An introduction of water is a strategic supply where without that introduction being made, there is a substantial risk that the water undertaker

¹⁰ These consist of the access code guidance and the licensing and eligibility guidance.

would be unable to maintain supplies to its own customers as well as supplying the relevant licensee's customers' domestic needs.

- **Collective modifications** – sets out how licensees' standard licence conditions can be modified from time to time where this is necessary in order to reflect the development of competition in the water industry.

Legal versions of conditions of Water Supply Licences and modifications to water undertakers' conditions of appointment: These were published in December 2004. These set out the WSL conditions and the changes that will be made to water undertakers' conditions of appointment to enable the new licensing regime to start. The consultation on the policy related to the conditions (WSL 01/04) was carried out in February 2004. The responses to that consultation have informed the legal drafting of the conditions.

Policy proposals on exceptions regulations and exemptions: The WIA91 prohibits access to a water undertaker's supply system for anyone that is not a licensee, or in some circumstances, another water undertaker. This paper outlines the type of arrangements that are and are not prohibited under the WIA91 licensing regime and sets out the proposed exceptions to the prohibitions, including the draft regulations.

These four documents, along with the WIA91, provide a complete picture of the framework for the new WSL regime and identify the links between them. We invite comments from all stakeholders on all four documents. However, figure 2 overleaf shows which parts of the consultations are of particular relevance to the role of each group of stakeholders in the new regime.

Customers	Water undertakers	Licensees
<ul style="list-style-type: none"> • Eligibility guidance • Exceptions regulations and exemptions • New customer exceptions • Customer transfer protocol <p>More detail in licensing and eligibility consultation and policy proposals on exceptions regulations and exemptions</p>	<ul style="list-style-type: none"> • Eligibility guidance • Exceptions regulations and exemptions • New customer exceptions • Strategic supplies • Customer transfer protocol • Licence application process <p>More detail in licensing and eligibility consultation and policy proposals on exceptions regulations and exemptions</p> <ul style="list-style-type: none"> • Access code guidance <p>More detail in the consultation on access code guidance</p> <ul style="list-style-type: none"> • Undertakers' conditions of appointment <p>More detail in the consultation on the legal versions of conditions of Water Supply Licences and modifications to water undertakers' conditions of appointment</p>	<ul style="list-style-type: none"> • Eligibility guidance • Exceptions regulations and exemptions • New customer exceptions • Strategic supplies • Customer transfer protocol • Licence application process • Collective modifications <p>More detail in licensing and eligibility consultation and policy proposals on exceptions regulations and exemptions</p> <ul style="list-style-type: none"> • Access code guidance <p>More detail in the consultation on access code guidance</p> <ul style="list-style-type: none"> • Licence conditions <p>More detail in the consultation on the legal versions of conditions of Water Supply Licences and modifications to water undertakers' conditions of appointment</p>

Figure 2: Relevance of consultations for stakeholders

3. Policy proposals on exceptions regulations

3.1 Sections 66I and 66J WIA91 – the prohibitions

The WA03 amends the WIA91 so as to permit a licensee to have access to a water undertaker's supply system for the purpose of supplying water to customers' eligible premises. The relevant provisions within the WIA91 were introduced in light of responses received by Defra and the Assembly to their July 2002 joint public consultation.¹¹

Sections 66A to 66C WIA91 set out the duties on water undertakers to provide a supply of water to a licensee (retail supply) and/or to permit a licensee to introduce water into a water undertaker's water supply system (common carriage). These sections of WIA91 also set out the circumstances in which those duties on water undertakers do not apply.

However, the WIA91 also prohibits access to anyone that is not a licensee or, in some circumstances, another water undertaker. Specifically, the WIA91 prohibits the following:

- Section 66I WIA91 prohibits the use of a water undertaker's supply system for the purpose of supplying water to any customers' premises except by the water undertaker or by a licensee in pursuance of its licence.
- Section 66J WIA91 prohibits the introduction of water into a water undertaker's supply system other than by the water undertaker itself or by a licensee in pursuance of its licence or by another water undertaker under a bulk supply agreement.

The July 2002 consultation paper explained the Government's intention that the right of a licensee to input water into a water undertaker's supply system for its supply to a customers' eligible premises will be applicable only where this is physically possible, ie the right to common carriage must be related to the physical conveyance of water.¹² This policy intention is achieved in the WIA91 through the requirement that, where a licensee introduces water into a supply system, the introduction must be the means by which any particular water supply by a licensee to its customer takes place and in connection with that supply.¹³ This means that a physical link is required between the licensee's introduction of water and the customer's premises (ie a pipe) and, with respect to the direction of flow of water, that the introduction of water has to be upstream from the customer. We take the view that this provision must be interpreted in the context of the practicalities of common carriage. Therefore, if the direction of water flow changes so that for a short period of time the licensee's source is temporarily downstream from the customer's eligible premises, this will still, overall, be in accordance with its combined licence and the licensee will therefore not be committing a criminal offence.

¹¹ Defra and Assembly consultation paper 'Extending Opportunities for Competition in the Water Industry in England and Wales' (July 2002).

¹² See paragraphs 40 and 101 of 'Extending Opportunities for Competition in the Water Industry in England and Wales' (July 2002).

¹³ See section 17A(5) WIA91.

When considering what activities are prohibited under sections 66I and 66J WIA91, it is important to note what is meant by the term ‘supply system’. A water undertaker’s supply system is defined in section 17B(5) WIA91 as consisting of:

- any water mains¹⁴ and other pipes that the water undertaker has a statutory duty to develop and maintain and which are used for the purpose of conveying water from its treatment works to the premises of customers (ie potable networks downstream from a treatment works); and
- any discrete networks of water mains and other pipes that the water undertaker uses for the purpose of conveying non-domestic water from its sources to the premises of customers (ie discrete non-potable networks).

It is also important to note that section 66I WIA91 prohibits, amongst other things, the use of a water undertaker’s supply system by another person for the purposes of supplying the premises of customers whether or not the water undertaker’s supply system is also used by that other person to supply its own pipe network. In many instances retail licensees, for example, will not have their own pipe network, but this may not always be the case for all potential third party users of water undertakers’ supply systems.

Additionally, for the purposes of section 66J WIA91, it is also important to note that both the incumbent water undertaker and the owner of a source (if different) are both introducing water when an agreement is made for this. By way of analogy, the offence of causing polluting matter to enter controlled waters (section 85 Water Resources Act 1991) has been interpreted by the courts to mean that concurrent liability exists. The fact that one person has caused the pollution does not necessarily prevent another from being concurrently liable. For the purpose of these prohibitions, we believe that the incumbent water undertaker and the licensee or any person who has a water source, (eg a private non-licensee), should be regarded as introducing water into the water supply system concurrently.

Finally, it is also necessary to take into account what defines a set of premises when considering what activities are prohibited under sections 66I and 66J WIA91. Our proposed definition of a set of premises for licensing purposes is covered by the licensing and eligibility consultation paper.¹⁵

3.2 Role of exceptions

There are numerous existing supply arrangements that may be captured by the prohibitions described above. Government does not intend to prevent existing water supply arrangements from continuing, but wants to minimise possible disruption by the new WIA91 prohibitions on existing supply arrangements. At the same time we want to minimise the scope for duplication of arrangements that are provided for in the new WSL regime. We want to enable the WSL regime to run in parallel with existing supply arrangements where it is sensible and appropriate to do so.

¹⁴ As defined in section 219 WIA91.

¹⁵ ‘Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies’ (29 October 2004).

Therefore, sections 66I(3) and 66J(3) WIA91 allow the Secretary of State by regulations to specify further circumstances in which the prohibitions do not apply (under sections 66I(8) and 66J(9) WIA91 the function of making regulations is exercisable by the Assembly in relation to any supply system of a water undertaker whose area is wholly or mainly in Wales). These are the exceptions regulations and they will be used to except certain general activities that would otherwise be criminal offences. This includes situations where it was found that the prohibition had unintentionally caught a particular activity.

However, where existing supply arrangements would not be unlawful under the WIA91 if the supply were made by a licensee, then the current supplier would be encouraged to apply for a Water Supply Licence to enable the arrangement to continue, rather than use the exceptions regulations.

Section 3.3 below lists activities that are caught by the WIA91 WSL prohibitions ('WIA91 prohibitions'). Section 3.4 then sets out the activities in respect of which we propose to grant an exception. The draft exceptions regulations are in appendix 2.

In addition to those we have listed below, the Secretary of State or the Assembly will consider requests for an exemption for specific individual supply arrangements on a case-by-case basis. Section 4 explains the procedure for granting and revoking or withdrawing exemptions.

3.3 Prohibited activities

The Government has been assisted by industry advisory group members in identifying the number and variety of existing agreements, so that a more informed decision on the most appropriate approach to the problem can be made. The list of existing agreements however is not exhaustive.

We have provided a breakdown of the supply scenarios likely to be caught by the prohibitions and, in section 3.4, explain those that we are proposing to except.

Q1: Are there any additional activities that you believe will require an exception? If so, please advise us of these.

3.3.1 Prohibitions under section 66I WIA91 – prohibition on use

Section 66I WIA91 makes it an offence for any person, other than a licensee in pursuance of its licence or the incumbent water undertaker, to **use** a water undertaker's supply system for the purpose of supplying water to customers' premises. A number of arrangements, including the following, will therefore be prohibited (unless excepted or exempted) once the new regime begins:

- **Third party retail supply**
Some existing retail arrangements where a third party purchases a wholesale supply of water from the incumbent water undertaker and retails it to customers. The third party acts merely as an intermediary, **using** the incumbent's supply system to supply customers' premises.

Not all third party retail supply and supplies by privately-owned water supply systems will be prohibited by section 66I WIA91. In determining whether a resale arrangement is prohibited or not it is essential to consider whether the supply system is being used¹⁶ and the extent of a set of premises. Resale arrangements where the customer of an incumbent water undertaker may wish to resell water to third parties within the curtilage of their premises will not be prohibited; for example, resale within a caravan park, airport or industrial estate. Generally, in these examples the individual caravans, shops or units are not premises in their own right, but the site as a whole is defined as a single set of premises. Therefore, the incumbent water undertaker's customer cannot be **using** the incumbent's supply system to supply customers' premises, because the caravan, shop or unit occupiers do not occupy premises as defined. The proposed definition of a set of premises is set out in our licensing and eligibility consultation paper.¹⁷

- **Supply by privately-owned water supply system**

Some privately-owned supply systems that are connected to the incumbent water undertaker's supply system where a third party purchases water from the incumbent water undertaker and then uses its own pipe work to supply customers' premises. In this case the third party is still **using** the incumbent's supply system to supply customers' premises.

- **Some bulk supply arrangements**

Some bulk supply arrangements¹⁸ that are between two water undertakers. There are two cases. In the first case, the purchasing water undertaker is an inset appointee whose area of appointment extends only to the boundary of a customer's premises and the water undertaker does not own any pipe work. This means there is a direct connection between the previous incumbent water undertaker's supply system and the customer's pipes. In this case the purchasing water undertaker is acting as a retailer, **using** the incumbent's supply system to supply the customer's premises, and the bulk supply would be prohibited. In the second case, the purchasing water undertaker's area of appointment extends beyond the boundary of a customer's premises and encompasses a water supply system serving one or more premises. The connection is between the supply systems of the purchasing and selling water undertakers. In this case, the purchasing water undertaker may be **using** the selling water undertaker's supply system in order to supply its own supply system, which it then uses to supply customers' premises. However, the purchasing water undertaker may be also concurrently **using** the selling water undertaker's supply system to supply customers' premises. In both cases, without the bulk supply, the purchasing water undertaker would not be able to meet its statutory supply obligations. It is therefore using the supply system of another water undertaker.

¹⁶ See section 17B(5) and section 3.1 above.

¹⁷ 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

¹⁸ A supply of water for distribution by a water undertaker taking the supply (section 219 WIA91).

3.3.2 Prohibitions under section 66J WIA91 – water input prohibition

Section 66J WIA91 makes it an offence for any person, other than a licensee in pursuance of its licence, the incumbent water undertaker, or another water undertaker for the purposes of bulk supply, to **introduce** water into the incumbent's supply system. A number of arrangements, including the following, will therefore be prohibited (unless excepted or exempted) once the new regime begins:

- **Common carriage arrangements**

Common carriage arrangements where a supplier **introduces** water into a water undertaker's supply system for the purpose of supplying its own water to a customer's premises. Section 66J WIA91 prohibits all existing and future common carriage arrangements because they involve the introduction of water into (and/or the use of) a water undertaker's supply system.

- **Licensee/other supplier water sale agreements**

Water sale agreements whereby a licensee or other supplier is able to sell its treated water to a water undertaker and thereby **introduce** water into a water undertaker's supply system (either alone or concurrently with that water undertaker). For example, this may occur in situations where a licensee stops supplying eligible premises or economies of scale result in more water being available than can be sold to customers at eligible premises.

- **Introduction of water by licensee downstream from eligible customer**

The WIA91 requires that an introduction of water by a licensee to supply a customer's eligible premises must have a physical link to and be upstream from those premises. Therefore, a permanent change of flow that would cause a licensee's **introduction** to be downstream from its eligible customer would mean that the introduction was not in pursuance of its combined licence and would cause the licensee to commit a criminal offence.

3.4 Proposed exceptions

- **Bulk supply arrangements**

Section 3.3.1 above sets out the type of bulk supply arrangements that would be caught by the WSL prohibitions. We propose to except the **use** of water supply systems pursuant to all existing and most future bulk supply arrangements between water undertakers. We believe that this will preserve the *status quo*. However, we do not propose to except future bulk supply arrangements by which a purchasing water undertaker uses the supply system of a second water undertaker to transport water to the first water undertaker's area where that water has been introduced into the second water undertaker's supply system either by the first water undertaker or by a third water undertaker or by another person under an agreement with the first water undertaker. This amounts to a common carriage arrangement¹⁹ and hence water undertakers or other persons wishing to do this will have to apply for a water supply licence.

¹⁹ There are no existing common carriage bulk supply arrangements. Therefore, the draft regulations do not need to make express provision for it.

- **Licensee/other supplier water sale agreements**

We propose to except **introductions** pursuant to agreements for selling treated water to a water undertaker by a licensee or other supplier. This will provide for cases such as when a licensee no longer supplies a customer's eligible premises in a water undertaker's area of appointment, or economies of scale mean that the amount of water the licensee can economically supply is higher than the amount of water it is supplying to its customers. It also provides for other suppliers selling treated water to the water undertaker. However, it is important to note that in such cases the water undertaker is not obliged to purchase the water but will be permitted to do so under an arrangement by an exception to the prohibition. Arrangements whereby a third party supplies untreated water to a water undertaker from its own water source, ie from a borehole, and introduces it into a water treatment works or upstream from the treatment works are not captured by the WIA91 prohibitions.

As explained in section 3.3.2, the WIA91 requires that an introduction of water by a licensee to supply a customer's eligible premises must have a physical link and be upstream from those premises. If, following the conclusion of an access agreement with a water undertaker, the direction of water flow in a supply system permanently changes, the upstream introduction would no longer be possible. In this instance, without any other action, the licensee's business would suffer as a result of the water undertaker's subsequent operational decisions. We believe the licensee's supply should not be prejudiced by unforeseen legitimate operational decisions. Therefore we consider that the water undertaker should be required to continue to accept the same **introduction** (that is now downstream of the premises) and to make a wholesale supply of water available to the licensee in respect of those premises.

We propose to introduce an obligation in new appointment condition R²⁰ on water undertakers to offer to accept an introduction in these circumstances. That appointment condition will state that the terms and conditions of that offer together with the terms and conditions of an offer for a wholesale supply of water in respect of those premises must be, broadly, the same as the terms and conditions on which the earlier introduction was made in pursuance of a combined licence. However, reasonably necessary amendments to the common carriage terms and conditions (for technical reasons, for example) will be permitted and disputes on this will be referred to Ofwat for determination. That is because decisions on change of flow are an operational matter for the water undertaker responsible for the supply system. Those decisions should not prejudice the licensee's supply if, when the supply started, the licensee's source was upstream of the customer's eligible premises and the change in flow direction had not been planned by the water undertaker or notified to the licensee. The **introduction** will be excepted from the prohibition on use of a water undertaker's supply system as it will be agreed with the water undertaker.

²⁰ See the consultation paper on the legal text of new conditions of appointment and conditions of water supply licences published in December 2004.

Q2: Do you agree with the proposed exceptions from sections 66I and 66J WIA91? If not, what do you propose and why?

Q3: Are there examples of situations that you consider might be prohibited under sections 66I and 66J WIA91? If so, please provide examples of specific situations with details as well as generic situations.

4. Exemptions

4.1 Process for making an exemption

Section 66K WIA91 allows the Secretary of State to grant an exemption from sections 66I (prohibition on unauthorised use of supply system) and 66J WIA91 (prohibition on unauthorised introduction of water) by order made by statutory instrument to:

- a person or persons of a class;
- generally or to such extent as may be specified by order; and
- unconditionally or subject to conditions as may be so specified.

Under section 66L(7) WIA91, the Assembly will have the power to grant exemption from sections 66I and 66J WIA91 in relation to any water supply system of a water undertaker whose area is wholly or mainly in Wales.

Sections 66K and 66L WIA91 also set out the procedure for granting and revoking or withdrawing exemptions. This is included in this paper for information.

The Secretary of State and the Assembly would expect to consider whether or not to grant an exemption, where it is approached with a request to do so. Requests should be made in writing to the Secretary of State or the Assembly and can be made at any time.

Before making an order the Secretary of State or the Assembly will give notice of the proposal to make an exemption order setting out the terms of the exemption. The notice will list the reasons for proposing an exemption in the terms proposed and give the time within which representations or objections may be made. The deadline for these must be not less than 28 days from the date of publication of the notice. A copy of the notice shall be sent to Ofwat, and published in such manner as the Secretary of State or the Assembly considers appropriate to bring it to the attention of those likely to be affected by the proposed exemption.

An exemption may contain conditions requiring any person carrying out an exempted activity to comply with certain directions, to do or not to do certain things, and to refer certain questions to the Secretary of State, the Assembly or Ofwat for determination.

Before making an order, the Secretary of State or the Assembly will consider any representations or objections that have been duly made and not withdrawn. An exemption may be granted indefinitely or for a period specified in or determined by or under the exemption.

The Secretary of State or the Assembly will serve notice of an exemption granted to a person to that person; and will publish the exemption in such manner as they consider appropriate for bringing it to the attention of other persons who may be affected by it. In the case of an exemption granted to a class of persons, the Secretary of State or the Assembly shall publish the exemption in such manner as they consider appropriate for bringing it to the attention of persons of that class; and

other persons who may be affected by it. Any exemption orders will be published as Statutory Instruments in the usual way. In addition, Ofwat will keep a register of all exemptions granted available in its library and on its website.

4.2 Process for revoking or withdrawing an exemption

Section 66L WIA91 allows the Secretary of State, by order made by Statutory Instrument, to revoke an exemption order made under section 66K WIA91. This may be done at the person's request (in the case of an exemption granted to that person as opposed to a class of persons), in accordance with any provisions of the order under which the exemption was granted or if it appears inappropriate to the Secretary of State that the exemption should continue. The Assembly has the power to revoke an exemption order made by it in relation to any water supply system of a water undertaker whose area is wholly or mainly in Wales.

In addition, the Secretary of State or the Assembly may by direction (ie not by Statutory Instrument), withdraw an exemption which applies to a class of persons from a particular person. This may be done at the person's request, in accordance with any provisions of the order under which the exemption was granted or if it appears inappropriate not to do so.

The procedure for revoking exemptions follows the procedure for granting them set out above, except that the Secretary of State must consult Ofwat before making an order or direction.

Appendix 1: Prohibited and proposed excepted activities under WIA91

Section 66I WIA91 – prohibition on use of supply system

- Some third party retail supplies.
- Supply by some privately-owned water supply system.
- Some bulk supply arrangements.

Section 66J WIA91 – prohibition on introduction of water into supply system

- Common carriage arrangements.
- Introductions by virtue of licensee/other supplier water sale agreements.
- Introductions of water by licensee downstream from eligible customer.

Proposed exceptions

- Use of supply systems under existing and future bulk supply arrangements other than future bulk supply arrangements which amount to common carriage²¹.
- Introductions by virtue of existing other supplier water sale agreements and future licensee/other supplier water sale agreements to water undertakers including future introductions of water by licensee downstream from eligible customer due to a permanent change of flow on access terms previously agreed.

²¹ There are no existing common carriage bulk supply arrangements. Therefore, the draft regulations do not need to make express provision for it.

Appendix 2: Draft Water Supply (Exceptions from Supply System Prohibitions) Regulations 2005

STATUTORY INSTRUMENTS

2005 No. []

WATER INDUSTRY, ENGLAND AND WALES

The Water Supply (Exceptions from Supply System Prohibitions) Regulations 2005

Made - - - - [] 2005

Laid before Parliament [] 2005

Coming into force - - [] 2005

The Secretary of State, in exercise of the powers conferred upon her by sections 66I and 66J of the Water Industry Act 1991(a),

and

the National Assembly for Wales, in exercise of the powers conferred upon it by sections 66I and 66J of the Water Industry Act 1991 in relation to any supply system of a water undertaker whose area is wholly or mainly in Wales,

hereby make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Water Supply (Exceptions from Supply System Prohibitions) Regulations 2005 and shall come into force on [] 2005.

Interpretation

2. In these Regulations—

“the Act” means the Water Industry Act 1991; and

“the Authority” means, until the coming fully into force of section 36(1) of the Water Act 2003(b) (transfer to the Authority and the Consumer Council for Water of functions, property etc) the Director, and thereafter, the Water Services Regulation Authority.

(a) 1991 c. 56; sections 66I and 66J were inserted by section 56 of the Water Act 2003 (c. 37). The powers to make regulations under sections 66I and 66J are exercisable by the National Assembly for Wales (and not the Secretary of State) in relation to any supply system of a water undertaker whose area is wholly or mainly in Wales; see sections 66I(8) and 66J(9). The supply system of a water undertaker shall be construed in accordance with section 17B(5) of the Water Industry Act 1991; see section 66I(9).

(b) 2003 c. 37.

Further circumstances in which prohibition on use of a supply system does not apply

3.—(1) Subject to paragraph (2), section 66I(1) of the Act shall not apply where a water undertaker (“A”) is using the supply system of another water undertaker (“B”) under an agreement for a supply of water in bulk.

(2) Paragraph (1) shall not apply where A uses B’s supply system for the purpose of supplying water to the geographical area to which A’s appointment relates where the water has been introduced into B’s supply system for that purpose by A or by any relevant person under an agreement with A.

(3) For the purposes of paragraph (2), “relevant person” means a person other than A or B.

Further circumstances in which prohibition on introduction of water into a supply system does not apply

4.—(1) Subject to paragraph (2), section 66J(1) of the Act shall not apply where the water is introduced under an agreement with the water undertaker.

(2) Paragraph (1) shall not apply where the water is introduced by any person for the purpose of supplying water to any premises of a customer of that person.

[] 2005 [Name]
[Minister]
Department for Environment, Food and Rural Affairs

Signed on behalf of the National Assembly for Wales

[] 2005 [Name]
Presiding Officer

EXPLANATORY NOTE

(This note is not part of the Regulations)

The Water Industry Act 1991 (“the Act”) requires water undertakers to grant licensed water suppliers access to their supply systems under certain conditions and for certain purposes. A retail licence permits a licensed water supplier to use a water undertaker’s supply system to supply water to eligible premises of customers. A combined licence additionally permits a licensed water supplier to introduce water into a water undertaker’s supply system in order to supply that water to eligible premises of customers.

Section 66I of the Act prohibits the use of a water undertaker’s supply system for the purpose of supplying water to any premises of a customer. This prohibition does not apply if the supply is made by the water undertaker, by a licensed water supplier in pursuance of its licence or in such further circumstances as the Secretary of State may specify in regulations.

Section 66J of the Act prohibits the introduction of water into a water undertaker’s supply system (other than by the undertaker itself). This prohibition does not apply if the water is introduced by a licensed water supplier in pursuance of its licence, by another water undertaker under an agreement for a supply of water in bulk or in such further circumstances as the Secretary of State may specify in regulations.

It is a criminal offence to breach the prohibitions in sections 66I or 66J of the Act.

These Regulations specify further circumstances in which the prohibitions in sections 66I and 66J of the Act do not apply.

Regulation 3 allows water undertaker A to use water undertaker B’s supply system for the purpose of allowing water undertaker A to make supplies to the premises of its customers where water undertaker A receives a bulk water supply from water undertaker B. A supply of water in bulk is defined in section 219(1) of the Act and means a supply of water for distribution by a water undertaker taking the supply. This exception does not apply where water undertaker A is using water undertaker B’s supply system under a “common carriage” arrangement.

Regulation 4 allows certain persons to introduce private water resources into an undertaker’s supply system where a water undertaker agrees. This exception does not apply where the introduction is part of a “common carriage” arrangement.

No regulatory impact assessment has been prepared in respect of these Regulations.