



WATER ACT 2003
WATER SUPPLY LICENSING

**Water undertakers' new conditions of
appointment**

**Licence conditions for water supply
licensees**

Consultation paper

December 2004

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1. Introduction

1.1 Purpose of this consultation

This consultation paper sets out the proposed legal drafts of the modifications to water undertakers'¹ Instruments of Appointment and standard conditions of Water Supply Licences that are necessary to implement the new water supply licensing (WSL) regime.

Section 17H of the Water Industry Act 1991 (WIA91)² provides for the Secretary of State, after consulting the National Assembly for Wales (the Assembly), to determine standard conditions of Water Supply Licences. Paragraph 4 of Schedule 4 to the Water Act 2003 (WA03) provides for Ofwat³ to make such modifications as it considers necessary or expedient to water undertakers' conditions of appointment in consequence of the introduction of the new WSL provisions in the WIA91. In practice the Department for Environment, Food and Rural Affairs (Defra), the Assembly and Ofwat have worked together in these matters.

A joint consultation paper on 'Modifications to water undertakers' existing conditions of appointment, conditions of Water Supply Licences' was published in February 2004⁴ (February 2004 paper). In the paper we outlined the new licensing provisions in the WIA91 and set out our policy proposals for modifying water undertakers' existing conditions of appointment and for standard licence conditions to be included in Water Supply Licences.

We received 23 responses (see annex C for a list of consultation respondents). These were largely positive and did not suggest any major changes to our proposed conditions, although many water undertakers suggested that we should introduce more standard licence conditions.

In preparing these proposals, our aim has been to avoid creating a regime that is too bureaucratic. We do not want to stifle competition with too much regulation. At the same time, we are also mindful of the Government's wider objectives (see section 2.1). The draft conditions in this consultation paper aim to strike a careful balance between these objectives. They also have been developed in the light of respondents' comments to our February 2004 paper.

The main outcomes of the February 2004 consultation are as follows.

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

² In this paper, references to the WIA91 refer to the WIA91 as amended by WA03.

³ Under the WIA91 as amended by the 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.

⁴ WSL 01/04 'Water Act 2003: Water Supply Licensing. Consultation on policy proposals to modify water undertakers' existing conditions of appointment and develop licence conditions for water supply licensees' (26 February 2004).

- Both potential licensees and water undertakers are broadly supportive of our proposals for the modifications of the conditions of appointment and conditions for the Water Supply Licence.
- Clear definitions are obviously important.
- There is a strong divide between potential licensees and water undertakers over whether certain information and obligations should be included as a standard licence condition. This applies to customer information, requirements to follow guidance on contract terms, compliance with water undertakers' drought or water resource plans and securing the compliance of group companies. The subject is explained in more detail in section 4.3.
- We need to ensure that licences achieve the right balance between being robust enough while achieving our aim to have light touch regulation where possible.

This consultation paper sets out in detail our proposals for modifications to the conditions of appointment (section 3) and new standard conditions of Water Supply Licences (section 4). Copies of responses have been placed in the Ofwat library unless they were marked as confidential.

We invite your views on our drafts of the standard licence conditions and the proposed modifications to conditions of appointment. We expect the final versions to be determined in summer 2005 when prospective suppliers will be able to apply for a Water Supply Licence, ahead of commencement of the overall regime in autumn 2005.

1.2 Structure of the paper

The rest of this paper is structured as follows.

Section 2: WSL regime

This section outlines the WSL regime and the other consultation papers that provide a complete picture of our proposals.

Section 3: Water undertakers' conditions of appointment

For each condition this section gives:

- a policy overview describing any proposed modifications;
- a summary of the responses we received to our February 2004 policy proposals;
- the conclusions we drew on these; and
- a statement of the status of that condition.

Section 4: Conditions of Water Supply Licences summary of responses

For each condition this section gives:

- a policy overview;
- a summary of the responses we received to our February 2004 policy proposals;
- the conclusions we drew on the basis of these; and

- any additional issues identified since we issued our February 2004 proposals and how we have taken account of these.

Section 5: Draft new appointment and standard licence conditions

This section sets out the draft legal text of the conditions.

Section 6: Partial regulatory impact assessment

This section sets out respondents' views to the partial RIA in the February 2004 paper and our conclusions to their responses.

1.3 Next steps

We invite your views on:

- our proposed modifications to the existing water undertakers' conditions of appointment;
- our proposed new standard conditions for the Water Supply Licence;
- any additional issues that you think should be dealt with;
- whether our proposals are practicable; and
- whether our proposals are likely to cause problems, and if so how they can be resolved.

We have also identified specific questions in each section of this paper. We welcome your views on these.

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

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

Or by e-mail to: hayley.purcell@ofwat.gsi.gov.uk

Unless otherwise requested, all responses will be placed in the Ofwat 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 Ofwat, 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 access⁵ to the public water supply systems⁶ 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 MI/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:

⁵ 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).

⁶ 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.

- 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
- 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 a time.

Along with the Environment Agency and the Drinking Water Inspectorate (DWI), Ofwat 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 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 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 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 existing conditions of appointment.

Ofwat normally make 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 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 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.

This consultation paper explains the responses we received to the policy proposals and how they have affected our drafting of the legal text.

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.

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

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 outlines the structure and inter-relationships of the groups.

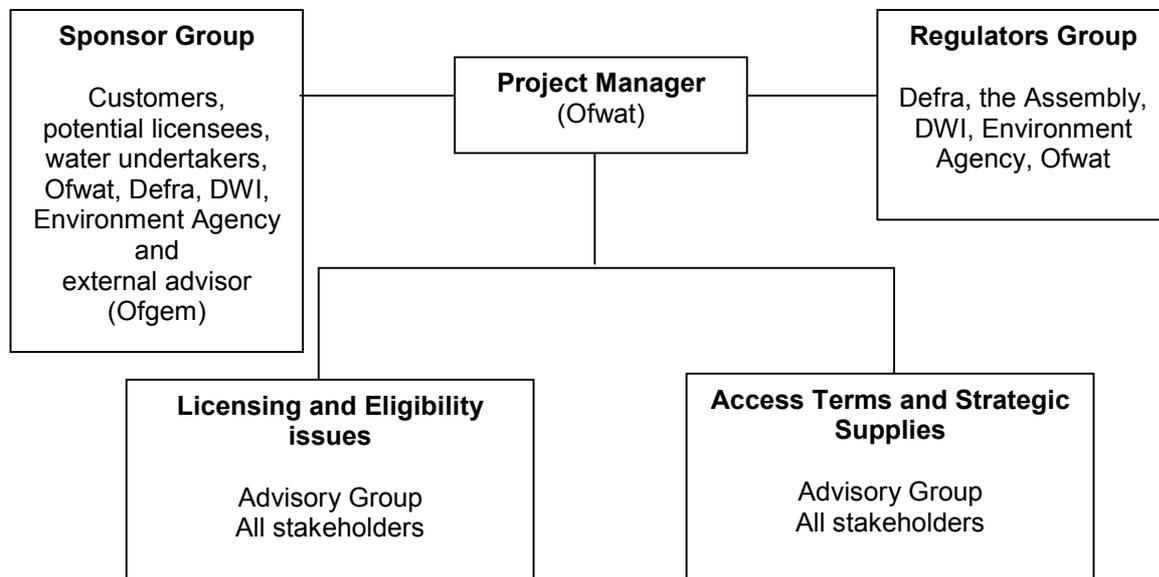


Figure 1: Structure and inter-relationships of the groups.

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. *Italics* indicate future events at the time of writing.

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 www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/content/wsl0104	27 February 2004
	Inaugural meetings of industry advisory	February 2004

	groups	
	Ofwat, Defra and the Assembly produced policy documents and presented these as discussion papers to advisory groups	February to September 2004
Autumn 2004 to spring 2005	Ofwat, Defra and the Assembly consult on - Legal text of Statutory Instruments. - Guidance notes ⁹ .	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	<i>December 2004</i>
	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.

⁹ These consist of the access code guidance and the licensing and eligibility guidance.

- **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 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 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: These have been published in December 2004. The WIA91 prohibits access to a water undertaker's supply system for any body 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 of the 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. Conditions of appointment

This section outlines the responses received to our proposals for modifying water undertakers' conditions of appointment and introducing new conditions in the light of the forthcoming WSL regime. Our conclusions are highlighted under each condition. Proposed new conditions R and S are explained in section 3.4 and the draft conditions are included in section 5.

The existing conditions of appointment are explained briefly with the responses and our conclusions set out in section 3.3 below. Individual water undertaker's conditions of appointment vary slightly between each other as a result of modifications made over time since the appointments were issued.

3.1 General comments raised

Definitions

In our February 2004 paper we proposed to amend condition A of water undertakers' Instruments of Appointment to incorporate relevant new terms as defined in the Water Supply Licence. Respondents commented that we needed to clarify the definitions in condition A, as these have an impact on all of the other conditions. We have checked the relevant definitions in condition A against the relevant conditions of appointment. We have not, however, identified any definitions that need to be modified or added.

Separate consultations

Respondents commented on the areas we should consider in our consultations on conditions B and P. We consulted on condition B in MD189 in March 2004. In MD189 we also stated that we would carry out another consultation on the inclusion of condition P in all water undertakers' Instruments of Appointment, after completion of the current periodic review. Our conclusions from the consultation on condition B are summarised in MD 194 issued in August 2004.

Provision of information to Ofwat

Water undertakers raised concerns that condition of appointment M did not account for situations where information to Ofwat from water undertakers depends on information from licensees. We address this situation in Water Supply Licence standard condition 8 (provision of information to Ofwat) in section 4.3.

Comments on the proposed new conditions of appointment

We received a large response to our proposal for new conditions R and S. These included a variety of suggestions and comments which we took into consideration when drafting them (see section 3.4). The proposed draft conditions can be found in section 5.

3.2 Proposals for existing conditions of appointment

CONDITION A: INTERPRETATION AND CONSTRUCTION

Policy overview

This condition explains the terms and expressions used in the Instrument of Appointment. We proposed to amend this condition to include additional terms and their definitions.

Respondents' views

Respondents generally agreed with the proposed amendment to the condition but raised the following comments.

- Most water undertakers commented that we needed to review the definitions of 'customer' and 'consumer' to make sure they had the same meaning in all contexts.
- Water UK commented that more thought should be given to this condition, otherwise there was a risk that conditions of appointment would be inconsistent with licence conditions.
- One water undertaker commented that the definition of domestic customers in the conditions of appointment should be reviewed.
- WaterVoice and several water undertakers supported the proposal to amend the terms and definitions in this condition but commented that the new definitions should be consistent with existing definitions.
- Potential licensees did not comment.

Our conclusions

Respondents commented that we needed to clarify the definitions in condition A as these had an impact on all of the other conditions. However, we have not identified any new terms that we need to include in condition A as a consequence of introducing conditions R and S. Any new terms defined in R and S are specific to the condition in which they are referred to. We have checked the relevant definitions in condition A against the relevant conditions of appointment and have not identified any definitions that need to be modified or added.

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

CONDITION B: CHARGES

Policy overview

This condition allows Ofwat to limit the average increases in the standard charges made by the water undertakers to the change in the retail price index over the previous year, plus an adjustment factor, called K. It provides for a review of all K factors by Ofwat at five-yearly intervals. Water undertakers have the right of appeal to the Competition Commission. Condition B also requires each water undertaker to produce an annual principal statement confirming that its tariffs are in line with its price limits. This allows Ofwat to approve every water undertaker's Charges Scheme (condition D).

Condition B also sets out the circumstances under which Ofwat (and the water undertaker) can request an interim determination to adjust K factors between periodic reviews.

We announced our intention to consult separately on proposed modifications to the definition of 'excluded charges' in condition B. Our proposal was for the definition to continue to be linked to the inset threshold, which in turn would be linked to the eligibility threshold. This, and other proposed modifications to condition B, are separate issues and not affected by the new licensing provisions.

Respondents' views

Most stakeholders did not comment on the condition in general but raised the following comments on 'excluded charges'.

- WaterVoice commented that we needed to clarify 'excluded charges', and how an interim determination on the basis of the substantial effects clause might disadvantage ineligible customers.
- One stakeholder suggested that a special consultation was needed on the link between competition and inset thresholds so all parties could understand how Ofwat would treat 'excluded charges' when carrying out a price review.
- Other stakeholders suggested that we should consider the impact of price averaging on licensees and water undertakers in our consultation on 'excluded charges'.

Our conclusions

Ofwat consulted separately on the proposed modifications to the definition of 'excluded charges' in condition B in MD189 in March 2004, and its conclusions were explained in MD194 issued in August 2004.

In MD 189 Ofwat proposed to make the definition of 'excluded charges' more consistent with the WIA91. As no respondents objected to the proposed change Ofwat is going ahead with the modification as described in MD189.

Defra is considering making an order under section 7(6) to reduce the threshold for large user inset appointments to 50MI/year in England. This would take effect from 1 April 2005, subject to Parliamentary approval. There is no decision yet as to when, or if, the threshold will be changed in Wales. The conclusions made in MD194 are not affected by the proposed standard licence conditions.

Status: unchanged

CONDITION C: INFRASTRUCTURE CHARGES

Policy overview

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

Respondents' views

Most stakeholders did not comment on this condition but four respondents raised the following points.

- Two water undertakers commented that condition C did not prevent them from recovering infrastructure charges from developers for works they needed to make adequate supplies available to new properties.
- Two other water undertakers were concerned about what effect the condition would have on their requisitioning calculations for connecting new mains at property developments. One undertaker said that requisitioning payments were calculated on the basis that the water undertaker will receive 100% of the revenue the water undertaker expects to be payable and cannot be revisited. Under the present proposal, a customer could obtain a reduced requisition charge by virtue of this principle and then switch supplier, the payment would then fall as a result of the transfer. This could lead to under-recovery of the water undertaker's costs.

Our conclusion

We believe it is reasonable for water undertakers to minimise the net effect from a customer switching to a licensee within the timescales of a requisitioning agreement through contract negotiations. The intent of a change in the requisitioning provisions of WIA91 was to ensure that the water undertaker's income stream remained unaffected by a customer moving to a licensee. This is provided for in section 43(7)(b) and 43A(4)(b) WIA91.

Status: unchanged

CONDITION D: CHARGES SCHEME

Policy overview

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

Respondents' views

Only two stakeholders commented on the proposed status of this condition.

- One water undertaker supported the charges scheme and proposed that licensees should submit an annual charges scheme for their customers to ensure charges were cost reflective.
- Another stakeholder suggested that Ofwat should consult with WaterVoice committees on water undertakers' proposals for any changes in charging policy or tariff structure and that the content of draft tariff structures should be included in this condition.

Our conclusions

This condition is unaffected by the new licensing provisions.

The charges scheme is not appropriate for licensees as their charges depend on access charges and these are largely unknown and specific to each customer. The licensee will also be competing in a competitive market and therefore a complementary standard licence condition is not necessary.

Status: unchanged

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

Policy overview

This condition applies to certain charges a water undertaker may levy for water supply and sewerage services. It imposes a duty to prevent undue preference towards or discrimination against any customers or potential customers in respect of:

- standard charges; or
- charges fixed by agreement.

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

Respondents' views

We received a few responses to the proposed status of this condition.

- One water undertaker commented that it accepted Ofwat's views on this condition.
- WaterVoice commented that water undertakers might change their tariff for large users within the tariff basket to counter the loss of revenue from eligible customers.

Our conclusion

This condition is unaffected by the new licensing provisions.

Status: unchanged

CONDITION F: ACCOUNTS AND ACCOUNTING INFORMATION

Policy overview

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

Respondents' views

We received one response to the proposed status of this condition.

- WaterVoice supported Ofwat's assessment that this condition would not be affected by the licensing conditions. It commented that ring-fencing would take on greater importance under the competition regime as water undertakers would need to establish separate associated companies if they wished to apply for a Water Supply Licence to operate outside their existing area.

Our conclusion

We address the issue of ring-fencing in conditions K and R and standard licence condition 7.

Status: unchanged

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

Policy overview

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

Respondents' views

The majority of respondents agreed with the current status of this condition but the following comments were made.

- Several water undertakers asked how water undertakers and licensees should collaborate during an emergency.
- Two water undertakers commented that this condition should clarify whether licensees' customers are covered by this condition. One suggested that licensees should have a standard licence condition requiring them to provide all necessary information to water undertakers and co-operate with them in such a situation. The other suggested that Water Supply Licences should require licensees to collaborate with water undertakers in informing the water undertaker of residential occupation in premises supplied by the licensee.

Our conclusions

Condition A defines which customers are covered by Condition G, which is complemented by proposed standard licence conditions 2 and 4. These between them provide for how water undertakers and licensees should interact in the planning of strategies for handling of and during an emergency. Water undertakers' access codes will set out the responsibilities on them and licensees to co-ordinate in these events.

Status: unchanged

CONDITION H: CODE OF PRACTICE AND PROCEDURE ON DISCONNECTION

Policy overview

All water undertakers have a Code of Practice on debt, which is submitted to Ofwat for approval, and gives guidance to household customers who have difficulty in paying their bills. The Water Industry Act 1999 amended the WIA91 to prevent the disconnection of household customers. Our view was that this condition would be unaffected by the licensing provisions and did not require modification. We explained that we were consulting separately on proposed modifications to this

condition, which were not the result of the new licensing provisions nor other provisions within the WA03¹⁰.

Respondents' views

The majority of respondents agreed with our view. The following comments were made.

- Two water undertakers suggested that this condition should define to which customers it applies.
- One water undertaker suggested that we should explain what obligations water undertakers had to licensees with regard to bad debt, and added that while licensees were commercial entities, some of their customers might include some residential premises.
- One water undertaker commented that this condition needed to be clear on the distinction (if any) between domestic premises and household premises.

Our conclusions

We understand that clear definitions are required to explain which customers the Code of Practice applies to, and this is covered in condition A. Issues relating to debt and disconnection under the WSL regime are addressed in the access code guidance¹¹. Essentially a water undertaker can disconnect a licensee (but not its customer, as the interim duty to supply under section 63AC WIA91 would apply) for non-payment of debt, provided this is in the access agreement. Therefore the duty of the water undertaker to the licensee is subject to the terms and conditions of the access agreement, and falls away if the access agreement provides for the licensee to be disconnected in case of debt.

Status: unchanged

CONDITION I: CODE OF PRACTICE AND PROCEDURE ON LEAKAGE

Policy overview

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

Respondents' views and our conclusions

The majority of respondents did not comment on the proposal for this condition. Those that did comment agreed with our proposal not to modify this condition.

Status: unchanged

CONDITION J: LEVELS OF SERVICE INFORMATION AND SERVICE TARGETS

¹⁰ See consultation in MD189 (Proposed licence modifications consultation) with responses to the consultation reported in MD 194 (Proposed licence modifications: conclusions).

¹¹ See 'Water Act 2003: Water supply licensing. Consultation on access code guidance' (15 October 2004).

Policy overview

Water undertakers are required to maintain an efficient and economical system of water supply. This condition requires them to provide Ofwat with an annual report setting out their performance against nine service standards (known as the DG indicators). This enables Ofwat to compare each water undertaker's performance with the rest of the industry. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

We received two comments.

- One water undertaker agreed with our proposal not to modify this condition but proposed that the levels of service reporting should allow water undertakers to exclude customers eligible for competition. This would mirror the absence of reporting requirements on licensees and ensure water undertakers' levels of service were not jeopardised by the actions of a licensee who, for example, failed to pass on complaints relating to network operation in a timely manner.
- WaterVoice agreed with our proposals but commented that Ofwat no longer required water undertakers to submit a Service Target as part of this condition and questioned whether the condition should be revised to reflect this.

Our conclusions

We appreciate water undertakers will want to protect their performance in their levels of service report. However, the actions of a licensee will not affect the outcome of a report, as it relates only to the water undertaker's own customers. We have checked that the definition of the term 'customer' refers only to those customers remaining with a water undertaker, consistent with our policy intention. We have no plans to re-introduce the Target Report as part of the levels of service report, as we have consulted on the levels of service report before, and it has industry approval. This consultation paper only considers modifications to conditions of appointment in consequence of the introduction of the new WSL provisions in the WIA91.

Status: unchanged

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

Policy overview

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

Respondents' views and our conclusions

The majority of respondents did not comment on the proposal for this condition. Those that did comment agreed with our proposal not to modify this condition.

Status: unchanged

CONDITION L: UNDERGROUND ASSET MANAGEMENT PLANS

Policy overview

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

Respondents' views

The majority of respondents agreed with our view although there were some concerns.

- Two water undertakers commented that the licensee should supply sufficient information to the water undertaker to allow them to plan properly and suggested that the condition should be revised to make this obligatory.
- Another stakeholder commented that if satisfaction of this condition depends on information from licensees and their co-operation, there is then the need for a licence condition to create a matching obligation for a licensee.

Our conclusions

We have drafted a standard licence condition creating the framework under which licensees will be required to provide water undertakers with information that they need. Under this standard condition a water undertaker may, subject to certain conditions, request information from a licensee for a number of purposes including:

- fulfilling its statutory functions;
- fulfilling its obligation under its Instrument of Appointment;
- complying with requests for information made by the Environment Agency.

We believe that standard licence condition 5 is adequate for this purpose. Therefore we have not amended this condition of appointment. For more information on standard licence condition 5 (provision of information to relevant undertakers) please see section 4.3.

Status: unchanged

CONDITION M: PROVISION OF INFORMATION TO OFWAT

Policy overview

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

Respondents' views

The majority of stakeholders agreed that this condition would be unaffected although some water undertakers raised comments about conditions for the Water Supply Licence.

- Several water undertakers commented that where information provided by water undertakers to Ofwat depends on co-operation from licensees, the licensees must have a complementary standard licence condition to provide water undertakers with relevant information.
- One water undertaker commented that licensees should have an obligation to comply with all reasonable requests from water undertakers for information, to allow water undertakers to discharge their obligation to Ofwat.

Our conclusion

We understand that water undertakers may rely on information from licensees when providing information to Ofwat and this is addressed in standard licence condition 5 (provision of information to relevant undertakers).

Status: unchanged

CONDITION N: FEES

Policy overview

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

Respondents' views

The majority of respondents did not comment on our proposals. However, we did receive the following views.

- One water undertaker supported the proposal that the requirements in this condition be replicated in the corresponding standard licence condition 9 (licence fees).
- One water undertaker commented that only those companies and customers benefiting from competition should fund increases arising from competition.
- WaterVoice agreed with Ofwat that this condition would be unaffected by the licensing provisions and required no related modification.

Our conclusions

This condition is being reviewed as part of a separate exercise to reflect consequential amendments in relation to the formation of CCW. We address licensee payments to Ofwat in standard licence condition 9 (licence fees).

Status: under review

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

Policy overview

Instruments of Appointment were granted from 1 September 1989. Generally a water undertaker can be replaced only after 25 years' notice of termination from the

Secretary of State. This condition permits other changes by agreement or to cover inset appointments. Our view was that it would be unaffected by the licensing provisions and did not require modification.

Respondents' views and our conclusions

The majority of respondents did not comment on the proposal for this condition. Those that did comment agreed with our proposal not to modify this condition.

Status: unchanged

CONDITION P: UNDERTAKING FROM A HOLDING COMPANY

Policy overview

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

We invited your views on whether you agreed that condition P (for those companies that have it) did not require modification in respect of the licensing provisions.

Respondents' views

The majority of respondents did not consider that condition P required modification and also agreed we should separately consult on whether all water undertakers should have the condition in their Instrument of Appointment.

- One water undertaker commented that condition P should be a standard licence condition for all water undertakers.
- A stakeholder, a water undertaker and a potential licensee agreed that condition P does not require further modification in respect of the licensing provisions.
- Two water undertakers and a stakeholder welcomed the proposed consultation on condition P.
- One stakeholder commented that Ofwat had powers to take enforcement action if a water undertaker breached its conditions of appointment or relevant legislation.

Our conclusion

This condition is complemented by provisions in proposed condition R and standard licence condition 7.

Status: We will consult separately on whether all statutory water undertakers should have condition P in their Instrument of Appointment.

CONDITION Q: INTERRUPTIONS IN SUPPLY BECAUSE OF DROUGHT

Policy overview

This condition requires water undertakers to pay compensation to business and household customers if their supply is interrupted or cut off under the authority of a drought order. Our view was that this condition would be unaffected by the licensing provisions and did not require modification.

Respondents' views

The majority of respondents agreed that compensation payments should be a matter for access agreements. We received the following additional comments.

- Several water undertakers agreed with our proposal and considered it important to be clear which customers were affected by this condition, as there was an incentive for customers to return to water undertakers solely to take advantage of more attractive compensation payments because of a cut in supply resulting from drought conditions.
- One water undertaker commented that this condition should remain unchanged providing licensees' conditions were consistent with water undertakers' conditions and considered that drought compensation must be calculated in the same manner for all customers.
- WaterVoice suggested that Ofwat should deal with this in the access agreement between water undertakers and licensees or the contract between the licensee and the customer.

Our conclusions

We agree that it needs to be clear which customers are covered by this condition, and we think condition A achieves this. This condition applies to customers remaining with the water undertaker and not the licensee or its customers. We agree that compensation payments between water undertaker and licensee should be dealt with in access agreements. Compensation payments between licensees and their customers should be dealt with through contractual arrangements.

Status: unchanged

3.3 Proposed new conditions of appointment

CONDITION R: PROVISION OF COMMON CARRIAGE AND WHOLESALE SERVICES

Policy overview

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

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

We invited your views on whether this condition went far enough to support the licensing provisions in the WIA91, and whether there were any issues that would be better dealt with in access agreements.

Respondents' views

Responses were wide-ranging.

- Potential licensees commented that any information between water undertakers, licensees and potential third parties must remain absolutely confidential.
- Most water undertakers supported the proposals in the condition but two water undertakers commented that while water undertakers must not show undue preference or undue discrimination against potential customers, they still had to adhere to the costs principle. This might result in different charges to licensees in a similar position.
- Several water undertakers suggested that the same non-discrimination text in condition E should be used in condition R, and that a similar non-discrimination provision should apply to licensees.
- Several water undertakers also commented that this is a key new standard licence condition which was still the subject of discussions by Ofwat's advisory group, whose work should not be pre-judged.
- One water undertaker did not consider it appropriate for water undertakers to provide annual reviews and updates of access codes for an area with no licensee activity in the previous year, as it created unnecessary administration.
- One water undertaker agreed with the proposed condition but said that Ofwat needed to modify the guidance to reflect growing competition in this area, and suggested that Ofwat included a means for appeal for water undertakers who might be disproportionately affected.

The majority of respondents did not consider there were any issues in condition R that could be better dealt with in access agreements. We also received the following comments.

- Both potential licensees and water undertakers suggested that the access agreement should include a clause to allow confidential requirements to be explicitly agreed in the context of a particular agreement.
- WaterVoice commented that they would wish to be notified of any changes in a water undertaker's code, in particular those relating to customers' protection or service issues.

Our conclusions

This condition is drafted to reflect the policy proposals set out above. Water undertakers will have to publish an access code and keep it updated. We consider that annual reviews are necessary, but that water undertakers should also amend their codes whenever appropriate, for example in response to changes by Ofwat to its guidance. This will be important to potential licensees.

Water undertakers will also be required to avoid discriminating unfairly between licensees (or their customers) and their other customers. They will be required to ensure that neither they nor their associates obtain an unfair commercial advantage as a result of their activities under this condition. We have drafted this condition to

include a provision for confidentiality with a parallel provision in proposed standard licence condition 2.

As part of this requirement we have added a provision for information to be reasonably requested by a licensee under certain circumstances. The condition also requires the water undertaker to pro-actively supply information to licensees in certain circumstances. This provision is complemented by those in standard licence condition 5 (provision of information to relevant undertakers). We have also provided that the water undertaker may impose reasonable confidentiality requirements on information which it supplies to any licensee for particular purposes, similar to that in standard licence condition 5. Ofwat may resolve disputes about the reasonableness of requests for information, or any conditions which the water undertaker might seek to impose upon disclosure.

Ofwat's consultation on access code guidance¹² included the proposal of access agreements including a confidentiality provision.

Any interested party may ask for a copy of a water undertaker's access code, although only Ofwat will be automatically informed by the water undertaker of any changes to its code.

We considered whether a further obligation was needed in cases where a water undertaker was prevaricating when dealing with requests for access. Under section 66D(2) WIA91, if an agreement cannot be reached between a licensed water supplier and a water undertaker, Ofwat can make a determination at the request of the licensee. Under 66F(10) the determination would then act as if it were an agreement, and could be disputed through the civil courts. We believe that this, combined with an obligation to comply with the statutory Ofwat guidance which will include guidance on timetables, is sufficient to encourage a water undertaker to agree access with a licensee promptly.

Additional issues considered

Under section 17A(5) of the Act, the holder of a combined licence must introduce water into a water undertaker's supply system upstream from the premises of the licensee's customer. However, 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. The licensee's supply pursuant to a combined licence (under a common carriage access agreement) would be replaced with an agreement for the introduction of

¹² See 'Water Act 2003: Water supply licensing. Consultation on access code guidance' (15 October 2004).

water into the supply system and a retail access agreement pursuant to a retail licence.

We believe the new agreement should be on, broadly, the same terms and conditions as the old agreement. 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. This has been provided for in condition R.

This condition is required 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 undertaker¹³.

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

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

CONDITION S: THE CUSTOMER TRANSFER PROTOCOL

Policy overview

In order to ensure a smooth transfer when customers move from a water undertaker to a licensee and vice versa, as well as between licensees, a customer transfer protocol will be needed.

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

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

These matters are being consulted on in our licensing and eligibility consultation¹⁴.

¹³ See our consultation paper: 'Policy proposals on exceptions regulations and exemptions'.

¹⁴ See section 5 of 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

We proposed this new condition, which would require water undertakers to abide by the terms of the transfer protocol once it was created. Following its implementation, we suggested that water undertakers could propose amendments to Ofwat, which would consult where appropriate on the changes and have the power to veto them if necessary. We proposed that, following its implementation, water undertakers would therefore not have the power to amend the protocol without Ofwat's consent and the involvement of all water undertakers and licensed water suppliers.

We invited your views on whether this condition went far enough to ensure the smooth transfer of eligible customers.

Respondents' views

The majority of respondents agreed that the condition ensures the smooth transfer of eligible customers but added the following suggestions.

- Two water undertakers agreed that the procedure was necessary but opposed the idea that it should be written into the Instrument of Appointment, specifically one water undertaker objected to a central customer database, or being forced to pay for new or duplicate billing systems.
- WaterVoice suggested that Ofwat should consult it on any modifications to the protocol.
- Another stakeholder suggested that the system should be enhanced to ensure the data were secure.

We asked your views on what issues you thought needed to be set out in this condition regarding the transfer of customers.

Respondents' views

Many of the responses centred on the amount of detail that should be exchanged between the licensee and the water undertaker.

- A potential licensee suggested that addresses and various details such as, current volumes, locations and meter points, types, and ages should be exchanged between the water undertaker and the licensee.
- One potential licensee suggested including details of standards of service and proposed timescales.
- Another potential licensee suggested that Ofwat should consider how data are transferred between companies and licensees in the gas and electricity industries.
- WaterVoice suggested that we should look into an independently managed database, because over time the market size would grow and the central database system would not be able to deal with the volume. WaterVoice also suggested that water undertakers should write to customers to explain licensees would be billing them from a given date. Customers would then have the time to get used to this, and could raise any issues before the transfer.
- Water undertakers commented on the importance of clear definitions of a customer and the relevant obligations of each party in the transfer. Water undertakers commented that for customers, the protocol should detail points of contact, what information needs to be exchanged and when, and explain to the customer the change of control procedures together with any timetables.

Our conclusions

We will ensure that this condition of appointment is aligned with standard licence condition 6 of the Water Supply Licence and both will require compliance with the customer transfer protocol. This implies also having arrangements which enable the licensee to comply with the provisions.

We agree that since the protocol will go into detail, there is no need to do so in this condition. This provides a more flexible process, which allows the customer transfer protocol to be amended if necessary instead of consulting on an amendment to the condition of appointment.

We propose taking a balanced approach to the level of detail that we prescribe in condition S and in the customer transfer protocol. This will ensure that we cover the key areas without placing an unnecessary burden on water undertakers. The draft customer transfer protocol is available in our consultation on licensing and eligibility¹⁵.

Additional issues considered

The draft condition includes a provision allowing a licensee or water undertaker to block a customer transfer. The reasons that a customer transfer might be blocked are explained in the draft customer transfer protocol and are listed below.

- Debt blocking – The old supplier may object to a transfer if debt has been outstanding for more than 30 days at the time of the proposed transfer. To allow the transfer to continue we propose in the customer transfer protocol that either the customer pays the debt prior to transfer or an agreement could be made to allow it to be assigned to the new supplier (in effect the old supplier is paid by the new supplier). In these circumstances the new supplier would need to agree such arrangements with both the customer and old supplier.
- Co-operative objection – The new supplier acknowledges that it has submitted a request to register change of supplier in error and the old supplier then agrees to raise an objection to prevent the transfer proceeding. These have been put to good effect within the gas and electricity industries and reduce the occurrence of erroneous transfers.
- Customer requested objection – The customer at the premises has advised the old supplier that they have not entered into a contract with the new supplier, which means that a change of supplier should not occur.
- Valid supply contract – The customer is being supplied by the old supplier under a contract that will neither expire nor be terminated on or before the proposed transfer date.

The advantage of dealing with transfer blocking in the customer transfer protocol is that it allows for easier changes to the reasons for objection than if they are covered in a standard condition. For this reason, we are not proposing to cover all the reasons for objection detailed above in this condition.

¹⁵ See section 5 of 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

However, we believe that debt blocking is so important to the success of the regime that it merits being in a standard condition. Debt-blocking provisions prevent customers moving suppliers to avoid paying a debt and causing difficulties to a creditor supplier.

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

We considered extending the powers that Ofwat has over the customer transfer protocol. We proposed that Ofwat should have right to veto amendments and the right to propose amendments. In the light of the comments received, Ofwat will also have the power to resolve disputes about amendments proposed by licensees and water undertakers (but not Ofwat) where there is disagreement about how to proceed. We want to make sure that the regime does not falter because of the lack of a means by which impasses can be cleared. We also propose that the customer transfer protocol will set out the disagreements that Ofwat will have the power to resolve. All licensees and all water undertakers will be involved in adopting amendments. This is reflected in the text of the draft condition.

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

3.4 Other issues

PIPELAYING

Policy overview

We considered whether a new condition concerning pipelaying was necessary for water undertakers. Sections 51A to 51E WIA91 contain provisions concerning pipelaying, requiring water undertakers to adopt pipes laid to an appropriate standard by licensees and allowing water undertakers to recover reasonable costs of pipelaying associated with licensees' activities. Under the WIA91, licensees will therefore be able to choose whether to lay the pipes themselves or ask the water undertakers to install them.

We proposed that the access agreement would be the best place to cover the issue of reasonable timetables for water undertakers to respond to licensees' pipelaying requests.

Respondents' views

Respondents agreed with our view that the access agreement is the best place to cover the issues of reasonable timetables for water undertakers to respond to licensees' pipelaying requests. One stakeholder and one water undertaker commented that this proposal should be consistent with UKWIR's¹⁶ paper, 'Self-

¹⁶ United Kingdom Water Industry Research

laying of water mains and services – a code of practice’ and with Ofwat’s guidance paper, ‘Competition in providing new water mains and service pipes’.

Our conclusion

No new condition is proposed to deal with this requirement. We are taking the issue forward in the access code guidance.

METERING

Policy overview

Section 205 of the WIA91 provides for the exchange of meter readings between the relevant water undertaker and the licensee.

We considered the option of having a condition on metering in the Instrument of Appointment. This could cover instances where, for example, the licensee has taken responsibility for reading the meter. In order to prevent the water undertaker from continuing to read the meter and charging the licensee for this service, we considered whether there should be a condition requiring the water undertaker to accept the licensee’s meter readings.

We proposed that it would be more appropriate for metering arrangements between the licensee and the water undertaker will be governed by the access agreement.

Respondents’ views

The majority of stakeholders agreed this should form part of the access agreement.

- Several water undertakers commented that they should retain the right to read meters as it was important where seasonal tariffs were concerned because unscrupulous operators have an incentive to understate summer consumption which is avoided if the water undertaker takes the reading.
- One potential licensee disagreed that that meter reading should be a matter for the access agreement and suggested that it should be included in the water undertakers’ Instrument of Appointment. The licensee added that water undertakers should be required to confirm meter service history if requested and there should be a provision for the issue of meter accuracy to be challenged without argument.

Our conclusions

We agree with the majority of respondents that meter reading should be governed by the access agreement. We stated in our consultation on the access code guidance¹⁷ that we would deal with situations in which there is a need for frequent meter readings by means of a standard licence condition. We considered whether there was a need for a standard licence condition dictating a minimum frequency for meter reading. However, we have not included one as:

¹⁷ See ‘Water Act 2003: Water supply licensing. Consultation on access code guidance’ (15 October 2004).

- at this threshold we expect meter readings to be monthly at least and section 205 WIA91 provides for the exchange of meter readings when a reading takes place; and
- even if the readings are not frequent section 205 allows for a sewerage undertaker to enter into an agreement with the licensee for the required readings (subject to paying the costs). If the parties are unable to reach agreement the matter may be referred to arbitration. Ultimately, the undertaker has a right of access to read meters under section 172 WIA91 and can make its own arrangements to take a reading.

4. Water Supply Licence

This section outlines our policy proposals for licence conditions and the responses we received. It also sets out our conclusions to these responses.

4.1 The Water Supply Licence: an overview

Each licensee will have its own Water Supply Licence, which will differ from water undertakers' Instruments of Appointment. Section 17A WIA91 establishes the licensing of new water suppliers and sets out the basis on which licensees can supply eligible customers.

The Water Supply Licence will state the licensee's name, address, registration number and the activity authorised (retail or combined). The Water Supply Licence will specify the date on which it comes into force and, unless revoked (see standard conditions 10,11 and 12 for details on revocation), it will continue in force until terminated (on not less than 25 years' notice given by the Secretary of State). Any notice of termination can be varied or withdrawn once given. In the case of combined licensees with designated strategic supplies ('qualifying licensed water suppliers'), a notice of termination cannot take effect unless the special administration procedures have been completed. Draft pro-forma retail and combined licences are contained in annex B.

Q6: We invite your comments on the draft pro-forma licences in annex B.

In our February 2004 consultation paper we explained that the WIA91 provides for Water Supply Licences to include conditions (section 17G) and for the Secretary of State, in consultation with the Assembly, to determine 'standard conditions' (section 17H). Conditions under 17G WIA91 are only different from standard licence conditions under 17H WIA91 in the way they can be modified.

In particular, section 17G provides for, amongst other things:

- such conditions as appear to the Secretary of State or Ofwat to be requisite having regard to duties imposed on him or it under Part 1 of the WIA91; and
- conditions requiring the rendering to the Secretary of State of a payment on the grant of a Water Supply Licence, and/or payments while it is in force, of amounts determined under the conditions.

Section 17H(6-8) WIA91 allows the Secretary of State or Ofwat, when granting a Water Supply Licence, to exclude or modify any of the standard conditions of a particular Water Supply Licence as appropriate to meet that licensee's circumstances. Before doing so, the Secretary of State or Ofwat is required to consult on the exclusions or modifications. They will give notice of their intentions, setting out the impact of, and the reasons for, the exclusions or modifications and allowing for representations to be made.

Each Water Supply Licence will refer to the full standard licence conditions which will be incorporated by reference and published separately in accordance with section 17H (5) WIA91. A full set of draft standard licence conditions is contained in section 5.

The proposals for Water Supply Licence conditions were described in our February 2004 paper. The following headings appear under each condition in section 4.3.

- Policy overview – this section sets out our policy proposals as explained in the February 2004 consultation paper.
- Respondents' views – this section summarises the responses to the proposals. The full responses that are not confidential are available for inspection in Ofwat's library.
- Our conclusions – sets out our conclusions to the February 2004 consultation paper in the light of the responses received.
- Additional issues – this section deals with any additional issues that have been considered subsequent to the February 2004 consultation paper.

4.2 General comments raised

Revocation

Generally, respondents misinterpreted the implications of revocation being a condition under section 17G(1)(a) or a standard licence condition. We have clarified the key differences between a condition under section 17G(1)(a) in standard form for all licensees and a standard licence condition under section 17H. This is explained in more detail in section 4.3.

Confidentiality

Following comments on Water Supply Licence conditions 2 and 5, we will include a confidentiality of information requirement similar to condition of appointment R. This is explained in more detail in section 4.3.

Customer transfer protocol¹⁸

Following respondents' comments, we will ensure that condition of appointment S is aligned with standard licence condition 6.

Complying with arrangements in water undertakers' drought plans

Following water undertakers' comments, we have considered whether a compliance condition for licensees is required. Water undertakers are concerned that if there is not a condition to ensure a licensee complies with the water undertakers' arrangements there may be situation where a water undertaker's actions in the event of a drought or emergency are delayed because of the actions of the licensee. We have considered responses and have provided for a condition dealing with drought plans (before a drought order or permit is in place) and emergencies (see standard licence condition 4).

Additional standard conditions

¹⁸ In the February 2004 consultation this condition was proposed under the title 'Condition 6: The registration and transfer protocol'.

A respondent suggested that licences should include standard conditions with similar provisions to those in conditions of appointment E (prohibition on undue discrimination and undue preference), H (code of practice and procedure on disconnection) and L (underground assets management plans). We do not believe that standard conditions on those terms are necessary. A standard condition on prohibition on undue discrimination is not appropriate for licensees competing in the competitive market. At the current level of the threshold, the procedure on disconnection of a licensee's customers will be captured in the contract between the licensee and its customer. Finally, as explained in section 3.3 above, we believe standard condition 5 (provision of information to relevant undertakers) is sufficient to provide for the role licensees will have in the development of the undertakers' underground assets management plans.

4.3 Conditions of the Water Supply Licence

The order of the conditions has changed since our consultation in February 2004. This reflects the order of the conditions in the draft licence. Where the condition title or number has changed since the February 2004 consultation, this is described in the footnotes. Draft standard licence conditions are in section 5.

STANDARD CONDITION 1: CITATION, INTERPRETATION AND EFFECT OF CERTAIN PROVISIONS¹⁹

Policy overview

This explains the terms and expressions used in the standard conditions. It includes definitions of the terms used throughout the standard conditions. Some of these are taken from the WIA91 and are not defined here expressly. This is because the Interpretation Act 1978 automatically applies those definitions in the WIA91. For ease of reference, footnotes indicate where such terms are defined in the WIA91. In addition, some terms are taken from the Interpretation Act 1978 and are not defined here expressly. Again, footnotes indicate where this applies.

Other terms used only in specific conditions are defined within them in each case.

As the term 'the Authority' will not be applicable until section 36 WA03 comes fully into force in April 2006, sub-paragraph (3) provides that, until then, any reference to 'the Authority' in the conditions shall have effect as if it were a reference to the Director General of Water Services.

Sub-paragraph (4) provides for certain cross-references in the standard conditions to refer to those provisions as amended in the future.

Sub-paragraph (5) also enables certain conditions, namely paragraphs 9(9)(b)(ii), 12, 13, and 14 to 'switch on' when a combined licence is held by a licensee and 'switch off' when that is no longer the case. These paragraphs only apply to combined licensees.

STANDARD CONDITION 2: CONDUCT OF A LICENSEE

¹⁹ Not included in the February 2004 consultation document.

Policy overview

In our February 2004 consultation paper, we proposed that this standard condition should require licensees to act in a reasonable manner in relation to the water undertaker's supply system to carry water in accordance with their access agreements.

This standard condition will give general regulatory oversight over licensees' access to the public supply system. Our February 2004 paper proposed that enforcement action will be possible in the event of disruption to a water undertaker's supply system as a result of breaches by licensees of access agreements. However, this standard condition should not be formulated so that it is invoked by every breach of an access agreement, regardless of its impact.

In the consultation paper we also proposed that a new combined licensee will not be allowed to introduce water into a water undertaker's supply system until DWI was satisfied that the technical management of its source and treatment works met the relevant regulatory requirements. In addition, we proposed that further enforcement action would be taken where a licensee, by act or omission, does something which is likely to affect the:

- safe and economic operation by water undertakers of their supply systems on a day-to-day basis;
- efficient balancing of the supply system by the water undertaker;
- proper functioning of access and wholesale arrangements; or
- quality of water conveyed through the system.

DWI will take enforcement action for any breaches of statutory duties relating to drinking water quality. DWI will inform Ofwat when such action is being taken and this could eventually result in a Water Supply Licence being revoked.

In our February 2004 paper we stated that this standard licence condition could also extend to making false statements about the amount of water a licensee puts into or takes out of the supply system.

Section 18 WIA91 (Orders for compliance with certain provisions) provides for enforcement action against the licensee in the event that it causes or contributes (or is likely to cause or contribute) to a problem that leaves the water undertaker in breach of any of its main obligations and open to enforcement action.

However, although most of these issues are provided for in legislation and will be covered in access agreements, we believe that this standard condition is necessary for instances where the licensee either continuously fails to meet its contractual or statutory obligations in minor ways, or it ever fails to meet those obligations in a significant way. Ofwat might need to revoke the Water Supply Licence and this standard condition allows Ofwat to do this.

We asked whether you thought this extra level of enforcement is necessary.

Respondents' views

The majority of respondents supported our proposal, although the following points were raised.

- One potential licensee was not convinced that the extra level of enforcement is necessary but understood that it could lead to a standardisation of conditions in contracts.
- One potential licensee queried who would judge the safe and economic operation of the supply system, and asked whether this should be a regulator or an independent verifier.
- One water undertaker agreed that this extra level of enforcement is necessary because it protects the customer and helps the incumbent operate effectively.
- One water undertaker suggested licensees should hold the same level of insurance as undertakers do. The respondent added that although the licensee may supply customers in a significantly smaller area than that of the incumbent undertaker, the potential liability extends beyond the licensee's area of activity.
- Several water undertakers commented that enforcement of this standard condition is an ex-post remedy that does not allow water undertakers to recover damage to their reputation. One added that that it may not always be possible to discover where responsibility for improper use lies and experience shows that it can take a long time to determine responsibility for accidents. The access code should allow undertakers to suspend access to the network to prevent an emergency or suspected emergency from occurring.
- Two water undertakers suggested this standard condition was not strong enough and that requiring licensees to act in a 'reasonable manner' and to adopt 'appropriate conduct' was inadequate.
- One water undertaker said that the language of the standard condition should match that of the legislation and the seriousness of the intent of the legislation.
- One water undertaker commented that that it is essential that licensees comply with access codes if there is not to be an increase in the risk of the safety or security of the water supply system.
- One stakeholder commented that the extra level of enforcement is definitely required to prevent any harm that may be caused to the public by breaches of those agreements. The stakeholder added that this standard condition would not interfere with access agreements but would reinforce them and could facilitate the negotiations by setting clear objectives.
- Another stakeholder suggested that the wording of this standard condition should be flexible enough to facilitate a pragmatic approach to the assessment of whether a licensee is in breach of a condition.
- Another stakeholder commented that licensees should be fully aware of the water quality issues associated with licence conditions. They also said that any unforeseen circumstances could arise where the actions of licensees could leave the water undertaker vulnerable to enforcement from the DWI. The stakeholder considered combined licences should be subject to the same level of technical audit as water undertakers are.

We asked for your views on what sort of instances you considered this extra level of enforcement might be used.

Respondents' views

We received limited responses to this question and they included the following suggestions.

- One potential licensee believed the extra level of enforcement should be used for gross and persistent breaches only.
- One water undertaker suggested it could provide for rapid enforcement for issues of public health.
- A water undertaker said that it allows Ofwat to issue pre-emptive warnings of enforcement action to licensees who are close to failing a condition.
- One water undertaker suggested this provision may be used when a licensee's water is of variable quality and may cause discolouration, or when a licensee's operation causes low-pressure events, or increases burst rates, or adversely affects service to other customers, or requires capital or operational expenditure (which would otherwise not be required) by the undertaker in order to avoid the possibility of regulatory action, including a financial penalty.
- One water undertaker commented that the emergency procedure should also empower the undertaker to assume control of a licensee's operations in an emergency. This may be significant where on discovery of an incident an undertaker's staff may be the first to the scene at the licensee's remotely operated plant.
- One water undertaker considered the standard condition should apply in all cases rather than general or persistent breaches; that if the undertaker involved in the supply, or another regulator, deems that a breach is non-trivial, then Ofwat will need to consider the breach as being non-trivial.
- WaterVoice commented this condition should apply where a breach occurs as a result of negligence, failure to act, or inappropriate action by a licensee and is likely to compromise the water undertaker's supply system. They also suggested this standard condition would be useful when it becomes apparent following several small contraventions, that there is a major cause at the root of the problem.

We asked whether you thought this condition would interfere with contractual arrangements between licensees and water undertakers.

Respondents' views

The majority of respondents did not think this standard condition would interfere with the contractual arrangements between licensees and water undertakers.

- One water undertaker suggested that the standard condition would provide additional protection not available through the contract.
- One water undertaker commented that a clear, unequivocal position would help, rather than interfere with, contractual arrangements.
- A potential licensee considered this standard condition is likely to affect contractual arrangements, but that a benchmarking standard may be a good thing to have.
- Another stakeholder commented that contracts between licensees and undertakers should be drafted to take account of this standard licence condition as this would minimise, if not eliminate, interference with contractual arrangements.

We asked how the condition might be formulated to avoid any interference with contractual arrangements between licensees and water undertakers.

Respondents' views

We received limited responses to this question, but the majority of those who did respond considered this standard condition would not affect the contractual arrangements between licensees and water undertakers.

- A potential licensee said that it is better addressed by a commercial lawyer.
- A water undertaker commented that the access agreements are likely to reflect this standard condition, therefore interference with contracts is unlikely.
- A water undertaker said that the contract between water undertaker and licensee and the access agreement should adhere closely to the legislation.
- WaterVoice expected this standard condition to be drafted by us to ensure it does not undermine the contractual agreements between licensees and water undertakers.

We asked how the general or persistent breaches might be specified.

Respondents' views

We received a mixed response to this question.

- A potential licensee commented that general breaches should be described as long-term abuse or failure to comply with licence conditions, and persistent breaches should probably include repeated quality test failures.
- One water undertaker suggested phrases like a 'general and persistent' breach implies a more lax regime than envisaged in the primary legislation.
- Two water undertakers commented that frequent breaches should be compelling evidence of unfitness.
- A water undertaker considered all breaches should be considered except trivial matters.
- Another stakeholder considered general or persistent breaches should be specified once the details of access agreements have been developed as this should identify the circumstances which need to be covered by standard condition 2.

Our conclusions

We consider this standard condition is necessary and support the level of additional enforcement it confers.

It requires licensees to organise and carry on their activities properly. It would prevent licensees from providing inaccurate information to water undertakers on operational matters if this would actually or potentially jeopardise a water undertaker's functions. This is also covered by standard licence condition 10(2)(b) which allows a licence to be revoked if information supplied to water undertakers is false or misleading.

Ofwat will seek advice from the relevant bodies (such as DWI) if necessary, to determine what is considered to be the proper, efficient and economic performance by an undertaker of its functions. We also agree with respondents that the level of

insurance which a licensee holds needs to be considered, and we have provided for this here and in standard licence condition 5 (provision of information to relevant undertakers).

Q7: Do you think that we need to define 'product and public liability insurance' more closely?

We agree that this standard condition should provide for circumstances where repeated minor failures are not in themselves significant enough to warrant enforcement. We believe the drafting does this. We also agree with water undertakers that the extra level of enforcement should be used to protect public health.

Ofwat will, when necessary, investigate the cause of an incident and responsibility for it; but an incumbent's loss of reputation will be remedied, if at all, by civil action, not regulatory measures.

As the majority of respondents did not consider this condition will interfere with the contractual arrangements between water undertakers and licensees we see no objection to including this condition.

We agree that persistent breaches should lead to enforcement and possibly revocation. This has been covered in the text of the draft standard condition. Water undertakers can make representations to Ofwat in the event of any alleged breach, but it would not be appropriate to have water undertakers determine what is trivial.

In Ofwat's access code guidance consultation Ofwat explained that a water undertaker must be able to reserve the right to suspend, without prior notice, the introduction of water into its supply system if it has reasonable grounds to suspect that continued introduction would put it at risk of supplying unwholesome²⁰ water or at the risk of committing an offence under section 70 WIA91 (ie the offence of supplying water unfit for human consumption).

Additional issues considered

Following responses on the need to ensure that a licensee does not input water until DWI has audited the source and treatment works, we are now proposing a new standard licence condition (condition 13, prohibition on introduction) for combined licensees. This condition makes it clear that licensees cannot input water into the potable supply system until the new source and treatment works have been audited by DWI.

Draft standard condition 2 (conduct of a licensee) also includes a new provision for confidentiality of information, similar to that proposed in condition of appointment R.

STANDARD CONDITION 3: CERTIFICATE OF ADEQUACY²¹

²⁰ See section 4 of the Regulations for a definition of unwholesomeness.

²¹ In the February 2004 consultation this condition was proposed under the title 'Condition 5: Certificate of adequacy'.

Policy overview

In applying for a Water Supply Licence, a licensee has to show it has the necessary management, financial, technical, operational and other resources to carry out its proposed activities in accordance with its statutory and contractual obligations. DWI will advise Ofwat in respect of the licensee's technical and operational competence.

We proposed that this condition should require annual submission of a certificate of adequacy (signed by the Directors of the company) confirming that a licensee has the ongoing management, technical and operational resources to carry out the activities in which it is engaged, and which it demonstrated at the licence application stage.

Where the licensee becomes aware of an actual or possible event which would prevent it from being able to submit a certificate of adequacy at any time, the licensee will have to notify Ofwat as soon as possible.

Respondents' views

We received broad support for this proposal, although there were a variety of suggestions for the certificate and its use and these are set out below.

- Potential licensees supported the proposals.
- One potential licensee agreed with this condition because it will help police the competence of companies involved in water supply, but suggested there should be a similar condition for water undertakers as well.
- Water undertakers commented that the certificate's accuracy should be audited independently.
- A water undertaker also suggested that the certificate of adequacy should be confirmed periodically not just when the licensee has a change in circumstances.
- Several water undertakers agreed that DWI should advise Ofwat on an entrant's competence to supply, and believe this advice and the reasons for it should be published to maintain public confidence in the safety of water.
- A water undertaker also stated that combined licensees should demonstrate and maintain financial resources, technical competence and indemnity insurance commensurate with the risks of putting its water into the public supply system.
- Another stakeholder commented that licensees will not be able to put treated water into a distribution system unless DWI is satisfied all regulatory requirements are met and suggests the certificate of adequacy should include a statement on technical competence.
- WaterVoice commented that licensees should notify Ofwat immediately, and not wait until the annual review, if the licensee is aware they will not be able to submit a certificate.

Our conclusions

Each water undertaker must certify annually the adequacy of its management and financial resources to enable it to operate for the next twelve months. It must tell Ofwat if anything happens to change that opinion. We think that new entrants should have a similar obligation. We agree that the certificate of adequacy should be subject to an independent verification. This policy is reflected in the draft condition.

We have made provisions for insurance to be covered in standard licence conditions 2 (conduct of a licensee) and 5 (provision of information to relevant undertakers). The certificate of adequacy will require licensees to certify that all of the arrangements required in standard licence condition 2 are in place. See the text under those standard conditions for further details.

DWI will advise Ofwat on an entrant's competence to supply, but we do not think that its advice should be published. We believe that it is sufficient for the public to know that DWI carries out a check on licensees' technical competency at the licence application stage, and before the input of water into a water undertaker's potable supply system.

Following responses on the need to ensure that a licensee does not input water until DWI has audited the source and treatment works, we are now proposing a new standard licence condition for combined licensees, which makes it clear that they cannot input water into a potable supply system until this has happened (see standard condition 13).

We have also provided that if a licensee becomes aware that it cannot provide a certificate of adequacy on the day required or, at other times, that there is an actual or potential change of circumstances which would prevent it from providing a certificate if it were obliged to do on that day, it must notify Ofwat immediately.

Additional issues considered

In our February 2004 paper, we proposed that when a change occurs that may affect a licensee's ability to comply with the conditions of its licence, or when they vary their licence, this condition will oblige a licensee to submit a further certificate of adequacy (together with an explanation of the change). In the light of subsequent discussions we do not think that licensees need to submit a certificate of adequacy when a licence is being varied.

Retail-only licensees applying for a variation to a combined licence would, if successful, be taking on additional responsibilities. Therefore, in our draft consultation paper on the Licence application guidance²², we propose that these licensees will be required to satisfy the same requirements as if initially applying for a combined licence. We will assess the licensee's suitability to be given a supplementary authorisation to input water, and this therefore removes the need for that applicant to submit a certificate of adequacy if the application is successful.

Also, where a combined licensee applies for a variation that will restrict it to providing retail-only services, it will already have demonstrated to us that it is capable of carrying out retail activities. A certificate of adequacy submitted on variation from combined to retail activities is therefore not necessary.

Q8: Do you agree with the proposed verification process?

²² See 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

STANDARD CONDITION 4: EMERGENCIES AND DROUGHT²³

Policy overview

In our February 2004 paper we considered the option of including a standard licence condition to require licensees to comply with arrangements set out in water undertakers' drought or water resources management plans. We said that such a condition might require a licensee to do all it can to comply with reasonable requests by water undertakers for the purpose of:

- securing adequate supplies of water when under drought orders; or
- facilitating the water undertakers' compliance with directions in times of drought.

We noted that we did not consider such a condition was necessary. The duty to prepare drought or water resources management plans is enforceable against the water undertaker, and we considered that the water undertaker could include the obligations referred to above in its access agreement with the licensee. We explained that we believed these issues were better placed in access agreements.

Respondents' views

Respondents were divided on this issue.

- Potential licensees agreed with our proposals that this does not need to be a standard condition.
- Several water undertakers and Water UK believed that such a standard condition is necessary. Three water undertakers explained that, while water undertakers can include obligations regarding drought or water resources management plans in access agreements, pursuit of breaches of those agreements could be a lengthy process, which would not provide satisfaction quickly enough to be of use in a drought situation. One water undertaker added that this should be extended to cover emergency planning.
- WaterVoice commented that it should not be a standard condition, but that Ofwat's guidance on access codes should set out what is required from licensees and water undertakers. However, WaterVoice also said that there might be scope for such a standard condition to be introduced for licensees operating in an area of water scarcity.

Our conclusions

We have considered the issues raised by respondents and still believe that there is no need for a standard condition dealing with water resources management plans. A licensee's contribution to the water resources management plan is already covered by provisions in sections 37C and 37D WIA91.

However, having considered comments regarding drought plans, we consider that certain provisions need to be reflected in a standard licence condition, as in this case the licensee has a potentially time-critical role. The condition is intended to cover actions that a licensee needs to undertake that are not yet covered by a drought order or permit. For example, if the water undertaker is asking for reduced

²³ In the February 2004 consultation this condition was proposed under the title 'Complying with arrangements in water undertakers' drought or water resource plans'.

consumption (before a drought order/permit is in place) then the licensee may have to do the same for its customers. If an order/permit is in place then that will provide a legal basis for anything the licensee (or its customers) must do. But under a permit/order there may be prohibitions on abstractions that affect the licensee as they do other abstractors.

Therefore, we have drafted a new standard condition so that the licensee complies with reasonable instructions from the water undertaker in relation to matters covered by statutory drought plans which are not the subject of a drought permit or order for a number of specific purposes. This part of the standard condition also allows Ofwat to decide whether instructions from a water undertaker to a licensee are reasonable. If a reference is made to Ofwat on this point, this suspends the effect of the instructions.

The draft text of the condition also deals with emergency events. Although the proposed new Emergency Direction²⁴ for licensees will set out the planning requirements and the need to notify the water undertaker of an emergency, for reasons of urgency we think that it is important to include a power for water undertakers to give instructions to licensees in emergencies for specific purposes. By putting this in the condition, it makes clear from the outset what is required of the licensee. Licensees will have to comply with all emergency instructions save those which are manifestly unreasonable.

This standard condition will be subject to the non-discrimination provisions in condition of appointment R.

STANDARD CONDITION 5: PROVISION OF INFORMATION TO RELEVANT UNDERTAKERS²⁵

Policy overview

In our February 2004 paper we proposed that this standard condition should ensure that, where the water undertaker makes a reasonable request for information, the licensee must comply with this request. A water undertaker might request information from a licensee for the purpose of:

- fulfilling its statutory functions;
- fulfilling its obligations under its Instrument of Appointment; or
- complying with Environment Agency requests for information.

We proposed that licensees would need to provide such information to water undertakers, as long as it is in their possession or is readily available. They are able to refuse this request on grounds of commercial confidentiality.

We asked whether you considered that this information condition went too far or not far enough in protecting the water supply network.

²⁴The Security and Emergency Measures (Water and Sewerage Undertakers) Direction 1998 will be supplemented by a new direction to cover licensees and will be consulted on shortly.

²⁵In the February 2004 consultation this condition was proposed under the title 'Condition 3: General information provision to water undertakers'.

Respondents' views

Generally, respondents agreed that the standard condition is needed, although we received mixed responses on how much information should be exchanged.

- A potential licensee commented that the standard condition may go too far, but considered that it may be acceptable if there is a reciprocal condition on water undertakers.
- A potential licensee suggested that the standard condition should specifically mention emergency requirements, as they are critical if such a situation were to arise.
- Another potential licensee suggested that Ofwat issue a standard questionnaire for water undertakers to use to ensure fair and equal treatment of all licensees.
- Water undertakers commented that this condition does not go far enough, specifically in relation to provisions for water resource, emergency and drought planning.
- Several water undertakers and WaterVoice supported the proposal to give licensees an obligation to supply undertakers with information; one water undertaker stated that this condition should mirror the obligation that licensees have to supply information to Ofwat.
- A water undertaker suggested that the condition should make clear that information might be needed at short notice, such as in the event of an emergency, and also suggested that, if the information is not readily available to a licensee, it should be clear that the licensee should commit to providing it (via Ofwat if necessary).
- WaterVoice commented that Ofwat must ensure licensees do not use the confidentiality clause to withhold relevant information from undertakers. WaterVoice added that there should be an agreed dispute procedure and Ofwat seems to be best placed to settle any dispute.

Our conclusions

In our February 2004 paper we proposed that licensees should be able to refuse to provide information where its disclosure would seriously and/or prejudicially affect the licensee's commercial interest. In such cases Ofwat would be able to direct (using powers in this condition) the provision of an item of information on the grounds that it is necessary or expedient in order for the water undertaker to fulfil its statutory functions.

The draft standard condition provides for water undertakers to make only reasonable requests and for the licensee to be able to impose reasonable conditions on the use the water undertaker may make of the information provided. Ofwat will determine any dispute on the reasonableness of either the water undertaker's request for information or the licensee's proposed conditions for the use of the information. If a reference is made to Ofwat on this point, this suspends the effect of the information request. The relevant water undertaker will also be subject to the confidentiality provisions in condition of appointment R and in the access agreement.

The draft standard condition protects information held by a licensee which is legally privileged. If the request is for a type and amount of information which Ofwat regards as reasonable, Ofwat will regard a request for readily available information to a licensee to be reasonable and therefore enforceable. This includes information

which is reasonably obtainable using best endeavours. The wording of the draft standard condition has been aligned with the standard condition of provision of information to Ofwat, and a reference to information being readily available is therefore unnecessary.

We do not think this condition should reflect the provision of information related to water resource and drought planning. These issues are dealt with in sections 37C and 39C WIA91 and do not need to be replicated in this condition. The standard condition therefore is subject to those provisions.

We are consulting on the need for a reciprocal condition on water undertakers. See condition R (in section 3) for further details.

Another proposal was for a standard questionnaire for all water undertakers. We consider it is not appropriate at this time to request or issue standard questionnaires, as there is no experience of the regime and a standard questionnaire might not include some information that is later found to be needed. There should therefore be flexibility for water undertakers to require information they need, subject to the safeguards mentioned above.

Additional issues considered

Following discussions with stakeholders in Ofwat's advisory groups on the need of securing that the licensee has sufficient insurance to cover any liability it might incur, the standard condition now includes a provision for the licensee to demonstrate, if requested, that it has sufficient product and public liability insurance (see also standard licence condition 2).

In Ofwat's consultation paper on access code guidance,²⁶ it was suggested that there needed to be provision in place for meter readings to be shared with the sewerage undertaker (where it is not the water undertaker who provides the sewerage service). The sewerage undertaker will not have an access agreement with the licensee, but still needs meter readings for its billing purposes.

In the access code guidance consultation, we suggested that this would be dealt with in a licence condition that would enable a sewerage undertaker to require a reading (eg on a particular date) as long as it pays the licensee's proper costs. We also proposed that minimum frequency of meter reading would be dealt with in a licence/appointment condition.

In the light of further discussions, we do not think we need to cover these points in a standard licence condition. No similar requirement is placed on water only undertakers. Section 205 WIA91 already makes a provision for the sharing of meter readings and if the sewerage undertaker requires more frequent readings than that provided by the licensee then it is open to them to seek an arrangement for this with the licensee (subject to paying the costs). If the parties are unable to reach agreement the matter may be referred to arbitration. Ultimately, the undertaker has

²⁶ See 'Water Act 2003: Water supply licensing. Consultation on access code guidance' (15 October 2004).

a right of access to read meters under section 172 WIA91 and can make its own arrangements to take a reading.

However, the draft standard condition does include a provision for licensees to inform sewerage undertakers of any premises connecting to the distribution system for the first time, so that the sewerage undertaker can start billing new customers. This is similar to the provision in water only undertakers' condition of appointment C (9) (infrastructure charges).

In the access code guidance consultation, section 4.5 also highlights that we proposed a licence condition to ensure that information flows without prompting from the licensee and its customer back to the water undertaker in relation to operational safety, including special needs consumers, diagnosis of emerging network issues, emergencies, drought and information concerning planned maintenance. This would include any incident that would put the water undertaker at risk of supplying unwholesome water, or at risk of committing an offence under section 70 WIA91 and that may affect drinking water quality, as explained in section 5.6 of the access code guidance consultation. We have included these points in this standard licence condition. The licensee will be responsible for identifying the needs of the customers who require additional services, which might include details of those residing at eligible premises who require water for specific medical purposes ('special needs consumers'). The licensee will be responsible for acting on the information it receives from the customer and passing it to water undertakers.

Q9: Do you agree that the qualifying list in SLC 5(9) is sufficient or should there be any additions/deletions?

STANDARD CONDITION 6: THE CUSTOMER TRANSFER PROTOCOL²⁷

Policy overview

In order to ensure a smooth transfer when customers switch suppliers from a water undertaker to a licensee and vice versa, as well as between licensees, a customer transfer/data management protocol (the customer transfer protocol) will need to be in place.

In our February 2004 paper, we proposed that this standard condition would require licensees to abide by the terms of the customer transfer protocol once it was created. Following its implementation, we suggested that licensees could propose amendments of the customer transfer protocol to Ofwat, who would consult where appropriate on proposed substantive changes and have the power to veto changes as necessary.

We also proposed imposing a similar requirement on water undertakers, through new condition S (see section 3.4).

²⁷ In the February 2004 consultation this condition was proposed under the title 'Condition 6: The registration and transfer protocol'.

We asked whether you thought this condition went far enough to ensure the smooth transfer of eligible customers.

Respondents' views

Most respondents commented that this standard condition is adequate providing it is aligned with water undertakers' condition S. Other comments included the following.

- Potential licensees agreed that this standard condition is adequate to support customer transfer.
- Two water undertakers commented there should be a condition on Ofwat to ensure that it takes timely action to enforce the use of the customer transfer protocol and amend where necessary. One added that Ofwat should be involved in dispute resolution.
- One water undertaker commented that the standard condition is sufficient to ensure the smooth transfer of eligible customers. The respondent also added that a relatively simple process will be sufficient and Ofwat should avoid creating unnecessary complexity.

We asked what issues you thought needed to be set out in this condition regarding the transfer of customers.

Respondents' views

We received a number of suggestions in addition to the responses to the proposed conditions mentioned in section 3.

- A potential licensee suggested that the provision of information should be in a timely manner and a standard format.
- A potential licensee suggested introducing financial penalties for water undertakers if the transfer of customers takes in excess of 28 days from receipt of written confirmation.
- One water undertaker commented there is no valid case for a costly central administration system.
- A stakeholder included detailed comments for the customer transfer protocol, eg to provide for an audit trail from request to transfer a customer to the customer transfer process itself.

Our conclusions

We will ensure that standard condition 6 and condition of appointment S are consistent. Both conditions will require compliance with the customer transfer protocol. This implies also having in place arrangements which enable the licensee (and undertaker) to comply with the provisions. Ofwat will notify each licensee of the latest version of the customer transfer protocol when its licence comes into force.

We agree that since the protocol will go into detail, there is no need to do so in this condition. This provides a more flexible process, which allows the customer transfer protocol to be amended if necessary, instead of consulting on an amendment to the standard licence condition.

We propose only that level of detail which we prescribe in a standard condition and that in the customer transfer protocol. This will ensure we do not place an

unnecessary burden on licensees whilst ensuring that the key areas are covered in the condition. The draft customer transfer protocol is available in our consultation on licensing and eligibility²⁸.

Additional issues considered

The draft condition includes a provision allowing a licensee or water undertaker to block a customer transfer. The reasons that a customer transfer might want to be blocked are explained in the draft customer transfer protocol, and are listed below.

- Debt blocking – The old supplier may object to a transfer if debt has been outstanding for more than 30 days at the time of the proposed transfer. To allow the transfer to continue we propose in the customer transfer protocol that either the customer pays the debt prior to transfer or an agreement could be made to allow it to be assigned to the new supplier (in effect the old supplier is paid by the new supplier). In these circumstances the new supplier would need to agree such arrangements with both the customer and old supplier.
- Co-operative objection – The new supplier acknowledges that it has submitted a request to register change of supplier in error and the old supplier then agrees to raise an objection to prevent the transfer proceeding. These have been put to good effect within the gas and electricity industries and reduce the occurrence of erroneous transfers.
- Customer requested objection – The customer at the premises has advised the old supplier that they have not entered into a contract with the new supplier, which means that a change of supplier should not occur.
- Valid supply contract – The customer is being supplied by the old supplier under a contract that will neither expire nor be terminated on or before the proposed transfer date.

The advantage of dealing with transfer blocking in the customer transfer protocol is that it allows for easier changes to the reasons for objection than if they are covered in a standard condition. For this reason, we are not proposing to cover all the reasons for objection detailed above in this standard condition.

However, we believe that debt blocking is so important to the success of the regime that it merits being in a standard condition. Debt blocking provisions prevent customers moving suppliers to avoid paying a debt and causing difficulties to a creditor supplier.

Q10: Do you agree that debt blocking should be included in this licence condition?

We considered extending the powers that Ofwat has over the customer transfer protocol. We proposed that Ofwat should have the right to veto amendments. In the light of the comments above, Ofwat will also have the power to propose amendments and resolve disputes about amendments proposed by licensees and undertakers (but not Ofwat) where there is disagreement about how to proceed. We

²⁸ See section 5 of 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

want to make sure that the regime does not falter because of the lack of a means by which impasses can be cleared. We also propose that the customer transfer protocol will set out the disagreements that Ofwat will have the power to resolve. All licensees and all water undertakers will be involved in adopting amendments. This is reflected in the text of the draft condition.

Q11: Do you think that this achieves the right balance between ensuring the system works and allowing the industry to retain ownership of the protocol?

STANDARD LICENCE CONDITION 7: AREA OF OPERATION & ARM'S LENGTH TRANSACTIONS²⁹

Policy overview

In our February 2004 paper we proposed this condition to make it clear that the licensee will be excluded from operating in the area of appointment of any water undertaker with which it is related. The condition includes an obligation on the licensee to notify Ofwat of any change of ownership or control that could affect this exclusion.

We invited you to comment on whether you agree that this should be drafted as a standard condition rather than as an individual condition.

Respondents' views

We received mixed responses to this question.

- Potential licensees commented that this should be a standard condition and one commented that it should only apply where a water undertaker, its parent or an associate has control of the licence.
- One potential licensee added that it should be a standard condition because a new entrant may be acquired by an existing undertaker.
- Two water undertakers commented that it should be a standard condition, one of whom gives the reason that it is important to see how Ofwat intends to deal with changes in an area of appointment that creates an overlap in licensee and related undertaker's areas.
- However, several water undertakers commented that it should not be a standard condition and one water undertaker considers the Competition Commission has a role to play if the areas of operation change.
- A water undertaker and another stakeholder both commented that the associated company should be defined in standard condition A.

We also received the following additional comments.

- One potential licensee commented that they are not comfortable with the requirements that exclude licensees operating in their associated undertaker's area, as this will stifle innovation from the undertaker to retain customers and

²⁹ In the February 2004 consultation this condition was proposed under the title 'Condition 7: Area of operation'.

gives incumbents a reason to resist disaggregating and making costs transparent.

- Another stakeholder agreed that licensees should be excluded from operating in the area of appointment of any undertaker with which it is associated.
- Two water undertakers believed that water undertakers should not be prevented from setting up subsidiary companies that are allowed to compete in their area because Ofwat has the powers to prevent the incumbent undertaker using cross-subsidies. The proposed condition would prevent a licensee associated to a water undertaker from concluding a national deal to supply a customer's sites all over the country if just one of the branches was in the associated water undertaker's area.

Our conclusions

Under section 2 WIA91, the Secretary of State, the Assembly and Ofwat have an obligation to act in a manner best calculated to ensure that customers of water undertakers are protected. Sections 2(3)(d)(i) and (iii) create an obligation to ensure that a licensee does not carry on any activities in the area of its related water undertaker and that any transactions are carried out at arm's length. We do this via licence (and appointment) conditions.

The relevant question is therefore whether this condition should be standard; not whether the policy set out in the WIA91 is correct.

Our view is that it should be a standard condition for all licensees, otherwise in each individual case it would need to be done by specific reference to the area of appointment, and would need to be changed every time that area changed. A standard condition is much simpler, and also provides for changes of ownership where a licensee becomes associated to a water undertaker after its licence has been issued. The draft condition provides for any changes in area of appointment that may arise where this results in a conflict with an associate licensee's relevant activities.

We set out at the end of this section how we intend to approach the definition of 'relevant activities' and 'related companies'.

Additional issues considered

The Government proposed³⁰ that related licensees should not enjoy unfair commercial advantage over other licensees by virtue of their association with their water undertaker. It proposed that:

- If a related licensee uses water produced by its related water undertaker to supply premises, an arm's length transaction for the wholesale supply must take place. For these purposes assets owned by a water undertaker that are located outside the appointed area but which are used for the purposes of carrying out the water undertaker's functions would be deemed 'in area'. This should ensure that there is no opportunity for cross-subsidy between the water undertaker and its associated company.

³⁰ 'Extending opportunities for competition in the water industry in England and Wales', July 2002, paragraph 155.

- It will not be allowed to develop a new source of water within its water undertaker's appointed area for the purpose of its licensed activities.
- It will not be allowed to sell water to that water undertaker.
- It will not be allowed to purchase water supply assets from that water undertaker that are deemed redundant for the purposes of the appointed business.

The condition has been drafted to reflect the first three of these objectives, while the fourth is addressed in appointment condition R. The deeming of 'in-area' is defined by the relationship between the water undertaker and the licensee.

We have specified in respect of the third bullet point above that a licensee may sell water to a related water undertaker, only if it has Ofwat's consent so to do. Similar provisions are set out in appointment condition R in respect of the fourth bullet point above. In some situations we believe it may be sensible to allow such transactions. For example, if a combined licensee becomes a retail licensee it may have a water source which is superfluous to its needs. Similarly, if a related water undertaker takes over another water undertaker, in whose area the licensee is operating, then the licensee becomes unable to operate as a licensee in that area. If it has a water source, then that water becomes an asset that cannot be used by the licensee to supply customers in that area, but may be used by the water undertaker. In both examples, it may be sensible to allow that licensee to sell the water to its associated water undertaker, if Ofwat consents.

This standard condition permits other transactions between a licensee and a water undertaker but only at arm's length.

We considered what would happen to existing customers if ownership of a licensee were to change such that it becomes related to a water undertaker, or if a water undertaker's area changes to include a related licensee's customers. In these cases, the licensee becomes unable to carry on supplying its customers. We believe that the best solution is for licensees' contracts with their customers to allow for termination in the case of the licensee not being able to supply in the customer's area due to changes of ownership that means it is now related to the relevant water undertaker. Those customers should be free to switch suppliers to another licensee or the water undertaker. This is not something we believe is appropriate to put in a licence condition, but is something of which licensees and their customers should be aware when agreeing supply contracts.

Q12: Do you agree that it is not appropriate to include this issue in a licence condition?

Relevant activities and related companies

The standard licence condition prohibits a licensee from engaging in 'relevant activities' in the geographical area of a related undertaker. Relevant activities are defined as:

- activities authorised by the licensee's licence (ie use of or introductions into supply system of an undertaker for the purpose of supplying premises of customers); and

- the development of a new source of water for activities authorised by the licensee's licence.

This definition therefore does not preclude the licensee from carrying out other activities in a related undertaker's area, such as the operation of a call centre.

It includes a definition of 'related' companies, which is reflected in appointment condition R. The definition of a 'related company' in appointment condition A is for different purposes.

Our definition of a 'related company' is based on the merger provisions in the Enterprise Act 2002 (ie common ownership or control under section 26 of that Act). At one end of the scale, the businesses of licensees and water undertakers will be related if they are in a group where the subsidiaries are all at least 51% owned by the parent company. At the other end of the scale, the businesses of licensees and water undertakers will be related where one company is able to exercise material influence over the policy of another, which may be at a much lower level of share ownership. There are various stages in between where two companies will be under common ownership or control. The relevant provisions in the Enterprise Act 2002 are modelled on the earlier UK merger regime under the Fair Trading Act 1973. There is a well-understood precedent which has been developed by the Office of Fair Trading and the Competition Commission over the years on the meaning of these provisions. We think that this is a sensible approach because if a licensee and a water undertaker were to merge, they would need to consider the application of these provisions of UK merger law. At the same time, this analysis can be used to assess whether there might be a breach of this standard licence condition.

Q13: Do you agree with our approach to 'relevant activities' and 'related companies'? If not, please explain why and what alternative you would propose.

STANDARD CONDITION 8: PROVISION OF INFORMATION TO OFWAT³¹

Policy overview

Ofwat need to be able to collect information from licensees in order to be able to fulfil its functions. We proposed that this condition would oblige licensees to provide Ofwat with such information and reports as Ofwat may reasonably require in order to fulfil its functions under the WIA91. It is similar to condition M of water undertakers' appointments.

Respondents' views

Only WaterVoice responded to this condition and commented that there should be a provision (either as a separate condition or by amending this licence condition) requiring licensees to provide information to the CCW.

³¹ In the February 2004 consultation this condition was proposed under the title 'Condition 4: Provision of information to Ofwat'.

Our conclusions

Sections 27H and 27K WIA91 (provision of information to the Council) allow for the provision of information to the CCW. They give the CCW the power to require information it needs from licensees to carry out its functions. We believe these provisions are sufficient and that there is no need to replicate them in a standard licence condition.

Additional issues

In our February 2004 paper we proposed that Ofwat should have powers by licence conditions to require the provision of information in order to exercise its functions under section 27 WIA91 and to carry out enforcement action (section 203 WIA91).

We also proposed that this condition should require licensees, if requested to do so by Ofwat, to give reasoned comments on the accuracy and text of any information or advice relating to its activities as a licensee which Ofwat proposes to publish under section 201 WIA91.

After further consideration, we believe that we should aim for light touch regulation where possible and therefore we have decided not to include these provisions.

STANDARD CONDITION 9: LICENCE FEES³²

Policy overview

Section 17G WIA91 allows for payment of a licence fee on the grant of a Water Supply Licence, and/or payments while such a licence is in force.

In our February 2004 paper we proposed that once a Water Supply Licence is granted, the licensee should pay an annual licence fee to the Secretary of State. We said the level of the fee would not be determined in the licence condition, although the formula for calculating it would be.

We proposed that fees would be set at a level to recover Ofwat's, the CCW's and the Competition Commission's costs in regulating or in relation to the competitive market. Ofwat will collect the fees on behalf of the Secretary of State.

Respondents' views

We received several responses to this condition and the main comments are listed below.

- Two water undertakers commented that it is unclear in this condition how the additional operating costs of the Environment Agency and the DWI will be recovered.
- Another stakeholder supported annual payments to Ofwat and for the payments to cover the additional costs of Ofwat and the CCW in administering the new regime.
- One water undertaker suggested that Ofwat, the Competition Commission and CCW should have sound financial monitoring in place to ensure that the licence

³² In the February 2004 consultation this condition was proposed under the title 'Condition 1: Payments to Ofwat'.

fees charged properly reflect regulatory resources consumed and only pass on costs that are demonstrably reasonable at audit, with wording to that effect included in the condition.

Our conclusions

DWI and Environment Agency costs are not recovered from water undertakers' fees and we do not propose that licensees should contribute to DWI's or the Environment Agency's costs through licence fees. We understand the reason for comments on the level of audit required. Ofwat and CCW are independently audited by internal auditors and are also subject to audit by the National Audit Office and to scrutiny by Parliament. We believe this level of oversight is sufficient and therefore there is no need to provide further for it in the text of the condition.

As a point of clarity, the proposed condition does not contain a mathematical formula as to how fees will be distributed between licensees, but describes the elements that will make up total costs to be recovered through fees.

Additional issues considered

The standard condition has been aligned with water undertakers' condition of appointment N in that payment will be required within 30 days of the notice given by Ofwat of the amount payable to the licensee. Ofwat will aim for a payment date of 1 April each year for existing licensees' renewal fees.

The fees will be set at a level to recover Ofwat's, the CCW's and the Competition Commission's costs in regulating or in relation to licensed water suppliers in a given year. We propose that all licensees should pay a proportion of Ofwat's and CCW's costs for regulating or in relation to licensed water suppliers in the coming year. The Competition Commission's costs of dealing with references are not estimates but real costs for the previous year. These will be allocated to individual licensees where the Competition Commission has considered a proposed modification for its particular licence or for a standard condition which applies to it.

Individual licensee's fees will be quantified in accordance with principles specified by Ofwat. These principles will be set out in writing and given to each licensee, and will be subject to review by Ofwat from time to time. The principles will state the fee for a licensee's first year will be in proportion to how long it has held its licence in that year. They will also specify how any overpayment or underpayment (due to final costs being lower or higher than estimated in previous years) will be distributed between licensees with an active licence in that year. The calculation and distribution of over and under-payments will also take into account any new licences that are issued during a given year, and the proportionate contribution they will be expected to make to the regulatory costs.

The approach outlined above would separate Ofwat's and CCW's WSL costs from their other costs for competition, regulatory (in the case of Ofwat) and other matters, and Ofwat would recover those costs solely from licensees on a proportionate basis. This approach is consistent with the principle that in general ineligible customers should not bear the costs of regulating the new regime. Because there may be suppliers who hold a licence but do not yet have customers to supply, a weighting mechanism based for instance solely on each licensee's turnover would mean that

some licensees would not be charged even though they may lead Ofwat and the CCW to incur costs. We will therefore need to operate a mixed approach, perhaps using a fixed fee for every licensee for certain basic matters and a variable fee based on turnover for additional matters. The principles specified by Ofwat will set out the final approach.

Q14: Based on this approach, what do you think is the most appropriate and balanced way of recovering costs from licensees?

We have considered an alternative approach to recovering Ofwat's and CCW's costs from licensees, using the same mechanism as Ofwat uses at the moment to recover costs from water undertakers. This alternative method would include licensees and the costs of the WSL in the same calculation that exists now, so that WSL costs are not separated from the other costs incurred by Ofwat or CCW.

Using this approach, each water company (water undertaker or licensee) would pay a proportion of the total cost incurred, weighted by their turnover (or in the case of licensees without customers, a basic fixed fee only). Depending on the number of licensees active in the competitive market and how much of Ofwat's WSL costs are fixed, it may impose less of a financial burden on water supply licensees, and therefore avoid a possible disincentive to licensees entering the market. As explained above, individual licensee's fees will be quantified in accordance with principles specified by Ofwat.

Q15: What do you think of this alternative approach to recovering costs from licensees?

STANDARD CONDITIONS 10, 11 AND 12: REVOCATION³³

Policy overview

In our February 2004 paper we explained that each Water Supply Licences would contain a standard condition describing the circumstances in which they may be revoked. We considered two options and invited views on whether revocation should be dealt with as a standard condition under section 17G(1)(a) WIA91, or as a standard licence condition under section 17H. The main difference between these two options is the procedure for modification.

All Water Supply Licences may be terminated after the expiry of a notice period of at least 25 years; this notice period is consistent with that of most incumbent water undertakers and reflects the approach generally taken in water undertakers' condition of appointment O. Provision for termination is contained in the licences themselves (see annex B). However, there may be circumstances where, for regulatory or enforcement purposes, the 25-year notice period would be too long. Therefore, provisions will specify other circumstances where revocation may take place over a much shorter period. Normally, the notice period will not be less than 30 days.

³³ In the February 2004 consultation this condition was proposed in section 4.4 under the title 'Conditions of the Water Supply Licence – Revocation'.

We proposed circumstances in which Ofwat would be able to revoke a Water Supply Licence following the shorter notice period, including:

- a request to do so by the licensee;
- false or misleading statements made by the licensee to Ofwat or DWI;
- failure by the licensee to pay all or any part of the licence fee;
- failure by the licensee to comply with either a final or provisional enforcement order;
- failure by the licensee to pay any financial penalty by the date for payment;
- if the licensee has not started to supply water to premises within three years of the coming into force of the Water Supply Licence or, having supplied premises, has not done so for a period of three consecutive years. This may offer some protection to restrict the influence licensee may have over the modification of standard licence conditions if they themselves are not active in the market;
- if the licensee has debts that it cannot pay, has a receiver appointed in respect of all or a material part of its assets; has an administration order made against it; passes a resolution for winding-up (other than one previously agreed in writing by Ofwat); or becomes the subject of a winding-up order by the High Court; and
- if the licensee is in breach of standard condition 7 (area of operation).

In each case, revocation would only take place if, in appropriate circumstances, there had been an orderly exit from the market.

We asked whether revocation issues should be dealt with as a condition which would be subject to modification by agreement (section 17I WIA91) or as a standard condition which would be subject to collective modification (section 17J WIA91). Section 17K WIA91 applies to both types of condition.

Respondents' views

The majority of respondents supported a standard licence condition.

- Potential licensees, water undertakers and other stakeholders agreed it should be a standard licence condition. One water undertaker said that it would allow greater consistency in the agreements a water undertaker has with a licensee. Another water undertaker said that a standard licence condition allows Water Supply Licences to be changed more easily if appropriate, and will help ensure consistency between licensees.
- Four water undertakers preferred the non-standard option because they believed revocation provisions should only be changed with the agreement of the individual licence holder or by reference to the Competition Commission.

We invited views on the proposed reasons for revocation to be set out in the Water Supply Licence.

Respondents' views

Most respondents supported the proposed reasons for revocation and we received the following suggestions.

- Potential licensees commented that they are happy with the proposed reasons for revocation, providing they are given time to remedy any defects in the event of default.
- One licensee added that there should also be an appeals process.
- One water undertaker suggested that persistent incidence of minor failure (not being sufficient to revoke individually) should be included as it is an example of management failure.
- Several water undertakers suggested that persistent breach of licence conditions, access agreements and/or other legislative provisions should be grounds for revocation.
- Three water undertakers suggested that licensees should not have their licence revoked until they have been inactive for five years.
- A stakeholder did not agree that a licence should be revoked if there was a legitimate dispute over the size of the penalty or whether it was justified, and felt that we should consider whether revocation should also cover making false or misleading statements to the Environment Agency or any other regulatory bodies, or even the CCW.

Our conclusions

We believe some respondents have misinterpreted the implications of revocation being a condition in standard form under section 17G(1)(a) or a standard licence condition under section 17H. We have clarified the implications of including revocation as a standard licence condition in this consultation paper and ask for further comments.

The main difference between these two options is that where the condition is not a standard licence condition, Ofwat will only be able to modify it with the agreement of the individual licence holder under section 17I WIA91 or by reference to the Competition Commission under section 17K WIA91.

However, if it is a standard licence condition, modifications may also take place where no licence holder objects to the modification, or where less than a prescribed percentage of the licence holders object measured by number of licence holders and by market share. These percentages will be specified in an order³⁴.

The condition has been drafted as a standard licence condition.

Q16: Should revocation issues be dealt with as an individual condition subject to modification by agreement or reference to the Competition Commission, or as a standard licence condition subject additionally to collective modification by vote?

On the issue of an appeal mechanism, standard licence condition 11(3) allows the Secretary of State and Ofwat to vary or withdraw a notice of revocation. In addition, other than in exceptional cases, there will be a minimum of 30 days' notice given to licensees before the notice of revocation will take effect. Ofwat expects to consult

³⁴ This is explained in more detail in section 7 of 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

with licensees before sending out a notice of revocation. In appropriate cases, this might give licensees time to remedy any defect. Generally, Ofwat or the Secretary of State approach licence revocation as an enforcement mechanism of last resort.

In addition, this standard licence condition builds in further protection for licensees in the following specific provisions.

- In cases of breaches of licence conditions or statutory obligations which can be remedied, revocation would generally only be used following enforcement action where the licensee has failed to comply with a statutory undertaking under section 19 WIA91 or a provisional or final enforcement order under section 18 WIA91. In relation to orders, revocation cannot take place if there is a challenge to the validity of the enforcement order.³⁵ However, some breaches of licence conditions or statutory obligations may be sufficiently serious as to merit revocation without enforcement action.
- The financial penalty provisions of WIA91 also provide for appeals to the courts, and a penalty would not be payable while this takes place. If an appeal were taking place in relation to financial penalties, the grounds for revocation would not be met. In addition, a further three months has been built in to the licence condition for payment to be made.³⁶
- An additional 30 days has also been built in to the licence condition for payment of licence fees to be made before the possibility arises.³⁷
- We have also added a provision for revocation if there are breaches of orders of the court in competition matters under the Competition Act 1998 and Enterprise Act 2002.³⁸ However, this will only be after the lengthy procedures under those Acts have been complied with.

Persistent or minor breaches which actually or potentially jeopardise the proper performance of a water undertaker's functions will be a breach of standard licence condition 2. Revocation will also be possible for breaches of other licence conditions as well as statutory obligations. We have additionally added a provision which reflects the special administration provisions in sections 23-26 WIA91, ie a licensee will be subject to revocation if it causes or contributes to a breach of a water undertaker's duties under section 37 WIA91. In all these cases, the breach will have to be sufficiently serious to justify revocation.³⁹

We believe the proposed period of inactivity of three years is appropriate and does not need to be extended to five years.⁴⁰ In most cases, three years of inactivity would mean that the licensee is not active in the market. However, there might be circumstances where the licensee might be active even if it has had no customer for three years, eg a combined licensee building treatment works. It is important to stress that revocation is not automatic and Ofwat would explore the circumstances of each case before giving notice of revocation.

³⁵ Standard licence condition 10(2)(e)

³⁶ Standard licence condition 10(2)(g).

³⁷ Standard licence condition 10(2)(f).

³⁸ Standard licence condition 10(2)(h).

³⁹ Standard licence condition 10(2)(c) and (d).

⁴⁰ Standard licence condition 10(2)(i).

We believe that there is no justification for applying revocation to the making of false statements to the Environment Agency or the CCW. False statements to Ofwat or DWI directly affect regulation of supply and impact directly on the operation of supply systems and customers. The Environment Agency has its own system for dealing with false statements made about abstraction licences. However, we have extended this provision to allow revocation where information supplied to water undertakers is false or misleading in a material particular. Operational matters will require the supply of accurate information to water undertakers to protect the integrity of supply systems. This provision should provide the necessary incentives for this.⁴¹

The provisions for revocation when a licensee is in financial difficulties⁴² are based on the approach to special administration in sections 23-26 WIA91 and for other utilities. We have included recent amendments to the Insolvency Act 1986 made by the Enterprise Act 2002 in respect to 'ordinary' administration procedures. If the company is in financial difficulties, revocation will not be automatic where Ofwat has agreed to measures adopted to try and save the licensee as a going concern. It should be noted that revocation on the grounds that a licensee 'is or is likely to be unable to pay its debts within the meaning of section 123 Insolvency Act 1986'⁴³ is a relatively low threshold. The current level of debt specified in that provision is £750. This is consistent with the approach taken in section 24 WIA91.

Other matters, including revocation by consent⁴⁴ and ensuring that designated strategic supplies are properly handled,⁴⁵ have been dealt with as we proposed in the February 2004 consultation paper.

STANDARD CONDITION 13: PROHIBITION ON INTRODUCTION – COMBINED LICENCES

Policy overview

Following responses to standard condition 2 (conduct of a licensee), standard condition 3 (certificate of adequacy) and discussions in Ofwat's advisory groups, we are proposing a new standard condition that prevents a licensee from introducing treated water into the potable supply systems until the new source and treatment works have been audited by DWI.

This standard condition will only apply to combined licensees. We consider that this standard condition is important, to allow DWI to ensure that the combined licensee is meeting all the regulatory requirements in respect of drinking water quality.

STANDARD CONDITION 14: SPECIAL ADMINISTRATION – COMBINED LICENCES⁴⁶

⁴¹ Standard licence condition 10(2)(b).

⁴² Standard licence condition 10(2)(j) to (q).

⁴³ Standard licence condition 10(2)(j).

⁴⁴ Standard licence condition 10(2)(a).

⁴⁵ Standard licence condition 12 which ensures that a revocation notice cannot be served or has no effect if a licensee holds designated strategic supplies until the special administration procedures have been completed. This condition works whether the designation is made before or after the notice of revocation has been served.

⁴⁶ In the February 2004 consultation this condition was proposed under the title 'Condition 8: Special administration and security of supply'.

Policy overview

Strategic supplies are an introduction of water by a combined licensee without which there would be a substantial risk that the water undertaker would not be able to maintain supplies to its own customers and supply the licensee's customers with water for domestic purposes. The WIA91 provides for Ofwat to designate a licensee's introduction as a strategic supply. Where an introduction has been designated as a strategic supply, the licensee becomes subject to special administration procedures in the case of insolvency rather than normal winding up procedures.

In our February 2004 paper we proposed this standard condition in order to enhance the strategic supply and special administration provisions in legislation. We said that it would only apply to combined licensees whose introduction of water had been designated strategic by Ofwat. We would require those licensees to maintain sufficient rights and assets as are necessary to ensure that the supply continues, thus ensuring that if the licensee failed, the special administrator would be able to continue introducing the licensee's water into the water undertaker's supply system.

We asked whether you thought this condition went far enough to enhance the strategic supply/special administration protections provided for in legislation.

Respondents' views

All respondents supported this standard condition, but we received mixed responses over its content.

- Potential licensees and water undertakers welcomed this condition to allow designation of strategic supplies.
- One potential licensee suggested that it should be consulted on the designation and their agreement should be sought. The designation should have a bearing on any access terms because if the licensee's supply is considered to be strategic by the water undertaker then it clearly must be of value to them and should therefore be given economic consideration in the financial access terms.
- One potential licensee suggested that in the event that a licensee failed, its strategic supplies should immediately be offered into the market via an auction. While the auction takes place the water undertaker should be directed to operate the supply and the eventual purchaser recompense the water undertaker for their costs through the interim period.
- Water undertakers asked what would happen in cases of insolvency where supplies are not strategic. The assumption is that the water undertaker would take the customer back. To the extent that water undertakers must retain back-up capacity to allow for this to happen, the costs of doing so should be borne by those eligible for competition not ordinary customers.
- Another stakeholder commented that licensees with strategic supplies should be subject to an asset-ring-fencing condition along the lines of that contained in water undertakers' condition of appointment K.
- WaterVoice commented that customers must be protected from any risk to their water supplies.

Our conclusions

We have drafted this condition in line with the policy proposed in the February 2004 paper and appointment condition K.

The proposed standard licence condition complements the provisions in WIA91 that allow for designation of introductions as strategic supplies. The licensees' involvement in this process is defined in WIA91 and in Ofwat's paper on strategic supplies.⁴⁷ However, matters relating to the operation and disposal of the assets used to make strategic supplies under special administration are for the special administrator.

We note water undertakers' concerns about how they will administer back-up capacity for situations where customers wish to return to them for their water supplies. Issues raised about how the access price would reflect the value of designated strategic supplies and the cost of back-up capacity are the matter for the water undertakers in setting access prices, in accordance with Ofwat's access code guidance, and not a matter for this standard condition⁴⁸. It is for water undertakers to decide how much capacity they need, taking account of all relevant factors. A licensee's customers considering switching back to the water undertaker will be treated like any other customer requesting a supply from the water undertaker. This means that no customer that asks for a supply for non-domestic purposes from a water undertaker is guaranteed a supply, as the duty to provide new customers for non-domestic purposes is not absolute. There is, however, an absolute duty on the incumbent water undertaker to supply water for domestic purposes. Therefore, supplies for domestic purposes will be protected from risk to their water supplies through the combination of this condition, the WIA91 and Ofwat's guidance on strategic supplies.

Additional issues – charges

The draft standard condition does not include an express provision stating that combined licensees will be deemed to have disposed of an asset if a creditor has a fixed charge over that asset or a floating charge over that asset which automatically becomes due and payable should the licensee go into special administration. However, this is the effect of this standard licence condition as currently drafted. The creditor outside the insolvency procedures can dispose of assets subject to a fixed charge or a floating charge that has become due for repayment. This would not ensure that a special administrator had sufficient assets to achieve the purposes of a special administration order, and would therefore mean that the licensee was in breach of this condition. If, even before a strategic supply designation is made, a combined licensee agrees to secure a debt by way of charge over an asset, this standard licence condition requires the terms of that loan agreement to take this standard condition into account. This will restrict the type of security which creditor of a combined licensee can obtain.

Additional issues – securing compliance with group companies

In our February 2004 paper we set out how, in respect of group companies, certain water undertakers are responsible for securing undertakings from their parent

⁴⁷ See 'Water Act 2003: Water Supply Licensing. Consultation on eligibility, licensing, customer transfer protocol and strategic supplies' (29 October 2004).

⁴⁸ See 'Water Act 2003: Water Supply Licensing. Access code guidance' consultation paper October 2004.

companies to the effect that activity by an associate company should not cause the water undertaker to breach its appointment or obligations under relevant legislation (see condition P in section 3.3 above).

We proposed that a standard licence condition which stipulated that a licensee must not cause the water undertaker to be in breach of its conditions or of relevant legislation was not necessary, as we already have a right of enforcement under primary legislation.

We asked whether you believed that it is necessary to place a condition on licensees which is similar to condition P. We also asked whether you believed that such a condition should be imposed on a licensee where it has an associated water undertaker which does not have condition P.

Respondents' views

Stakeholders had different views on the first question, and we received few responses to the second question. Some of the responses were the same for both questions.

- Three potential licensees did not think this standard licence condition was necessary; one said it generates unnecessary duplication, another said that it might be useful, while a third said separation and disaggregation of costs would increase transparency and makes the condition unnecessary.
- Water undertakers commented that licensees should have a similar condition to condition P for consistency, clarity and to ensure that, where a licensee belongs to a group, it can abide by its obligations to ensure that strategic supplies remain available.
- A stakeholder supported a standard condition similar to condition P to assist compliance with statutory and regulatory requirements.
- WaterVoice said that it was unnecessary to duplicate existing enforcement action powers in a licence condition, although it might be easier to use a specific licence condition than rely on references to primary legislation. However, it also said that if condition P is imposed on all water undertakers, then it should also be extended to licensees for consistency.

Our conclusions

We have considered respondents' views carefully. We do not believe that a general standard licence condition similar to condition P is necessary. However, on further reflection, we do believe that the mechanism of requiring a combined licensee to secure an undertaking from its ultimate parent company is necessary in the context of special administration and ensuring that a combined licensee retains sufficient rights and assets to support the special administration regime.

Therefore, we consider that, if the ultimate parent company of a combined licensee is not a water or sewerage undertaker, then it should give legally binding undertakings to the licensee to support the special administration regime and this standard licence condition. This is to ensure that if a licensee was to breach this condition due to action by its parent (or other members of its corporate group) which was outside its control, the licensee could, nevertheless, ensure that relevant assets which relate to introductions which have been designated as strategic supplies would

be returned to the licensee. In turn, this would ensure that the purpose of the special administration order could still be achieved.

If a licensee's ultimate parent company is a water or sewerage undertaker, then we can use section 18(1A)(a) to enforce against the undertaker to ensure it supports the special administration regime. We believe there is no need to duplicate this power in a licence condition, and our approach avoids the work involved in securing undertakings in cases where the ultimate parent company is an undertaker.

Q17: Do you agree with the draft condition that we use the appointment condition P-type mechanism to ensure that the special administration regime is supported?

Q18: Do you agree that we only need to restrict this mechanism to situations where the ultimate parent company of a licensee is not a water undertaker? The alternative would be for licensee to secure undertakings from its ultimate parent company irrespective of whether it was an undertaker.

4.4 Other issues

INFORMATION TO CUSTOMERS – CODE OF PRACTICE

Policy overview

In our February 2004 paper we considered including a standard licence condition that required licensees to provide customers with certain information in a code of practice.

Water undertakers do not have a similar obligation to provide non-domestic customers with a code of practice. We do not want licensees to be subject to tougher requirements than water undertakers, so we do not think it appropriate to compel licensees to submit one. We proposed that potential licensees could negotiate appropriate information provisions as part of their contract.

We asked whether you thought there were any reasons why a condition of this type might be necessary, and how any concerns could be dealt with in a standard condition.

Respondents' views

We received a mixed response to this issue.

- A potential licensee did not think a code of practice is necessary at the moment because of the size of the market.
- Water undertakers expressed mixed views. One commented that it should be a standard condition because it will benefit the customer. Another commented that the code of practice is not needed. One said that a standard licence condition equivalent to condition of appointment H (Code of Practice and procedure on disconnection) might be beneficial, as there will be circumstances where a domestic property will change supplier.

- WaterVoice suggested that licensees might consider adopting a similar policy to the Business Customer Charter operated by water undertakers. WaterVoice also suggested that Ofwat's guidance on access agreements needs to be clear on what should be covered in the contract between licensees and customers so that the customer is clear about what service will be delivered by the licensee and who to contact if there is a query or a problem.

Our conclusions

After considering responses, we still believe that a standard condition on a code of practice is not necessary, given the size of the market at the moment and the fact that water undertakers do not have a similar obligation for business customers. Licensees and customers will agree required levels of service in their contract. Ofwat's access code guidance⁴⁹ covers terms and conditions of access agreements between licensees and water undertakers, and therefore does not cover levels of service between a licensee and its customers, which is left to the private contract.

We do not believe that it is appropriate to include a standard licence condition which reflects appointment condition H. The issues for customers of licensees will be different to those for customers of water undertakers, and we expect that licensees' customers will be able to negotiate terms which suit their commercial needs.

OBLIGATION TO FOLLOW GUIDANCE ON CONTRACT TERMS

Policy overview

In our February 2004 paper we considered the option of including a standard licence condition to ensure that certain basic provisions were included in licensees' supply contracts with customers. These would include, for example, ensuring that licensees did not enter into a contract for the retail of water to any premises unless it provided for termination within a certain time period.

However, given that customers at eligible premises will be large users, we expect that they should be able to negotiate appropriate contractual terms with the licensee without reference to a standard licence condition.

We asked whether you thought there were any reasons why a condition of this type might be necessary, and how any concerns could be dealt with in a standard condition.

Respondents' views

We received a mixed response to this question.

- A potential licensee commented that this type of arrangement is not necessary given the commercial nature of arrangements.
- WaterVoice commented that a standard condition is not necessary because these details can be negotiated during discussions over the contractual terms between the licensee and the customer. It believed that if any information is to be provided on the basic provisions for inclusion in licensees' supply contracts

⁴⁹ 'Water Act 2003: Water Supply Licensing. Access code guidance' consultation paper October 2004

with customers, this should be covered in guidance issued by Ofwat. This might help set a level playing field.

- Several water undertakers commented that this should be a standard condition. In particular, one water undertaker believed it would be better to include a standard condition with minimal requirements that can be expanded as appropriate if the eligibility threshold were reduced. Two water undertakers and a stakeholder believed that a standard condition is needed in order to ensure that contracts included a standard term requiring that a licensee's customer inform it of any change in circumstances which could affect its eligibility. They argued that this would reduce the need for challenge about eligibility in contractual negotiations.

Our conclusions

We have considered responses on the need for a standard condition to ensure that licensees' customers provide them with information in respect of any changes that might affect their eligibility, so that licensees can comply with their legislative obligations. However, we do not believe this is needed, because it is already in licensee's interests to ensure it does not supply an ineligible customer. To do so would be a strict liability criminal offence⁵⁰ under the WIA91, with no statutory defences. For the same reasons, we do not think it is necessary or appropriate for Ofwat to issue guidance on terms for contracts between licensees and their customers.

COMPLYING WITH ARRANGEMENTS IN WATER UNDERTAKERS' DROUGHT OR WATER RESOURCE PLANS

Policy overview

In our February 2004 paper we considered including a standard licence condition to require licensees to comply with arrangements or undertakings set out in water undertakers' drought or water resources management plans. **We did not consider that such a condition was necessary, and invited your views on this.**

Based on the responses received and on further reflection, we have decided that a condition that deals with drought plans would be appropriate. This policy is now reflected in standard licence condition 4 (see section 4.3 above). Text under standard licence condition 4 also addresses why we consider a standard licence condition dealing with water resources management plans is not necessary.

SECURING COMPLIANCE IN GROUP COMPANIES

Policy overview

In our February 2004 paper we raised the issue of some water undertakers having an appointment condition P that requires them to secure undertakings from their parent companies to the effect that activity by an associated company should not cause the water undertaker to breach its appointment or its obligations.

⁵⁰ The offences would be using an undertaker's supply system or introducing water into an undertaker's supply system other than in pursuance of its licence. See sections 66I and 66J WIA91.

We did not consider that a similar condition was necessary for licensees, and invited your views on this.

Based on the responses received and on further reflection, we have decided that such a standard condition would be appropriate for licensees. This is now addressed in standard licence condition 14 (see section 4.3 above).

5. Draft new appointment and standard licence conditions

This section sets out the draft legal text of the conditions. Proposed new conditions of appointment R and S are set out in section 5.1 and proposed standard licence conditions are set out in section 5.2.

5.1 Proposed conditions of appointment R and S

MODIFICATION OF THE CONDITIONS OF APPOINTMENT OF WATER AND WATER SEWERAGE UNDERTAKERS IN ENGLAND AND WALES

CONDITION R

Made2005

Coming into effect.....2005

The access code

1.—(1) The Appointee shall have an Access Code which complies with paragraphs 2 to 4 of this condition.

(2) The Appointee shall comply with its Access Code.

2. —The Access Code shall –

- (a) conform to the guidance for the time being issued under section 66D(4);
and –
- (b) set out –

- (i) the Appointee's proposed procedure for dealing with a licensed water supplier which makes an application to it under sections 66A to 66C;
- (ii) the feasibility studies which the Appointee will or might undertake in response to any of those possible applications (including the method of calculation of any costs associated with any such study which the Appointee proposed to use with a view to recovering them from any such applicant); and
- (iii) the terms (including prices, commencement time and duration of service upon which the Appointee will offer to perform each duty under sections 66A to 66C.

3.—(1) Subject to paragraph 2, the Appointee –

- (a) shall review its Access Code annually not later than the anniversary of the date upon which this condition comes into effect; and
- (b) may at any time modify it.

(2) If the Authority modifies its guidance under section 66D(4), the Appointee shall modify its Access Code to conform to the modified guidance.

4.—(1) The Appointee shall –

- (a) include the text of its Code, as modified from time to time, in any Internet website which it may maintain; and
- (b) in response to any request, provide a copy of it free of charge.

- (2) The Appointee shall provide to the Authority –
- (a) free of charge a copy of the Code; and
 - (b) within seven days of making them, written particulars of any modifications of it.

Anti-competitive behaviour

- 5.—(1) If and for so long as the Appointee is related to any licensed water supplier, it shall not –
- (a) without the consent of the Authority, sell (or otherwise make available) to that licensed water supplier any water, or any of its other assets; or
 - (b) otherwise transact with it, except at arm's length.

(2) For the purpose of this paragraph the Appointee is “related” to a licensed water supplier if their enterprises are under common ownership or common control (giving those expressions the meanings they have in section 26(1) of the Enterprise Act 2002).

(3) The Appointee shall by notice inform the Authority, if at any time it becomes, or ceases to become, related to a licensed water supplier.

6.— The Appointee shall not show undue preference towards, or undue discrimination against –

- (a) persons (or classes of persons) supplied or seeking to be supplied by a licensed water supplier, as compared with either its own customers or potential customers (or classes of customers) or those of any other licensed water supplier; or
- (b) a licensed water supplier, as compared with any other licensed water supplier or itself.

7.— This paragraph applies where –

- (a) the Appointee is performing its duties under section 66B or its duties as a primary water undertaker under section 66C on terms and conditions which, under section 66D(2), have been agreed with a licensed water supplier or, in default of such agreement, have been determined by the Authority; and
- (b) by reason of a permanent change in the direction of water flow in the supply system (as defined in section 17B(5)) in question, such change not having been planned and notified to that licensed water supplier at the time the agreement or determination referred to in sub-paragraph (a) was made, the licensed water supplier would be precluded by its supplementary authorisation (as defined in section 17A(5)) from continuing to introduce water into that supply system in pursuance of its licence in respect of particular premises of a customer.

(2) Where this paragraph applies, the Appointee shall offer to the licensed water supplier terms and conditions for –

- (a) any subsequent introduction of water by that licensed water supplier at the same point into its supply system, and
- (b) the performance of its duties under section 66A for a supply of water to the premises,

which are equivalent to the terms and conditions referred to in sub-paragraph (1)(a) above, save for any amendments which are a reasonably necessary consequence of that change in the direction of water flow.

(3) Any question as to the reasonableness of any amendments under sub-paragraph (2) shall be resolved by referring that question to the Authority for its determination.

Obligations about information

- 8.— (1) Whenever the Appointee is –
- (a) negotiating with a licensed water supplier the period for which and terms and conditions on which it might discharge any of its duties under sections 66A to 66C; or
 - (b) is discharging any of those duties,

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

(2) Without prejudice to the generality of sub-paragraph (1) above, the Appointee shall not use or disclose information received in the course or contemplation of the discharge of its duties under sections 66A to 66C, except –

- (a) to the minimum extent necessary to discharge those duties; or
- (b) where required by law.

9.—(1) The Appointee shall provide to a licensed water supplier such information as the latter reasonably requires to –

- (a) enable it apply for, negotiate, conclude and operate an agreement or determination under section 66D;
- (b) comply with any condition of its licence, or any statutory requirement imposed in consequence of its licence; or
- (c) comply with any reasonable request for information made by the Environment Agency.

(2) The Appointee may impose reasonable conditions on the use which any licensed water supplier makes of information provided under this paragraph.

(3) Any question as to the reasonableness of –

- (a) any requirement to provide information under sub-paragraph (1); or
 - (b) any condition proposed by the Appointee under sub-paragraph (2);
- shall be resolved by referring that question to the Authority for its determination.

(4) A reference under sub-paragraph (3) shall have the effect of suspending the requirement so referred, pending the Authority's determination.

(5) The Appointee shall not be required under this paragraph to provide any information which would be protected from disclosure in proceedings in the High Court on grounds of legal professional privilege.

(6)(a) The Appointee shall immediately inform the licensed water supplier of relevant details, if it is aware that a special needs consumer occupies or is likely to occupy any premises which the licensed water supplier is proposing to supply.

(b) For the purpose of sub-paragraph (a) above, a special needs consumer is a person who is diagnosed by a medical practitioner as suffering from

- (i) desquamation;
- (ii) weeping skin disease;
- (iii) incontinence;
- (iv) abdominal stoma;
- (v) renal failure requiring dialysis at the premises proposed to be supplied by the licensed water supplier;
- (vi) Crohn's disease;
- (vii) such other medical conditions resulting in a person being obliged to use significant additional volumes of water as –

(a) may be specified in the Water Industry (Charges) (Vulnerable Groups) Regulations 1999;

- (b) may be verified by a registered medical practitioner and notified to the Appointee; or
- (c) the Authority may determine.

- (7) Without prejudice to the generality of paragraph 6 of this condition –
- (a) the Appointee shall immediately inform each licensed water supplier which is supplying water to premises in its Water Supply Area of every actual or potential incident which affects or is likely to affect –
 - (i) water quality;
 - (ii) water pressure;
 - (iii) continuity of supply, or
 - (iv) any other matter related to the Appointee's supply system as defined in section 17B(5); and
 - (b) information provided by the Appointee under sub-paragraph (a) above shall be as detailed as the information which the Appointee uses or intends to use or would use, when dealing with complaints from its own customers arising out of the same matters.

- 10.**— The Appointee shall not seek –
- (a) from a licensed water supplier; or
 - (b) from a person supplied or seeking to be supplied by a licensed water supplier.

more information than necessary –

- (i) for the purpose of carrying out any of its functions;
- (ii) to comply with any condition of its Appointment;
- (iii) in relation to national security or civil emergencies; or
- (iv) to comply with any reasonable request for information from the Environment Agency.

11.— Until the coming fully into force of section 36(1) of the Water Act 2003 (transfer to the Water Services Regulation Authority and the Consumer Council for Water of functions, property etc), any reference to the Authority in this condition shall have effect as if it were a reference to the Director.

CONDITION S

Made2005

Coming into effect.....2005

Customer transfer protocol

1. — For the purposes of this condition –
 - (a) “the Protocol” means the “Customer Transfer Protocol”–
 - (i) complying with the requirements of paragraphs (3) to (6);
 - (ii) served by the Authority on the Appointee when this condition comes into force and
 - (iii) as subsequently amended from time to time in accordance with this condition; and
 - (b) until the coming fully into force of section 36 (1) of the Water Act 2003 (transfer to the Water Services Regulation Authority and the Consumer Council for Water of functions, property etc), any reference to that Authority in this condition shall have effect as if it were a reference to Director.
2. — The Appointee shall comply with the Protocol.
3. — The Protocol shall provide a clear, simple and standardised process for the timely and efficient transfer of supplies to premises of customers–
 - (a) between any water undertaker and any licensed water supplier; and
 - (b) between any two licensed water suppliers.
4. — The Protocol shall –
 - (a) make the same provision for all of the transfers referred to in paragraph 3 above; and
 - (b) include provisions for its amendment which shall –
 - (i) allow the Authority to propose amendments:
 - (ii) subject to (iii) below, require the agreement of the Authority and such majorities, as the Protocol shall specify, of all water undertakers and all licensed water suppliers, before any amendment can be made; but
 - (iii) in the case of any disagreements, as the Protocol shall specify, about any amendment to the Protocol which has been proposed other than by the Authority, allow the Authority to determine that that amendment shall be made.
5. — Where –
 - (a) any water undertaker or licensed water supplier (“the old supplier”) is supplying water to premises of a customer;
 - (b) that customer has failed to pay the old supplier’s charges for that supply;
 - (c) those charges have been demanded by notice served on the customer; and
 - (d) they have remained unpaid for 30 days or more after the date of that notice,

the Protocol shall include provisions to the effect that the old supplier may suspend the transfer of the supply of water to those premises of that customer until the old supplier is satisfied that provision has been made for the outstanding debt to be paid to it.

6. — Where the Authority so determines, the Protocol shall provide for such matters as are, or are of a type, specified in the Protocol to be referred to and determined by the Authority.

5.2 Proposed standard licence conditions

WATER INDUSTRY ACT 1991: SECTION 17H STANDARD CONDITIONS OF WATER SUPPLY LICENCES

The Secretary of State, in exercise of the powers conferred on her by section 17H of the Water Industry Act 1991(a), having consulted the National Assembly for Wales, hereby determines that the following conditions shall be standard conditions of all water supply licences:

Citation, interpretation and effect of certain provisions

1.—(1) These conditions may be cited as the Standard Conditions of Water Supply Licences.

(2) In these conditions—

“the Act” means the Water Industry Act 1991;

“the Licensee” means the company which is the holder of the relevant water supply licence(b);

“qualifying licensed water supplier” has the same meaning as in section 23(6) of the Act(c) (meaning and effect of special administration order); and

“relevant water undertaker” means any water undertaker(d) whose supply system(e) the Licensee uses for the purpose of supplying water to the premises of its customers.

(3) Until the coming fully into force of section 36(1) of the Water Act 2003 (transfer to the Authority(f) and the Council(g) of functions, property etc), any reference to the Authority in these conditions shall have effect as if it were a reference to the Director General of Water Services.

(4) In these conditions, any reference to any provision of —

(a) these conditions; or

(b) any enactment,

is a reference to that provision as amended from time to time.

(5) Paragraphs [9(9)(b)(ii)], [12], [13] and [14] below shall only have effect during the period when a combined licence(h) held by the Licensee is in force.

(a) 1991 c. 56; section 17H was inserted by the Water Act 2003 (c. 37).

(b) See section 17A(1) of the Act, inserted by the Water Act 2003 as to the meaning of “water supply licence”.

(c) Subsection (6) was inserted by the Water Act 2003.

(d) See section 5 of and Schedule 1 to the Interpretation Act 1978 (c. 30) as to the meaning of “water undertaker”.

(e) See section 17B(5) of the Act, inserted by the Water Act 2003 as to the meaning of “supply system”.

(f) Water Services Regulation Authority; see section 219(1) of the Act.

(g) Consumer Council for Water; see section 219(1) of the Act.

(h) See section 17A(5) and (6) of the Act, inserted by the Water Act 2003 as to the meaning of “combined licence”.

Conduct of Licensee

2.—(1) The Licensee shall carry on the activities authorised by its licence in a manner which does not actually or potentially jeopardise the proper, efficient and economical performance by any water undertaker of its functions(a).

(2) The Licensee shall not use or disclose information received from a relevant water undertaker in the course of or in contemplation of its dealings with that undertaker under sections 66A to 66C of the Act(b) (wholesale water supplies and introduction of water into a supply system) except—

- (a) to the minimum extent necessary for those dealings; or
- (b) where required by law.

(3) The Licensee shall ensure that all such arrangements have been made as are necessary for securing that it—

- (a) is and continues to be able to meet its obligations under—
 - (i) its water supply licence; and
 - (ii) any statutory requirement imposed on it in consequence of its licence, including its obligations under terms and conditions agreed or determined under section 66D of the Act(c) (sections 66A to 66C: determinations and agreements); and
- (b) has sufficient product and public liability insurance for the activities authorised by its licence.

Certificate of adequacy

3.—(1) On 1st April in each year the Licensee shall submit a certificate to the Authority in the prescribed manner and in a form determined by the Authority, certifying—

- (a) that all of the arrangements required by paragraph [2(3)] above are in place; and
- (b) in particular, that the Licensee has all the management, financial, technical, operational and other resources needed for securing that the Licensee is able to meet the obligations mentioned in paragraph [2(3)] above and will be able to do so for the next 12 months.

(2) For the purposes of sub-paragraph [(1)] “in the prescribed manner” means—

- (a) signed and dated after 1st March in that year by each director of the Licensee; or
- (b) signed and dated by any authorised director or the company secretary of the Licensee if authorised for that purpose, such authorisation having been given by resolution of the board of directors of the Licensee at a duly convened meeting of that board held after 1st March in that year, and accompanied by a certified copy of the minutes of that meeting.

(3) Where any notice(d) served(e) by the Authority so requires, the certificate submitted under this paragraph shall be accompanied or supplemented by such verification reports as the notice may reasonably require.

(4) The Licensee shall notify the Authority immediately if at any time it becomes aware—

- (a) that it is or will be unable to certify as to the matters set out in sub-paragraph [(1)],
or

(a) Inserted by the Water Act 2003.

(b) Inserted by the Water Act 2003.

(c) Inserted by the Water Act 2003.

(d) See section 219(1) of the Act as to the meaning of “notice”.

(e) See section 216 of the Act for provisions relating to the service of documents by virtue of the Act.

- (b) of any actual or potential change of circumstance which would or could prevent the Licensee from being able to submit a certificate under sub-paragraph [(1)] if the obligation to do so fell at that time.

Emergencies and drought

- 4.—**(1) The Licensee shall, for relevant purposes, comply with any—
- (a) reasonable instructions given to it by a relevant water undertaker in relation to matters specified in a drought plan which are not the subject of drought order or drought permit under Chapter 3 of Part 2 of the Water Resources Act 1991^(a); or
 - (b) instructions given to it by a relevant water undertaker during any emergency (save any which are manifestly unreasonable).
- (2) For the purposes of sub-paragraph [(1)]—
- (a) “drought plan” shall be construed in accordance with section 39B of the Act^(b) (drought plans: preparation and review); and
 - (b) “relevant purposes” are the purposes of—
 - (i) ensuring that water quality is not adversely affected;
 - (ii) avoiding prejudice to the integrity of the supply system;
 - (iii) protecting customers;
 - (iv) mitigating adverse effects upon the environment;
 - (v) maintaining essential supplies; or
 - (vi) conserving supplies.
- (3) Any question as to the reasonableness of any instructions given under sub-paragraph [(1)(a)] shall be resolved by referring that question to the Authority for its determination.
- (4) A reference under sub-paragraph [(3)] shall have the effect of suspending the instructions so referred pending the Authority’s determination.
- (5) Any instructions given under this paragraph shall not include requirements to provide information.

Provision of information to relevant undertakers(c)

- 5.—**(1) In so far as the provision of information to a relevant water undertaker is not provided for by or under any other enactment, the Licensee shall provide any relevant water undertaker with such information^(d) as the undertaker reasonably requires—
- (a) for the purposes of carrying out its functions;
 - (b) to demonstrate that the Licensee has sufficient product and public liability insurance for the activities authorised by its licence;
 - (c) to comply with any condition of the undertaker’s appointment;
 - (d) in relation to national security or civil emergencies; or
 - (e) to comply with any reasonable request for information made by the Environment Agency.
- (2) The Licensee may impose reasonable conditions on the use which the undertaker may make of information provided under this paragraph.
- (3) Any question as to the reasonableness of—

^(a) 1991 c. 57.

^(b) Inserted by the Water Act 2003.

^(c) See section 219(1) of the Act as to the meaning of “relevant undertaker”.

^(d) See section 219(1) of the Act as to the meaning of “information”.

- (a) any requirement to provide information under sub-paragraph [(1)]; or
 - (b) any condition proposed by the Licensee under sub-paragraph [(2)],
- shall be resolved by referring that question to the Authority for its determination.

(4) A reference under sub-paragraph [(3)] shall have the effect of suspending the requirement so referred pending the Authority's determination.

(5) The Licensee shall not be required under this paragraph to provide any information which would be protected from disclosure in proceedings in the High Court on grounds of legal professional privilege.

(6) The Licensee shall immediately inform the relevant water undertaker of relevant details—

- (a) if the Licensee becomes aware of any actual or potential incident which affects or is likely to affect—
 - (i) water quality;
 - (ii) water pressure;
 - (iii) continuity of supply; or
 - (iv) any other matter relating to the relevant water undertaker's supply system; or
- (b) if a special needs consumer occupies or is likely to occupy any premises which the Licensee supplies.

(7) The Licensee shall inform the relevant water undertaker as soon as reasonably practicable if—

- (a) any premises which the Licensee supplies are no longer occupied by any special needs consumers; or
- (b) the Licensee has any planned interruptions in supply.

(8) Where the Licensee begins supplying water to the premises of a customer which were not previously connected to a relevant water undertaker's supply system, the Licensee shall, as soon as reasonably practicable, inform any third party sewerage undertaker^(a) which provides or will provide services to those premises of—

- (a) the date of connection;
- (b) the address of the premises; and
- (c) the name and address of the Licensee's customer with respect to those premises.

(9) For the purposes of sub-paragraph [(6)], an incident includes regulatory infringements which would put the Licensee or relevant water undertaker at risk of supplying water which is unwholesome or unfit for human consumption within the meaning of sections 67 (standards of wholesomeness) and 70 (offence of supplying water unfit for human consumption) of the Act.

(10) For the purposes of sub-paragraphs [(6)] and [(7)], a special needs consumer is a person who is diagnosed by a medical practitioner as suffering from—

- (a) desquamation;
- (b) weeping skin disease;
- (c) incontinence;
- (d) abdominal stoma;
- (e) renal failure requiring dialysis at the premises supplied by Licensee;
- (f) Crohn's disease;

^(a) See section 5 of and Schedule 1 to the Interpretation Act 1978 (c. 30) as to the meaning of "sewerage undertaker".

- (g) ulcerative colitis; or
- (h) such other medical conditions resulting in a person being obliged to use significant additional volumes of water as—
 - (i) may be specified in the Water Industry (Charges) (Vulnerable Groups) Regulations 1999(a);
 - (ii) may be verified by a registered medical practitioner(b) and notified to the Licensee; or
 - (iii) the Authority may determine.

Customer transfer protocol

6.—(1) For the purposes of this paragraph, the “Protocol” means the customer transfer protocol—

- (a) complying with the requirements of sub-paragraphs [(3)] to [(6)];
- (b) served by the Authority on the Licensee when its licence comes into force; and
- (c) subsequently amended from time to time in accordance with this paragraph.

(2) The Licensee shall comply with the Protocol.

(3) The Protocol shall provide a clear, simple and standardised process for the timely and efficient transfer of supplies to premises of customers—

- (a) between any water undertaker and any licensed water supplier(c); and
- (b) between any two licensed water suppliers.

(4) The Protocol shall—

- (a) make the same provision for all of the transfers referred to in sub-paragraph [(3)];
- (b) include provisions for its amendment which shall—
 - (i) allow the Authority to propose amendments;
 - (ii) subject to sub-paragraph [(iii)], require the agreement of the Authority and of such majorities, as the Protocol shall specify, of all water undertakers and all licensed water suppliers before any amendment can be made; and
 - (iii) in the case of such disagreements, as the Protocol shall specify, about any amendment to the Protocol which has been proposed other than by the Authority, allow the Authority to determine that that amendment shall be made.

(5) Where—

- (a) any water undertaker or licensed water supplier (“the old supplier”) is supplying water to the premises of a customer;
 - (b) that customer has failed to pay the old supplier’s charges for that supply;
 - (c) those charges have been demanded by notice served on the customer; and
 - (d) they have remained unpaid for 30 days or more after the date of that notice,
- the Protocol shall include provisions to the effect that the old supplier may suspend the transfer of the supply of water to those premises of that customer until the old supplier is satisfied that provision has been made for the outstanding debt to be paid to it.

(a) S.I. 1999/3441 as amended by the Water Industry (Charges) (Vulnerable Groups) (Amendment) Regulations 2000 S.I. 2000/519, the Water Industry (Charges) (Vulnerable Groups) (Amendment) Regulations 2003 S.I. 2003/552, and the Water Industry (Charges) (Vulnerable Groups) (Amendment) Regulations 200[] S.I. 200[]/[].

(b) See section 5 of and Schedule 1 to the Interpretation Act 1978 (c. 30) as to the meaning of “registered medical practitioner”.

(c) See section 219(1) of the Act as to the meaning of “licensed water supplier”.

(6) Where the Authority so determines, the Protocol shall provide for such matters as are specified or of a type specified in the Protocol to be referred to and determined by the Authority.

Area of operation and arm's length transactions

7.—(1) The Licensee shall not at any time—

- (a) carry on any relevant activities in the geographical area to which a water undertaker's appointment relates, or
- (b) without the consent of the Authority sell water (or otherwise make it available) to a water undertaker, or
- (c) otherwise enter into any transaction with a water undertaker except at arm's length,

if at that time the Licensee is related to that water undertaker.

(2) For the purposes of this paragraph—

- (a) "relevant activities" means—
 - (i) activities authorised by the Licensee's licence; or
 - (ii) the development of a new source of water for activities authorised by the Licensee's licence; and
- (b) the Licensee is related to a water undertaker if their enterprises are under common ownership or common control (within the meaning those expressions have in section 26(1) of the Enterprise Act 2002^(a) (enterprises ceasing to be distinct enterprises)).

(3) The Licensee shall by notice inform the Authority if at any time after the grant of its licence it becomes, or ceases to be, related to a water undertaker.

Provision of information to the Authority

8.—(1) The Licensee shall provide the Authority with such information as it may by notice reasonably require for the purpose of carrying out its functions under the Act.

(2) Information required under this condition shall be provided in such form and manner, at such time and place, and be accompanied by or supplemented by such explanations, as the Authority may reasonably require.

(3) The Licensee shall not be required under this paragraph to provide any information which would be protected from disclosure in proceedings in the High Court on grounds of legal professional privilege.

Licence fees

9.—(1) The Licensee shall pay an annual fee to the Secretary of State determined in accordance with the following provisions of this paragraph.

(2) The fee shall be paid no later than the thirtieth day after the day on which the Authority serves notice on the Licensee of the amount of the fee for the year in question.

(3) Subject to sub-paragraph [(3)], the fee for any year shall be the amount determined by the Authority to be the regulatory cost for that year of the Licensee's licence.

(4) For the purposes of this paragraph, the regulatory cost for any year of the Licensee's licence is—

- (a) the Licensee's share of the estimated costs of the Authority for that year of regulating licensed water suppliers;

^(a) 2002 c. 40.

- (b) from such time as section 35(1) of the Water Act 2003 (the Council), in so far as it inserts section 27A of the Act (establishment of the Council and committees), and section 35(2) to (4) of the Water Act 2003 are fully in force, the Licensee's share of the estimated costs of the Council for that year in relation to licensed water suppliers; plus
 - (c) if in the preceding year there was a subsisting reference under section 17K of the Act **(a)** (water supply licences: modification references to Competition Commission) which related to the Licensee's licence—
 - (i) in the case of a reference under section 17K(1) (references in relation to activities authorised or regulated by a particular licence), the whole of the costs of the Competition Commission for that year in connection with the reference; and
 - (ii) in the case of a reference under section 17K(2) (references in relation to activities authorised or regulated by retail licences or combined licences), the Licensee's share of the costs of the Competition Commission for that year in connection with the reference.
- (5) The fee for any year shall be adjusted to take account of the Licensee's share of any under-estimate or over-estimate of the regulatory cost for any earlier year if—
- (a) the under-estimate or over-estimate has not been previously taken into account; and
 - (b) the Licensee held a water supply licence during the earlier year in which the under-estimate or over-estimate occurred.
- (6) The Licensee's share of the costs and any under or over-estimate mentioned in sub-paragraphs [(4)] and [(5)] shall be determined in accordance with general principles specified by the Authority and set out in a notice, published in such manner as the Authority considers appropriate and served on the Licensee.
- (7) For the purposes of sub-paragraph [(6)], "general principles" means principles which are the same for all licensed water suppliers but which may vary from one year to another.
- (8) For the purposes of sub-paragraph [(4)], the estimated costs of the Council and of the Competition Commission respectively shall be such amounts as the Authority shall determine to be their costs after consulting the Council and Competition Commission respectively.
- (9) For the purposes of sub-paragraph [(4)], a reference under section 17K(2) shall be taken to be related to the Licensee's licence if—
- (a) the Licensee held a water supply licence during all or part of the preceding year; and
 - (b) the reference was related to—
 - (i) any matter connected with the carrying on of any activities authorised or regulated by a retail authorisation **(b)**; or
 - (ii) for licensed water suppliers who held a supplemental authorisation **(c)** during all or any part of the preceding year, any matter connected with the carrying on of any activities authorised or regulated by a supplemental authorisation.
- (10) For the purposes of this paragraph, "year" means a period of 12 months beginning on 1st April.

(a) Inserted by the Water Act 2003.

(b) See section 17A(2) of the Act, inserted by the Water Act 2003 as to the meaning of "retail authorisation".

(c) See section 17A(5) of the Act, inserted by the Water Act 2003 as to the meaning of "supplemental authorisation".

Revocation

10.—(1) This licence may be revoked by notice served on the Licensee by the Secretary of State or, with the consent of the Secretary of State or in accordance with a general authorisation given by her, by the Authority, in any of the circumstances specified in sub-paragraph (2).

(2) The circumstances mentioned in sub-paragraph (1) are—

- (a) the Licensee has consented to the revocation;
- (b) any information provided by the Licensee to the Secretary of State, an inspector within the meaning of section 86 of the Act (enforcement of water quality), the Authority or a relevant water undertaker was false or misleading in a material particular;
- (c) there has been, is or is likely to be such a contravention by the Licensee of any principal duty, not being a contravention in respect of which a notice has been served under section 19(3) of the Act (notice that one of the exceptions to the duty to enforce applies), as is serious enough to make it inappropriate for the Licensee to continue to hold its licence;
- (d) the Licensee has caused or contributed to a contravention by a water undertaker of any principal duty and the Licensee's role was serious enough to make it inappropriate for the Licensee to continue to hold its licence;
- (e) there has been, is or is likely to be such a contravention by the Licensee of the provisions of any enforcement order which—
 - (i) is not for the time being the subject-matter of proceedings brought by virtue of section 21(1) of the Act (proceedings challenging the validity of an enforcement order); and
 - (ii) if it is a provisional order, has been confirmed, as is serious enough to make it inappropriate for the Licensee to continue to hold its licence;
- (f) the Licensee has failed to pay the whole or part of any fee due under paragraph [9] above and—
 - (i) the Authority demanded payment of that sum by notice served on the Licensee at least 14 days after it became due; and
 - (ii) any part of that sum remained unpaid 14 days after service of that notice;
- (g) the Licensee has failed to pay the whole or part of any penalty (together with any interest) imposed on it under section 22A(1) or (2) of the Act^(a) (penalties) and—
 - (i) the Authority demanded payment of that sum by notice served on the Licensee after that sum became recoverable as a civil debt under section 22F^(b) of that Act (recovery of penalties); and
 - (ii) any part of that sum remained unpaid for three months after the service of that notice;
- (h) the Licensee has failed to comply with an order made by the court under—
 - (i) section 34 of the Competition Act 1998^(c) (enforcement of directions); or
 - (ii) sections 94 (rights to enforce undertakings and orders) or 95 (rights to enforce statutory restrictions) of the Enterprise Act 2002^(d);
- (i) the Licensee has not supplied any water using the supply system of any water undertaker during a period of at least three years beginning on or after the date

^(a) Inserted by the Water Act 2003.

^(b) Inserted by the Water Act 2003.

^(c) 1998 c. 41.

^(d) 2002 c. 40.

on which its licence came into force and ending on the date on which notice is served on the Licensee in accordance with paragraph [11] below;

- (j) the Licensee is or is likely to be unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986^(a) (definition of inability to pay debts);
 - (k) the Secretary of State has petitioned for the winding up of the Licensee under sections 124(4) and 124A of the Insolvency Act 1986 (petition for winding up on grounds of public interest);
 - (l) a voluntary arrangement has been proposed in relation to the Licensee under section 1 of the Insolvency Act 1986 (those who may propose an arrangement), other than for the purpose of reconstruction or amalgamation on terms and within a period which have been approved in writing by the Authority;
 - (m) the Licensee has entered into a scheme of arrangement under section 425 of the Companies Act 1985^(b) (power of company to compromise with creditors and members), other than for the purpose of reconstruction or amalgamation on terms and within a period which have been approved in writing by the Authority;
 - (n) a receiver has been appointed in relation to the whole or a material part of the Licensee's assets or undertaking;
 - (o) an administrator of the Licensee has been appointed under Schedule B1 of the Insolvency Act 1986^(c) (administration), other than for the purpose of rescuing the Licensee as a going concern on terms and within a period which have been approved in writing by the Authority;
 - (p) a resolution has been passed by the Licensee for its the winding up, other than a resolution has been approved in writing by the Authority; or
 - (q) a winding up order has been made in relation to the Licensee by a court of competent jurisdiction.
- (3) In this paragraph—
- “principal duty” means—
 - (a) in relation to a water undertaker, a requirement imposed on the water undertaker by section 37 of the Act (general duty to maintain water supply system etc); and
 - (b) in relation to the Licensee, any condition of its licence or any statutory requirement imposed it in consequence of its licence; and
 - “receiver” includes an administrative receiver within the meaning of section 251 of the Insolvency Act 1986 (expressions used generally).

Notice of revocation

- 11.—**(1) A notice of revocation must specify—
- (a) the matters relied on by the Secretary of State or the Authority to justify the revocation;
 - (b) the date on which the revocation is to take effect; and
 - (c) if the Secretary of State or the Authority relies on urgency as a reason for abridging the 30 day period mentioned in sub-paragraph [(2)], the reasons for this.
- (2) Except in case of urgency or where the Licensee has consented under paragraph [10(1)(a)] above, the date on which the revocation takes effect must not be less than 30 days after the date on which the Secretary of State or the Authority serves the notice.

^(a) 1986 c. 45.

^(b) 1985 c. 6.

^(c) Inserted by Schedule 16 to the Enterprise Act 2002 (c.40).

(3) At any time after the service of a notice of revocation, the Secretary of State or the Authority may by further notice served on the Licensee vary or withdraw the notice.

Revocation – combined licences

12.—(1) Subject to sub-paragraph [(2)], notice of revocation shall not be served or take effect while the Licensee is a qualifying licensed water supplier.

(2) Sub-paragraphs [(3)] and [(4)] apply where arrangements have been made to ensure that activities relating to the introduction or introductions of water mentioned in section 23(6)(b) of the Act will be properly carried on after the relevant water supply licence is revoked.

(3) Where this sub-paragraph applies and the notice of revocation has not been served or the date specified under paragraph [11(1)(b)] above has not passed, sub-paragraph [(1)] shall cease to apply.

(4) Where this sub-paragraph applies and the date specified under paragraph [11(1)(b)] above has passed, the notice of revocation shall take effect.

Prohibition on introduction – combined licences

13.—(1) The Licensee shall not introduce water in pursuance of its licence into any relevant water undertaker's relevant supply system until the Chief Inspector of Drinking Water^(a) has served notice on the Licensee stating that she has conducted a satisfactory audit in relation to the relevant regulatory standards^(b) applicable to the water source and treatment works used by the Licensee in relation to that introduction.

(2) In sub-paragraph [(1)]—

(a) “relevant supply system” means any supply system within the meaning of section 17B(5)(a) of the Act^(c); and

(b) the reference to the treatment works used by the Licensee shall be construed consistently with the reference to a water undertaker's treatment works in section 17B(5)(a) of the Act.

Special Administration – combined licences

14.—(1) Whether or not the Licensee is currently a qualifying licensed water supplier, the Licensee shall at all times ensure that, if a special administration order were made in relation to it, the Licensee would have available to it sufficient rights and assets to enable the special administrator so to manage the affairs, business and property of the Licensee as to ensure that the purposes of such an order could be achieved.

(2) Where its ultimate parent company is not a relevant undertaker, the Licensee shall, within 30 days of its Licence coming into force, procure from its ultimate parent company legally enforceable undertakings in favour of the Licensee in a form determined by the Authority and expressed to remain in force for as long as the Licensee is a combined licensee.

(3) The undertakings referred to in sub-paragraph [(3)] shall provide that the ultimate parent company shall not, and shall procure that its subsidiaries shall not, cause or contribute to a contravention of this paragraph by the Licensee.

(4) In this paragraph—

(a) See section 86 of the Act.

(b) See sections 67 (standards of wholesomeness), 68 (duties with respect to water quality) and 69 (regulations for preserving water quality) of the Act and the Water Supply (Water Quality) Regulations 2000 S.I. 2000/3184 (as amended by the Water Supply (Water Quality) (Amendment) Regulations 2001 S.I. 2001/2885) and the Water Supply (Water Quality) Regulations 2001 S.I. 2001/3911 (W. 323).

(c) Inserted by the Water Act 2003.

“subsidiary” has the same meaning as in section 736 of the Companies Act 1985 (subsidiary, holding company and wholly-owned subsidiary);

“ultimate parent company” shall be construed in accordance with paragraph 31 of Schedule 5 to the Companies Act 1985; and

“business”, “property” and “special administration order” have the same meanings as in section 23 of the Act (meaning and effect of special administration order).

[Signed by authority of the Secretary of State]

[Name]

[Date]

An official of the Department for Environment, Food and Rural Affairs

6. Comments on the partial regulatory impact assessment

This section sets out respondents' views to the partial RIA in the February 2004 paper and are conclusions to their responses.

Policy overview

In our partial regulatory impact assessment (RIA) (see annex A) we set out three options for the modifications to water undertakers' conditions of appointment.

1. Do nothing.
2. Make minimal changes.
3. Amend them to ensure that all or most new competition arrangements between water undertaker and licensee are covered.

We also set out three options for standard conditions for licensees.

1. Have none, or a few that are very limited, but prescribe in the access code guidance what licensees should do.
2. Have most appropriate to cover the main issues, with the flexibility to deal with case-specific matters in an access agreement.
3. Prescribe most things by these means.

Our preferred approach is option 2 in both cases. We performed cost/benefit analysis on the impact of these proposals on the industry. We received four comments on the options and analysis.

Respondents' views

General points made by respondents

- A potential licensee commented that the barriers to cross-subsidy restricted market growth. This can be avoided by unbundling income and costs within a water undertaker relevant to the competitive market, to encourage new entrants.
- A potential licensee commented that for the market to operate effectively the core requirement was the disaggregation of all costs to ensure transparency. Partial disaggregation requires water undertakers to charge themselves differently from the way they charge licensees, which would lead to litigation.

Options and rationale

- WaterVoice agreed with option 2 in both cases, and commented that it did not believe in excessive legislation but comment it would like assurance that all 'loopholes' were addressed.

Costs and benefits

- WaterVoice commented that it wanted evidence that the new regime could deliver reduced charges and better services. It asked Ofwat to clarify the meaning of 'modest' in terms of any price increases to ineligible customers in the

short term, and to explain how the cherry picking of large users and the associated cross-subsidy issues would be handled.

- A potential licensee commented that if new entrants paid the costs associated with Ofwat's activities it would put them at a disadvantage. Ofwat is the industry regulator so its costs must be borne by the whole industry, especially because licensees are operating at slim margins.

Our conclusions

We have considered the comments on the possible costs and benefits of the new proposals. Overall, we expect the benefits of extending the competition and increasing customers' choice to outweigh the minimal costs for all stakeholders, including Ofwat.

We have not changed our view on our preferred option and we consider that the approach in this consultation paper is consistent with this.

Annex A: Partial regulatory impact assessment

1. Purpose and intended effect of the policy and its timing

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

The WIA91 permits access to a water undertaker's supply system to enable a licensee to supply water to the premises of eligible customers. Prospective suppliers will need to obtain a Water Supply Licence before they can compete with water undertakers in the supply of water through the public supply system. They can apply for either:

- a 'retail' Water Supply Licence, which entitles the licensee to purchase water from a water undertaker (a 'wholesale supply') and retail it to a customer's eligible premises; or
- a 'combined' Water Supply Licence, which is a retail licence with a supplementary authorisation, that enables the licence holder to introduce water into a water undertaker's supply system and to retail that water to a customer's eligible 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.

The purpose of the consultation paper is to invite your views on our proposals. Responses to this consultation will help us to finalise the new standard conditions for licensees and the modifications to water undertakers' conditions in their existing Instruments of Appointment.

In February 2004 we consulted on our policy proposals⁵¹ to modify water undertakers' Instruments of Appointment and develop licence conditions for Water Supply Licences. We received 23 responses, and in the light of these and subsequent discussions we drafted two new conditions of appointment to ensure that water undertakers published an access code, kept it under review, and complied with a customer transfer protocol. This consultation is on the legal text of the proposed modifications to water undertakers' conditions of appointment and the standard licence conditions. We expect these to be finalised in summer 2005. Prospective suppliers will be able to apply for a Water Supply Licence in summer 2005, with the overall regime due to commence in autumn 2005.

⁵¹ '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).

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

There will need to be an access agreement between the licensee and the water undertaker to govern arrangements between the two parties. Section 66D(4) WIA91 requires Ofwat to publish guidance in accordance with which the terms and conditions of such agreements shall be made. We published a consultation on our access code guidance in October 2004⁵².

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

Due to the complex nature of this regulatory regime, and the difficulty in predicting how a competitive market will develop and behave, the assessment of costs and benefits included in this regulatory impact assessment (RIA) is mainly qualitative. Although there will be a degree of fixed costs associated with the start up of competition, we expect that the scale of these will be limited because of the size of the initial market. 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.

The focus of this RIA shows how the new licensing provisions are best reflected in the water undertakers' conditions of appointment and the Water Supply Licence for licensees. The wider regulatory impact of the extension of competition in the water industry was dealt with in the RIA to the Government consultation paper 'Extending Opportunities for Competition in the Water Industry in England and Wales' (July 2002).

2. Options and Rationale

2.1 Modifications to water undertakers' conditions of appointment

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

⁵² 'Water Act 2003: Water Supply Licensing. Access code guidance consultation paper' (15 October 2004).

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

Option 1

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

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

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

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

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

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

Option 2

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

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

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

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

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

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

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

Option 3

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

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

Option 3 is more prescriptive with limited potential flexibility for water undertakers to tailor their agreements with licensees to reflect case specifics. In regulatory terms, if we wanted to change any aspect of supply arrangements, it would be far more difficult to make changes to conditions of appointment than it would be to change our guidance that would inform access agreements.

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

2.2 Standard conditions for licensees

In creating standard licence conditions for licensees, we have identified the following options:

- **Option 1:** have none, or a few that are very limited, but prescribe in the access code guidance what licensees should do;
- **Option 2:** have sufficient to cover the main issues, with flexibility to deal with case specific matters in an access agreement; or
- **Option 3:** prescribe most things by these means.

Option 1

This option is likely to increase regulatory uncertainty. For example, a licensee would not be under a duty to provide Ofwat and the appropriate water undertaker with relevant information. There would, therefore, be a greater risk of the regime not working effectively.

Without an obligation to comply with the customer transfer protocol as a licence condition, there would be detrimental effects on competition since Ofwat would not have any powers to ensure the licensee acted fairly or to prevent it from restricting competition.

Licensees would have a greater degree of flexibility to do what they wanted and could therefore act inappropriately without the risk of having their Water Supply Licence revoked.

Subject to compliance with Ofwat's statutory guidance, this option would mean greater flexibility for water undertakers and licensees and could therefore lead to greater inconsistencies in approaches taken, such as in the transfer of a customer. This could prove detrimental to the implementation of competition and could impact on the service customers received.

This option would also introduce greater risks to eligible customers. Eligible customers might be deterred from switching from a water undertaker to a licensee, due to the greater risks involved as a result of the limited enforcement powers which Ofwat would have. In any event, the WIA91 envisages a balance between licence conditions and guidance on access terms and conditions.

Option 2

We believe this option will produce the right balance of clarity and flexibility. The most important and central issues which need to be enforceable directly by Ofwat would be covered through standard licence conditions. Water undertakers and licensees would still retain a degree of flexibility to deal with case specific matters

through an access agreement (subject to compliance with Ofwat's statutory guidance).

The proposed standard licence conditions are detailed in the consultation paper and include duties to ensure that the licensee co-operates with the water undertaker and Ofwat by complying with reasonable requests for information. Licensees will also be under a duty to comply with a customer transfer protocol (to be developed by Ofwat in conjunction with the industry via advisory groups).

The access agreement between a water undertaker and licensee will govern case-specific issues such as: how the parties intend to deal with customer queries and complaints, emergency procedures and contacts, certain water quality issues, billing, and debt collection. Ofwat guidance on access terms (including prices) will guide water undertakers and licensees as to what issues should be considered when drawing up access agreements. If these terms were contained in standard licence conditions, it would be difficult and costly to modify a condition every time a change was required. In any event, the WIA91 envisages a balance between licence conditions and guidance on access terms.

Risks to the network and customers will be limited by requiring potential licensed suppliers to ensure that they are competent to enter the market and comply with their legal obligations and standard licence conditions.

This is our preferred option. This approach would give more reassurance to customers and water undertakers as standard licence conditions will set out obligations of the licensee and instances where they can be called to account.

Option 3

This option would mean that most issues that could otherwise be dealt with through an access agreement, would instead be imposed in the form of standard licence conditions.

However this might create unnecessary burdens and costs. For example, if all issues were listed in standard licence conditions, then a licensee would be under a duty to comply with them in its dealings with water undertakers. This would reduce the scope for flexibility to respond to the circumstances of individual access agreements. It would be costly for a licensee to comply with its standard licence conditions when it was not essential for the supply in question.

By putting most requirements in standard licence conditions, Ofwat would incur greater costs of regulating and monitoring licensees' activities. This is because Ofwat would need to collect more information from licensees and spend more time assessing this on an ongoing basis to ensure licensees were complying with their conditions and providing the required services. Also, by maximising the number of standard licence conditions, this could potentially increase the amount of time spent by Ofwat investigating trivial breaches. This would impose more regulatory costs on Ofwat, which ultimately could lead to price rises for customers.

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

difficult to make changes to standard licence conditions than it would be to change the guidance that would inform access agreements. In any event, the WIA91 envisages a balance between licence conditions and guidance on access terms and conditions.

3. Summary of costs and benefits to support the adoption of Option 2

This section provides a summary of the costs and benefits already identified in this RIA associated with the adoption of Option 2 in this consultation paper, for water undertakers and licensees. This section is intended to verify the reasons why we favour Option 2.

3.1 Benefits

Benefits to water undertakers / licensees

- It enables water undertakers/licensees to plan policies to implement the licensing provisions more effectively.
- It reduces uncertainties for water undertakers/licensees, by clearly setting out key duties that should be complied with.
- It will enable water undertakers/licensees to reduce some costs in the long term, as they will be aware of their obligations prior to agreeing any terms of access.
- It provides clarity to those interested in entering the competitive market. A prospective supplier will be provided with details of standard licence conditions that will need to be adhered to if its licence application is successful.

Benefits to customers

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

Benefits to Ofwat

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

3.2 Costs

Costs to Ofwat

Ofwat expects that there will be some increased costs to administer both the new obligations we are proposing for water undertakers as well as the new standard licence conditions for licensees. Although these costs are difficult to quantify at this stage, they will, for example, relate to assessing and analysing information provided by the licensee, which will be requested to enable Ofwat to fulfil its functions under

the WIA91. There will also be costs involved in instances where we have to take enforcement action if licence conditions are breached.

Section 17G WIA91 allows for payment of a licence fee on the grant of a Water Supply Licence, and/or payments while such a licence is in force. Any net increases in Ofwat's expenditure arising from the proposals on competition would ultimately be recovered from the fees paid by water undertakers and licensees.

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

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

Greater competition will increase the complexity of our regulatory activities.

Costs to water undertakers

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

Costs to licensees

Section 17G WIA91 allows for payment of a licence fee on the grant of a Water Supply Licence, and/or payments while such a licence is in force.

Fees will be set at a level to recover Ofwat's and the Competition Commission's costs in regulating the competitive market. The fees will ensure that ineligible customers will not be subsidising the regulatory costs of the new WSL regime through water undertakers' appointment fees.

4. Questions

We welcome your views on this partial RIA, in particular on the following.

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

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

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

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

Annex B: Draft retail and combined Water Supply Licences

Licence Number [R]

WATER INDUSTRY ACT 1991: SECTION 17A

WATER SUPPLY LICENCE

The Director General of Water Services, in exercise of his powers under section 17A of the Water Industry Act 1991(a), in accordance with a general authorisation given by the Secretary of State, hereby grants a water supply licence to [](b) [](c) (“the Licensee”) of [](d):

Application of the standard conditions of water supply licences and interpretation

1. This licence is subject to the Standard Conditions of Water Supply Licences(e).
2. In this licence any reference to any provision of—
 - (a) the Standard Conditions of Water Supply Licences; or
 - (b) any enactment,is a reference to that provision as amended from time to time.

Duration of licence

3. —(5) Subject to paragraph (2), this licence comes into force on [](f) and, unless revoked in accordance with the Standard Conditions of Water Supply Licences (which set out the conditions of revocation), continues in force until it is terminated by not less than 25 years’ notice served by the Secretary of State on the Licensee.

(1) At any time after the service of a termination notice under sub-paragraph (1), the Secretary of State may by further notice served on the Licensee vary or withdraw the notice.

Retail authorisation

4. This licence authorises the Licensee to use a water undertaker’s(g) supply system(h) for the purpose of supplying water to the premises of customers of the Licensee in accordance with Chapter 2A of Part 3 of the Water Industry Act 1991(i) (supply duties etc: licensed water suppliers) and subject to section 17A(3) of that Act (requirements to be satisfied in relation to each of the premises supplied by the Licensee).

[Signature]

(a) 1991 c. 56; section 17A was inserted by the Water Act 2003 (c. 37) and relevant amendments conferring powers on the Director were made by S.I. [transitional provisions SI].

(b) Insert Licensee’s name.

(c) Insert Licensee’s registered number.

(d) Insert address of Licensee’s registered office.

(e) The Standard Conditions of Water Supply Licences were determined by the Secretary of State under section 17H of the Water Industry Act 1991 and published on [] 2005. A copy may be obtained from [www.ofwat.gov.uk].

(f) Insert commencement date.

(g) See section 5 of and Schedule 1 to the Interpretation Act 1978 (c. 30) as to the meaning of “water undertaker”.

(h) See section 17B(5) of the Water Industry Act 1991, inserted by the Water Act 2003 as to the meaning of “supply system”.

(i) Inserted by the Water Act 2003.

[Date]

Director General of Water Services

Licence Number [C]

WATER INDUSTRY ACT 1991: SECTION 17A

WATER SUPPLY LICENCE

The Director General of Water Services, in exercise of his powers under section 17A of the Water Industry Act 1991(a), in accordance with a general authorisation given by the Secretary of State, hereby grants a water supply licence to [](b) [](c) (“the Licensee”) of [](d):

Application of the standard conditions of water supply licences and interpretation

1. This licence is subject to the Standard Conditions of Water Supply Licences(e).
2. In this licence any reference to any provision of—
 - (a) the Standard Conditions of Water Supply Licences; or
 - (b) any enactment,is a reference to that provision as amended from time to time.

Duration of licence

3. —2. Subject to the following provisions of this clause, this licence comes into force on [](f) and, unless revoked in accordance with the Standard Conditions of Water Supply Licences (which set out the conditions of revocation), continues in force until it is terminated by not less than 25 years’ notice served by the Secretary of State on the Licensee.

(1) At any time after the service of a notice under paragraph (1), the Secretary of State may by further notice served on the Licensee vary or withdraw the notice.

(2) Subject to paragraph (4), the licence shall not be terminated by virtue of a notice under paragraph (1) while the Licensee is a qualifying licensed water supplier within the meaning of section 23(6) of the Water Industry Act 1991(g) (meaning and effect of special administration order).

(3) Paragraphs (5) and (6) apply where arrangements have been made to ensure that activities relating to the introduction or introductions of water mentioned in section 23(6)(b) of the Act will be properly carried on after this licence is terminated.

(4) Where this paragraph applies and the date specified in the notice of termination has not passed, paragraph (3) shall cease to apply.

(5) Where this paragraph applies and the date specified in the notice of termination has passed, that notice shall take effect.

(a) 1991 c. 56; section 17A was inserted by the Water Act 2003 (c. 37) and relevant amendments conferring powers on the Director were made by S.I. [transitional provisions SI].

(b) Insert Licensee’s name.

(c) Insert Licensee’s registered number.

(d) Insert address of Licensee’s registered office.

(e) The Standard Conditions of Water Supply Licences were determined by the Secretary of State under section 17H of the Water Industry Act 1991 and published on [] 2005. A copy may be obtained from [www.ofwat.gov.uk].

(f) Insert commencement date.

(g) Inserted by the Water Act 2003.

Retail authorisation

4. This licence authorises the Licensee to use a water undertaker's(a) supply system(b) for the purpose of supplying water to the premises of customers of the Licensee in accordance with Chapter 2A of Part 3 of the Water Industry Act 1991(c) (supply duties etc: licensed water suppliers) and subject to section 17A(3) of that Act (requirements to be satisfied in relation to each of the premises supplied by the Licensee).

Supplementary authorisation

5. This licence also authorises the Licensee to introduce water into a water undertaker's supply system, by means of which any particular supply of water in accordance with its retail authorisation under paragraph [4] is to take place, in connection with that supply and in accordance with Chapter 2A of Part 3 of the Water Industry Act 1991.

[Date]

[Signature]

Director General of Water Services

(a) See section 5 of and Schedule 1 to the Interpretation Act 1978 (c. 30) as to the meaning of "water undertaker".

(b) See section 17B(5) of the Water Industry Act 1991, inserted by the Water Act 2003 as to the meaning of "supply system".

(c) Inserted by the Water Act 2003.

Annex C: List of consultation respondents

Water companies

Anglian
Welsh
Northumbrian
Severn Trent
Southern
Thames
United Utilities
Wessex
Bristol
South East
Sutton and East Surrey
Tendring Hundred
Three Valleys

Potential licensees⁵³

Aquavitae
Watergrid

Regulators

Drinking Water Inspectorate
Water Industry Commissioner for Scotland

Organisation representing consumer interests

Water Voice

Environmental Bodies

English Nature

Others

Ewan
Electralink
Water UK

⁵³ A response was sent in confidence.