

July 2018

Trust in water

Consultation under section 13 of the Water Industry Act 1991 on proposed modifications to the licence conditions

About this document

This document invites comments on two proposed modifications of the conditions of the appointment ('licence') of each of the 17 largest water companies¹ in England and Wales (listed in table 1).

The first proposed modification would prohibit water companies from showing undue preference towards or undue discrimination against themselves, other water companies (including new appointees, sometimes referred to as 'NAV's'), water supply and/or sewerage licensees or unlicensed third parties in relation to the provision of certain water and sewerage services.

The second proposed modification would place restrictions on the circumstances in which water companies could externally disclose or internally use information they were provided with in relation to the submission of bids to provide certain services or agreements for the adoption of infrastructure.

Under section 13 of the Water Industry Act 1991 ('WIA91'), the Water Services Regulation Authority ('Ofwat') may modify the conditions of a water company's licence if the company consents to the modifications.

Before making modifications under section 13 of the WIA91, Ofwat must give notice in accordance with that section. This document (including attached appendix) is a Notice under section 13.

¹ For the purpose of this document, a reference to a water company or company means a company holding an appointment as a water and/or sewerage undertaker under the Water Industry Act 1991.

Responding to this consultation

We invite stakeholders to consent to the proposed modifications by no later than x. Each relevant water company should also indicate its acceptance or otherwise of the proposed modification by this date. You can email your responses to PR19@ofwat.gsi.gov.uk or post them to:

Licence changes consultation
PR19
Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA.

If you wish to discuss any aspect of this document, please direct your enquiry to David Young on 0121 644 7509 or by email to David.Young@ofwat.gsi.gov.uk.

We will publish responses to this document on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), data protection law and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

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1. Introduction

- 1.1 Markets can deliver a wide range of benefits for customers in terms of both the quality, choice and cost of the services they receive. Markets are a key driver for efficiency and innovation for the benefit of both customers and the environment. Where competition is being introduced into monopolistic markets, it is crucial to create the right market conditions and to promote competition on fair and equal terms for the markets to develop.
- 1.2 Water companies in England and Wales are monopoly providers of water and wastewater services. We use price controls to regulate the price and service package that these companies offer to ensure that customers are protected.
- 1.3 In PR19, we aim to facilitate a greater role for markets in England and, where it aligns with Welsh Government policy, in Wales to encourage greater efficiency and innovation as well as to promote resilience across the sector. Promoting wholesale markets will encourage water companies to make better use of water resources and bioresources.
- 1.4 New wholesale markets for water resources, demand management, leakage services and bioresources will, in line with our Water 2020 regulatory framework and PR19 methodology, mean greater involvement by a range of market participants.
- 1.5 An important way of facilitating the development of these new wholesale markets, is to ensure that water companies do not show undue preference or undue discrimination towards themselves or against other potential providers of services in respect of these markets. Showing undue preference towards (including towards itself) or undue discrimination against other market participants, could significantly hinder development of these markets.
- 1.6 A level playing field is not only important for new and developing markets, but also for existing markets where this conduct has already been identified as a barrier to market development. Undue preference or undue discrimination can be used by vertically integrated monopolies to prevent or harm effective competition by disadvantaging competitors in the downstream markets, so as to force them to exit the market, or induce them to compete less aggressively. The need for a level playing field between new entrants and water companies was identified in the review of the New Appointment and Variations (NAV') market, published in October 2017 ('the NAV review'). The NAV' market allows

competition for existing or new entrant water companies to serve specific sites, such as new housing developments, by providing the 'last mile' infrastructure' on site, supplying water and providing wastewater services. When a new development needs to be connected to water or wastewater services (the self-lay market), the connection services can be provided by the existing water company, a NAV or a Self-Lay Organisations (SLOs).

- 1.7 The NAV review, identified potential barriers that could impact on the ability of NAVs to compete effectively with water companies to serve sites such as new housing or mixed developments. Similar issues arise in the self-lay market, where NAVs and SLOs may compete with a water company's in-house service to provide new connections.
- 1.8 To protect and support the development of both new and existing markets, we propose a stand-alone licence modification to create an enforceable obligation on water companies not to show undue preference or undue discrimination in the provision of services in the new wholesale markets, the NAV market and the self-lay market. We consider the proposed licence modification will be an effective tool for changing company behaviour and signal that water companies are willing to facilitate and participate in the these markets.

Safeguarding against the misuse of information

- 1.9 We also propose to introduce a specific provision requiring water companies to restrict the use of information submitted to them as part of a bid for the provision of services in the new wholesale markets or submitted by those making enquiries about, or entering into, agreements for the adoption of self-laid infrastructure.
- 1.10 We consider this proposed modification complements and supports the proposed modification prohibiting undue preference or undue discrimination. as it will prevent water companies from disclosing the information within their business, which could give them an unfair commercial advantage and dissuade potential bidders from submitting bids in future or SLOs from seeking to serve developers. This could potentially dampen competition in the new wholesale markets and the self-lay market respectively.

2. Background

- 2.1 In our document, [Water 2020: Our regulatory approach for water and wastewater services in England and Wales](#) (the 'May document') which set out our policy decisions related to how we intended to set price controls for the water and wastewater sectors from 1 April 2020, we noted that there was one further licence modification that we propose to make but was not part of the set of policies that we consulted on in December 2015.
- 2.2 In the May document we acknowledged that a licence modification to ensure water companies do not show undue preference or undue discrimination in relation to the provision of water and sewerage services could help support some of our policies on the use of markets in water resources and bioresources. We said we would plan to take forward work on the development of a more general licence modification in view of the new general duty (section 2(3) (ba) of the Water Industry Act 1991) introduced by section 23 of the Water Act 2014, which gives Ofwat an objective to regulate in the way we consider would best ensure that undertakers do not give advantages to themselves, other water companies (including NAVs) or water supply and/or sewerage licensees ('WSSLs') in relation to the provision of services.

Developing the licence modification

- 2.3 We shared drafts of the proposed modifications with the relevant water companies, ahead of the publication of this document. The proposed modifications reflect where appropriate, the feedback received from companies. We welcome the constructive approach taken by companies in this process.
- 2.4 We are now seeking each company's consent for the purpose of section 13 of the WIA91 to the licence modifications proposed in this document (and summarised in section 3).

Who the proposed licence modifications will apply to

- 2.5 Table 1 lists the companies that, subject to agreement, the licence modifications will apply to. We are only proposing licence modifications for the 17 of the largest monopoly providers of water and/or wastewater services in England and Wales.

Table 1: List of the companies we propose the modifications will apply to

Water and sewerage undertakers:	Water only undertakers:
Anglian Water Services Limited Dŵr Cymru Cyfyngedig (Welsh Water) Hafren Dyfrdwy Limited(formerly Dee Valley Water Limited) Northumbrian Water Limited Severn Trent Water Limited Southern Water Services Limited South West Water Limited Thames Water Utilities Limited United Utilities Water Limited Wessex Water Services Limited Yorkshire Water Services Limited	Affinity Water Limited Bristol Water plc Portsmouth Water Limited South East Water Limited South Staffordshire Water plc Sutton and East Surrey Water Plc

Interaction with PR19 methodology

- 2.6 As part of our [PR19 methodology](#), we had set out our expectation for companies to actively and effectively consider markets and third-party delivery options for water resources and bioresources for both this review period and the longer term. The proposed licence modification will support this and complement the other PR19 measures designed to address undue preference or undue discrimination, such as the company bid assessment framework for water resources, demand management and leakage services.
- 2.7 As part of our PR19 approach to delivering outcomes for customers, we have created a new incentive to improve the customer experience for new connections customers (developer services), the D-Mex. These customers include small and large property developers, SLOs and NAVs². The proposed modification will support this, by ensuring water companies do not show undue preference or undue discrimination as between their own in house services and NAVs or SLOs.

² We have not made final decisions on all aspects of the design of the D-MeX. This is because we plan to pilot both of these incentive mechanisms in 2018-19 and the final design decisions will be informed by the pilots.

2.8 WSSLs are already under an obligation to show no undue preference or undue discrimination where they are related to a water company. Condition 7 of Part A of the standard conditions of water supply licences and sewerage licences includes:

- a requirement for arm's length transactions with a related water company; and
- a prohibition on the showing of undue discrimination towards, or undue preference against, a related water company as compared with any other water company.

3. What are the changes we are proposing?

- 3.1 The first proposed licence modification introduces a new requirement for a water company not to show undue preference towards (including towards itself), or undue discrimination against, other market participants, whether they are other water companies (including NAVs) water supply or sewerage licensees or other entities.
- 3.2 Paragraph 6 of Condition R of water companies' licences already includes a requirement on water companies not to show undue preference or undue discrimination in relation water supply and/or sewerage licensees and their customers. This was introduced to support the business retail market. The proposed licence modification is a stand-alone condition which would extend this requirement to market participants in the new wholesale markets, the SLO market and the NAV market.
- 3.3 The second proposed licence modification introduces a specific provision requiring water companies to restrict the use of information submitted to them in relation to a bid for the provision of services in the new wholesale markets or submitted by those making enquiries about, or entering into, agreements for the adoption of self-laid infrastructure.

Detail of the proposed licence modifications

- 3.4 The proposed wording for these modifications is set out in the appendix. The key aspects of the proposed licence modifications are set out below.

Undue preference or undue discrimination

- 3.5 The effect of the proposed licence modification will be that, when carrying out their regulated activities, water company must show no undue preference (including for itself), or undue discrimination in the doing of such things as relate to the provision of services by itself or another person of the following services:
- the provision, management and development of water resources;
 - activities connected with the promotion of the efficient use of water and the reduction of demand for water (Demand Management);
 - activities connected with the discovery and repair of unplanned or unintended leaks of water from pipes (Leakage Services);

- the laying of lateral drains, service pipes, sewers and/or water mains that are intended to be connected to the water company's system(s), or the alteration or removal of a pipe or other apparatus that is for the time being kept installed by the water company on, under or over any land;
- the provision of supplies of water or, as the case may be, sewerage services to premises by a water company (which can in some cases, such as new housing developments, be provided by a different water company); and
- activities connected with the transport, treatment and disposal of sludge produced by sewage disposal works (Bioresources).

3.6 The prohibition of undue preference and undue discrimination is not intended to prevent water companies from treating third parties differently where there is an objective justification for that difference. For example, for the provision of new connections to the existing water network SLO's may need to demonstrate that they have the necessary technical skills, such as through an accreditation scheme where SLOs undergo a technical assessment (e.g. the Water Industry Registration Scheme) and therefore do not need to be approved by individual water companies or equivalent means. If an SLO cannot demonstrate that it has the necessary technical skills, a water company might reasonably refuse to allow it to make new connections to the existing water network.

Restriction on use of information

Purpose and scope

3.7 The purpose of this proposed licence modification is to ensure that information provided to the water company by other persons in specific circumstances, is used only for the purpose for which it was provided and is not otherwise disclosed externally or used or disseminated within the water company. This restriction will be subject to exceptions. These are where the use of the information is:

- required or permitted by law;
- necessary to protect public health or to prevent the contamination, waste, undue consumption or misuse of water supplied by the water company;
- necessary to investigate or prosecute criminal offences; or
- otherwise agreed with the person furnishing the information.

3.8 The specific circumstances where the restriction on the use of information is intended to apply are where information is provided to a water company:

- in relation to the submission of a bid for the provision, management and/or development of:
 - water resources,
 - activities connected with demand management or leakage services, or
 - activities connected with the transport, treatment and disposal of bioresources; or
- when making an enquiry about, or entering into, an agreement for the adoption of water mains and/or services pipes or sewers, drains and/or sewage disposal works.

3.9 The proposed licence modification will not restrict the disclosure of information which is in the public domain or which is already in the possession of the water company. Nor will it restrict the disclosure of protected information to a water company's agents or contractors, as long as it is for a permitted use.

4. Why do we need these licence modifications?

Undue preference or undue discrimination

4.1 We are proposing a licence modification prohibiting water companies from showing undue preference towards, or undue discrimination in relation to the provision of certain services to help ensure a level playing field, to support the development of new markets and to bring about a change in water companies' behaviour in relation to the self-lay and NAV markets.

New wholesale markets

4.2 Market developments for water resources, demand management, leakage services and bioresources will, in line with our Water 2020 framework and PR19 methodology, mean greater involvement by a range of market participants. New markets – places where buyers meet sellers – create opportunities for third party involvement in developing innovative approaches and solutions to deliver new services that create value for customers, the environment and wider society. It is vital that a level playing field exists, to ensure these markets can develop.

4.3 As part of PR19, we have already taken a number of steps to create opportunities for new entry into the new wholesale markets. These include;

- setting separate binding wholesale revenue controls for water resources (including demand management and leakage services and bioresources (sludge treatment, transport, recycling and disposal);
- introducing market information requirements to increase transparency in bioresources and water resources to enable others to identify opportunities to offer services, if they can provide them at a lower cost and/or a higher quality; and
- a requirement for companies to produce a bid assessment framework to give third parties more clarity and confidence that their bids to supply water resources, leakage or demand management services will be assessed fairly, in particular, against the water company supplying its own in-house solution.

4.4 In the PR19 methodology, we have made clear that we consider that the water resources market, in particular, can benefit from significantly more trading from out of area water companies or other wholesale providers of water (e.g. power

generators) rather than water companies relying on their own in-house solutions to meet their future water needs.

- 4.5 A second area for potential development in the water resources market is the future scope for participation from third parties or out of area water companies in England, to sell water directly to water retailers ('the bilateral market') as the retail business market develops. The development of this market is contingent on the relevant provisions of the Water Act 2014 being enabled by DEFRA³. The bilateral market will involve water resource providers paying an access prices to the incumbent water company for use of their distribution system and, if needed, treatment facilities. Even with an access framework in place, incumbent water companies may have incentives to engage in undue preference or undue discrimination. Therefore, the proposed licence modification will protect against undue preference or undue discrimination in the bilateral market.
- 4.6 For bioresources, market participants will be able to transport, treat, recycle and/or dispose of bioresources. There is evidence that there is scope for increased optimisation of activities across the water companies and greater participation from firms operating in wider waste markets. For companies in both England and Wales, there may be cross-boundary opportunities which could lead to more efficient operations and lower costs. There are also other organic waste (OOW) facilities that may be able to offer bioresources treatment services to companies in both England and Wales. The realisation of these opportunities could enhance the economic, social and environmental wellbeing of people and communities.
- 4.7 If water companies' behaviour is slow to change and/or the perception of new entrants means that they will consider it too risky to enter, market development will be hindered. We may also continue to receive complaints from NAVs and SLOs and potentially other market participants in relation to the new wholesale markets.

³ Our working assumption is that 2022 is a likely implementation date. The Welsh Government has decided not to establish a Welsh bilateral market at this time.

Self-lay and NAV markets

- 4.8 When deciding how to provide new connection services for a site, a developer can choose between the water company, a SLO (where the infrastructure is then adopted by the water company) or a NAV. If a NAV is chosen (and appointed as the water company) it becomes the monopoly provider for the site and generally provides, owns and operate the 'last-mile' on-site infrastructure and retail services. In most cases, however, it is reliant on a range of input services from the incumbent water companies – including a “bulk-supply” or “bulk discharge” delivered to/from the site boundary; network information; and sometimes network reinforcement in the incumbent water companies' area to enable the site's connection.
- 4.9 The NAV review revealed that NAVs considered the majority of water companies did not treat their requests for connections and infrastructure on a level playing field with their own quotes to developers or SLOs, both as regards requirements, costs and speed of response. It was noted in the review that a licence modification prohibiting water companies from showing undue preference towards, or undue discrimination against, all providers of these new connections services, including a water company's in-house developer services would help accelerate behaviour change.
- 4.10 Similar issues have been raised in the self-lay market, therefore we are proposing to include protection for SLO's as well as NAVs from undue preference or undue discrimination in the proposed licence modification.

Our statutory duties

4.11 We also consider that this licence modification will help deliver our statutory duties as amended by the Water Act 2014. Under section 2 of the Water Industry Act 1991, Ofwat is required to carry out relevant functions in the manner that we consider is best calculated to (among other things):

- further the consumer objective to protect the interests of consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the provision of water and sewerage services; and

- (a secondary duty introduced by section 23 of the Water Act 2014) secure that no undue preference (including for itself) is shown, and that there is no undue discrimination, in the doing by a water company of:
 - such things as relate to the provision of services by itself or another water company, or
 - such things as relate to the provision of services by a water supply licensee or a sewerage licensee.

Restriction on the use of information

- 4.12 We are proposing a licence modification to restrict the use of information provided to water companies by third parties, in certain circumstances. This will ensure that water companies do not gain an unfair commercial advantage where they are, or could be, competing internally or externally to provide the same services.
- 4.13 In the new wholesale markets, out of area water companies or third party providers may submit bids to the incumbent water company to provide, manage or develop water resources, demand management, leakage services or bioresource services. To maintain trust and confidence in these markets, those submitting bids must be reassured that any information they disclose to the incumbent water company will only be used in limited circumstances, to ensure the incumbent water company does not gain an unfair advantage. Similarly NAVs, or SLOs who submit information to the incumbent water company as part of an enquiry into entering an agreement to adopt water mains or service pipes, or sewer, drain or sewage disposal works, should benefit from the same reassurance.
- 4.14 The licence modification introduces a specific provision requiring water companies to restrict the use of information submitted to them as part of a bid for the provision of services in the new wholesale markets or submitted by those making enquiries about, or entering into, agreements for the adoption of self-laid infrastructure.

Taking a proportionate approach

4.15 In assessing the need for these proposed licence modifications, we have had regard to the potential for new entry into the new wholesale markets and the need to ensure a well-functioning NAV market and self-lay market, balanced against the regulatory costs incurred by water companies to secure compliance. We have also noted the existing obligations on WSSLs to show no undue preference or undue discrimination toward or against a water company to which it is related. Therefore, we have taken a proportionate approach and propose that the licence modifications only apply to the 17 largest water companies in England and Wales.

5. Next steps

We invite stakeholders to comment on the proposed modifications by no later than 8 August 2018. Each relevant water company should also indicate its acceptance or otherwise of the proposed modification by this date. You can email your responses to PR19@ofwat.gsi.gov.uk or post them to:

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7 Hill Street
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Subject to agreement, we expect the proposed modifications to companies' licences to come into effect from 1 April 2019.

Appendix: Proposed modifications

This appendix sets out an example of the text of the proposed modifications. The purpose of this appendix is to help to show the effect of the proposed modifications. It does not necessarily include the exact wording that will apply for each water company because the conditions of each company's licence are individual and may vary or because technical errors or inconsistencies may need to be corrected without changing the substance and intended effect. In particular, please note that the text in square brackets is only relevant to water companies that are both a water undertaker and a sewerage undertaker (often known as water and sewerage companies or WaSCs).

Undue preference or undue discrimination

The Appointee shall, when carrying out the Regulated Activities, not show undue preference towards (including towards itself), or undue discrimination against, any person in the doing of such things as relate to the provision by itself or by other relevant undertakers, water supply [and/or sewerage] licensees or any other person of the following services:

- (a) the provision, management and/or development of water resources;
- (b) activities connected with the promotion of the efficient use of water and the reduction of demand for water (Demand Management);
- (c) activities connected with the discovery and repair of unplanned or unintended leaks of water from pipes (Leakage Services);
- (d) the laying of [lateral drains,] service pipes[, sewers] and/or water mains that are intended to be connected to the Appointee's supply system [or its sewerage system (as defined in section 17BA(7) of the Water Industry Act 1991)] or the alteration or removal of a pipe or other apparatus that is for the time being kept installed by the Appointee on, under or over any land;
- (e) the provision of supplies of water [or, as the case may be, sewerage services] to premises by a relevant undertaker; and
- (f) [activities connected with the transport, treatment and disposal of sludge produced by sewage disposal works (Bioresources)].

Drafting notes

Section 219 (General interpretation) of the Water Industry Act 1991 is relevant to the interpretation of a number of the terms used above (including lateral drain, service pipe, sewer and water main and the supply system of a water undertaker).

Restrictions on the use of information

- X The Appointee shall not disclose the information referred to in paragraph Y below, or otherwise use, distribute or disseminate such information within the Appointed Business, otherwise than for the purpose or purposes for which that information was furnished by the relevant person, except –
- (a) where required or permitted by law;
 - (b) where necessary to protect public health or to prevent the contamination, waste, undue consumption or misuse of water supplied by the Appointee;
 - (c) where necessary to investigate or prosecute criminal offences; or
 - (d) where otherwise agreed with the person furnishing the information.
- Y The information referred to in paragraph X above is information disclosed to the Appointee by any person when:
- (a) submitting, or providing information in relation to, a bid to the Appointee for the provision, management and/or development of –
 - (i) water resources,
 - (ii) activities connected with the promotion of the efficient use of water and the reduction of demand for water (Demand Management),
 - (iii) activities connected with the discovery and repair of unplanned or unintended leaks of water from pipes (Leakage Services), and/or

- (iv) [activities connected with the transport, treatment and disposal of sludge produced by sewage disposal works (Bioresources)]; or
 - (b) making an enquiry about, or entering into, an agreement under section 51A (Agreements to adopt water main or service pipe at future date) [or section 104 (Agreements to adopt sewer, drain or sewage disposal works, at future date)] of the Water Industry Act 1991.
- Z For the avoidance of doubt, paragraph X above does not restrict the disclosure, use distribution or dissemination of information that is in the public domain or that has been disclosed to the Appointee in circumstances that do not fall within paragraph Y above.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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