

6 November 2018

Trust in water

**Response to the consultation under section 13
of the Water Industry Act 1991 on proposed
modifications to the licence conditions**

About this document

This document is a response to the consultation for 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).

Under section 13 of the Water Industry Act 1991, the Water Services Regulation Authority ('Ofwat') may modify the conditions of a water company's licence if the company consents to the modifications. Following our consultation we received consent from each of the 17 water companies and have made the modifications in line with our consultation proposals. This document sets out the reasons for that decision. The modifications come into effect on 1 April 2019.

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

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

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.

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1. Introduction

- 1.1 In July 2018 we [consulted on licence modifications](#) for water companies in England and Wales to prohibit them from showing undue preference towards or undue discrimination against themselves, other water companies (including new appointees, or 'NAV's'), unlicensed third parties in relation to the provision of certain services.
- 1.2 We also proposed a second modification that would place restrictions on the circumstances in which water companies could disclose information, either within their company or to external parties, in relation to the submission of bids for the provision of certain services or agreements for the adoption of infrastructure assets.
- 1.3 This document provides a response to the consultation on the two modifications pursuant to section 13 of the Water Industry Act 1991 ('WIA91'). All water companies provided consent to the proposed modifications to their licence. We have therefore made the modification in line with the proposals in the consultation. This document is structured as follows:
- This first chapter provides an introduction to need for the licence modifications;
 - Chapter 2 provides background to the licence modification, how the requirement has been identified, who it applies to and how it relates to the methodology for our 2019 price review ('PR19');
 - Chapter 3 sets out the changes that we have made to licence conditions
 - Chapter 4 sets out the reasons for our decision to make each of the licence modifications
 - Chapter 5 sets out our response to the issues raised in the consultation

The text of the licence modifications has also been published on our website.

Undue preference and undue discrimination

- 1.4 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.

- 1.5 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.
- 1.6 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.
- 1.7 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.
- 1.8 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.
- 1.9 A level playing field is not only important for new and developing markets, but also for existing markets where the possibility of such 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.
- 1.10 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).

- 1.11 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.

Safeguarding against the misuse of information

- 1.12 We have also introduced 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.
- 1.13 This modification complements and supports the 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 WIA91) 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 water companies 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 In developing this licence modification we shared drafts of the proposed modification with the relevant water and wastewater companies. In July we published our proposed modification for water companies licence pursuant to section 13 of the WIA91 seeking their consent. This reflected, where appropriate, the feedback received from companies. We welcome the constructive approach taken by companies in this process.

Who the licence modifications apply to

- 2.4 Table 1 lists the companies whose licence conditions have been modified. The licence modifications have only been made for the 17 largest monopoly providers of water and/or wastewater services in England and Wales.

Table 1: List of the companies the modifications 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

- 2.5 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 licence modification supports this and complements 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.
- 2.6 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 NAVs. The modification will support this, by ensuring that water companies do not show undue preference or undue discrimination as between their own in house services and NAVs or SLOs

2.7 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 have made?

- 3.1 We have made the licence modifications by inserting a new Condition E1 (entitled “Prohibition on undue discrimination and undue preference and restrictions on the use of information in relation to the provision of certain services”) into the conditions of the relevant water companies’ licences. The new Condition E1 comes into effect on 1 April 2019.
- 3.2 The first part of the new Condition E1 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.
- 3.3 This new requirement is in addition to paragraph 6 of Condition R of water companies’ licences, which already included a requirement on water companies not to show undue preference or undue discrimination in relation water supply and/or sewerage licensees and their customers. That was introduced to support the business retail market. The new 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.
- 3.4 The second part of the new Condition E1 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 licence modifications

- 3.5 The text of the licence modifications for each water company have been published on our website. It reflects the wording included in the appendix to our consultation document. There have only been two or three minor changes to that wording in the interests of clarity (none of which change the intended effect of the licence modification that was proposed in the consultation document):

- It has been made clear in paragraph 1 of Condition E1 that the term “supply system” has the same meaning in section 219(4A) of the WIA91. This reflects the drafting note in the appendix to the consultation document that “Section 219 [...] is relevant to the interpretation of a number of the terms used above (including [...] the supply system of a water undertaker)”.
- For water only undertakers, paragraph 1(5) of Condition E1 refers to the provision of supplies of water to premises by a **water** undertaker instead of a “relevant undertaker” (which means a water undertaker or sewerage undertaker).
- An obviously missing comma has been included in paragraph 4 of Condition E1 between the words “use” and “distribution”.

Undue preference or undue discrimination

3.6 The effect of the licence modification will be that, when carrying out their regulated activities, a 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 supply system, 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; and
- activities connected with the transport, treatment and disposal of sludge produced by sewage disposal works (Bioresources).

3.7 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, whether this is 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

3.8 The purpose of this 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 disclosed, used or disseminated within the water company. This provision will be subject to exceptions. These, set out in paragraph 2(1) - (4) of Condition E1 are:

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

3.9 The specific circumstances where the restriction on the use of information applies, set out in paragraph 3 of Condition E1, are when 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;
 - activities connected with the transport, treatment and disposal of bioresources; and
- when making an enquiry about, or entering into, an agreement to adopt a water main or services pipes or a sewer, drain or sewage disposal works.

3.10 The 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 or the disclosure of information to a water company's agents or contractors, as long as it is for a permitted use.

4. Why have we made these Licence Modifications?

Undue preference or undue discrimination

- 4.1 We have introduced a licence condition 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 DEFRA². The bilateral market will involve water resource providers paying an access price to the incumbent water company for the 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 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.

² 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 included protection for SLO’s as well as NAVs from undue preference or undue discrimination in the licence modification.

Our statutory duties

- 4.11 We consider that this licence modification helps to deliver our statutory duties as amended by the Water Act 2014. Under section 2 of the WIA91, 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 have introduced a licence condition restricting the use of information provided to water companies by third parties, in certain circumstances. The reason for this licence condition is to 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 licence modifications, we 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
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the regulatory costs incurred by water companies to secure compliance. We 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. We therefore decided that it was a proportionate approach to only make the licence modifications for the 17 largest water companies in England and Wales.

5. Responses to our Consultation

- 5.1 In July we published our proposed modifications. We have received consent from each of the 17 water companies to modify their licences. We also received additional support for the modification from other stakeholders. Despite this consent, some companies raised concerns which we have sought to address below.

Relationship with the Competition Act 1998

- 5.2 Three companies, South West Water, Southern Water and United Utilities, raised questions about the relationship between the new prohibition on undue preference and undue discrimination condition and the Competition Act 1998.
- 5.3 Our general approach to the enforcement of this new licence condition will be the same as for the enforcement of the existing prohibitions on undue preference and undue discrimination in water company licences. The WIA91 itself includes procedural safeguards for water companies. For example, sections 19(1A) and 22A(13) of the WIA91 require Ofwat to consider whether it would be more appropriate to proceed under the Competition Act 1998 before we can make an enforcement order or impose a financial penalty under the WIA91.
- 5.4 We have published an enforcement policy, [Ofwat's approach to enforcement](#) (January 2017), which sets out our aims when we engage in enforcement action under the WIA91 and, in broad terms, the process we will follow. We have also published guidance on how we will apply the Competition Act 1998 to the sector, including [Guidance on Ofwat's approach to the application of the Competition Act 1998 in the water and wastewater sector in England and Wales](#) (March 2017).
- 5.5 We consider that the WIA91 and our existing policies provide sufficient detail for water companies on our approach to the enforcement of these and other licence conditions and how we will approach the relationship between enforcement under water industry legislation and under the Competition Act 1998.
- 5.6 In chapters 3 and 4 of this document, we set out the intended coverage and purpose of the new prohibition on undue preference and undue discrimination.

As we set out in paragraph 3.7, the new prohibition 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.

- 5.7 We consider that this provides stakeholders with sufficient detail on the intended purpose and coverage of the conditions. We will of course consider each individual case or complaint on its merits.

Use of information

- 5.8 Dŵr Cymru expressed concerns that the drafting of the provisions around the use of information was, in their view, open to a very narrow interpretation on water companies' ability to use the information that had been provided. In particular Dŵr Cymru was concerned that obtaining agreement from the person providing the information on the future use of that information would be unduly onerous for water companies and not be practical in all circumstances.
- 5.9 We consider that in most cases the reasonable use of protected information will be consistent with the purpose or purposes for which that information was provided or, alternatively, permitted by one of the exceptions included in paragraph 2 of Condition E1. For example, information about the layout or construction of new pipework that is provided to a water company when entering into an adoption agreement is being provided for the purposes of maintaining appropriate records and operating the public network when the new pipework is connected and/or adopted. We therefore do not consider that these provisions will place an undue burden on water companies.
- 5.10 We also note that it would help to improve trust and transparency if water companies were able to set out in advance, such as in standard form agreements, how they intend to use protected information.

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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