

September 2018

Trust in water

Consultation under section 13 of the Water Industry Act 1991 on proposed modification to simplify various conditions of all undertakers' licences

About this document

This document invites comments on our proposal to modify various conditions of all undertakers' appointments (licences). The intention is to simplify and modernise the licence conditions, while maintaining the protections for customers and the balance of risk for companies. We have been working with the sector to identify where the licence can be simplified and streamlined, and this is a package of changes which we would like to make to all licences as a step towards modernising licences.

Under section 13 of the Water Industry Act 1991 (WIA91), we are able to modify the conditions of a company's licence if it agrees to the changes we are proposing to make.

This document and the attached appendices is a Notice under section 13 of the WIA91.

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Responding to this consultation

We invite stakeholders to comment on our proposed modifications by **19 October 2018**. Companies should also indicate their acceptance or otherwise of the proposed modification by this date. You can email your responses to FinanceAndGovernance@ofwat.gsi.gov.uk or post them to:

Finance and Governance
Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA.

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to this document on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished.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), the General Data Protection Regulation, the Data Protection Act 2018 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.

1. Introduction and Background

Licences and licence conditions

Water and sewerage undertakers (Appointees) are appointed by Ofwat under the WIA91 to provide water and sewerage services. Their appointments are for specific areas and are subject to conditions which set out:

- the services the company must or may provide; and
- the obligations that the company must comply with in delivering those services.

The conditions of these appointments are set out in Instruments of Appointment, which we call licences. They are an important tool for protecting customers. Companies must comply with their licences and we can take enforcement action using our powers under the WIA91 if a company fails to comply with its licence obligations.

The context to this work

A central aim of our current work is to challenge water companies to improve their delivery of services to customers, and to improve the way companies are run. To achieve this, it has become clear that the way in which companies are regulated is transparent, and that there is simplicity and clarity about the standards and requirements for which the regulated companies are held to account.

Because licences are a key tool in holding companies to account, it is important that licences reflect that transparency and clarity. Therefore Ofwat considers the simplification and modernisation of licences to be an important underpinning of our strategy.

Through our licence simplification exercise, we have been working with the sector to update the licences in the relatively straightforward areas where streamlining, clarification or removal of duplication is possible. We have avoided in this package of work cutting across those conditions which might give rise to more substantive issues or on which we are currently doing other work, such as:

- Those conditions which are fundamental to the operation of our price review process currently in progress (Condition B)

- Those conditions we anticipate consulting on separately to bring all companies up to the same most up to date standards and/or to strengthen the ring fencing conditions (Conditions F (except accounting), K and P), and
- Those conditions only recently created for the operation of the retail market (Conditions R and S)

The coverage of the licence conditions is explained in Appendix 1, while Appendix 2 shows the proposed revised licence conditions and Appendix 3 provides a condition-by-condition commentary.

Scope and Objectives

Table 2 below indicates what we aim to achieve in the simplification proposals.

Table 2 Scope and objectives of simplification work

Deliver a licence that allows...	It covers...	It does not cover...
<ul style="list-style-type: none"> • For key obligations and requirements to be clearly stated in a way that is, as far as possible, easily understood by companies and interested stakeholders. • us to regulate in accordance with our regulatory model, and facilitates delivery of our strategy • for evolution in our regulatory approach, and is adaptable to changes in sector structure and our regulatory environment 	<ul style="list-style-type: none"> • Simplifying the language and structure of the licence. • Removing conditions or reducing and rationalising conditions which are identified as being no longer relevant or do not reflect the environment in which companies now operate. • Updating the requirements of the licence where needed to reflect the current policy drivers and align with other requirements 	<ul style="list-style-type: none"> • introducing new conditions. • Seeking to address any existing, substantive differences between companies' licences. • substantively altering the requirements of the licence in anticipation of long term deregulation. • 'modularisation' of the licence

Implications of this work

We expect significant intangible effects from the exercise. Simplified licence conditions set out obligations in a more direct, intelligible and concise manner. This provides greater regulatory clarity for companies, ourselves and other stakeholders. This will make it easier for:

- Companies to understand what is expected of them,
- Us to determine whether companies are complying with their obligations, and
- Stakeholders to understand for what we will hold the companies to account.

Alongside our other regulatory tools, customers will remain at least as well protected as they are at present.

There is one aspect which may have financial implications. This is the indexing provision in relation to the fees levied to pay for the work of the Consumer Council for Water and ourselves in Condition N. Changing from RPI to the relevant index (CPIH) will mean that the licence fees which companies' pay may change by a different amount than they otherwise would have done.

2. What are the changes that we are proposing?

The conditions covered by this consultation

The conditions which are covered by this consultation are set out below.

Table 3 Conditions in scope

Condition A - Interpretation and Construction (but only insofar as changes flow from changes to conditions below)
Condition D – Charges schemes
Condition E – Undue discrimination
Condition F – Accounting information element only
Condition G – Code of practice for customers and relations with CCWater
Condition H – Code of practice and procedure on debt recovery
Condition I – Code of practice and procedure on leakage
Condition J – Levels of service and service targets
Condition M – Provision of information
Condition N – Licence fees
Condition O – Replacement appointment
Condition Q – Interruptions in supply because of drought
Condition R1 – Open Water Programme
Condition R2 – Retail Market Opening

Summary of proposed changes by condition (condition lettering as proposed)

Condition D (New connections)

We consider that the provisions in the current Condition D are either no longer necessary or are adequately covered in statutory charges scheme rules in England.

We are proposing removing the whole of the current Condition D for companies operating wholly or mainly in England. For companies operating wholly or mainly in Wales, we will implement these changes only once the new charging regime for developer services is in place in Wales.

In the current Condition C there is requirement for a water undertaker to notify a sewerage undertaker when a new connection is made. This requirement is still apposite but needs to be moved to a different place in the licence as Condition C has either been amended to limit its effect from 1 April 2018, for companies operating wholly or mainly in England. For companies operating wholly or mainly in Wales Condition C has not been amended and for all new appointees¹ it has been removed in its entirety. For uniformity, we are proposing moving this provision into Condition D for all companies.

Condition E (Undue preference/discrimination in charges)

Current Condition E incorporates relatively straight forward requirements, which are set out in a very complex manner (with a list of statutory references). The proposed revision retains the straight forward requirements, but frames them as broader obligations, retaining a number of exceptions where these appear still to be relevant. We consider that a number of the exceptions are now redundant and can be removed. Changes have also been made to the regulation of Infrastructure Charges through new Charges Scheme Rules and our proposals would bring Condition E into line with those changes.

Condition F (Regulatory accounting statements) (see also a new Condition I below)

We are proposing to use this opportunity to provide a clearer demarcation between Condition F and the Regulatory Accounting Guidelines (RAGs) to which the condition refers. The existing condition provides a large amount of detailed accounting information which is more appropriate to, and duplicates, the RAGs. We propose stripping out this redundant material and relying on the material in the RAGs. Instead of including this detail, the condition is now focussed on what the RAGs may contain and the checks and balances for making and applying them. We also intend to

¹ New appointees are companies which did not exist at privatisation. These are companies that have successfully applied for an appointment to replace one of the seventeen largest existing water and or sewerage companies at a particular site.

consult shortly on complementary revisions to the RAGs which will accurately reflect this clearer interface.

Conditions G (Core customer information), H (Procedure on leakage) and existing I (Code of practice and procedure on leakage)

Current Conditions G, H and I all require companies to provide Codes of Practice on various subjects and set out arrangements for making them. This represents a considerable amount of duplicated material in the licence which we propose streamlining. We are proposing to consolidate those parts of Conditions G, H and I which deal with providing a Code of Practice into one new Condition G. We are also moving away from focussing on the bureaucratic form of a Code of Practice to focussing on the information to be provided to customers. The proposal brings the condition up to date with current practice by removing the provisions about Ofwat approving the Codes of Practice. We have not done this for some years, as we wanted companies to take more ownership for the content of the codes. If companies do not provide the information required we can enforce the condition in any case.

We have revised the condition to make it clear which information we expect to be provided to all customers and which information need only be provided to those customers who are not eligible to take part in the business retail market.

The latter part of the current Condition I contains procedures for charging in the event that leakage is discovered. The current wording is ambiguous as to the scope of the condition, and there is an inconsistent application of the condition by companies. We consider it important that the scope of the condition is consistently understood and applied. We propose to resolve this ambiguity by restricting the scope of the new condition to customers in domestic premises, as this appears to have been the original intention.

New condition I (Ring-fencing)

On 11 May 2018 in a consultation entitled [Change of control - general policy and its application to Thames Water](#) ('the Change of Control – general policy consultation'), we highlighted some areas of the financial ring fencing framework which we think can be strengthened. We intend to follow this up with a consultation on a more specific set of licence modifications to provisions currently found in Conditions F, K and P of companies' licences.

As an interim measure, we propose extracting all the provisions from the current Condition F that do not deal solely with accounts and accounting information but

instead focus on ring-fencing, and have placed them in a new Condition I. The existing Condition I will become unused under our proposals as set out above, where we are proposing to replace current Conditions G, H and I with new Conditions G and H. This separation will help clarify where different elements of the licence can be found.

We do not propose simplifying the provisions being moved to the new Condition I, which would simply contain the existing relevant provisions from condition F in a separate condition, with minor consequential amendments. We present an example condition in Appendix 2, but recognise that there is a range of formulations in existing company licences which will need to be replicated in each new Condition I. Some companies already have a more modernised and consolidated condition on ring fencing, and those companies will not need this new Condition I.

Condition J (Levels of service information and service targets)

We propose moving the information and investigation-related elements of Condition J into a revised Condition M.

Condition M

There are information-providing requirements dotted throughout the licence, which represents unnecessary duplication and potential confusion. We propose deleting information requirements which are currently contained in the other conditions which are in scope of this consultation. These will be incorporated within the general information provisions in Condition M.

We also propose moving into Condition M a provision that is currently in Condition J. This provision gives us power to seek information from companies to facilitate investigations by Ofwat for the purpose of deciding whether to make an application to the Secretary of State in respect of standards of performance regulations. We consider this fits better in Condition M than in Condition J.

Currently, we cannot use Condition M for gathering information from companies for the purposes of section 27 of WIA91. We propose deleting this exception. Section 27 places a duty on Ofwat to collect certain information (for the purposes of keeping the sector under review), but does not provide a power for doing so. Deleting the exception will enable us to use Condition M for collecting information, consistent with our statutory duty under section 27.

The proposed changes will bring the drafting up to date by referring to Ofwat's general legislative functions rather than referring specifically to our functions under

the WIA91. When originally drafted the WIA91 was the only place describing Ofwat's functions, but this is no longer the case.

Condition N

The proposed revision of Condition N is intended to simplify the fee-levying mechanisms by adopting shorter, more consistent provisions and more clearly signposting the different fees.

There is one substantive change proposed in this condition and this is in relation to the indexation of fees. RPI will be used up until 2020 and CPIH will be used thereafter. The index change is in line with licence amendments introduced in April 2017 in other parts of the licence, notably dealing with price controls.

Condition O

The proposed changes to Condition O are minor, to increase clarity, and do not change the meaning.

Condition Q

Condition Q makes provision for companies to make a payment or credit if customers' water supplies are interrupted while a drought order is in force. One of the important parts of Condition Q which was ripe for simplification was the provision which stated that no payment or credit was payable if 'the circumstances were so **exceptional** that it would have been unreasonable to have expected the interruption or cut-off to have been avoided.' We did not consider that this exception was helpful given that a drought order, when the condition applies, can only be made 'by reason of an **exceptional** shortage of rain'. There is therefore a lack of clarity which could lead to inconsistency in the extent to which companies pay compensation to customers.

Our view is that it is that the Appointee should not be required to make payments where it took all reasonable steps to avoid the circumstances which gave rise to the making of the drought order. We are therefore proposing the following text to be inserted in paragraph 5 of the revised condition to improve clarity:

"The Appointee is not required to pay or credit (as the case may be) any amount under this condition if it can demonstrate that it took all reasonable steps to avoid the circumstances which gave rise to the making of the drought order."

On 2 August 2018 we published our “[Call for evidence consultation – Guaranteed Standards Scheme \(GSS\)](#)”. This posed a question as to whether compensation in the event of supply restrictions should be moved within the scope of the Guaranteed Standards Scheme. We propose to proceed with the simplification of the licence condition in any case, although the call for evidence could result ultimately in more fundamental changes in the nature of the obligations.

Conditions R1 and R2

We propose removing Conditions R1 (Open Water Programme) and R2 (Retail Market Opening) as these are redundant, from the licences of companies operating wholly or mainly in England. Companies operating wholly or mainly in Wales do not have these conditions.

Condition R1 ceased to have effect on 1 April 2018, and Condition R2 ceased to have effect at market opening (1 April 2017).

Overall changes to the original licence conditions

Application across companies

One of the objectives of the licence simplification work is to have consistent drafting across licences. Inconsistency may have arisen, for example, where companies were given obligations at different times and we updated the text used in later versions. However if a company does not currently have an obligation in its licence that most other companies have, we are not proposing that it takes on this obligation in this particular licence simplification exercise.

Thus while Appendix 2 sets out the standardised simplified conditions we propose making, there may be minor differences between the conditions in this Appendix and the final conditions that apply to companies. This is because of the need to retain existing company specific provisions and because changes may be made as a result of this consultation process. We will re-consult if we are minded to make further significant changes but we will not re-consult for minor changes made following the consultation.

General changes

Introductory paragraph: We are proposing an introductory paragraph for each condition. This provides a short summary of the reason for the condition and is intended to aid navigation and help those not familiar with the licence.

Paragraph numbering: In order to aid navigation through the licence we are proposing that paragraph numbers are prefixed with the letter of the condition which they are in. Beyond the proposal to prefix paragraph numbers with the condition letter, we are proposing that we no longer use a mixture of letters and numbers for paragraphs. We also propose to limit the levels to which sub-paragraphs go down.

Definitions: We are proposing to move all definitions within the conditions in the scope of this particular licence simplification exercise to Condition A. This is in line with our current practice when amending existing conditions. Our aim is to eventually have all definitions in one place rather than split between Condition A and individual conditions as they are now.

Ofwat: We are proposing that references to Ofwat will appear as 'Ofwat' rather than 'the Water Services Regulation Authority' for brevity and to reflect common usage. 'Ofwat' will be defined in Condition A as 'the Water Services Regulation Authority'.

Legislation: For ease of reference, legislation will be cited in full e.g. Water Industry Act 1991.

We have also used the following principles, as far as possible in developing the proposed drafts:

- language should be accessible to people of a non-technical/legal background, where practical;
- sentences should be kept short; and
- reflect the current usage of language.

Terminology in relation to customers

The licences present two challenges in the definition of customer:

- A range of terms is used which has related but not identical meanings (for example, 'domestic customer'; 'household customer'; 'domestic premises'; and 'eligible premises'), and
- The opening of the non-household retail market in April 2017 created new classifications of customer which are not reflected in parts of the existing licences (ie 'customer' of a retailer' and 'customer' of an undertaker).

We propose replacing the various terms with three new related definitions ('appointee's customer'; 'customer'; and 'potential customer'), which are still grounded in the definition of 'customer' in section 219(1) of the Water Industry Act 1991. The new definitions work both with the revised conditions, and those

conditions in the licence which we are not currently looking to modify. The drafting makes clear that for some purposes (but not all) customers of water and/or sewerage supply licensees (licensees) are customers. By dealing with this issue expressly, there is a clearer and more appropriate alignment with market codes for the retail market, so that protections for customers will be maintained, without duplication or gaps in protection. We have, however, continued to use different terms in a limited number of places where a change would have reduced the level of protection for customers (for example, in condition H (Procedures on leakage) the term 'domestic premises' is used and in condition Q (Interruptions in supply on drought) the term 'household premises' is used).

Applying the conditions to new appointees

The licences of new appointees are slightly different from the licences for the seventeen largest appointees.

We intend to make similar changes to the licences of new appointees, subject to the special considerations in table 4 below

Table 4 New appointee-specific modifications

Condition	New appointee-specific issue	Proposed modification
A	All companies, other than new appointees have a definition of 'Relevant Index', which is now being updated for the change we are making to move from RPI to CPIH.	We propose amending the definition of 'Relevant Index' for all companies and inserting the amended definition into Condition A of new appointees' licences as it is not currently included in their licences.
D	Condition C was deleted with effect from 20 October 2017 for new appointees. For the seventeen largest companies it was modified to retain some provisions for certain transitional purposes. This was not considered necessary for new appointees as Condition B for new appointees already prevents them from setting charges that would be higher than those of the regional incumbent water company.	For all companies we propose that Condition D will comprise an updated provision from the previous Condition C. We see no reason why this should not apply to new appointees.
F Accounting information element only	Paragraphs 5, 7 and 8 of the existing Condition F are suspended for new appointees.	For new appointees, we do not propose suspending any provisions in the revised text. This is because the proportionality that is currently achieved by suspending certain conditions is set out in more detail in the RAGs and therefore the revised

Condition	New appointee-specific issue	Proposed modification
		arrangement will give new appointees the same protection as is currently the case.
M	<p>We propose moving current paragraphs 7 – 11 of existing Condition J into a revised Condition M. These paragraphs deal with information required by us in deciding whether to make an application to the Secretary of State in relation to standards of performance regulations (the current GSS Regulations). Condition J is suspended for new appointees.</p>	<p>As Condition J is currently suspended for new appointees, the inclusion of these provisions in Condition M will be new for new appointees. However, we do not propose suspending them for new appointees as the function they enable Ofwat to perform is an industry wide function rather than a function specific to the seventeen largest companies.</p>
N	<p>The current Condition N has slightly different provisions for new appointees to reflect the fact that new appointees are not subject to the price review and therefore do not contribute towards price review work.</p>	<p>The proposed Condition N14.2 relating to the calculation of the cap on the Annual General Fee and Special Fee refers to 'an amount equal to 0.3% of the average of the annual turnover of the Appointed Business...'. We propose to change the amendment to 0.1 % for new appointees to maintain the status quo (see current Condition N, paragraph 3.2). Our Information Notice 17/07 on fees confirms that new appointees will not be charged for the costs of running the price review.</p>

3. Next steps

We would like responses to this document by **19 October 2018**. Formal responses to our proposals by the companies holding appointments must indicate whether or not they accept the modifications proposed.

Subject to agreement, we aim to amend the companies' licences by **19 December 2018**.

Appendix 1: Coverage of Licence Conditions

Table 1 The licence conditions

Condition	Coverage
A	Definitions and rules for interpretation of the licence
B	Charges and the regulation of the price review process
C	Infrastructure charges
D	The requirement to have a charges schemes
E	Prohibition against undue discrimination
F	Sets out details of the accounts and financial information which companies are required to produce. It also includes a number of provisions related to the regulatory ring-fence
G	Requires companies to provide a Code of Practice for customers, which describes services provided and charges, billing arrangements and complaint handling, matters relating to water meters, and what to do in emergencies
H	Requires companies to provide a Code of Practice on debt recovery
I	Requires companies to provide a Code of Practice on leakage, which covers liability of metered customers where there is an unidentified leak on the supply pipe. Also sets out procedures for dealing with leaks when a new meter is installed
J	Requires companies to provide an annual report setting out their performance against defined service standards
K	Ring-fencing provisions relating to rights and assets, and also governs the disposal of Protected Land
L	Requires companies to maintain underground asset management plans, which must be updated (and submitted to us) at each periodic review of prices
M	A general obligation to provide us with information, subject to exceptions
N	Requires companies to pay licence fees to the Secretary of State to cover the costs of regulation. Fees relate to the costs of Ofwat, Consumer Council for Water, and any Competition and Markets Authority references. The licence also sets caps for certain combinations of fees
O	Sets out that a company may only be replaced following twenty-five years' notice from the Secretary of State
P	Ring-fencing provisions related to the conduct of the company's Ultimate Controller
Q	Requires companies to pay compensation to customers whose water supply is interrupted because of drought
R	Provisions of wholesale water supplies to Water Supply Licensees, and includes provisions related to access codes, anti-competitive behaviour, and provision of information between companies
R1	This provided for funding necessary for opening the non-household retail market

Condition	Coverage
R2	This required companies to be ready for retail market opening on 1 April 2017
R3	Requires companies to be part of and comply with the Market Arrangements Code
R4	Requires those companies that have not exited the non-household retail market to comply with the Wholesale Retail Code
R5	Requires those companies that have not exited the non-household retail market, to comply with the Customer Protection Code of Practice
S	Defines (and requires companies to comply with) the Customer Transfer Protocol, which governs the transfer of contestable customers between companies

Appendix 2: Proposed modification to licence conditions

This appendix sets out the modifications we propose implementing for all companies. This is subject to the caveat that the exact wording for each company may be slightly different from this appendix, given that not all companies have identical licences. We do not expect to introduce new obligations on individual companies where they do not have these obligations at present but other companies do. We may also make minor changes following the consultation process.

Condition A: Interpretation and construction

Definitions to be added

“Appointee’s customer” means a customer of the Appointee who is not also a customer of a Licensee, and the expressions **“customer of the Appointee”** and **“Appointee’s own customer”** shall have the same meaning;

“customer” means any person who is provided with water or sewerage services within the Area by either the Appointee or a Licensee, but does not include a Licensee acting in its capacity as such.

“potential customer” means any person who is capable of becoming a customer on making an application for that purpose to either the Appointee or a Licensee.

Definition to be amended

Note: Additional text is underlined and deleted text has been struck through

“the Relevant Index” means —

- (a) for any period before 1 April 2020, the Retail Prices Index,
- (b) for any period including, or after, 1 April 2020, either—
 - (i) ~~the Consumer Prices Index, or~~
 - (ii) ~~the Consumer Prices Index (H)~~

~~as the Water Services Regulation Authority shall determine to be appropriate in all the circumstances no later than 31 January 2018;~~
- (c) in any year where the Statistics Board has not published the index to be applied by 31 December, such index for such month as Ofwat ~~the Water Services Regulation Authority~~ may not later than the following 7 January determine to be appropriate in all the circumstances after such consultation with the Appointee as is reasonably practicable;”

Paragraph 7 to be amended

7. The Appointee may refer to Ofwat ~~the Water Services Regulation Authority~~ for determination by it (having considered any representations by the Appointee and any other water undertaker or, as the case may be, sewerage undertaker) any question arising as to whether any area, island, premises or installation is, or, as the case may be, are, comprised within the Area Water Supply Area or, ~~as the case may be, the Sewerage Services Area, as those expressions are defined in Schedule 1 to this instrument.~~

Condition D: New connections

Introduction

This condition requires that, where the Appointee makes a new connection to one of its water mains, the Appointee must provide specified information to any separate sewerage undertaker for the premises.

Informing sewerage undertakers of connections

D1 Where the Appointee connects premises to a water main which is owned by the Appointee, and the drainage of those premises is into a public sewer owned by a sewerage undertaker which is not the Appointee, the Appointee must as soon as reasonably practicable inform that sewerage undertaker of:

D1.1 the address of the premises;

D1.2 the date of the connection; and

D1.3 to the extent known to the Appointee:

D1.3.1 the name and address of the person who is liable to pay charges for the supply of water to the premises; and

D1.3.2 the name and address of any other person who is liable to pay Infrastructure Charges in respect of the premises.

Defined terms used in Condition D (to be included in Condition A)

“Infrastructure Charge” means a Water Infrastructure Charge or a Sewerage Infrastructure Charge.

Condition E: Undue Preference/Discrimination in Charges

Introduction

This condition requires that the Appointee must not set its charges in a way which results in undue preference in favour of, or undue discrimination against, any of its customers or potential customers. This condition also sets out a number of limits to this requirement.

Requirement not to show undue preference or undue discrimination

- E1 Subject to paragraphs E2 to E4, in fixing or agreeing any charges for the carrying out of the Regulated Activities (whether Class Charges or Bespoke Charges), the Appointee must not show undue preference to, or exercise undue discrimination against:
- E1.1 any class of customers or potential customers of the Appointee;
 - E1.2 any particular customer in relation to whom the Appointee has fixed or agreed a Bespoke Charge; or
 - E1.3 any potential customer in relation to whom the Appointee has offered to fix or agree a Bespoke Charge.

Limits to requirement not to show undue preference or exercise undue discrimination

- E2 Paragraph E1 shall not apply to the fixing or agreeing of:
- E2.1 any charge which is an Infrastructure Charge the amount of which is subject to a limit set out in Condition C (Infrastructure Charges);
 - E2.2 any charge which is determined by terms or conditions of an agreement that was:
 - E2.2.1 entered into by the Water Authority and transferred to the Appointee in accordance with a scheme under Schedule 2 to the Water Act 1989; or
 - E2.2.2 entered into by the Appointee before the transfer date but continuing in effect after that date;
 - E2.3 any charge which is determined by:

- E2.3.1 where the Appointee is a water undertaker, terms or conditions on which any supply of water in bulk is given by the Appointee to another water undertaker; or
- E2.3.2 where the Appointee is a sewerage undertaker, terms or conditions on which any main connection by another sewerage undertaker is permitted into the Appointee's sewerage system;
- E2.4 any charge which is determined by terms or conditions determined by Ofwat (or by a person appointed by Ofwat) under section 56 of the Water Industry Act 1991;
- E2.5 any charge which is determined by conditions imposed by Ofwat under section 122 of the Water Industry Act 1991; or
- E2.6 any charge which is determined by the provisions included in any notice served by the Environment Agency or Natural Resources Wales under section 132 of the Water Industry Act 1991 or anything required to be done by the Appointee under section 133 of the Water Industry Act 1991 so as to secure compliance with those provisions.
- E3 In fixing or agreeing any charges in compliance with paragraph E1, the Appointee is not required to consider any charges referred to in paragraph E2.
- E4 Paragraph E1 shall not require the Appointee to take any action in contravention of any local statutory provision.

Defined terms used in Condition E (to be included in Condition A)

“**Bespoke Charge**” means any charge fixed or agreed by the Appointee, in respect of any customer of the Appointee, which is not a Class Charge;

“**Ofwat**” means the Water Services Regulation Authority;

“**Class Charge**” means any charge fixed or agreed by the Appointee which applies to a particular class of the Appointee's customers.

Condition F: Regulatory accounting statements (excluding current ring fence obligations)

Introduction

This condition requires the Appointee to keep appropriate accounting records which are consistent with guidelines published by Ofwat. Ofwat will publish the guidelines and revise them, subject to certain procedural protections.

The Regulatory Accounting Guidelines

- F1 Ofwat will publish the **Regulatory Accounting Guidelines** which will:
- F1.1 relate to the accounting records that must be kept by the Appointee and the accounting Information that must be provided by it to Ofwat; and
 - F1.2 have the purpose of ensuring that:
 - F1.2.1 Ofwat may obtain all appropriate accounting Information in respect of the Appointed Business; and
 - F1.2.2 the financial affairs of the Appointed Business are recorded and reported on, and may be assessed, separately from any other business or activity of the Appointee.
- F2 The Regulatory Accounting Guidelines may in particular include provisions in relation to:
- F2.1 the form and content of the accounting records that the Appointee is required to keep;
 - F2.2 the form and content of the accounting statements, and any associated reports or analyses, that the Appointee is required to prepare;
 - F2.3 any audit of the accounting records and statements that the Appointee is required to procure, the terms on which that audit is to be procured, and the basis on which the record and conclusions of that audit must be provided to Ofwat; and
 - F2.4 the time by which the Appointee is required to provide any accounting Information to Ofwat and any requirement on the Appointee to publish that Information.

- F3 The Regulatory Accounting Guidelines may not require the disclosure of Information which relates solely to a transaction wholly unconnected with the Appointed Business.
- F4 Ofwat may, from time to time, revise the Regulatory Accounting Guidelines in any manner that it considers appropriate, provided that, before any revision takes effect, Ofwat:
- F4.1 consults the Appointee on a draft of the proposed revision;
 - F4.2 has regard to any representations made by the Appointee;
 - F4.3 publishes a final version of the revision, incorporating any changes made to the draft following consultation; and
 - F4.4 gives reasonable notice (of at least one month) to the Appointee of the date on which that revision will take effect.
- F5 The Appointee may notify Ofwat, within one month of receiving notice that a revision to the Regulatory Accounting Guidelines will take effect, that it disputes the revision, and in that case:
- F5.1 the question of whether the revision is appropriate shall (unless Ofwat withdraws the decision to make it) be referred by Ofwat to the Competition and Markets Authority for determination; and
 - F5.2 the revision shall not take effect unless and until the Competition and Markets Authority determines that it shall.

Compliance with the Regulatory Accounting Guidelines

- F6 The Appointee must:
- F6.1 prepare a set of regulatory accounting statements, in respect of the twelve month period ending on 31 March in each Charging Year, which are in accordance with the Regulatory Accounting Guidelines; and
 - F6.2 comply with all other requirements that are set out in the Regulatory Accounting Guidelines.

Condition G: Core Customer Information

Introduction

This condition requires the Appointee to publish and make available specified information for customers. It also requires the Appointee to have a complaints handling procedure and to provide specified information with its bills.

Core Customer Information

- G1 The Appointee must maintain information in written form for customers (the **Core Customer Information**) in accordance with this condition.
- G2 The Core Customer Information must include, in relation to all customers, a description of:
 - G2.1 how customers can contact the Appointee, and what customers should do, in the event of an emergency;
 - G2.2 the means by which customers may identify officers authorised by the Appointee when those officers visit customers' premises;
 - G2.3 the arrangements which the Appointee has in place for the testing of meters and any charge which may be payable for such testing;
 - G2.4 the charges which the Appointee may levy where metered premises have been vacated; and
 - G2.5 the offences set out in section 175 of the Water Industry Act 1991 (offence of tampering with meter).
- G3 The Core Customer Information must include, in relation to customers whose premises are not Eligible Premises, a description of:
 - G3.1 how those customers can contact the Appointee to make general enquiries;
 - G3.2 the role of the Consumer Council for Water and how those customers can contact it;
 - G3.3 the services provided to those customers by the Appointed Business;

- G3.4 the terms on which those services are provided, including the charges levied for the services;
 - G3.5 the payment methods available to customers in respect of those charges, including payment by instalments and budget plans;
 - G3.6 the Complaints Handling Procedure which applies for those customers; and
 - G3.7 any independent dispute resolution scheme which is in place for resolving disputes between the Appointee and those customers and how customers can access the scheme.
- G4 The Core Customer Information must include guidance for customers whose premises are not Eligible Premises who are having difficulty paying their bills and a description of the procedures which the Appointee may apply to collect outstanding debt from those customers.
- G5 The Core Customer Information must include, in relation to Domestic Customers, the procedures which the Appointee applies in relation to leakage (in accordance with Condition H) and the charges which the Appointee may levy where there is an unidentified leak on the Supply Pipe at metered Domestic Premises.

Publication of the Core Customer Information

- G6 The Appointee must:
- G6.1 publish the Core Customer Information, presenting it in a manner which is effective, accessible and clear as a means of informing customers;
 - G6.2 publicise the Core Customer Information to its customers; and
 - G6.3 where any customer requests information which is part of the Core Customer Information, provide that information to the customer in writing.

Revising the Core Customer Information

- G7 The Appointee must ensure that the Core Customer Information is accurate and up to date.

- G8 The Appointee must review the Core Customer Information as a whole and, where necessary, revise it:
- G8.1 at least once every three years; and
 - G8.2 whenever requested to do so by Ofwat, provided that such a request may not be made more than once in each year.
- G9 In carrying out any review under paragraph G8, the Appointee must consider whether the content of the Core Customer Information remains appropriate and whether the manner in which the Core Customer Information is published is effective.
- G10 Whenever it undertakes a review of the Core Customer Information under paragraph G8 or proposes to make any substantive revision to the Core Customer Information or the manner in which it is presented, the Appointee must consult the Consumer Council for Water and take its representations into account before (as the case may be) completing the review or making the revision.
- G11 Where a revision is made to the Core Customer Information or the manner in which it is presented, the Appointee must inform the Consumer Council for Water of the revision which has been made and of how the revised Core Customer Information may be accessed.
- G12 Where a revision is made to the Core Customer Information, the Appointee must publicise the revised Core Customer information to its customers.

Inclusion of information with bills

- G13 The Appointee must:
- G13.1 with every bill for Metered Charges, inform the customer of how the Core Customer Information set out at paragraphs G2.3 to G2.5 may be accessed;
 - G13.2 with every bill for charges payable by a customer whose premises are not Eligible Premises, inform the customer of how the Core Customer Information set out at paragraph G4 may be accessed; and

G13.3 with every bill for Metered Charges payable by a Domestic Customer, inform the customer of how the Core Customer Information set out at paragraph G5 may be accessed.

Complaints Handling Procedure

G14 The Appointee must establish, maintain and comply with a **Complaints Handling Procedure** for handling complaints from customers.

Defined terms used in Condition G (to be included in Condition A)

“Eligible Premises” has the meaning given in the Wholesale-Retail Code (as amended from time to time).

Condition H: Procedure on Leakage

Introduction

This condition sets out the procedure which the Appointee must follow in relation to leaks or potential leaks on Supply Pipes of Domestic Premises.

Application

- H1. The Appointee must follow the procedure set out in this condition in relation to customers whose premises are Domestic Premises.
- H2. In this condition, any reference to the Appointee making an adjustment to Metered Charges for water supply in respect of premises means:
 - H2.1 in any case where the Appointee supplies water at the premises, making an adjustment to the Metered Charges payable by the customer for that supply; and
 - H2.2 in any case where the premises are supplied by a Licensee with whom the Appointee has an agreement under section 66D of the Water Industry Act 1991, making an adjustment to the Metered Charges payable by the Licensee for that supply.
- H3. In this condition, any reference to the Appointee making an adjustment to Metered Charges for sewerage services in respect of premises means:
 - H3.1 in any case where the Appointee provides sewerage services at the premises, making an adjustment to the Metered Charges payable by the customer for those services; and
 - H3.2 in any case where the premises are provided with sewerage services by a Licensee with whom the Appointee has an agreement under section 117E of the Water Industry Act 1991, making an adjustment to the Metered Charges payable by the Licensee for those services.

Checking for a leak on the Supply Pipe

- H4. At the time of the installation of a meter at a customer's premises, the Appointee must check the Supply Pipe between the meter and the customer's tap to detect whether there are any leaks.
- H5. Where, as a result of that check, a leak is detected on the Supply Pipe:
 - H5.1 if the leak can be repaired without additional excavation at the time the meter is installed, the Appointee must repair the leak; and

H5.2 if the leak cannot be repaired without additional excavation at that time, the Appointee must notify the customer of the leak and either:

H5.2.1 repair the leak; or

H5.2.2 request that the customer repairs the leak at the customer's own expense.

Adjustment of charges for water supply

H6. Paragraph H7 applies where, after a meter has been installed:

H6.1 a meter reading indicates that there could be an undetected leak on the Supply Pipe; and

H6.2 such a leak is subsequently discovered.

H7. Where this paragraph applies, the Appointee must make an adjustment to the Metered Charges for water supply in respect of the premises, subject to paragraphs H8 and H9.

H8. The requirement to adjust Metered Charges under this condition is conditional on the leak being repaired within any reasonable period of time specified by the Appointee.

H9. The Appointee is not required to make any adjustment to Metered Charges under this condition in relation to any leak:

H9.1 detected following the repair of a previous leak in relation to which such an adjustment has been made;

H9.2 which was caused through the negligence of the customer, the owner of the Supply Pipe or anyone acting on behalf of either of them;

H9.3 where the Appointee has requested that a customer repairs the leak under paragraph H5.2.2 and the customer has failed to repair it; or

H9.4 which the customer otherwise knew or ought to have known about and failed to repair.

The amount of the adjustment of charges for water supply

H10. In making an adjustment to the Metered Charges for water supply in respect of the premises under this condition:

H10.1 where the Appointee has a record of the customer's past consumption, the adjustment must be based on that consumption, and

H10.2 where the Appointee has no such record:

H10.2.1 the adjustment must be based on typical usage for properties of a similar type; and

H10.2.2 the Metered Charges in respect of the premises must be further adjusted if the customer's subsequent actual usage is significantly different.

Adjustment of charges for sewerage services

H11. Where the Appointee is required to make any adjustment to the Metered Charges for water supply under this condition:

H11.1 if the Appointee is the sewerage undertaker for the premises, it must also make an adjustment to the Metered Charges for sewerage services in respect of the premises; and

H11.2 if another relevant undertaker is the sewerage undertaker for the premises, the Appointee must inform that undertaker as soon as reasonably possible of the adjustment the Appointee is required to make to the Metered Charges for water supply (specifying the basis on which the adjustment has been, or will be, made).

H12. The Appointee must also make an adjustment to the Metered Charges for sewerage services in respect of premises where:

H12.1 the Appointee is the sewerage undertaker for the premises; and

H12.2 the Appointee is informed by a water undertaker that the undertaker is required to make an adjustment to the Metered Charges for a supply of water to the premises (specifying the basis on which the adjustment has been, or will be, made).

H13. Where the Appointee is required to make any adjustment to Metered Charges for sewerage services under this condition, it must make that adjustment on a similar basis to the adjustment being made to the Metered Charges for water supply in respect of the premises.

Defined terms used in Condition H (to be included in Condition A)

“Licensee” means the holder of a water supply licence or a sewerage licence granted by Ofwat under (respectively) section 17A or section 17BA of the Water Industry Act 1991;

“Metered Charges” means charges for services that are based wholly or partly on measured quantities of volume of water supplied;

“Supply Pipe” means that part of the service pipe which is not owned by the Appointee.

Condition I: Ring-fencing

Introduction

The purposes of this Condition are to ensure that:

- (1) there is no cross-subsidy between the Appointed Business and any other business of the Appointee or between the Appointed Business and any Associated Company;
- (2) the transfer of assets (including the provision of financial support) to Associated Companies does not adversely affect the Appointee's ability to carry out its functions as a water and sewerage undertaker or to finance those activities; and
- (3) the Appointee has at its disposal sufficient financial and managerial resources to carry out the Regulated Activities (including the investment programme necessary to fulfil its obligation under the Appointment(s)).

Interpretation and Construction

- I1. In this Condition and for the purposes of this Condition:
 - I1.1 references to "**the Appointed Business**" shall be construed as if the Appointed Business included the management and holding by the Appointee of any protected land; and
 - I1.2 "**sewerage services**" includes sewage treatment and disposal and reception, treatment and disposal of trade effluent.
- I2. Except where otherwise expressly provided, references in this Condition to costs or liabilities shall be construed as including taxation, and references to any profit and loss account shall be construed accordingly.
- I3. For the purposes of this Condition:
 - I3.1 all forms of property shall be assets, whether situated in the United Kingdom or not, including:
 - I3.1.1 options, debts and incorporeal property generally; and
 - I3.1.2 any currency including sterling;

I3.2 references to the supply of a service include references to anything (including the services of any employee) being made available; and

I3.3 references to a transfer of an asset or liability include references to a part transfer of an asset or liability and, without limitation, there is a part transfer of an asset where an interest or right in or over the asset is created.

Transactions entered into by the Appointee or the Appointed Business with or for the benefit of Associated Companies or other businesses or activities of the Appointee

I4. The Appointee shall ensure that every transaction between the Appointed Business and any Associated Company (or between the Appointed Business and any other business or activity of the Appointee) is at arm's length, so that neither gives to nor receives from the other any cross-subsidy.

I5. The Appointee shall not, in respect of any Charging Year, make any payments to any Associated Company in respect of the services rendered to the Appointee by that company, which exceeds:

I5.1 such prices in respect of the service in question which the Appointee has ascertained by market testing in accordance with such arrangements as Ofwat may have approved for the purpose of this Condition I and as set out in Regulatory Accounting Guideline 5 (Transfer Pricing in the Water and Sewerage Industry) or any revision or modification of it for the time being in force, provided that those arrangements have no prejudicial effect upon the proper carrying out of the Appointee's functions or any of them; or

I5.2 if, in the opinion of Ofwat, the Appointee has demonstrated that market testing as described in paragraph I5.1 above is inappropriate, such proportion as Ofwat may agree of the Associated Company's costs in providing to the Appointee the service in question (including a reasonable return to the Associated Company).

I6. Without prejudice to paragraph I4 above, the Appointee shall obtain from any Associated Company referred to in paragraph I5, such information about the latter's costs as Ofwat may reasonably require.

I7. The Appointee shall not, without the consent of Ofwat and otherwise than in compliance with its directions concerning the valuation of the asset and the treatment of the consideration in the Appointee's accounts, transfer to any

Associated Company to which paragraph I5 applies any right or asset to which paragraph 3 of Condition K of these Conditions applies.

- I8. The Appointee shall not, without the consent of Ofwat:
- I8.1 give any guarantee of any liability of any Associated Company; or
 - I8.2 make to any such company any loan.
- I9. The Appointee shall not, without the consent of Ofwat:
- I9.1 enter into an agreement or incur a commitment incorporating a cross-default obligation, or
 - I9.2 subject to paragraph I10 below, continue or permit to remain in effect any agreement or commitment incorporating a cross-default obligation.
- I10. Where liability under the cross-default obligation would arise only on a default by a subsidiary company of the Appointee, the Appointee may permit that cross-default obligation to remain in effect for the period for which it was fixed by the instrument which created it, so long as its potential liability is not increased and no changes are made in the terms under which that liability might arise.
- I11. For the purposes of paragraphs I8 to I10:
- I11.1 "**liability**" includes the creation of any mortgage, charge, pledge, lien or other form of security or encumbrance, the making of any loan and the undertaking of any other indebtedness;
 - I11.2 "**loan**" includes the transfer or lending, by any means, of any sum of money or of any rights of that sum; and
 - I11.3 "**cross-default obligation**" means a term of any agreement or arrangement whereby the Appointee's liability to pay or repay any debt or other sum arises or is increased or accelerated by reason of a default of any person other than the Appointee.
- I12. The Appointee shall declare or pay dividends only in accordance with a dividend policy which has been approved by the Board of the Appointee and which complies with the following principles:

I12.1 the dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business; and

I12.2 under a system of incentive regulation dividends would be expected to reward efficiency and the management of economic risk.

Ring-fencing

I13. The Appointee shall at all times act in the manner best calculated to ensure that it has adequate:

I13.1 financial resources and facilities;

I13.2 management resources; and

I13.3 systems of planning and internal control,

to enable it to secure the carrying out of the Regulated Activities including the investment programme necessary to fulfil its obligations under the Appointment(s). The above requirements must not be dependent upon the discharge by any other person of any obligation under, or arising from, any agreement or arrangement under which that other person has agreed to provide any services to the Appointee in its capacity as a Relevant Undertaker.

I14. For the purposes of paragraph I13.3 above, the Appointee shall ensure that its systems of planning and internal control comply with such guidance as Ofwat may, from time to time, specify in writing for the purposes of this Condition.

I15. Paragraph F4 shall apply to revisions to the guidance referred to in paragraph I14 above, as it applies to revisions to the Regulatory Accounting Guidelines.

I16. In paragraphs I17 and I18:

I16.1 “**Wholesale Business**” means the business undertaken as part of the Appointed Business excluding the Retail Business;

I16.2 “**Retail Business**” means those activities that constitute the provision of goods or services by the Appointee directly to one or more End-Users, and such activities ancillary to such provision including ownership of meters, and that are so designated from time to time (which designation, for the avoidance of doubt, shall be reversible) by Ofwat or by such

person or persons as may be nominated by Ofwat to do so, but for the avoidance of doubt shall not include the following:

- (a) water resources, raw water distribution, water treatment, treated water distribution, sewage collection, sewage treatment, sludge treatment or sludge disposal (as each of those is defined in Ofwat's Regulatory Accounting Guideline 4.04); or
- (b) in so far as the ownership of meters is so designated, the ownership of meters that were installed at, or in order to measure supplies to, End-Users' premises on or before the date of such designation;

I16.3 “**NHH Retail Business**” means those aspects of the Appointee's Retail Business in respect of non-household customers, which would, if carried on by a Licensee, fall within the scope of a retail authorisation as set out in Schedules 2A or 2B to the Water Industry Act 1991 or restricted retail authorisation as set out in Schedule 2A to that Act;

I16.4 “**Residual Business**” means the Retail Business excluding the NHH Retail Business together with the Wholesale Business;

I16.5 “**End-User**” means a person who, otherwise than as a person holding an appointment or a licence under the Water Industry Act 1991 or under other legislation in respect of the supply of water or sewerage services enacted from time to time, is a customer of the Appointee or a user of the goods or services concerned

I16.6 “**Exit Date**” shall have the same meaning as in the Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations 2016.

Requirement for certificates of adequacy

I17. The Appointee shall, at the same time as it complies with any requirement in the Regulatory Accounting Guidelines to submit regulatory accounting statements to Ofwat, submit to Ofwat separate Certificates in respect of each of its NHH Retail Business and its Residual Business in the following terms:

"(1) that in the opinion of the Directors, the Appointee will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment

programme necessary to fulfil the Appointee's obligations under the Appointment(s));

(2) that in the opinion of the Directors the Appointee will, for at least the next 12 months, have available to it -

(a) management resources; and

(b) methods of planning and internal control

which are sufficient to enable it to carry out those functions as required by paragraph I13 above; and

(3) in respect of the Wholesale Business only, that in the opinion of the Directors, all contracts entered into with any Associated Company include all necessary provisions and requirements concerning the standard of service to be supplied to the Appointee, to ensure that it is able to meet all its obligations as a water and a sewerage undertaker".

- I18. The provisions in paragraph I17 requiring a separate certificate of adequacy for the Appointee's NHH Retail Business shall cease to have effect on the Exit Date.
- I19. The Appointee shall, when it complies with paragraph I17, submit with each Certificate a statement of the main factors which the directors have taken into account in giving that Certificate.
- I20. Without prejudice to paragraphs I21 and I22 below, the Directors shall inform Ofwat in writing as soon as they become aware of any circumstances which causes them to believe that the most recent Certificate under paragraph I27 could not be repeated in the light of that circumstance.
- I21. Whenever the Directors become aware that the Appointee or any Group Company is proposing to embark upon any activity which is not one of those described in paragraph I13 and which may be material in relation to the Appointee's ability to finance the carrying out of the functions mentioned in that paragraph, they shall as soon as practicable, having regard to the purposes of this Condition, notify Ofwat about that proposal.
- I22. Not later than 14 days after the Directors become aware that the Appointee or any group Company has embarked upon any activity to which paragraph I21 applies, they shall submit to Ofwat a Certificate in the terms specified in paragraph I17.

I23. Each Certificate under paragraphs I17 to I22 shall be either:

I23.1 signed by the Directors of the Appointee for the time being; or

I23.2 approved by a duly-convened meeting of the board of Directors of the Appointee for the time being, signed (in confirmation of that approval) by a Director or the Secretary of the Appointee and have attached to it a certified copy of an extract of the minutes of the relevant meeting containing the resolution to approve it.

I24. Each Certificate under paragraph I17, shall be accompanied by a report prepared by the Appointee's Auditors and addressed to Ofwat, stating whether they are aware of any inconsistencies between that certificate and either the regulatory accounting statements referred to in paragraph F5 or any information which the Auditors obtained in the course of their work as the Appointee's Auditors and, if so, what they are.

I25. Each Certificate under paragraph I17(2) shall be accompanied by a report prepared by the Appointee's Reporter and addressed to Ofwat, setting out the Reporter's opinion about the extent to which the Appointee has, during the preceding 12 months complied with its obligation in paragraphs I13.3 and I14.

I26. The Appointee shall, at all times, conduct the Appointed Business as if it were substantially the Appointee's sole business and the Appointee were a separate public limited company. The Appointee should have particular regard to the following in the application of this Condition:

I26.1 the composition of the Board of the Appointee should be such that the directors, acting as such, are able to act independently of the parent company or controlling shareholder and exclusively in the interests of the Appointee;

I26.2 the Appointee must ensure that each of its Directors must disclose, to the Appointee and Ofwat, conflicts between duties of the Directors as Directors of the Appointee and other duties;

I26.3 where potential conflicts exist between the interests of the Appointee as a water and a sewerage undertaker and those of other Group Companies, the Appointee and its Directors must ensure that, in acting as Directors of the Appointee, they should have regard exclusively to the interests of the Appointee as a water and a sewerage undertaker;

- I26.4 no Director of the Appointee should vote on any contract or arrangement in which he has an interest by virtue of other directorships. This arrangement should be reflected in the Articles of Association of the Appointee;
- I26.5 the Appointee should inform Ofwat without delay when:
- I27.5.1 a new Director is appointed;
- I27.5.2 the resignation or removal of a Director takes effect; or
- I27.5.3 any important change in the functions or executive responsibilities of a Director occurs.
- I26.6 The Appointee should notify Ofwat of the effective date of the change and, in the case of an appointment, whether the position is executive or non-executive and the nature of any specific function or responsibility;
- I26.7 the dividend policy adopted by the Appointee and the implications of paragraph I12; and
- I26.8 the Principles of Good Governance and Code of Best Practice (or any successor document having a similar purpose and content) as may from time to time be incorporated into or approved for the purposes of the Listing Rules of the Financial Conduct Authority.
- I27. The Appointee shall, at such times and in such ways as may from time to time be required by the Listing Rules of the Financial Conduct Authority, publish such information about its annual interim and final results as is by those rules required to be announced by a company whose shares are for the time being listed on the London Stock Exchange.
- I28. Subject to paragraph I29 below, the Appointee shall maintain the listing of a financial instrument and shall use all reasonable endeavours to retain that financial instrument, whose market price should react to the financial position of the Appointee's Appointed Business, on the London Stock Exchange, or with the prior agreement of Ofwat, some other exchange of similar standing.
- I29. The obligation in paragraph I28 applies unless the Appointee satisfies Ofwat that market conditions make it inappropriate for the Appointee to maintain such a financial instrument.

I30. The Appointee shall use all reasonable endeavours to ensure that it, or any Associated Company as an Issuer of corporate debt on its behalf, maintains at all times an issuer credit rating which is an Investment grade rating.

I31. In this Condition:

"Investment grade rating" means a rating recognised as investment grade by Standard and Poor's Rating Group (or any of its subsidiaries), by Moody's Investors Services Incorporated (or any of its subsidiaries) or by Fitch Ratings Limited, or any other reputable credit rating agency which has comparable standing in the United Kingdom and the United States of America,

"Issuer credit rating" means a credit rating assigned to an issuer of corporate debt by Standard and Poor's Rating Group (or any of its subsidiaries), by Moody's Investors Services Incorporated (or any of its subsidiaries) or by Fitch Ratings Limited, or any other reputable credit rating agency which has comparable standing in the United Kingdom and the United States of America.

I32. Except with the prior consent of Ofwat, the Appointee shall not transfer, lease, license or lend any sum or sums, asset, right or benefit to any Associated Company of the Appointee if:

I32.1 the Appointee does not hold an Issuer credit rating that is an Investment grade rating;

I32.2 where the Appointee holds more than one Issuer credit rating, one or more of the ratings so held is not an Investment grade rating; or

I32.3 any Issuer credit rating held by the Appointee is BBB- by Standard & Poor's Ratings Group or Fitch Ratings Ltd or Baa3 by Moody's Investors Service, Inc. (or such higher Issuer credit rating as may be specified by any of these credit rating agencies from time to time as the lowest Investment grade rating), or is an equivalent rating from another credit rating agency that has been notified to the Appointee by Ofwat as of comparable standing for the purposes of paragraph I30 and:

I32.3.1 is on review for possible downgrade; or

I32.3.2 is on "Credit Watch" or "Rating Watch" with a negative designation;

or, where neither I32.3.1 nor I32.3.2 applies:

I32.3.3 the rating outlook of the Appointee as specified by any credit rating agency referred to in paragraph I32.3 above which at the relevant time has assigned the lower or lowest Issuer credit rating that is an Investment grade rating held by the Appointee has been changed from stable or positive to negative

I33. Where any of paragraphs I32.1, I32.2 or I32.3 apply the exceptions are:

I33.1 payment properly due for any goods, services or assets in relation to commitments entered into prior to the date on which the circumstances described in paragraph I32 arise, and which are provided on an arm's length basis and on normal commercial terms;

I33.2 a transfer, lease, licence or loan of any sum or sums, asset, right or benefit on an arm's length basis, on normal commercial terms and where the value of the consideration due in respect of the transaction in question is payable wholly in cash and is paid in full when the transaction is entered into. For the avoidance of doubt this exception does not include a dividend or other distribution out of distributable reserves or a repayment of capital;

I33.3 repayment of, or payment of interest on, or payments to an Appointee's financing subsidiary of any fees, costs and other amounts arising under:

I33.3.1 a loan made between the Appointee and the Appointee's financing subsidiary, for so long as the Appointee's financing subsidiary continues to be an Associated Company of the Appointee; or

I33.3.2 a loan not prohibited under other provisions of these Conditions and which was contracted prior to the date on which the circumstances in paragraph I32 arise, provided that payment in respect of such loan is not made earlier than the original due date for payment in accordance with its terms; and

I33.4 payments for group corporation tax relief or for the surrender of Advance Corporation Tax calculated on a basis not exceeding the value of the benefit received, provided that the payments are not made before the date on which the amounts of tax thereby relieved would otherwise have been due.

- I34. For the purposes of paragraph I33.3 a financing subsidiary is a subsidiary of the Appointee which is wholly owned by the Appointee and is dedicated solely to raising finance on behalf of, and on lent to the Appointee for the purposes of the Appointee's Regulated Activities and this is reflected in the Articles of Association of the financing subsidiary.

Condition J: Levels of Service Information and Service Targets

Introduction

- 1 We propose removing certain provisions of Condition J and placing them in Condition M as they deal with the submission of information and powers of investigation. The paragraphs to be deleted from Condition J are 7 - 11

Condition M: Provision of Information to Ofwat

Introduction

This condition requires the Appointee to provide information to Ofwat (subject to certain limitations) and to co-operate with certain investigations carried out by Ofwat for purposes relating to standards of performance.

Duty to provide Information

- M1 The Appointee must provide Ofwat with any Information that Ofwat may reasonably require for the purpose of carrying out its functions under any enactment.
- M2 The Appointee must provide any Information required by Ofwat by such time, and in such form and manner, as Ofwat may reasonably require.

Limits on the duty to provide Information

- M3 The Appointee is not required to provide Ofwat with Information for the purpose of Ofwat carrying out any function under section 14 or 201 of the Water Industry Act 1991, but if Ofwat requires it to do so the Appointee must provide reasoned comments on the accuracy of any information or advice which Ofwat proposes to publish under section 201 of that Act.
- M4 The Appointee is not required to provide Ofwat with any Information for the purpose of Ofwat carrying out an enforcement function if the Appointee could not have been required to provide that Information under section 203 of the Water Industry Act 1991.
- M5 The Appointee is not required to provide Ofwat with any Information that is protected by legal professional privilege.

Use of Information provided

- M6 Ofwat may use or disclose any Information which it has received from the Appointee for the purpose of carrying out any of its functions under the provisions of any enactment, including its functions under sections 14 and 201 of the Water Industry Act 1991.

Relationship to other conditions

- M7 Any duty on the Appointee to provide Information to Ofwat under any other Condition does not limit the duty of the Appointee to provide Information under paragraph M1.
- M8 The requirement in paragraph M2, and the limits in paragraphs M4 and M5, also apply in any other Condition under which the Appointee has a duty to provide Information to Ofwat.

Standards of Performance

- M9 Paragraph M10 applies in any case in which Ofwat notifies the Appointee that, for the purpose of deciding whether to make an application to the Secretary of State under either section 39 or 96 of the Water Industry Act 1991, it intends to investigate:
- M9.1 any Information provided by the Appointee to Ofwat in relation to the Appointee's service levels in carrying out the Regulated Activities; or
 - M9.2 the means by which that Information was collated or recorded.
- M10 Where this paragraph applies, the Appointee must co-operate fully with any investigation by Ofwat, including in particular by allowing Ofwat (at reasonable hours and on reasonable notice) to:
- M10.1 access any plant or premises used by the Appointee in carrying out the Regulated Activities;
 - M10.2 while at the plant or premises, carry out inspections, measurements or tests, and take copies of any document or record held for the purpose of the Appointed Business; and
 - M10.3 take with it any persons or equipment necessary for those purposes.

Defined terms used in Condition M (to be included in Condition A)

"Information" means information which the Appointee:

- (a) holds;
- (b) can reasonably obtain; or
- (c) can reasonably prepare from information which it holds or can reasonably obtain.

Condition N: Fees

Introduction

This condition provides for the payment of fees by the Appointee to cover costs incurred by Ofwat, the Consumer Council for Water and the Competition and Markets Authority and sets out how the amount of those fees will be determined.

Fees

- N1 The Appointee must pay the following **Fees** to the Secretary of State in accordance with this condition:
- N1.1 the Annual General Fee (or such part of the Annual General Fee as is payable under paragraph N2);
 - N1.2 the Special Fee (if any);
 - N1.3 the Interim Determination Fee (if any);
 - N1.4 the Consumer Council for Water Fee; and
 - N1.5 the Competition and Markets Authority Fee (if any).
- N2 Where Ofwat notifies the Appointee of an amount which is payable towards the Annual General Fee, the Appointee must pay that amount no later than 30 days following the notification, provided that:
- N2.1 the total of such amounts in a Charging Year may not exceed the Annual General Fee; and
 - N2.2 Ofwat may not give such a notification more than twice in a Charging Year.
- N3 Where Ofwat notifies the Appointee of the amount of any Fee other than the Annual General Fee, the Appointee must pay that amount no later than 30 days following the notification, provided that Ofwat may not give such a notification in respect of any one of these Fees more than once in a Charging Year.
- N4 In this condition any determination by Ofwat of a fair proportion of an amount may only be made in accordance with a method which Ofwat has disclosed to the Appointee in writing.

Annual General Fee

N5 The **Annual General Fee** is Ofwat's determination of a fair proportion of its estimate of costs incurred or likely to be incurred by it in the Charging Year in the carrying out of its functions under any enactment, provided that any such determination is subject to paragraph N13.

Special Fee

N6 The **Special Fee** is Ofwat's determination of a fair proportion of its estimate of any costs incurred or likely to be incurred by it which:

N6.1 could have been included in the estimate used by it to determine the Annual General Fee for the Charging Year; and

N6.2 were not included in that estimate,

provided that any such determination is subject to paragraph N13.

Interim Determination Fee

N7 The **Interim Determination Fee** is an amount determined by Ofwat which represents its estimate of any costs incurred by it in the previous twelve months in relation to any Interim Determination which it is required to make.

Consumer Council for Water Fee

N8 The **Consumer Council for Water Fee** is:

N8.1 Ofwat's determination of a fair proportion of its estimate of costs incurred or likely to be incurred by the Consumer Council for Water in the Charging Year in the carrying out of its functions under any enactment, provided that no such amount will exceed the amount calculated in accordance with paragraph N10; or

N8.2 where a direction has been given to Ofwat by the Secretary of State under section 37(8) of the Water Act 2003, any greater amount which Ofwat determines is necessary to give effect to that direction.

N9 Any estimates which are used in the determination of the Consumer Council for Water Fee will be arrived at following consultation with the Consumer Council for Water

N10 A Consumer Council for Water Fee determined under paragraph N8.1 shall not exceed an amount calculated as $G \times A$ where:

N10.1 G is the amount of £7.65 million, as increased from November 2015 to the November immediately before the Charging Year using the Retail Prices Index (for any period up to November 2019) and the Relevant Index (for any period thereafter); and

N10.2 A is the Appointee's Turnover Share for the Charging Year.

Competition and Markets Authority Fee

N11 The **Competition and Markets Authority Fee** is an amount determined by Ofwat (in accordance with paragraph N12) which is the sum of:

N11.1 Ofwat's estimate of the costs incurred by the Competition and Markets Authority in the previous twelve months in relation to any reference under section 12 or section 14 of the Water Industry Act 1991, where the reference related solely to the Appointed Business; and

N11.2 Ofwat's determination of a fair proportion of Ofwat's estimate of the costs incurred by the Competition and Markets Authority in the previous twelve months in relation to any reference under section 14 of the Water Industry Act 1991, where the reference related to the Appointed Business and the appointed businesses of other relevant undertakers.

N12 Any estimates which are used in the determination of the Competition and Markets Authority Fee will be arrived at following consultation with the Competition and Markets Authority.

Cap on Annual General Fee and Special Fee

N13 The sum of the Annual General Fees and any Special Fees in a Relevant Five Year Period must not exceed the Regulation Fee Cap.

N14 Subject to paragraph N16, the **Regulation Fee Cap** is an amount which is the sum of:

N14.1 the sum of the amounts calculated as $S \times A$ for each Charging Year in the Relevant Five Year Period, where:

N14.1.1 S is the amount of £18.8 million, as increased from November 2015 to the November immediately before the Charging Year using the Retail Prices Index (for any period up to November 2019) and the Relevant Index (for any period thereafter); and

N14.1.2 A is the Appointee's Turnover Share for the Charging Year; and

N14.2 an amount equal to 0.3% of the average of the annual turnover of the Appointed Business, as shown in the accounting statements prepared by the Appointee under Condition F, over the Prior Five Year Period.

N15 Ofwat may refer to the Secretary of State for determination the question of whether the Regulation Fee Cap should be changed in relation to any Relevant Five Year Period (and if so what change should be made).

N16 The Regulation Fee Cap shall be changed to the extent required to give effect to any determination which:

N16.1 has been made following a reference made under paragraph N15; and

N16.2 is made before the start of the Relevant Five Year Period to which it relates.

Definitions for Condition N (to be included in Condition A)

“Appointee's Turnover Share” means, in relation to a Charging Year, the amount calculated as t / T where:

(a) **“t”** means an amount equal to the turnover of the Appointed Business as shown in the accounting statements prepared by the Appointee under Condition F for the twelve month period ending twelve months before the start of the Charging Year; and

(b) **“T”** means an amount equal to the sum of the turnover of the appointed businesses of all relevant undertakers, including the Appointee, as shown in their accounting statements prepared under Condition F, and the provisions of appointments which are equivalent to Condition F, for the twelve month period ending twelve months before the start of the Charging Year;

“Prior Five Year Period” means the period of five consecutive Charging Years immediately before the Relevant Five Year Period;

“Relevant Five Year Period” means, as the context requires:

- (a) the period from 1 April 2015 to 31 March 2020; or
- (b) the subsequent period of five consecutive Charging Years starting on the relevant five year anniversary of 1 April 2015.

Condition O: Termination and replacement appointments

Introduction

This condition, which sets out circumstances in which the Appointee can be replaced as the undertaker for its area, has effect under section 7(4)(c) of the Water Industry Act 1991.

Other circumstances of potential replacement are also set out at section 7(4) of that Act.

Circumstances when a replacement appointment may be made

- O1 An appointment replacing the Appointee as either water or (where applicable) sewerage undertaker in respect of the Area may be made where:
 - O1.1 the Secretary of State has given at least 25 years' notice to the Appointee of the termination of the relevant Appointment in respect of the whole of the Area; and
 - O1.2 the replacement appointment is to come into effect on the expiry of that notice.

Condition Q: Interruptions in supply because of drought

Introduction

This condition sets out the payments that the Appointee must make where customers have their water supply interrupted because of a drought order.

Payments following interruption in supply

- Q1 Subject to paragraph Q5, where the supply of water to Household Premises is interrupted under the authority of a drought order, the Appointee must make a payment to the customer who is liable to pay charges for water supply at the premises or credit that customer's account in accordance with paragraph Q2.
- Q2 The Appointee must pay or credit an amount equal to $D \times d$, subject to a maximum of A in any Charging Year, where:
- Q2.1 D is £10;
- Q2.2 d is the number of days during which, or part of which, the supply of water to the premises is interrupted; and
- Q2.3 A is the average water charge payable to the Appointee in respect of Household Premises for the Charging Year preceding the date of the interruption.
- Q3 Subject to paragraph Q5, where the supply of water to premises other than Household Premises is interrupted under the authority of a drought order:
- Q3.1 where the Appointee supplies water at the premises, it must make a payment to the customer who is liable to pay charges for that supply or credit that customer's account in accordance with paragraph Q4; and
- Q3.2 where the premises are supplied with water by a Licensee with whom the Appointee has an agreement under section 66D of the Water Industry Act 1991, the Appointee must make a payment to the Licensee in accordance with paragraph Q4.
- Q4 The Appointee must pay or credit (as the case may be) an amount equal to $B \times d$, subject to a maximum of N in any Charging Year, where:
- Q4.1 B is £50;

Q4.2 d is the number of days during which, or part of which, the supply of water to the premises is interrupted; and

Q4.3 N is:

Q4.3.1 the amount of water charges which were payable in respect of those premises by the customer who is liable to pay such charges for the Charging Year preceding the date of the interruption (excluding any amount payable in respect of any separate supply which was provided solely for purposes other than domestic purposes); or

Q4.3.2 if the customer was not liable to pay those charges, £500.

Q5 The Appointee is not required to pay or credit (as the case may be) any amount under this condition if it can demonstrate that it took all reasonable steps to avoid the circumstances which gave rise to the making of the drought order.

Determination of disputes

Q6 Where there is a dispute between the Appointee and a customer, or between the Appointee and a Licensee, over a right to a payment or credit under this condition:

Q6.1 either party may refer the matter to Ofwat for determination; and

Q6.2 the Appointee must give effect to any determination which is made.

Defined terms used in Condition Q (to be included in Condition A)

"**drought order**" means an order made under section 73 of the Water Resources Act 1991;

"**Household Premises**" has the meaning given in the Wholesale-Retail Code (as amended from time to time).

Appendix 3: Commentary on proposed modifications by licence condition

This appendix sets out a commentary on the proposed modifications. The purpose of this is to explain the drafting changes made in some detail.

Commentary on Condition A

Introduction

The intention is to move all the new definitions in the revised conditions to Condition A.

The three new related definitions ('appointee's customer'; 'customer'; and 'potential customer') are relevant for all conditions and therefore are set out separately in Condition A.

The definition of 'Relevant Index' is amended to remove an historical provision.

The final paragraph of Condition A is amended to remove reference to schedule 1 of companies' instrument of appointment.

Definitions of 'customer'

We wanted to make it clear whether or not the term 'customer' included customers of a licensee as well as customers of the Appointee.

This is necessary because the Water Industry Act 1991 defines customer as:

"any person for or to whom that company provides any services in the course of carrying out the functions of a water undertaker or sewerage undertaker (other than a water supply licensee or sewerage licensee)".

Although the statutory definition is clear that the definition of 'customer' excludes licensees, it is not as clear that it only refers to customers of the Appointee and not customers of a licensee. On one interpretation, an undertaker provides a 'service' to anyone who is connected to its physical network, regardless of whether their legal relationship is with the undertaker or with a licensee. On that interpretation, customers of licensees would also be customers of the undertaker.

However, another reading of this definition is that the undertaker provides a service to a person (making them a 'customer') only where it has a direct legal relationship with them, and not where its legal relationship is with a licensee.

To put this matter beyond doubt for the purposes of the interpretation of the term in the conditions, we propose introducing the three new related definitions. The new definitions make it clear that for some purposes (but not all) customers of licensees are customers.

Compatibility with Existing Drafting

We have reviewed the licence conditions for the use of ‘customer’; ‘potential customer’; and ‘appointee’s customer’ – both in the redrafted simplified conditions and those which are not being amended and we are satisfied that the new definitions do not give rise to any unintended consequences.

‘Relevant Index’

The current definition provides that Ofwat will determine by 31 January 2018 whether the Consumer Prices Index, or the Consumer Prices Index (H) will apply from 1 April 2020. That determination has now been made and the definition has therefore be simplified.

The area of appointment

As most undertakers’ areas of appointment have varied since privatisation, the reference to the Area being the area set out in schedule 1 to companies’ instrument of appointment is no longer accurate as, for most companies, schedule 1 must now be read with the various instruments of variation that have been made. The simplification of paragraph 7 of Condition A is possible because ‘the Area’ is defined in Condition A as: "the area for which for the time being the Appointee holds the appointment as water undertaker or, as the case may be, sewerage undertaker".

Commentary on Condition D

Introduction

We do not propose to retain any provisions from the current Condition D on the basis that all of the provisions are either unnecessary or are or will be adequately covered in statutory charges scheme rules.

However, we propose to add an updated provision from current Condition C into Condition D.

Further commentary

New paragraph D1: Informing sewerage undertakers of connections

Paragraph D1 is an updated and simplified version of current Condition C, paragraph 9. Ofwat considers that this requirement should be introduced in Condition D for all undertakers.

This is because, with effect from 1 April 2018 in all licences other than those of undertakers operating wholly or mainly in Wales, the other provisions in Condition C (which regulate Infrastructure Charges) will be replaced by other regulatory obligations and will cease to have effect, except for certain transitional purposes. For new appointees, Condition C will cease to have effect in its entirety.

When these changes are made, the provision to inform sewerage undertakers of new water connections will need to be retained, and we propose that this should be in a standalone Condition D. The defined term 'Infrastructure Charge' will be included in Condition A.

We are proposing to update the obligation in current Condition C, paragraph 9 in a number of ways:

The obligation should apply regardless of whether or not it is the Appointee that makes the connection - the updated drafting makes this clear.

The relevant sewerage undertaker may not be providing services to the premises at the point when the new connection is made. The undertaker which must be notified is any undertaker into whose public sewers the premises drain. The updated drafting makes this clear.

In some cases, it may be that the Appointee does not have all of the relevant customer information, because the premises are supplied by a water supply licensee. The Appointee is only required to notify the sewerage undertaker of customer information which it holds.

The reference to 'Relevant Multiplier(s) for the premises' is removed, on the basis that the obligations to which that information relate will cease to have effect going forwards.

We consider that the above is consistent with the approach adopted in the Wholesale Retail Code for business customers – see [Code Subsidiary Document No. 0101: Registration: New Supply Points](#). The Code provides that wholesalers must notify the market operator in respect of any new supply points. If a wholesaler is only providing a connection for one of the services (water or sewerage services), the market operator must confirm the provision of the other service with the other wholesaler.

Removing the current provisions of Condition D

We consider that the provisions in the current Condition D can be removed from the licence. Current paragraph 2 requires the Appointee to have in effect a charges scheme by which it fixes the charges paid for supplies of water for domestic purposes and for the drainage of premises for domestic purposes (where not determined by agreement) and by which it fixes Infrastructure Charges.

In relation to charges paid for supplies of water and drainage, we do not consider that this requirement needs to be contained in the licence. Under section 142 of the Water Industry Act 1991, the Appointee's power to charge for services is exercisable in accordance with a charges scheme or by agreement. We consider that the need to charge in circumstances where it is not legally possible to charge by agreement or where agreement cannot be reached provides adequate incentive on the Appointee to have a charges scheme in place.

In relation to Infrastructure Charges, for undertakers operating wholly or mainly in England, the statutory [charges scheme rules](#) require that these are fixed in a charges scheme². We expect to consult on new connection charges arrangements

² Paragraph 26 of the Charges Scheme Rules (July 2018). Note paragraph 26 does not apply to new appointees. However, new appointees' charges may not be more than the charges of the previous incumbent (as set out in the previous incumbent's charges scheme). This means that the

for undertakers operating wholly or mainly in Wales during 2018. To the extent that Ofwat wishes to further regulate the new connection charging arrangements, this will not be done through the licence.

Current paragraph 3 is out of date and in any case becomes redundant once current paragraph 2 is removed.

Current paragraph 4 requires the Appointee to allow specified connection charges to be paid for in instalments (in the manner set out in the condition). We do not consider that such a specific requirement is needed. The statutory charges scheme rules require that charges schemes must include provisions giving customers a reasonable choice as to the times and methods of payment of the charges fixed by the scheme³. We consider that this provision is adequate.

Current paragraph 5 sets out a number of requirements for the Appointee to publicise its charges scheme and to make copies of the charges scheme available. We consider that these requirements are adequately covered in the charges scheme rules⁴.

Current paragraph 6 is a 'for the avoidance of doubt' provision, stating that nothing in the Condition prevents the Appointee from entering into agreements referred to in section 142 of the Act. We consider that this is an unnecessary provision, in particular given the removal of other provisions as set out above.

infrastructure charge of a new appointee may not be more than the infrastructure charge of the previous incumbent.

³ Paragraph 24 of the Charges Scheme Rules (July 2018).

⁴ Paragraphs 9 to 11 of the Charges Scheme Rules (July 2018).

Commentary on Condition E

Introduction

Current Condition E incorporates relatively straightforward requirements, which are set out in a very complex manner (with a list of statutory references). The draft revision retains the straightforward requirements, but frames them as broader obligations, retaining a number of exceptions.

We consider that a number of the exceptions are now redundant and can be removed from the condition. There are also some specific policy changes relating to Infrastructure Charges and agreements between undertakers.

Further commentary

Condition E prohibits the Appointee from showing undue favour to or unduly discriminating against customers. Current paragraph 1 sets out the charges to which the Condition applies. It does this in a complex way which is difficult to follow, referencing a number of statutory provisions and also referencing 'standard charges', a term which is not defined. Broadly, the charges covered are charges for water supply or sewerage services and charges for trade effluent functions.

Paragraph E1 takes a much simpler approach, by defining the charges which the Condition applies to as any charges for the carrying out of the Regulated Activities (a term which is defined in Condition A). This will mean that the Condition applies to a broader range of charges than the current Condition E. For example, the Condition will now apply to all connection charges. We consider this to be an appropriate simplification given section 2(3) of the Water Industry Act 1991, which provides that we must perform its functions in a manner best calculated to secure that there is no undue preference or discrimination in the setting of charges or the provision of services. We consider that it is appropriate that all charges for the carrying out of the Regulated Activities should not be unduly preferential or discriminatory unless there is a particular reason for an exception.

Instead of referring to charges which are 'in accordance with standard charges', paragraph E1 uses a defined term of 'Class Charge', which is defined as charges fixed or agreed by the Appointee and which apply to a particular class of the Appointee's customers. Charges which are not 'Class Charges' are defined as 'Bespoke Charges'. Condition E applies to the setting of both Class Charges and Bespoke Charges.

After setting out the charges to which it applies, paragraph E1 then sets out the requirements which the Appointee must comply with when setting charges. The Appointee must not set/fix charges in a way which is unduly preferential for or discriminatory against classes of customers or potential customers or customers on Bespoke Charges (or who have been offered such charges). We consider that paragraph E1 provides an appropriate update to current paragraphs 2 and 3.

Current paragraphs 4 and 5 require the Appointee to make available information in relation to matters covered in Condition E. These provisions are omitted in the draft revision, on the basis that Condition F and Condition M will, between them, contain adequate provision to allow Ofwat to gather the information it requires.

Paragraphs E2 to E4 set out the exceptions to the requirements to ensure that there are no unduly preferential/discriminatory charges. The drafting has been updated in some places, but the intention of the provision is the same. One exception to this is that in paragraph E2, the exception relates to Infrastructure Charges where the amount of the charge is limited in accordance with Condition C. This is a slight change from the current paragraph 6(5), which excludes Infrastructure Charges which do not exceed the relevant amount specified in Condition C.

Some of the exceptions set out in current paragraphs 6 and 7 have been omitted or changed. In particular:

Current paragraphs 6(1) and 6(2) contain exceptions relating to metering trials schemes made by the Water Authority before the transfer date (1 September 1989). These have been omitted, on the basis of our understanding that there are no longer any such schemes in existence. Companies were asked to confirm whether our understanding is correct.

Current paragraph 6(4) refers to the Secretary of State determining terms and conditions, imposing conditions and serving a notice. In each case, the Secretary of State no longer has such a role because the relevant legislation was either repealed or amended to include another decision maker. Given the legislation was changed a long time ago, we do not consider that this needs to be retained. In particular, we do not consider it to be likely that there are still any charges determined by such a decision of the Secretary of State.

Current paragraph 6(6) contains an exception relating to terms and conditions on which any supply of water in bulk is given by the Appointee to another water undertaker. We propose to expand this exception so that it also covers agreements between the Appointee and another sewerage undertaker to permit a sewerage

connection (referred to as a 'main connection' in the Water Industry Act 1991 – see section 110A(3)).

Current paragraph 7(1) provides that the Appointee shall not be treated as having fixed or agreed charges where a charges scheme made by the Water Authority has effect after the transfer date. This has been omitted, on the basis that there are no longer any such charges schemes in effect.

Paragraph E3 sets out charges which are not required to be considered for the purpose of complying with the Condition (by referencing the charges in paragraph E2). Current paragraph 3 provides that nothing in the paragraph shall require the Appointee to have regard to charges fixed/agreed by the Water Authority prior to the transfer date. We consider that this exception is generally redundant, because the Appointee would not be expected to have regard to charges set so long ago. The exception may not be redundant in relation to charges in agreements which were transferred to the Appointee under a statutory transfer scheme – this part of the exception is retained in paragraph E3.

Paragraph E3 covers current paragraph 6(4) (see the wording 'or so as to require the Appointee to have regard to any such terms, conditions or provisions').

Paragraph E3 also provides that the Appointee is not required to consider the other charges which fall within the exception in paragraph E2. We consider it to be appropriate that this provision should apply to all charges which are excluded from the main obligation in paragraph E1.

Commentary on Condition F

Introduction

This draft revision of Condition F is concerned only with those parts of the existing condition which relate to accounts and accounting information. The ring-fencing provisions (which for this purpose include the provisions about arm's length transactions) will be considered later. As an interim measure we are proposing that the ring-fencing provisions form part of a new condition I.

General approach

There is a lot of detail on the face of the existing Condition F about accounting information to be provided to Ofwat – far more than might be expected or is strictly necessary. The detail of most information requirements (e.g. requests made under Condition M) are set out in separate documents issued by Ofwat and not on the face of the licence.

The existing Condition F also contains (at paragraph 5.3) a right for Ofwat to issue accounting guidelines which vary certain requirements of the condition. The new draft of Condition F proceeds from the basis that these guidelines can be used to set out all the requirements about accounting information, so that there is no need to describe them in detail in the condition. Consequently, the draft condition is limited to describing the nature of the guidelines, what can be contained in them, and the way in which they can be changed.

Specific provisions

Paragraph F1 says that there will be these guidelines ('Regulatory Accounting Guidelines') published by Ofwat. Their purpose will be to ensure that we may obtain all the accounting information it needs in relation to the Appointed Business, and that the financial affairs of the Appointed Business can clearly be distinguished from those of any other business or activity of the Appointee.

Paragraph F2 then states in broad terms what the guidelines can include (in effect, the things currently set out on the face of Condition F).

Paragraph F3 places an express limit on the guidelines by stating one thing that they cannot include. This is drawn from existing paragraph 6.7, in a part of the condition that is otherwise proposed to be incorporated in Condition I (see below).

Paragraph F4 provides that we can amend these guidelines, but only with reasonable notice and after consultation with the Appointee.

Paragraph F5 provides that if the Appointee objects to an amendment to the guidelines, that amendment can only be made after a reference to the CMA. This in effect preserves the protection that Appointees currently have by virtue of the information requirements being on the face of the condition (and, in respect of the existing guidelines, because of existing paragraph 10).

Paragraph F6 gives the provisions of the guidelines the same binding status as if they were on the face of the condition. As in paragraph 4.1 of the existing condition, the regulatory accounting statements are not limited to accounting information in respect of the Appointed Business, but may also be required to include accounting information relating to other businesses and activities of the Appointee.

Commentary on Condition G

Introduction

We are proposing to merge the requirements in relation to codes of practice (currently set out in Conditions G, H and I) into a single revised Condition G. This will remove duplication of drafting without compromising customer protection.

Instead of requirements to prepare and maintain a 'Customer Code' document, the condition will require the Appointee to maintain 'Core Customer Information' which includes specified descriptions and guidance. We also propose to make changes to the category of customers which is covered by this Information, to avoid unnecessary overlap between the licence condition and the Customer Protection Code of Practice.

We do not propose to retain an approval role for itself or a role of specifying revisions to the Appointee's Core Customer Information in the licence conditions. This will bring the condition in line with current practice.

The drafting of a number of provisions has been simplified and updated and some provisions which are considered to be unnecessary have been removed.

Further commentary

Current Conditions G, H and I require the Appointee to have three codes of practice⁵. These requirements have been merged into a single revised Condition G. This will remove considerable duplication across these conditions.

Instead of requiring that the Information should be maintained in one or more Customer Codes, Ofwat proposes that the condition should require the maintenance of a body of Information, referred to as the 'Core Customer Information'. This is on the basis that customers no longer look to a particular code document which contains this Information, and there may be a number of different ways to present this Information accessibly.

⁵ A code of practice for customers and relations with the Consumer Council for Water, a code of practice and procedure on debt recovery and a code of practice and procedure on leakage.

In the current conditions, each code of practice was required to be submitted to us for approval. We consider that the onus should be on the Appointee to maintain appropriate Core Customer Information and to present it appropriately. We do not propose to approve the Core Customer Information and this requirement is omitted in the draft revision (in line with current practice). Instead, a new provision has been included to oblige the Appointee to ensure that the Core Customer Information is accurate and up to date (and this is set out in paragraph G7).

Paragraphs G2, G3, G4 and G5 set out what must be contained in the Core Customer Information. These are taken from current Conditions G, H and Condition I⁶. The current Conditions require that some Information must relate to all customers and other Information is required to relate to 'domestic customers'.

As part of the opening up of competition in the non-household sector, Appointees are now required to comply with the Customer Protection Code of Practice in relation to customers who are eligible to be supplied or served by a licensee⁷. The requirements of the Customer Protection Code of Practice overlap significantly with the requirements in current Conditions G and H and we consider that the overlap in obligations is undesirable.

Of the requirements for Information to be provided in current Condition G, there are a small number which we consider should continue to be requirements in the licence conditions relating to all customers and these are set out in Paragraph G2.

In relation to other Information required in current Conditions G and H, we consider that where it is proposed that this Information should still be required to be included in the Core Customer Information, that Information should be provided 'in relation to customers whose premises are not Eligible Premises' – in other words, to premises for which the Customer Protection Code of Practice does not apply. This will create a clear separation so that:

- for customers who are eligible to be supplied or served by a licensee, the Appointee must comply with the Customer Protection Code of Practice⁸; and

⁶ Current Condition G, paragraph 1, Condition H, paragraph 1 and Condition I, paragraph 2

⁷ See Condition R5

⁸ We will consider further whether any changes should be made to the Customer Protection Code of Practice following on from the change to the licence condition.

- Condition G will require the Appointee to include Information in its Core Customer Information in relation to customers who are not eligible to be supplied or served by a licensee.

This change, which is set out in paragraphs G3 and G4, will mean a substantive change in relation to the Information required to be provided under the condition. To the extent customer Information is no longer required to be provided, we consider that this change is justified because these customers will be covered by the Customer Protection Code of Practice.

For undertakers wholly or mainly in Wales, the change will mean that the Appointee is required to provide Information relating to business customers who are not eligible to be supplied or served by a licensee. Although this will be an extension of the current obligations, we consider that this extension is justified. In particular, the Information required to be provided is limited in nature. We consider that all customers should be given protection either under this condition or under the Customer Protection Code of Practice.

The matters to be covered in the Core Customer Information are covered by drafting which has been simplified. There are a few particular points to note in relation to these requirements:

A new provision has been added, which is that the Core Customer Information must include, in relation to customers whose premises are not Eligible Premises, a description of any independent dispute resolution scheme (paragraph G3.7).

Current Conditions H and I⁹, require the Appointee to include in the relevant code of practice 'such other information as the Appointee considers appropriate'. We do not consider this provision to be necessary and it is omitted in the draft revision.

As in current Condition I, paragraph G5 requires that the Core Customer Information must contain a description of the procedures which the Appointee applies in relation to leakage. These procedures have been separated out into a revised Condition H and apply to Domestic Customers only (see the commentary on Condition H).

The obligation to publish and publicise the existence of the Core Customer Information is retained in paragraph G6 in a simplified and modernised form. Since

⁹ Current Condition H, paragraph 1(3) and Condition I, paragraph 2

the Core Customer Information will no longer be required to take the form of a single published document, the Appointee is no longer required to provide a copy on request, but must instead provide when requested any relevant Information which forms part of the Core Customer Information. We propose to omit the express requirement for Information to be available for inspection at the Appointee's premises.

The obligation to conduct a review of the Core Customer Information is retained in paragraph G8. Paragraph G9 sets out a revised test as to what the Appointee must consider in conducting a review – this is intended to be clearer than the current test (which can be found in Condition G, paragraph 2). The obligations to consult the Consumer Council when the Appointee reviews/revise the Core Customer Information is retained in paragraph G10. Instead of an obligation to provide the Consumer Council with a copy of a revised document, paragraph G11 requires the Appointee to inform the Consumer Council of the revision which has been made and how it may access the revised Core Customer Information.

The current Conditions require the Appointee to revise the relevant code where specified by Ofwat¹⁰. As noted above, we do not propose to include a requirement for the Core Customer Information to be submitted to us for approval. Similarly, we do not propose to retain a general role for it to propose revisions to the Core Customer Information and so this provision has been omitted. However, if it considers that the Appointee is failing to maintain the Customer Core Information in line with Condition G, we have the power to impose an enforcement order on the Appointee to revise the Core Customer Information to ensure compliance.

Paragraph G12 covers a number of current obligations for the Appointee to provide Information with specified types of bill¹¹.

The obligation to have a complaints handling procedure is retained in paragraph G13. Ofwat proposes to omit the reference to training in relation to customer complaints (currently in Condition G, paragraph 7) as this is inherent in the broader obligation to 'establish, maintain and comply with a Complaints Handling Procedure.

There is one further obligation in current Condition G which has been omitted. This is the obligation to have specified meetings with the Consumer Council (see current

¹⁰ Current Condition G, paragraph 5, Condition H, paragraph 5 and Condition I paragraph 6

¹¹ Current Condition G, paragraph 6(5), Condition H, paragraph 6(2) and Condition I paragraph 7(2)

Condition G, paragraphs 9 to 11). We consider this provision to be unnecessary as companies have a broader obligation to consult and engage with the Consumer Council.

Commentary on Condition H

Introduction

The draft revision of Condition H contains the procedure on leakage which is currently contained in Condition I. The current procedure contains a number of lengthy and complex provisions and the draft revision is intended to simplify the drafting and the structure and to clarify the procedure in some places, while retaining the current procedure.

We are aware that there are discrepancies as to how this condition has been applied. We consider that the revised draft should make it clear which customers the licence obligation applies to.

There is a substantive change to provide that in relation to customers of a water supply licensee, the adjustment that is required to be made is an adjustment of the metered charges payable to the Appointee by the licensee.

Further commentary

Condition I, paragraphs 8.1 to 8.6 set out the procedure to be applied when a meter is installed to check for leaks and to be applied subsequently in relation to specified leaks which have been detected. It is not entirely clear from the current drafting whether the procedure applies in relation to the 'domestic customers' of the Appointee (as defined in Condition A) or all customers. We are aware that some companies apply the procedure on leakage in respect of all their customers while others only apply it to domestic customers.

We propose that the procedure should apply to domestic customers and this is made clear in paragraph H1, by applying the procedure only to customers of Domestic Premises (defined in Condition A as 'any premises used wholly or partly as a dwelling or intended for such use'). This category of premises includes mixed use premises, many of which will be eligible to be supplied or served by a licensee.

Paragraphs H2 and H3 therefore include a substantive change by providing that where the condition refers to an adjustment of charges, where the customer is a customer of a licensee, this means making an adjustment to the metered charges which are payable to the Appointee by the licensee. The Wholesale Contract sets

out the process for licensees to pass on to their customers any volumetric adjustments that may be made (including those made for leakage)¹².

Where the customer is a customer of the Appointee, any adjustment will continue to be required to be made to the metered charges which are payable to the Appointee by the customer.

Paragraphs H4 and H5 set out the procedure which must be followed where a meter is installed and where a leak is detected on the supply pipe. Paragraph H5.2.1 states that, where a leak is detected which cannot be repaired without additional excavation, the Appointee may fulfil its obligation by repairing the leak. This is an addition to the obligation in current paragraph 8.2 – we consider that it should be clear that the Appointee could decide to repair the leak itself (at its own expense), rather than requesting that the customer repairs it.

Paragraphs H6 and H7 set out the circumstances in which an adjustment must be made to metered charges for water supply. The current wording setting out these circumstances (in paragraph 8.3) refers to a meter reading indicating that a customer 'has an abnormally high consumption which could be due to an undetected leak on the supply pipe'. The reference to consumption is removed in paragraph H6, on the basis that it is unnecessary drafting.

Paragraph H8 sets out the provision, in current paragraph 8.3, that the requirement to make an adjustment is conditional on the customer repairing the leak. The inclusion of 'necessary remedial work' in the current wording has been clarified and the remaining wording has been simplified.

Paragraph H9 sets out the various exceptions to the requirement to make an adjustment – these have been grouped in one paragraph for ease of use. In particular, it has been made clear that the wording currently at the end of paragraph 8.2 operates as an exception to the requirement to make an adjustment.

Paragraph H10 then sets out how the amount of any adjustment to metered charges for water supply must be determined and when a further adjustment is required to be made.

¹² Part H of Part 3 of Schedule 1 of the Operational Terms

Paragraphs H11 and H12 set out the circumstances in which an adjustment must be made to metered charges for sewerage services. These are in line with current paragraphs 8.5 and 8.6.

There is also an addition in paragraph H11 making clear that where the Appointee is the sewerage undertaker for premises supplied with water by another undertaker, the Appointee is only required to make an adjustment where the other undertaker has specified the basis on which the adjustment has been or will be made.

Paragraph H13 clarifies how any adjustment to metered charges for sewerage services must be determined.

To further clarify how the provisions in Condition H apply, a definition of 'Metered Charges' has been added (which will be included in Condition A). The definition used aligns with the Charges Scheme Rules (July 2018), but making clear that the charge must be based on volume of water supplied.

In addition, a change has been made to the definition of 'Supply Pipe'. The current definition is limited to pipes for which the owner is responsible, but we consider that this should also cover pipes which are not owned by the Appointee but for which another person is responsible.

Commentary on Condition I

Introduction

Condition I contains those provisions of existing condition F which do not deal with accounting and accounting information. These provisions have not been simplified but have simply been retained in a new condition, with minor consequential changes.

Each company has a bespoke version of these provisions and we will ensure each company's unique provisions are retained. Some companies already have a more modernised and consolidated condition on ring fencing, and those companies will not need this Condition I.

Interpretation and construction

The purpose provisions are taken from Condition F, para 1.1.

We have included the definitions and rules of interpretation in Condition F that are used in the provisions in Condition I.

Transactions between the Appointee and Associated Companies

Some of the provisions dealing with Associated Companies deal with reporting and are covered by RAG 3, section 6. These are paras F6.2-6.7 and the appendix to the existing Condition F. We have therefore excluded these provisions and the appendix from Condition I.

The one existing provision on Associated Companies that is not covered by the RAG is existing F6.7 which states:

'Nothing in this paragraph 6 or the Appendix shall require the disclosure of information which relates solely to a transaction wholly unconnected with the Appointed Business.'

This deals with reporting rather than ring-fencing and we have therefore inserted a new provision into the simplified F to reflect this provision (see F3).

Ring-fencing

On 25 August 2016 Condition F for all undertakers (other than undertakers operating wholly or mainly in Wales) was amended to reflect the opening of the non-household retail market. These provisions have been retained in I16 – I18. These provisions

will not be included in the revised Condition I for undertakers operating wholly or mainly in Wales.

As noted earlier, we will be consulting shortly on changes to the ring fencing conditions in most licences. Any changes made as a result will supersede the text we propose here.

Consequential changes

There are a few consequential changes to Condition R that will need to be made to reflect that the ring-fencing and associate company provisions will now be in a new Condition I. These are in Condition R, paragraphs 1 and 5(4) - the various references to Condition F will become references to Condition I.

Condition J: Levels of Service Information and Service Targets

Introduction

We propose moving some provisions from Condition J (levels of service information and service targets) to Condition M. We set out below those provisions which are being retained but moved elsewhere.

The provisions we propose moving from Condition J to Condition M

In order to enable us to make recommendations to the Secretary of State in connection with standards of performance regulations, we can require information from companies and we have extraordinary powers to investigate the accuracy and sufficiency of information given to us. This includes giving us access to any relevant plant or premises, allowing us to inspect and make copies of any documents, and allowing us to carry out tests and measurements.

The rationale for moving provisions from Condition J to Condition M

Our aim is to put all information gathering provisions into a consolidated Condition M. Our proposal, therefore, is to move the above provisions from Condition J into Condition M. We consider that these provisions are primarily about collecting information and they would therefore sit better in a revised Condition M.

Commentary on Condition M

Introduction

The draft revision of Condition M makes an attempt to reduce the excessive legalism and complexity in the drafting of the current condition, while retaining essential protections for the Appointee.

We propose to delete information requirements which are currently contained in other conditions. These will be incorporated within the general provisions in Condition M, so that unnecessary duplication is avoided.

We have also introduced into the condition provisions from Condition J which allow us to collect information from companies to facilitate investigations by Ofwat for the purpose of deciding whether to make an application to the Secretary of State in respect of standards of performance regulations.

Further commentary

The current equivalent of paragraph M1 refers to information that we may reasonably require for the purpose of carrying out its functions under the Water Industry Act 1991. When this was originally drafted, there was only one statute setting out our functions. However this is no longer the case. The drafting therefore brings the provision up to date, and also future-proofs it, by referring generally to all of the statutory functions that we have.

Current paragraph 2 overlapped heavily with the defined term 'Information'. Both the paragraph and the definition have been rationalised and updated, so as to make them clearer and remove this overlap. New paragraph M2 sets out duties on the timing and quality of information to be provided. To the extent to which those duties were in the definition, they have been removed – duties should be on the face of the condition where they can be most visible, and not in a definition. Conversely, the new definition encompasses everything that is meant by 'information', so it has been possible to remove descriptions of the type of information in paragraph M2.

Paragraph M3 is a clarified version of the current, overly-complex paragraph 3. However, the substance of it has been retained, except in two respects. First, the current paragraph excludes three of our statutory functions from the scope of the condition; two of these exclusions (sections 14 and 201 of the Water Industry Act 1991) have been retained, but the other (section 27 of the Act) has been removed because it has no clear justification. Section 27 of the Act places a duty on us to collect certain information, but does not provide a power for doing so. Our ability to

fulfil our duty under section 27 is consequently now found in paragraphs M1 and M2. Furthermore, deletion of the section 27 disapplication here also paves the way for the deletion of the information provision in Condition J, which does reference section 27. Second, the reference to section 206 of the Act (confidentiality of information) has been removed. It was not necessary, since that section is binding on us regardless of any reference to it in the condition.

Paragraphs M4 and M5 are versions of current paragraphs 4 and 5, but do not change anything substantive in either paragraph.

Paragraph M6 addresses an issue that is currently dealt with under paragraph 3, but which is more clearly stated under a separate heading. Its purpose is to state, for the avoidance of any doubt, that where we receive information it may use it in the exercise of any of our statutory functions. Specific reference is made to sections 14 and 201 of the Water Industry Act 1991. As paragraph M3 makes clear, the Appointee is not required to provide information for the purpose of those functions. However, where information is provided, we are entitled to use it for that purpose.

Paragraph M7 is a slimmed down version of the current paragraph 6. It makes the simple point that this Condition M operates in conjunction with, and not to the exclusion of, other information requirements. The current paragraph sets out a presumption of sufficiency for responses to information requests under other conditions, but this has been removed – since that presumption was rebuttable by a notice given by us, it added complexity and a layer of procedure, while offering no real benefits to either us or the Appointee.

Paragraph M8 states that the provisions of paragraphs M2, M4 and M5 also apply to information obligations under any other condition. However, it may be possible to remove this later, depending on the extent to which information provisions are consolidated in Condition M across the licence as a whole.

Paragraphs M9 and M10 derive from current paragraphs 7 to 11 of Condition J. We consider that these paragraphs fit better in Condition M than Condition J as they are primarily about collecting information.

The duties under these paragraphs are limited in scope. They apply only to cases in which we are considering applying to the Secretary of State, under either section 39 (water) or section 96 (sewerage) of the Water Industry Act 1991, for the making of standards of performance regulations. Where, for that purpose, we carry out an investigation into information that relates to the Appointee's service levels, the Appointee has a duty to co-operate with that investigation. This may include allowing us to carry out a site visit, inspect premises, and take copies of documents.

Commentary on Condition N

Introduction

Condition N sets out the mechanism for the Appointee to pay a range of fees to us. The draft revision of Condition N is intended to simplify these mechanisms by adopting shorter provisions and more clearly signposting the different fees. In addition, there are some substantive changes to the relevant fees and these are explained further below.

The redrafted condition necessarily applies to water and sewerage undertakers, but this is not the whole picture for recovery of fees. Now that the retail market has opened, there are more companies which need to be regulated and hence a revised apportionment of funding requirements between the existing undertakers and the new licensees. In October 2017, following consultation, we issued an Information Notice on how we will apportion fees between licensees and undertakers.

Further commentary

Current paragraph 2 sets out the fees which are required to be paid in a single provision with a number of long paragraphs. The provision is difficult to follow. Revised paragraph N1 starts by setting out all of the fees which the Appointee is required to pay under the Condition in a single short paragraph. The different fees (which are capitalised defined terms) are then detailed in separate paragraphs. In Paragraph N1, the words '(if any)' make clear that there are some fees which will always be levied and others which may not be levied in each Charging Year.

Current paragraph 2 includes a range of different dates for payment, with some fees stated to be payable within 30 days of a notification from Ofwat, one fee stated to be payable on 1 January and some fees stated to be payable at the start of the Charging Year. Paragraphs N2 and N3 simplify the provision by consistently stating that all fees will be payable within 30 days of a notification from us.

Paragraph N2 sets out two substantive changes in relation to the collection of the Annual General Fee. The first is that we may give two notifications in a Charging Year of amounts which are payable towards the Annual General Fee. This will give us further flexibility in relation to when amounts are collected. The second is that, while the amounts of the payments must not exceed the Annual General Fee determined in accordance with the Condition, we may recover a lesser amount. This covers the situation where it becomes clear that the amount of the Annual General Fee is based on an overestimate of our costs (as happened recently). The new provisions allow us to require the balance of the Annual General Fee later in the

year, once more accurate budgetary information becomes available. This will reduce the likelihood of us needing to issue credit notes at the year-end and will make it more likely that the funds remain in company accounts until they are needed.

Paragraph N4 sets out a rule of interpretation for the Condition that where it is stated that we will determine a fair proportion (to be paid by the Appointee), this will be in accordance with a disclosed methodology. This removes duplication (in current paragraph 2) by removing the need for the point to be repeated in provisions setting out how different fees will be determined.

Paragraph N5 sets out how the Annual General Fee will be determined. This replaces the renewal fee and the additional fee (as set out in current paragraphs 2(5) and 2(6)). Ofwat considers that both of these fees can be combined in a general fee which covers the costs incurred by us in the carrying out of our functions.

The current wording in paragraph 2(5) no longer covers all of our statutory functions. The revised drafting therefore brings the provision up to date, and also future-proofs it, by referring generally to all the statutory functions that we have. (This is in line with the approach taken in the draft revision of Condition M.)

Paragraph N6 retains the Special Fee in a simplified form – the Special Fee now covers our determination of a fair proportion of costs incurred or likely to be incurred which could have been included in the estimate used to determine the Annual General Fee, but were not so included. We envisage that the Special Fee is only likely to be necessary in response to external events such as company failure, implementation of new ministerial priorities or other circumstances which were unforeseen at the beginning of the year. Much of the detail in current paragraph 2(7) has been removed on the basis that it is not necessary.

Paragraph N7 retains the Interim Determination Fee in a simplified form. Current paragraph 2(4) states that this fee applies to costs in respect of references by the Appointee under Condition B, paragraph 14 and any determination by us under Condition B, paragraph 15. Paragraph N7 is simplified by using the defined term 'Interim Determination' which will be moved to Condition A. It is stated expressly that the costs must relate to Interim Determinations which we are required to make, because the defined term includes some determinations made by the Competition and Markets Authority.

There has been a minor substantive change in paragraph N7, in that the time period covered by the fee is the previous twelve months, rather than the previous Charging Year. Linked to this change, the provision now only covers our estimate of costs incurred, rather than costs likely to be incurred.

Paragraphs N8 and N10 retain the Consumer Council for Water Fee. This is covered by current paragraph 2(9) (although no reference is made currently to the Consumer Council). The revised draft contains a substantive change, in that the amount determined by the relevant formula in paragraph N10 is a cap on the Consumer Council for Water Fee; in absence of any direction to us under section 37(8) of the Water Act 2003 setting out a greater amount. The general position is that the fee is a determination by us based on our estimate of the Consumer Council's costs. We will continue to arrive at this estimate after consulting the Consumer Council. This substantive change brings the provision into line with current practice. It is also made clear in paragraph N8 that, where there is a statutory direction, the fee will be our determination or any greater amount necessary to give effect to that direction.

Paragraph N9 sets out an updated formula for calculating the cap for the Consumer Council for Water fee (in absence of a statutory direction). The two changes to the formula are that the base amount for indexation has been updated to £7.65 million as the 2015 amount and the inflation measures to be used have been changed (by reference to 'Relevant Index', which is now defined in Condition A). The index change is in line with licence amendments introduced in April 2017, whereby RPI is used up until 2020 and CPIH will be used thereafter. The reference to RPI specifically is retained in the medium-term to avoid the position that for any period between 2019 and 2024, CPIH would be applied to the whole period.

In addition, since the formulation of t / T is currently used more than once (see current paragraphs 2(9) and 3.1), a new definition of 'Appointee's Turnover Share' will be introduced in Condition A to cover this part of the formula. The duplication can then be removed from Condition N and the defined term is included in paragraphs N10 and N14.

Paragraphs N11 and N12 set out the updated Competition and Markets Authority (CMA) Fee. As with current paragraphs 2(2) and 2(3), the fee is made up of the costs of determinations which relate to the Appointee only and a fair proportion of the costs of determinations which relate also to other appointments. As above, there has been a minor substantive change in paragraph N9, in that the time period covered by the fee is the previous twelve months, rather than the previous Charging Year.

In addition, instead of referring to references made under Conditions B and C (as in current paragraph 2(2)), paragraph N10.1 refers to references made under section 12 of the 1991 Act. This means that the provision covers all determinations of the CMA which are set out in the licence. This change reflects the fact that there are now broader determinations made by the CMA than those referred to in Conditions B and C. This change also future proofs the condition.

Paragraphs N13 and N14 set out the default cap which will apply to the Annual General Fee and the Special Fee. As a substantive change, Paragraph N13 sets out a cap to apply over a five year period (with a new definition of 'Relevant Five Year Period' being added in Condition A). For example, this is in contrast to current paragraph 3.1, which sets out a cap in a given Charging Year. In the past, the cap has been set (in part) by reference to the timing of a price control (see current paragraph 3.2 and the reference to 'Periodic Review Year'), which has meant considering the cap on a five year basis in line with the price control process. We propose to retain a set five year period and to decouple this from the price control process, given that price controls may be more frequent going forwards.

As above in relation to the Consumer Council for Water Fee, in the formula in paragraph N14.1 which is used to determine the Regulation Fee Cap, the base amount for indexation has been updated (to £18.8 million as the 2015 amount) and the inflation measures to be used have been changed. In paragraph N14.2, the provision in current paragraph 3.2 has been brought into line with the cap applying to the Relevant Five Year Period and the drafting has been clarified.

Paragraphs N15 and N16 set out the manner in which the Regulation Fee Cap may be altered (see current paragraphs 3.3 and 3.4). The provision in current paragraph 3.2 has been brought into line with the cap applying to the Relevant Five Year Period and the drafting has been simplified.

Commentary on Condition Q

Introduction

The draft revision of Condition Q follows a similar structure to the current condition, with a number of provisions which we consider to be unnecessary removed.

There has been a substantive change in that, instead of different payments being available for customers of 'domestic premises' and other premises, these different payments will be available for customers of 'Household Premises' and other premises. In addition, where a payment needs to be made to a customer of a water supply licensee, the Appointee is obliged to make the payment to the licensee (rather than to the customer).

The current exception to the obligation to make payments where there has been an interruption in supply has been clarified. The methods of calculation of amounts payable are now set out in formulae to make them more straightforward to apply.

Further commentary

Condition Q requires the Appointee to make payments to customers of both domestic and non-domestic premises where the supply of water to the premises is interrupted under the authority of a drought order.

Current Condition Q uses the defined terms 'household customer' and 'business customer', being the person liable to pay charges in respect of water supply at (respectively) domestic premises and other premises. The term 'domestic premises' is defined in Condition A.

These requirements are now set out in paragraphs Q1 and Q3, but with the lower payment amount applying to 'Household Premises', rather than 'domestic premises'. This change means that the lower amount will only be applicable to customers where the principal use of the customer's premises is as a home. We consider that it is appropriate that premises whose principal use is not as a home should be treated in the same way as business premises. In addition, we consider that the change is appropriate because it will align the provision more closely to the modern regulatory regime.

Throughout the current condition, it is stated that a payment will be made where a supply is 'interrupted or cut off'. Given that a cut off supply will necessarily be an interruption in supply, we consider the words 'cut off' to be redundant and these are omitted in the draft revision.

It is made clear in paragraph Q1 that the payment to be made in relation to Household Premises under the condition is to be made to the person who is liable to pay charges in respect of water supply. (In the current condition, this is set out in the definition of 'household customer'.)

Current paragraph 3.1 sets out how the amount payable will be calculated in relation to domestic premises. Paragraph Q2 sets out the same methodology for determining the amount payable in relation to Household Premises, but this is now expressed as formulae, to make it more straightforward to apply.

Paragraph Q3 includes a substantive change in relation to premises supplied by a water supply licensee with which the Appointee has an agreement under section 66D of the 1991 Act. In this case, the payment must be made to the licensee. The Wholesale Contract¹³ provides that if there is an interruption to water supplies as a result of a restriction authorised by a drought order, the wholesaler shall pay the relevant retailer any required sums and the retailer must pass those amounts on to its business customers. We intend asking for the relevant paragraph to be amended so that it refers to condition Q rather than to schedule 5 of the Business Terms (which deal with GSS payments) as we think the reference to GSS payments is incorrect. Where the supply of water is made by the Appointee, the Appointee will continue to be required to make a payment to the customer (or credit the customer's account).

Current paragraph 3.2 sets out how the amount payable will be calculated for premises other than domestic premises. Paragraph Q4 sets out the same methodology for determining the amount payable for premises other than Household Premises.

Current paragraph 2.2 provides an exception to the requirement to make a payment where the circumstances 'were so exceptional that it would have been unreasonable to have expected the interruption... to have been avoided'. While the drafting of this exception is not entirely clear, our understanding of it is that the Appointee should not be required to make payments where it took all reasonable steps to avoid the circumstances which gave rise to the making of the drought order. The drafting has therefore been aligned to this position and this is set out in paragraph Q5.

¹³ At Schedule 1, Part 2 - Section 2.4.4.

Current paragraph 3.3 provides that in specified circumstances where a customer owes money to the Appointee, an amount owed under Condition Q should be credited to the customer's account, rather than paid to the customer. We consider this provision to be unnecessary. If there is an amount owing, the Appointee is incentivised to credit the amount, rather than paying it. We do not consider that this should be a regulatory requirement.

Paragraph Q6 retains the provision in paragraph 4 for a dispute relating to a payment to be made under Condition Q to be referred to us for determination. Given the above change providing for payment to licensees supplying premises, paragraph Q5 contains an addition that a dispute between an Appointee and a licensee relating to a payment under the condition may also be referred. It is clarified in paragraph Q5 that the Appointee is required to give effect to our determination (in place of the current wording that the determination is 'final').

Current paragraph 4.2 states that, if the Appointee fails to give effect to the determination, the customer may set off the amount in question against any payment which is due. We do not consider that it is appropriate to retain this provision. If the Appointee fails to give effect to a determination, this is a breach of the licence and we may take appropriate enforcement action. The conditions do not create a contractual right for a customer to enforce against the Appointee.

Current paragraph 5 allows for the cessation or modification of Condition Q where the Secretary of State makes regulations implementing the recommendations made by the Director General (in May 1996) for the making of payments to customers for interruptions or cut-offs because of drought. Given the time which has passed since 1996, we consider that this provision is now redundant. It is omitted from the draft revision of Condition Q.

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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