

July 2021

Consultation under section 13 of the Water Industry Act 1991 on proposed modification to Condition I of Wessex Water's licence

About this document

This document invites comments on our proposal to modify Condition I of Wessex Water Services Limited's (**Wessex Water**) Instrument of Appointment (**licence**). Our proposed licence modification would insert the requirement relating to having adequate systems of planning and internal control to enable it to carry out its regulated activities. This modification will bring Wessex Water's licence in line with the licences of all other large water and sewerage companies, which currently contain this requirement in Condition P.

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 change we are proposing to make. Wessex Water has indicated its consent to this modification.

Before making modifications under section 13 of the WIA91, Ofwat must give notice in accordance with that section. In respect of Wessex Water's licence, this document is a Notice under section 13 of the WIA91.

Responding to this consultation

We invite Wessex Water and other stakeholders to comment on our proposed modification by **29 July 2021**. Wessex Water's formal response to our proposal must indicate whether or not the company accepts the modification proposed. Subject to agreement, we aim to amend Wessex Water's licence by **26 August 2021**.

You can email your responses to:

Harpreet.Atwal@ofwat.gov.uk

We intend to publish responses to this consultation on our website at www.ofwat.gov.uk. Subject to the following, by providing a response to this consultation you are deemed to consent to its publication.

If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our [Privacy Policy](#) explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the Water Industry Act 1991, information provided in response to this consultation, including personal data, may be published or disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice' which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

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1. Background and reasons

1.1 Licence Condition I – Ring-fencing

Each water company's licence includes a series of conditions setting out obligations the company has in relation to its regulated activities as an appointed water company. Licence Condition I in Wessex Water's licence (or Condition P in most other companies' licences) relates to “**ring-fencing**” of the regulated business.

The purpose of the ring-fencing provisions is to protect customers and the regulated business and includes an obligation for the company to ensure there is no cross-subsidy between its regulated activities as an appointed water company and other business activities that that company or any of its Associated Companies may undertake. Further obligations include ensuring that any transfer of assets from the appointed company to associated companies does not adversely affect the appointed company's ability to fulfil or finance its functions as an appointed water company; and that the appointed company has adequate resources (financial and other) to carry out its regulated activities.

Condition I of Wessex Water's licence includes a number of requirements to ensure appropriate ring-fencing of the regulated business. The proposed modification we are consulting on relates to the wording of a specific section about ensuring the appointed company has adequate resources and means to carry out its regulated activities. It does however have relevance to other parts of Condition I in terms of requirements relating to transfer pricing (that is how the charges for transactions between the appointed company and its associated businesses are established); and the requirement for the appointed company's board to submit an annual certificate of adequacy to Ofwat confirming the company has sufficient resources to enable it to carry out its regulated activities for at least the next 12 months.

Due to how company licences have evolved over time, there are currently some differences in some of the specific wording in the ring-fencing provisions across companies' licences. For most companies the requirement to ensure they have adequate resources to enable them to carry out their regulated activities explicitly describes those resources as financial resources and facilities; management resources; and systems of planning and internal control. Wessex Water's current licence include the first two of these but does not explicitly state the latter.

Our proposed modification is to insert this third aspect explicitly in this section of Wessex Water's licence Condition I.

1.2 Why we are proposing this modification

Our proposal to insert a new requirement relating to systems of planning and internal control into Wessex Water's licence has arisen out of our regulatory work and engagement with Wessex Water following our final price control determination for the company, which we published in December 2019.

In our [PR19 final determination for Wessex Water](#) we set the allowed revenue that Wessex Water can recover from its customers for the 2020 to 2025 period. Wessex Water operates using an associate company as part of its bioresources activities. During our price control process, we raised a number of queries to understand Wessex Water's methodology for calculating the price charged by the appointed business to the non-appointed business for the supply of biogas produced during the sludge treatment process. This was to understand the boundaries between Wessex Water's appointed and non-appointed activities within its bioresources strategy to clarify how the risks and benefits are shared with customers.

We concluded that Wessex Water's proposals for 2020-25 appeared to include making an inappropriately low charge for biogas supply to the non-appointed business. As a result, we intervened to reduce the amount of revenue Wessex Water could raise through customer bills by £8.5 million, to ensure that customers were protected from paying more for their wastewater charges than they should. In our final determination we confirmed that Ofwat would be considering if any further action was required to satisfy itself that Wessex Water's costs and charging arrangements complied with transfer pricing obligations.

Over the past year and a half, we have further investigated Wessex Water's transfer pricing arrangements, in particular to understand how it establishes the value of and charges for its transactions with its associated businesses in relation to its bioresources activities, and how it ensures compliance with its Condition I ring-fencing obligations on an on-going basis.

Through our constructive discussions with Wessex Water we identified a number of areas where Wessex Water could and has strengthened its processes and controls in relation to its transfer pricing arrangements with its associated businesses and therefore its compliance with relevant parts of Condition I of its licence.

As referred to above, another issue that has been identified during our investigations with Wessex Water is that across the 11 largest water and sewerage companies, Wessex Water is the only company which does not have a licence requirement to ensure it has

adequate systems of planning and internal control to enable it to carry out its regulated activities.

We consider this to be an anomaly which has been brought to light as a result of the concerns we have been investigating with Wessex Water this year. Water company licences contain a number of conditions that have been subject to several modifications over the years, for example as a result of a licence review when a change of control takes place, which can result in some differences in the wording across licences. Where we identify gaps or anomalies we seek to resolve these via such modifications (as we are doing in this consultation) to ensure that customers in England and Wales have the same standard of protection.

We expect water companies to have robust systems of planning and internal controls in place to carry out their regulated activities. This includes ensuring that arrangements with associated companies are supported by clear and transparent agreements, policies and procedures (including guidance to employees) and that these are reviewed on a regular basis.

Based on the above we have proposed, and Wessex Water has given its indicative consent to, a modification of its licence to bring this requirement into effect. We believe having this requirement in its licence will help prevent the issues we identified in our PR19 determination and in our subsequent investigation.

It would also bring Wessex Water's licence requirements in line with other large water and sewerage companies' licences, and would strengthen alignment with the reporting requirement already set out in paragraph 17 of Condition I of Wessex Water's existing licence, which requires the board of Wessex Water to confirm it has adequate systems of planning and internal control in its annual certificate of adequacy¹.

¹ In February 2020, we published an Information Notice titled [Requirements and expectations for ring-fencing certificates](#) which provides companies with guidance on what to include in their ring-fencing certificate, known as the "certificate of adequacy" in Wessex Water's licence.

2. What is the change that we are proposing?

We are proposing to insert a requirement relating to having adequate systems of planning and internal control as an addition to the existing text of Condition I13 of Wessex Water's licence, as follows (new text **emphasised**):

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; ~~and~~

I13.2 management resources; **and**

I13.3 systems of planning and internal control,

to enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil its obligations under the Appointment(s)).

**Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.**

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