

## Water Bill

### Competition Framework under the Water Bill

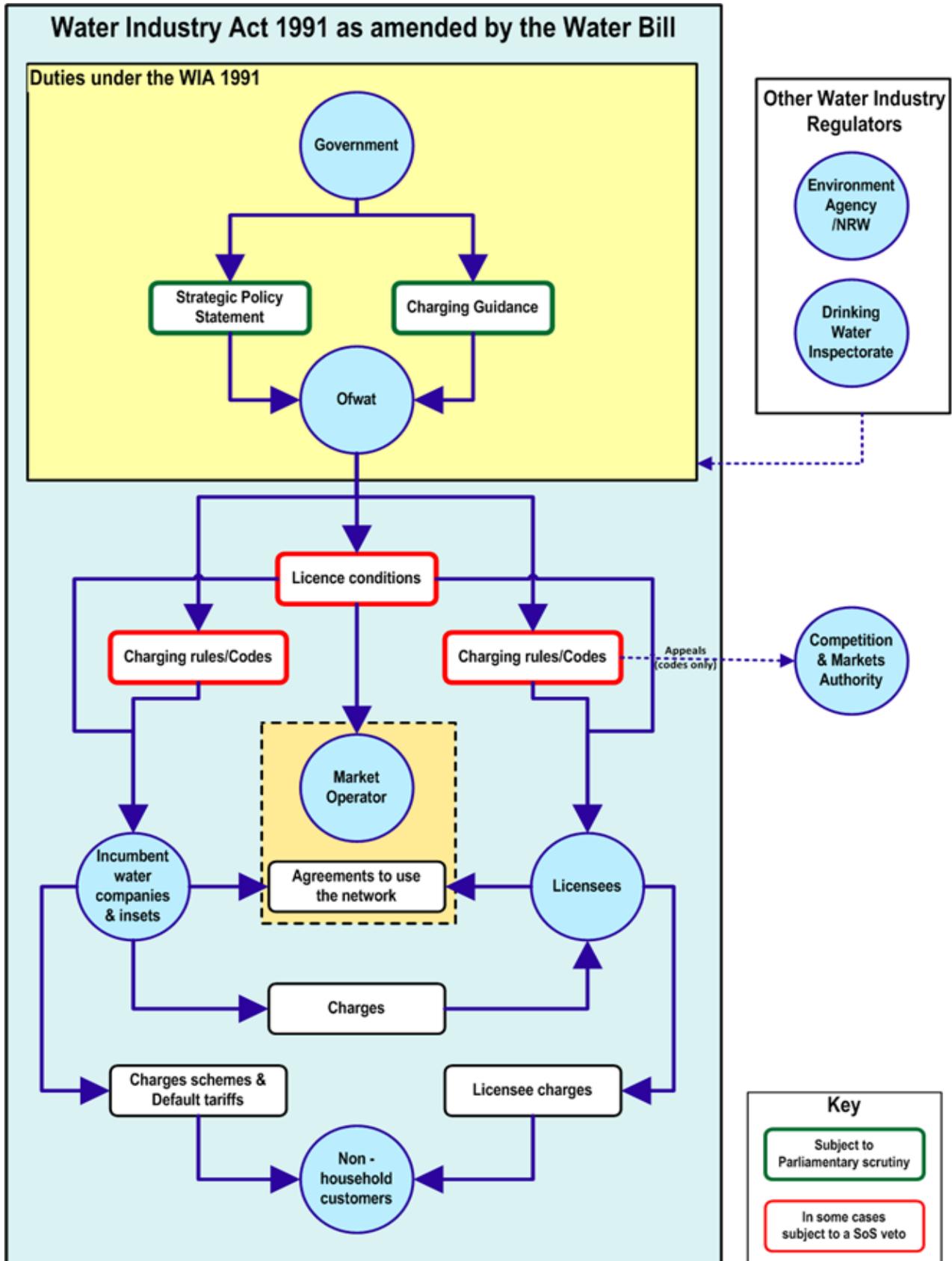
November 2013

This is one of a series of briefing notes on the Water Bill. This note explains in detail the new competition framework the Water Bill will put in place. It explains what it will look like and how it will work. Further detail on the Water Bill can be found in other briefing notes.

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**Figure 1: The competition framework under the Water Bill**



# How will competition in the water sector be regulated?

The Water Bill will reform the water industry to help to ensure that our water resources are more resilient to future pressures, to increase customer choice and to drive economic growth. It does this by introducing greater competition to the sector within a broader policy and regulatory framework set out in the Bill. This will ensure that the pace and scope of competition is set by the UK Government and the Welsh Ministers – with appropriate oversight from Parliament and the National Assembly for Wales – while economic regulation of the industry within that policy framework is delivered by Ofwat. The diagram on page 1 illustrates how this will work. There is a brief description of each of the key elements below.

## General duties

The new competition framework will be governed by the Water Industry Act 1991 (WIA), as amended by the Water Bill. This will be subject to Parliamentary scrutiny through the legislative process. The Welsh Government is maintaining the current threshold that applies to competition, but this framework will also apply in Wales. Both the UK and Welsh Governments and Ofwat are subject to the general duties in the WIA: that is, protecting the interests of customers, ensuring that incumbent water companies and water supply licensees properly carry out their functions and ensuring that incumbent water companies are able to finance their functions by, in particular, securing reasonable returns on their capital. The Water Bill also adds a new primary duty to secure resilience.

## Strategic Policy Statement (SPS)

The SPS will provide detailed guidance on the respective priorities of the UK Government (in respect of incumbent water and sewerage companies wholly or mainly in England) and the Welsh Government (for incumbents wholly or mainly in Wales) for Ofwat in delivering its duties. It includes ensuring a fair deal for customers, supporting economic growth and effective water management.

The UK Government had previously published an SPS alongside Social and Environmental Guidance to Ofwat. This covers the importance of ensuring a customer-focused water industry as well as guidance on resilience and environmental protection. The Welsh Government has only published stand-alone Social and Environmental Guidance to Ofwat.

The Water Bill strengthens the role of the SPS by consolidating both of these documents and by giving a scrutiny role to Parliament (in respect of incumbent water and sewerage companies wholly or mainly in England) and the National Assembly for Wales (for

incumbents wholly or mainly in Wales) before it is published. It also strengthens the role of the SPS by obliging Ofwat to act in accordance with it.

## Charging guidance

The Water Bill gives the UK and Welsh Governments a new duty to produce overarching guidance to Ofwat that will set out a policy framework for Ofwat's approach to regulating charges. This will apply to the charges incumbent water companies set for customers as well as those for other businesses that use the network such as licensees, insets and developers. The charging guidance will need to strike a careful balance between protecting customers and ensuring that incumbent water companies can generate a return on existing infrastructure and finance future investment, while also allowing a sufficient margin to make the market attractive to new businesses and to encourage innovation. Ofwat must have regard to the charging guidance when they set charging rules. This will ensure that competition develops within the clear framework of government policy. The charging guidance, in combination with Ofwat's charging rules, will replace the current "costs principle" that has had a chilling effect on competition in the current market.

The UK and Welsh Governments will publish the charging guidance prior to market opening. It will be subject to Parliamentary scrutiny (negative resolution). The Secretary of State may also issue more detailed guidance that relates to individual areas such as the water supply and sewerage licensing (WSSL) regime, which will sit below the overarching guidance. In the interim, the UK Government has published high level principles that will underpin the development of this guidance and give a broad indication of Government policy on charging issues.

## Charging rules

Ofwat will be required to issue charging rules on the charges schemes that incumbent water companies use to charge customers for water supply and sewerage services. Companies must comply with the charging rules. This replaces the current system under which Ofwat annually signs off companies' charges schemes individually. This will reduce bureaucracy while still ensuring that incumbent water companies' charges schemes are consistent with Government policy.

Ofwat will also issue rules on the access prices charged to water supply or sewerage licensees for using part of the network, on charges for connecting premises to the system, adoption of pipes laid by developers, water trading (or "bulk supply") agreements between incumbent water companies and sewage sludge trading (or "main connection") agreements. Regulations may also permit further rules to be issued on the sale of water to companies by other persons, for example farmers with a spare supply of water.

Ofwat's charging rules will be subject public consultation and may be vetoed by the Secretary of State (in relation to incumbent water and sewerage companies wholly or mainly in England) or Welsh Ministers (for incumbent water and sewerage companies

wholly or mainly in Wales) if he or she considers that the rules are inconsistent with the relevant Government's policy as set out in the charging guidance or the strategic policy statement.

## Default tariffs and licensee charges

Ofwat will set Default tariffs that establish the minimum standards of service that incumbent water companies should provide to their non-household customers. This will include controls on the prices they may charge various groups of customers. It will be up to water companies to set their own default tariffs within that framework. Companies will be able to charge less than the default tariffs if they are able to offer the minimum standards at a cheaper price or if they want to offer a "no frills" package. They will also be able to offer discounts where customers take action to reduce costs, for example discounts for direct debit or advance payments or paperless billing. In addition, companies may charge more where they offer value-added services on top of the minimum standards package. These might include on-site support, leak detection services, smart meters and named account managers.

Licensees will be free to price their services at whatever level they want, but Ofwat will decide whether they should also be required to offer an equivalent 'default' to customers as part of the work to develop the market framework.

## Codes

Ofwat will issue codes that will set the rules for the market. These codes are also known as market codes, operational codes or access codes. The codes will govern the behaviour of incumbent water companies and licensees that provide water and sewerage services in the market place. The relationships between these companies and customers will be contractual, regulated by Ofwat under the codes. In combination with charging rules, codes will help the market work better by ensuring that agreements to use the water company's network are fair, transparent and efficient. For example, codes will be able to set standard terms and conditions as well as principles for reaching agreement. Most of these agreements (with the exception of certain upstream services) will no longer need to be individually negotiated, which currently takes time and money. The Annex provides some examples of the types of issues that we anticipate codes will cover.

Ofwat's initial codes will be subject to a veto by the Secretary of State to ensure that the new markets operate within Government's policy framework. However, we know from experience in Scotland that codes will need to change over time as the market develops. Ofwat will therefore have the flexibility to revise the codes and may determine in some cases that they are unnecessary because the market is working fairly and efficiently without them. As a safeguard, the Government may make regulations to establish an appeal mechanism to the Competition and Markets Authority for certain parties to challenge future changes that Ofwat may make to the codes after the initial codes have been published.

Ofwat must also consult the Drinking Water Inspectorate, CC Water and the Environment Agency (or Natural Resources Wales) on the relevant codes. This will ensure that the competitive markets do not have any adverse impacts on public health and that the environment continues to be protected.

## **Licence conditions**

All businesses providing water supply or sewerage services must be licensed by Ofwat. The Government will set standard licence conditions for water and sewerage retail licensees at market opening in 2017. The Water Bill also gives Ofwat a time-limited power to amend the licence conditions of incumbent water companies and licensees if necessary or expedient to reflect any changes made by the Bill. This will ensure that their licences are consistent with the new competition regime. The Secretary of State will have a power of veto over Ofwat's changes. Ofwat will remain responsible for enforcing the licence conditions and issuing new licences after market opening.

## **Market operator**

A market operator will function within the scope of the codes to manage switching services and financial settlements on behalf of market participants. It will act merely as an administrator and will not possess any formal powers.

## **Competition and Markets Authority (CMA)**

The CMA was created by the Enterprise and Regulatory Reform Act 2013 to take over most of the functions of the Competition Commission and the Office of Fair Trading. The Government aims to have the CMA operational by April 2014. The CMA will be responsible for hearing appeals against Ofwat's decision to revise the codes. Subject to consultation, we anticipate that both water companies and licensees will have a right of appeal to the CMA.

## **Environment Agency and Natural Resources Wales**

In England, the Environment Agency is responsible for protecting and improving the environment and promoting sustainable development. In Wales, these functions are performed by the Natural Resources Wales (NRW).

## **Drinking Water Inspectorate (DWI)**

The DWI is the independent regulator of drinking water in England and Wales, responsible for ensuring that companies provide safe drinking water that is acceptable to consumers and meets the standards set down in law.

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<https://www.gov.uk/government/policies/reforming-the-water-industry-to-increase-competition-and-protect-the-environment/supporting-pages/reform-of-the-water-market-the-new-water-bill>

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