

Water Bill

Codes for agreements with water companies

January 2014

This is one of a series of briefing notes on the Water Bill. This note explains the different types of codes introduced in the Water Bill and how these may be used to deliver reform in the new water and sewerage markets.

This background note is intended to aid debate in Parliament and does not reflect any final decisions made by the UK Government, Ofwat or the Open Water programme on what may or may not be included in a future code.

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Introduction

The case for reform of the water industry was set out in Professor Martin Cave’s report to Government: *Competition and Innovation in Water Markets*. This recommended a package of changes to increase competition and bring new ways of working to the sector. This included the introduction of operational and market codes in the water supply licensing and inset regimes. The Water Bill builds on this recommendation by providing powers for Ofwat to issue codes for various regimes in the new markets.

The codes will set the “rules of the game” by governing the behaviour of the incumbent water companies, inset appointees, licensees, developers and other relevant market participants. Alongside charging rules and licence conditions, codes will form an important part of the new competition framework set out in the Bill. This will ensure that Ofwat’s regulation of the industry takes place within the policy framework set by Government. Please see the briefing note *Competition Framework under the Water Bill* for further details on how the new competition framework will work.

Figure 1: The difference between charging rules, codes and licence conditions

Charging rules	Ofwat will issue charging rules setting out the relevant charges for various activities under the Water Industry Act 1991 (WIA). These rules will govern the charges that incumbent water companies/inset appointees set for customers under their charges schemes. They will also govern the charges for other businesses that use the network. This will include charges to licensees for using the network to provide water and/or sewerage services, charges to other water companies for bulk transfers of water or sewage, and developer charges for connecting new premises to the network. Rules may also be introduced under clause 12 to govern the sale of water to water companies by other relevant parties.
Codes	Ofwat will issue codes setting out the terms and conditions that must be contained in individual agreements or the principles for determining those terms and conditions between the various parties that use the network. The codes will also set out the procedure that must be followed for putting these agreements into place. Please see below for further details on the possible content of codes.
Licence conditions	Government will set licence conditions at the retail market opening in April 2017. The conditions will set out the rights and duties of licensees, incumbent water companies and inset appointees. This might include, for example, rules around mis-selling.

Why are codes important?

The introduction of codes is essential to ensure the effective operation of the reforms in the Bill. In *Water Market Governance Arrangements – a discussion document*, Ofwat stated that:

“A successful competitive market requires a clear understanding of the responsibilities and activities required of all parties in all elements of water and sewerage service delivery (retail, networks, treatment and resources). Clear, unambiguous rules – in the form of codes – with which all parties comply will enable the market to operate efficiently in customers’ interests.”¹

Clear rules are essential in utility markets because all market participants need access to common services and facilities to provide relevant services to their customers.² Regulated access to common services and facilities through the codes will therefore enable market participants to compete effectively with each other. It will also reduce the need for agreements to be individually negotiated, which can be both time-consuming and costly. This is essential to ensure that the reforms contained in the Water Bill deliver our key objectives of increasing resilience, improving customer choice and supporting economic growth.

The scope of the codes

There are a number of established codes in other utility markets. This includes the balancing and settlement code in the electricity market, the uniform network code in the gas market and the market and operational codes in the Scottish retail water market.

Ofwat have provided a useful summary of the Scottish codes:³

“...The two main codes are the market code and the operational code.

The market code governs the relationship between the Central Market Authority (CMA) and the other parties in the market. It also sets out the duties of the CMA. The CMA administers the market, operating the computer systems that run it and keeps a record of supplier activities in the market, including recording which suppliers are responsible for the services at each connection point. Every month the CMA uses this information to work out the wholesale charges that suppliers must pay to Scottish Water.

The operational code governs the relationship between Scottish Water (as the provider of wholesale services) and the licensed providers.”

¹ Ofwat, *Water market governance arrangements – a discussion document*: 3. Last accessed 24 January 2014: http://www.ofwat.gov.uk/competition/review/pap_tec201309marketgovernance.pdf.

² *Ibid.* at 8.

³ *Ibid.* at 16.

The Water Bill will introduce powers for Ofwat to issue codes to regulate a number of regimes in the new water and sewerage markets. The proposed content of the initial code for the retail market will be developed by the Open Water programme in close partnership with the industry. However, Ofwat is a key member of the Open Water Programme and will have the final decision over issuing the code. This will cover the water and sewerage licensing regimes. Open Water is currently undergoing work in preparation for the retail market opening in April 2017. Further information on this work can be found in Open Water's *Market Blueprint*, which was published on 2 January 2014.⁴

Which regimes will be covered by the codes?

Ofwat has the power to introduce codes in the following regimes⁵:

- The water supply licensing regime for retail and wholesale agreements between incumbent water companies and water supply licensees. See new section 66DA-DC of the WIA, inserted by Schedule 2;
- The sewerage licensing regime for retail and wholesale agreements between incumbent water companies and sewerage licensees. See new section 117F-H of the WIA, inserted by Schedule 4;
- The bulk supply regime for bulk transfers of water between incumbent water companies and between incumbent water companies and inset appointees. See new section 40B-D of the WIA, inserted by clause 8;
- The main connections regime for wholesale sewerage agreements between incumbent water companies and between incumbent water companies and inset appointees. See new section 110C-E of the WIA, inserted by clause 9;
- The water supply self-lay regime for agreements between incumbent water companies and any person, for example a developer, that constructs mains and pipes for future adoption by incumbent water companies. See new section 51CA-CC of the WIA, inserted by clause 10;
- The sewerage self-lay regime for arrangements between incumbent water companies and any person, for example a developer, that constructs sewers and drains for future adoption by incumbent water companies. See new section 105ZC-ZE of the WIA, inserted by clause 11;

⁴ Open Water, *Market Blueprint*. Last accessed 24 January 2014:
<http://www.open-water.org.uk/media/1041/market-blueprint.pdf>.

⁵ Please note that the clause numbers below apply to the Bill as introduced in the House of Lords on 7 January 2014.

- Regulations made under clause 12 could also allow Ofwat to issue codes to regulate the private water storage market, i.e. the sale of water by a third party, such as a farmer, to incumbent water companies. See new section 66O of the WIA, inserted by clause 12.

Possible content of the codes

The content and coverage of the codes will not be the same as they all cover very different regimes. The powers to issue codes are not identical in each regime. With regard to the water and sewerage licensing regime, the Open Water Programme and Ofwat have not yet made any final decisions on the precise content of the codes. However, here are some specific examples of the kind of areas that these codes *might* cover—

- The time period for switching, i.e. a standard number of business days for a switch to take place and what happens if a customer wants to switch their water and/or sewerage provider at a later date;⁶
- Standard terms and conditions between incumbent water companies and licensees. This might include notice periods and late payment terms;⁷
- Minimum standards for the services an incumbent water company provides to a licensee, for example the maximum time that it should take to replace a faulty water meter;
- A requirement for water bills to include a direct help line telephone number for customers to call if they have a problem with their drinking water;
- Standards for accessing and maintaining a water company's network for fire fighting purposes.

Please see Annex 1 for further details about the provisions on codes contained in the Bill.

⁶ *Ibid.* at 31-32.

⁷ See Open Water, *Financial Settlement Strategy*: 21. Last accessed 24 January 2014: <http://www.open-water.org.uk/media/1043/financial-settlement-strategy.pdf>.

The development of the codes

Initial creation of codes

Ofwat will issue the codes in line with its statutory duties and following consultation with relevant parties such as the Drinking Water Inspectorate, Consumer Council for Water and the Environment Agency or Natural Resources Wales. This will ensure that the competitive markets do not have any adverse impacts on public health and that the environment continues to be protected. Ofwat is currently consulting on whether the codes should be created from scratch or whether existing codes should be used as a starting point.⁸ As a further safeguard, 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.

Modification of codes

We know from the experience in Scotland that the codes will need to change over time as the market develops. Ofwat will therefore have the flexibility to revise the codes and may determine that they are unnecessary in some cases because the market is working fairly and efficiently without them. Ofwat has recognised that any modifications to the codes must be in the interests of all market participants. It has also acknowledged the importance of harnessing the expertise of companies that operate in the market as well as taking account of customers' views.⁹ Ofwat is currently consulting on whether it should establish a panel to consider proposed code modifications, similar to the Balancing and Settlement Code panel in the energy sector.¹⁰

Ofwat must consult the water sector and other relevant parties before revising the codes. As a further safeguard, the Government may make regulations allowing certain parties to appeal to the Competition and Markets Authority to challenge Ofwat's decisions to change the codes after the initial codes have been published.¹¹ Exceptionally, Ofwat can make minor or urgent revisions without consultation. Minor revisions to a code might include small, uncontroversial changes or technical amendments, such as a change in contact details. Urgent revisions might include changes that are needed to protect consumers, public health or the environment. However, any urgent revisions made without consultation would fall away after six months.

⁸ fn1, above at 4.

⁹ *Ibid.* at 11.

¹⁰ *Ibid.* at 4.

¹¹ The Competition and Markets Authority will take over most of the functions of the Competition Commission and the Office of Fair Trading. The Government aims for it to be operational by April 2014.

Enforcement

Ofwat will be able to enforce the codes by issuing a direction, enforceable under section 18 of the WIA. Ofwat may impose a financial penalty for failure to comply with such a direction. Failure to comply with an enforcement order may be subject to court action by the party affected by the breach.

Annex 1: Provisions on codes in the Bill

Water supply licensing (Schedule 2)

Under new section 66DA of the WIA, inserted by Schedule 2 of the Bill, a code concerning the water supply licensing regime may include provisions about:

- The procedures for making, varying or terminating an agreement between a water supply licensee and an incumbent water company or an inset appointee for use of the public supply system;
- The terms and conditions of such an agreement, including the duration of the agreement;
- The principles for determining which terms and conditions should be incorporated into such an agreement.

Sewerage licensing (Schedule 4)

Under new section 117F of the WIA, inserted by Schedule 4 of the Bill, a code concerning the sewerage licensing regime may include provisions about:

- The procedures for making, varying or terminating an agreement between a sewerage licensee and an incumbent sewerage company or an inset appointee for use of the public sewerage system;
- The terms and conditions of such an agreement, including the duration of the agreement;
- The principles for determining which terms and conditions should be incorporated into such an agreement.

Bulk supply regime (clause 8)

Under new section 40B(2) of the WIA, inserted by clause 8 of the Bill, a code concerning the bulk supply regime may include provisions about:

- The procedures for making, varying or terminating a bulk supply agreement;
- The procedures for Ofwat to determine whether to order or vary a bulk supply agreement;
- The terms and conditions of a bulk supply agreement, including the duration of the agreement;

- The principles for determining which terms and conditions should be incorporated into a bulk supply agreement;
- How Ofwat will determine whether a person is complying with a code.

Main connection regime (clause 9)

Under new section 110C(2) of the WIA, inserted by clause 9 of the Bill, a code concerning the main connections regime may include provisions about:

- The procedures for making, varying and terminating a main connection agreement;
- The procedures for Ofwat to determine whether to order or vary a main connection agreement;
- The terms and conditions of a main connection agreement, which might include the duration of the agreement;
- The principles for determining which terms and conditions should be incorporated into a main connection agreement;
- How Ofwat will determine whether a person is complying with the code.

Self-lay regime (clause 10)

Under new section 51CA(2) of the WIA, inserted by clause 10 of the Bill, a code concerning agreements to adopt infrastructure under the water supply self-lay regime may include provisions about:

- The procedures for making, varying and terminating a relevant agreement;
- The procedures for Ofwat to determine whether to order or vary a relevant agreement. This might include a requirement to consult the Drinking Water Inspectorate;
- The circumstances in which it is appropriate for the work to be carried out someone who is not an incumbent water company or inset appointee. This might depend on the nature of the work and the type of premises;
- The terms and conditions of a relevant agreement. This might include terms on constructing associated infrastructure, constructing water mains to meet additional supply requirements and connecting new water mains or service pipes as well as terms on the duration of the agreement;
- The principles for determining which terms and conditions should be incorporated into a relevant agreement;
- How Ofwat will determine whether a person is complying with the code.

The sewerage equivalent of the self-lay regime (clause 11)

Under new section 105ZC(2) of the WIA, inserted by clause 11 of the Bill, a code concerning agreements to adopt infrastructure under the sewerage self-lay regime may include provisions about:

- The procedures for making, varying and terminating a relevant agreement;
- The procedures for Ofwat to determine whether to order or vary a relevant agreement;
- The circumstances in which it is appropriate for the work to be carried out someone who is not an incumbent water company or inset appointee. This might depend on the nature of the work and the type of premises;
- The terms and conditions of a relevant agreement. This might include terms on constructing associated infrastructure and connecting to a public sewer;
- The principles for determining which terms and conditions should be incorporated into a relevant agreement;
- How Ofwat will determine whether a person is complying with the code.

Private water storage (clause 12)

Under regulations made under new section 66O(1) of the WIA, inserted by clause 12 of the Bill, a code concerning private water storage may include provisions about:

- The procedures for making, varying and terminating a water supply agreement;
- The procedures for Ofwat to determine whether to order a relevant agreement;
- The terms and conditions of water supply agreements;
- Ofwat's enforcement of the code.

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This document/publication is also available on our website at:

<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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