Consultation on Draft Regulations: 'Code Appeals for the Water Supply and Sewerage Licensing Regime'

Summary of responses and the government's response

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Introduction

The Water Act 2014 (WA14)[1] introduces reforms to the water sector, including allowing for increased competition in the retail market for non-household water and sewerage services under the water supply and sewerage licensing (WSSL) regime.

These reforms include the introduction of codes, which are commonly used in regulated utility markets, to govern agreements between incumbent undertakers and water supply and sewerage licensees wishing to compete to provide water and sewerage services in the new market. To ensure that the regulatory framework for the new market is both transparent and effective, the WA14 includes amendments to the Water Industry Act 1991 which provide for the introduction of regulations allowing appeals to the Competition and Markets Authority (CMA) against a decision by Ofwat to make a revision, or not to make a proposed revision, to any code designated under the Regulations.

Defra initially stated our intention to introduce an appeals approach similar to the procedure which exists for the energy sector through a consultation published in December 2015[2]. We also indicated that we had identified two draft codes for the WSSL regime that should be designated by the Regulations, known as the Market Arrangements Code (MAC) and the Wholesale-Retail Code (WRC). These codes will regulate arrangements between undertakers and licensees and between the wholesale and retail sides of undertakers' businesses.

Following further dialogue with the CMA, the Welsh Government and Ofwat, a full public consultation was held on these policy objectives, the draft Regulations and an accompanying Impact Assessment, which ran between 15 November 2016 and 13 December 2016.

Summary and next steps

The consultation included six questions. We received 13 responses, of which eight were from undertakers and three were from retailers who will operate under a WSSL. Also included was one response from the customer group Consumer Council for Water (CCWater), and one from Market Operator Services Limited (MOSL), who will deliver and operate the required central information systems and processes for the new market. The summary of responses is shown in Figure One.

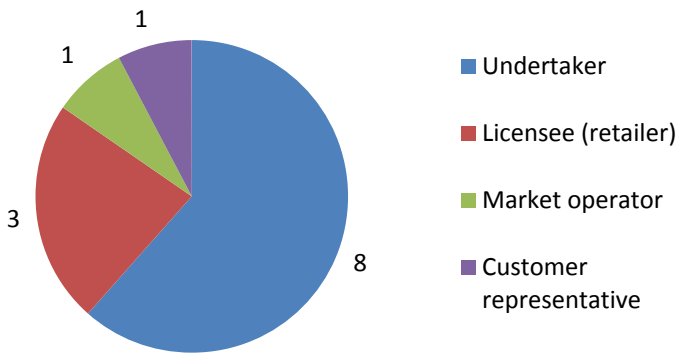
Of those who replied, two undertakers did not break down comments for each question, instead indicating their overall support for the proposals as presented. The remaining eleven respondents stated their preferences in relation to each question, with further information supplied for some or all of the questions. There was a high degree of

[1] http://www.legislation.gov.uk/ukpga/2014/21/contents

[2] https://consult.defra.gov.uk/water/water-supply-and-sewerage-licensing-regime/supporting_documents/WSSL%20Licensing%20Consultation%20Document.pdf

consensus amongst respondents, and it was of particular importance that all welcomed the introduction of an appeals mechanism allowing market participants to challenge decisions. Respondents noted regulatory, time and cost benefits for the water sector that would ultimately support the development of the market and increase levels of service for non-household customers.

Figure One: Summary of responses to the consultation



A detailed summary of responses is provided from page six onwards. In particular we would highlight that a number of useful comments were offered in relation to the question of parties who hold the right to appeal. Opinion was split between those who suggested that only an undertaker or licensee in possession of a WSSL should be permitted to raise an appeal (and only those that can demonstrate material impact of a change), and others who suggested either alternative criteria, or that the right be extended to those in the process of applying for a WSSL or appointment. The government has considered all of the arguments made and responses are found on pages eight and nine.

A further point we wish to highlight is that respondents, including both MOSL and CCWater, asked that we review the Regulations as the retail market matures. The government agrees that this is a sensible and necessary measure. It is to be expected that the regulatory structure around a healthy, well-functioning market may need to evolve when competition has become long-established. Alongside Ofwat and MOSL, we will regularly evaluate market performance indicators, ensuring the appeals mechanism remains effective and appropriate. We also expect to review our regulations if relevant changes are made to the energy code appeals regime, or new water codes are designated in future.

We are grateful to all those who have responded, as well as to those who have engaged with us throughout the development of these Regulations. As a result we are confident this is the right approach to achieving the stated policy objectives, and that they have the support of market participants.

Alongside this response we have laid the Regulations in Parliament under the affirmative resolution procedure for statutory instruments. Subject to the approval of Parliament we expect these will come into force for the date on which the market opens, or shortly thereafter. The CMA will consult upon appeal rules and accompanying guidance as to how it will conduct appeal cases.

Responses to individual questions and the government's response

Part 1 – Water Codes

Q1: Do you agree that the WRC and the MAC should be designated codes under the regulations? If you disagree, please state which code, or part(s) of the codes, should not be designated and explain your reasons why.

There was widespread support for the government's proposal to specify the main codes developed to govern the WSSL regime, the MAC and the WRC, as designated codes. As a consequence Ofwat's decisions to amend or not to amend them following consultation can be appealed to the CMA. All eleven respondents who addressed this question agreed that both these codes should be designated under the Regulations. There were no additional comments on the MAC or WRC or areas of disagreement highlighted. We will therefore proceed with this designation.

One undertaker additionally specified that they would support water codes referring to the bulk supplies and mains connections regimes (new appointee regime) and the self-lay regime becoming designated under the Regulations at a later date. The same company also stated the appeals process could be extended to other matters, such as eligibility determinations of brownfield sites. Further to this point, MOSL suggested Defra consider whether the same or a similar appeals mechanism would apply for any codes designated in future.

Q2: Do you have any comments on the evidence provided in the impact assessment? Do you have any information on costs and benefits that should be included in the impact assessment?

This question invited views on the draft impact assessment published alongside the consultation. That assessment summarised the costs and benefits expected to result from the implementation of the fast-track appeal process, baselined over a ten year period against a situation where a full judicial review had to be initiated to challenge changes to the codes.

Five respondents offered specific comments addressing the impact assessment, and the overall feedback was that the evidence offered was comprehensive, well presented, and logical. No additional factors were identified for inclusion beyond those already discussed in the impact assessment.

Two respondents specifically noted that they expected the mechanism to be rarely used, because the code modification process, and the Codes Panel which oversees this, is designed to ensure it represents the market. The interim arrangements which this will mirror are felt to have worked well. This aligns with the assumptions we have set out when working through costs and benefits for the impact assessment. As a result we have updated the impact assessment ahead of publication to reflect both the support within the

sector for a streamlined, low-cost appeals mechanism, and to indicate that the assumptions underpinning our analysis of costs and benefits are supported by the sector.

Part 2 – What decisions are appealable?

Q3: Do you agree that Ofwat's decisions to accept or refuse a recommendation on a change proposal from the Code Panel should be appealable if Ofwat consults on that change?

Ten of the eleven respondents offering a direct answer to question three supported this proposal. It was particularly noted that this improves accountability, offering a straightforward route for eligible parties to access an appeals route to challenge Ofwat's decision, regardless of size.

CCWater noted that they would be concerned if the CMA should overturn a change which had received broad support during the consultation phase, particularly if it were focused on customer service improvements. We note this concern, but believe that the Regulations have been drafted with appropriate concern for the customer experience. The Regulations specify the basis upon which the CMA would have grounds to disagree with a decision and the subsequent actions available to them.

Q4: Should Ofwat have a power to stop an appeal if it believes that a delay caused by an appeal could have an adverse impact on water or sewerage services?

Ofwat are able to amend the WRC without consultation in the case of any minor changes or in the case of urgent changes required to protect people or the environment. This is through powers in new sections 66C and 117H of the Water Industry Act 1991. This action is not appealable, so the government regarded any provision to allow Ofwat to stop appeals to the CMA for this purpose to be redundant. Having invited views, we found that nine of the eleven respondents who commented supported this view, agreeing that Ofwat already has the required powers to affect urgent changes necessary to avoid adverse customer impact. One undertaker noted that where Ofwat has decided to pursue changes through routine consultation, they will have factored any potential appeal and delay into the timeline and therefore would already be expected to have determined that the delay poses no material risk.

One response stated that Ofwat should have the power to stop any appeal if there was to be a negative impact on customers. One respondent stated that Ofwat should have the power to make a representation to halt an appeal for this purpose, with the CMA then able to make the final decision on whether to proceed. For the reasons set out above, we cannot envisage any scenario where this sort of code change would be subject to consultation and associated appeal to the CMA, rather than being progressed through the powers available to Ofwat under sections 66C and 117H - indeed it would be Ofwat's duty to use its existing powers in this way to do so. We therefore agree with the majority of respondents that the Regulations as drafted provide the necessary protections for customers and we will not be providing any such power for Ofwat to stop an appeal at the

opening of the retail market. Three respondents stated that they would like this element to be kept under review as the retail market matures, and so we will commit to doing so.

As we stated in the consultation document, urgent changes cease to have effect after six months during which time Ofwat would consult to formally adopt the changes or replace them with something permanent. This clarity was welcomed by those responding to the proposal.

Part 3 – Who can appeal?

Q5: Do you agree that only undertakers and licensees materially affected by a decision should be able to apply for (or intervene in) a CMA appeal? If not, please state who else should be able to appeal and why.

The majority of respondents agreed with the government's stated position. Eight of the eleven responses specifically addressing question five supported the restriction of potential appellants to undertakers and licensees materially affected by the decision. One wholesaler agreed that only undertakers and licensees should be able to apply, but did not feel a materiality restriction was necessary for the right to apply, believing it should be for the CMA to determine this and subsequently accept or refuse the appeal.

Two respondents (MOSL and CCWater) disagreed with the statement, as they noted that under the energy code regime, any person, body or association who is materially affected is able to apply. CCWater noted that they nevertheless understood the reasons for the government's proposed restrictions at this stage and so support keeping those able to apply or intervene under review as the retail market matures.

Whilst we believe it is appropriate to deliver an appeals mechanism similar to the system in place for the energy sector, there is no requirement to follow this to the letter. Not every provision suited to the energy sector is applicable to the water industry, particularly in the early stages of market development. In the initial period following market opening, we would expect a higher volume of code changes as market participants continue to refine operations based on learning in the live market. To ensure that there is a transparent process around this, an enduring Codes Panel has been set up as part of the governance structure specified in the Market Arrangements Code. This is an appropriate mechanism to ensure a wide range of expert views are accounted for in the process of amending and refining market codes. For the formal code appeals mechanism, we therefore consider that limiting the class of appellant and interveners to materially affected market participants is the most proportionate approach. It will mean that the CMA does not have to incur time or monetary costs to assess appeals that may be vexatious, by ensuring it is not open to parties with no meaningful stake in the decision As we have stated in the consultation, material affect is not defined in legislation, but the evidence suggests to us that only undertakers and licensees will realistically be in the position to demonstrate this

In summary therefore, having reviewed responses to this consultation, the government is not persuaded that there is currently a case to allow parties other than undertakers or

licensees materially affected by a decision to participate in an appeal. As we state in the consultation document, we will consider our position again as the market matures; our commitment to review the arrangements was welcomed in three of the responses offered.

Q6: Do you think that those applying for a licence or appointment should be able to apply or intervene in an appeal?

In the consultation, we invited views on whether those applying for a relevant WSSL licence or a new appointment should also be able to apply to the CMA or intervene in an appeal (e.g. where an application is with Ofwat pending a decision). We received a mixed response on this point.

Four of eleven respondents, consisting of three undertakers and one licensee, were of the opinion that applicants should not be eligible, because only those in possession of a license of appointment had the ability to demonstrate material impact.

Five of eleven respondents, consisting of three undertakers and two licensees, felt that there was merit in extending the right to appeal. The primary argument here was that the impact of a code change can be longstanding and that as a result, in the future, there may be a material impact on those in the process of application.

The remaining two respondents restated their position from question five, namely that they would prefer the same arrangements as for energy regime appeals, where all materially affected parties hold the right to appeal. MOSL did caveat this with the statement that as applicants would not be subject to license conditions or the regulatory regime at this point, it would be difficult for them to produce a case demonstrating material impact.

Whilst recognising that a legitimate case was made by both sets of respondents, we ultimately reached the view that the ability to appeal should not be extended to those applying for a license or appointment at this time. This is primarily on the grounds of ensuring that those that are not yet parties to the codes could not delay important changes to the MAC and WRC. We will review this at a later stage of the market.