



Department
for Environment
Food & Rural Affairs

Water code appeals

Consultation on code appeals for the water supply & sewerage licensing regime

November 2016



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Introduction

The Water Act 2014 (WA14)¹ introduces reforms to the competition regimes in the water sector to achieve increased resilience, increased customer choice and support economic growth.

These include changes that will allow more competition in the retail market for non-household water and sewerage services under the water supply and sewerage licensing (WSSL) regime. From April 2017 all non-household customers in the areas of water and sewerage undertakers (undertakers) that are wholly or mainly in England will be able to switch to an alternative supplier. As is currently the case, customers using 50 megalitres of water a year in the areas of water undertakers wholly or mainly in Wales will also be able to switch their water supplier.

These reforms require the introduction of codes to regulate agreements between undertakers and new entrants that want to provide water and sewerage services in competition with those undertakers. In the case of the WSSL, codes will regulate the agreements between undertakers and water supply and sewerage licensees (licensees). Codes developed for the non-household market in the areas of English undertakers will also apply to agreements between Welsh undertakers and licensees providing services to customers in the 50 megalitre market. Amendments made to undertakers' appointments (or licences) which will come into force at market opening will include provisions that will require arrangements between the wholesale and non-household parts of undertakers' businesses to comply with the Wholesale-Retail Code.

The WA14² also includes amendments to the Water Industry Act 1991 (WIA91) which will allow for regulations to be made for appeals to the Competition and Markets Authority of a decision by Ofwat to make a revision, or not to make a proposed revision, to a code designated under the regulations. A designated code is a code, or a part of a code, made by Ofwat under or by virtue of WIA91 and which is designated by the regulation.

This consultation seeks views on the appeal mechanism itself and the proposals to allow appeals relating to certain codes for the WSSL retail market.

What happens next?

There is an opportunity for all interested parties to scrutinise and comment on the details outlined in this document. The consultation will run from 15 November for four weeks, ending on 13 December 2016.

¹ <http://www.legislation.gov.uk/ukpga/2014/21/contents>

² See section 37 and Schedule 6 of Water Act 2014.

Once the consultation has concluded, and we have taken account of any comments, we will publish a summary of responses. In January 2017 the draft Regulations will be laid before both Houses of Parliament under the affirmative procedure. Subject to both Houses approving the draft Regulations, they will be made and come into force in time for retail market opening.

The CMA will consult upon appeal rules and guidance on how it will conduct appeal cases.

How to respond

The consultation period will run from 15 November 13 December 2016. You can respond via email to: wssl.consultation@defra.gsi.gov.uk. Alternatively the postal address for responses is: Water Code Appeals Consultation, Water Services Team, Defra, Area 3D, 17 Smith Square, London SW1P 3JR. Please make sure your responses reach us by 13 December 2016.

Water codes

The WA14 introduced a number of reforms to the competition regimes in the WIA91. Central to these reforms is the introduction of statutory codes to regulate agreements between incumbent undertakers and new entrants that want to provide water services in competition with those incumbents.

Codes are commonly used in regulated utility markets to reduce the costs and burdens around making agreements between incumbent network owners and entrants to amongst other things enable those entrants to use the incumbents' networks to provide services for and on behalf of customers.

The first set of regulations in respect of codes appealable to the CMA will be made for codes produced for the new WSSL retail regime which is due to open in April 2017 (see designated codes section below). It is these Regulations which are now being consulted upon. This was announced in the Defra consultation on the WSSL standard conditions published in December 2015. Ofwat will amend the appointments of undertakers so that codes developed for the retail market are applied to regulate transaction and arrangements between the undertakers' wholesale and non-household retail sides of their businesses.

Water codes

Codes that may be produced under, or by virtue of, the WIA91 that may be designated under the Regulations at a later date:

- the interim supply regime which allows Ofwat to allocate to other licensees the customers of a licensee that leaves the retail market;
- the bulk supply and mains connection regimes which allows undertakers to provide wholesale water services to each other and to entrants that have been appointed to replace

the incumbent undertaker for new housing developments, etc (the new appointments and variation or “NAVs” regime);

- the self-lay regime which allows self-lay organisations to compete with undertakers to provide new pipes and mains for new developments that will eventually be adopted by the undertaker;
- the code that Ofwat will be required to produce under the Exit Regulations for terms and conditions applicable to customers of licensees that do not have formal contract (the retail exits code); or
- the Customer Code of Protection produced by Ofwat to address issues such as mis-selling in the new retail market.

An earlier consultation said that the right to appeal would not extend to changes to the interim supply code and the retail exit code. This remains the case for the Regulations that will come into force at retail market opening and we do not intend to introduce a right of appeal for changes to the Customer Code of Protection.

Decisions will be taken in due course on codes which may be developed for the wholesale and supplementary authorisations in the new water supply licence and whether changes to these codes will be appealable. Such matters will be considered as Ofwat develops its Water 2020 programme.

There are no plans to provide for appeals for changes to codes that are currently being developed for the self-lay market. Decisions will be taken in due course on whether changes to codes regulating the NAV regime will be appealable. In all cases, Defra will launch public consultations before any decisions are made to designate codes.

Water code appeals

The WA14 amends the WIA91 to provide powers for the Secretary of State to introduce regulations that will allow for Ofwat’s decisions to amend or not to amend codes designated in the regulations to be appealable to the CMA.

The policy objective is to introduce an appeals mechanism that contributes to the delivery of a coherent, transparent and effective regulatory framework that includes appropriate safeguards for market participants to challenge decisions that might impede the development of effective and fair water markets. The intention is that the proposed appeal framework will contribute to robust regulation that benefits the water sector and, ultimately, customers.

In considering options, we want to deliver an appeals process which:

- a) supports robust, predictable decision-making whilst minimising uncertainty;
- b) provides proportionate regulatory accountability – the appeals framework needs to be able to correct mistakes and test decisions made by Ofwat;
- c) minimises the end-to-end length and cost of regulatory decision-making by making the appeal process as streamlined and efficient as possible; and

- d) ensure access to justice is available to all water businesses – not just to the largest companies with the greatest resource and expertise.

The appeals regime that we intend to introduce will be similar to the one provided for code appeals in the energy sector. The Energy Act 2004³ (EA04) sets out an appeals procedure whereby applicants have 15 working days (counting from the day after the day on which Ofgem’s decision as to whether to consent to amending a designated code is published) to submit an application for permission to appeal against a decision on a code change to the CMA.

The CMA has 10 working days from the submission of the application to decide whether to grant or refuse the application for permission to appeal. Ofgem has 15 working days after the submission of the application for permission to appeal to submit its representations or observations, should it choose to do so. Where permission to appeal is granted, the CMA will must determine the appeal within a tight timetable, with it normally being required to make its appeal decision within 30 working days following the last day for the making of representations or observations by Ofgem (though it can extend this period by a maximum of 10 working days if necessary). The CMA can among other things confirm or quash the original decision or direct Ofgem to reconsider and determine taking into account certain factors.

The WIA91 provisions allow us to deliver a similar CMA appeal mechanism through secondary legislation. While we don’t have to follow the energy regime to the letter, we do consider that an appeals process similar to the energy regime process does fall within the extent and scope of our regulation making powers.

We believe that providing a fast-track appeal mechanism similar to that provided for energy code modifications will help us achieve all of these objectives.

A draft of the Water Industry Designated Codes (Appeals to the Competition and Markets Authority) Regulations 2017 and an impact assessment are published alongside this document.

Designated codes

The WA14 enables the regulations to provide for appeals against Ofwat’s decision to amend or not amend “designated codes”. Codes are designated through the regulations. A designated code is a code, or part of a code, issued by Ofwat under or by virtue of the WIA91.

³ <http://www.legislation.gov.uk/ukpga/2004/20/contents>

There are two draft codes for the WSSL regime retail market, which are currently being developed by the Open Water Programme:

- a) **Market Arrangements Code (MAC)** – these are codes which are signed by undertakers (as wholesalers and retailers) and licensees. They mainly deal with issues around the setting up and the constitution/governance of the Market Operator and a Code Panel (see below). Compliance with this code is through the conditions of appointments and licences.
- b) **Wholesale-Retail Code (WRC)** - a code given effect by the wholesale contract made under new sections 66DA and 117F of the WIA91 (as inserted by Schedules 2 and 4 to the WA14) which sets out arrangements between undertakers and licensees.

The government proposes that changes to any provisions in the WRC or the MAC should be appealable. We would, however, like views on whether any **parts** of these codes should not be defined as “designated codes” and therefore not appealable.

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.

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?

What decisions are appealable?

The content of the first editions of the MAC and WRC are not appealable to the CMA but the Secretary of State or the Welsh Ministers may direct Ofwat not to issue the codes or to issue the codes with their own changes.

Thereafter any Ofwat decisions to change or not to change the MAC or WRC made following a public consultation should be appealable. This means that Ofwat must carry out a public consultation on a proposal to significantly amend these codes and its decisions following such a consultation may be appealable.

The code provisions in the WIA91 include statutory duties on Ofwat to consult market participants on changes to codes unless, in the opinion of Ofwat, they are *minor or urgent revisions* (e.g. see new section 66DC as inserted by Schedule 2 to the WA14). Minor revisions are those where a consultation may be unnecessary, such as changes of contact details, legislative references, etc. Urgent changes are those revisions that are necessary and may need to be made without delay. These might be to protect customers or the environment. Urgent changes cease to have effect at the end of six months during which time Ofwat would consult to formally adopt the changes or replace them with something

more permanent. **Minor and urgent changes to the WRC proposed by Ofwat in accordance with its statutory powers under sections 66DC and 117H will not be appealable to the CMA.**

The various code provisions in the WA14 also list the bodies that Ofwat must consult when making changes. In the case of the WRC and the MAC, the following will be consulted whenever a change is proposed:

- a) the Secretary of State;
- b) the Welsh Ministers;
- c) the Drinking Water Inspectorate;
- d) the Environment Agency;
- e) Natural Resources Wales;
- f) the Consumer Council for Water;
- g) undertakers; and
- h) licensees.

Not all proposals to amend the retail codes will be initiated by Ofwat. The MAC establishes a Code Panel made up of undertakers, licensees and independent members that may from time to time make proposals to change these codes (change proposals). The parties to the codes and the Consumer Council for Water may also make change proposals. If Ofwat accepts change proposals it will launch a public consultation (unless it determines that the changes are minor or urgent). **Ofwat's subsequent decision to accept or not accept a change proposal from the Change Panel following its consultation will be appealable** (as with Ofwat's decisions on its own proposals).

We note, however, that in the energy sector⁴ some of Ofgem's decisions to accept an equivalent change proposal from a majority of code panel members are not appealable. We don't think this would be appropriate for the retail codes in the early days of the new market, but would welcome views from stakeholders. The government's view is that this might be something we could consider as the market matures and the Code Panel finds its feet, but for the time being all decisions to amend codes should be appealable.

We also note that Ofgem has a power to exclude changes from the right of appeal if the delay caused by the holding of the appeal against that decision is likely to have a material adverse effect on the availability of electricity or gas for meeting the reasonable demands of consumers. Given that urgent changes to the WRC under sections 66C and 117H are not appealable, we do not think that such a provision is necessarily required for the water sector – particularly in relation to codes regulating the retail market. We would nevertheless welcome views.

⁴ For example, article 6 of the Electricity and Gas Appeals (Designation and Exclusion) Order 2014.

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?

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?

Who can appeal?

Under the energy code modification regime appeals against certain code modifications of Ofgem can be appealed to the CMA by persons whose interests are "materially affected" (or a representative organisation of such persons) by the decision. The bringing of such an appeal requires the CMA's permission. The CMA is only able to refuse permission to appeal if it determines that applicants are not materially affected or where reasons for seeking an appeal are frivolous or trivial or the appeal has no reasonable prospect of success. Others who could have appealed the decision, but did not apply for permission to do so, have a limited timeframe within which to apply to become interveners in the appeal.

With the opening of the new market, the government thinks that only those that are parties to the retail codes should be in a position to be able to challenge decisions whether to change those codes. Again, this is something we can keep under review as the retail market matures. We therefore intend to only allow water code appeals in relation to the MAC and WRC where undertakers or licensees with retail or restricted retail authorisations are materially affected by a decision of Ofwat to change a code. In our view, situations in which an applicant or intervener might be materially affected by an appealable Ofwat decision could include where it is likely to lose market share, incur additional costs or be put at a competitive disadvantage as a direct result of that decision, but the term is not defined in legislation. The CMA will consider the "materially affected" requirement in the context of each application.

The purpose of these requirements is to ensure that appeals are not launched merely because someone does not like a decision. While a trivial or vexatious test may filter out some speculative applications where someone wants to delay or frustrate progress on a decision, limiting the class of appellants/interveners to materially affected market participants will mean that the CMA does not have to consider appeals from persons (or their representatives) without a meaningful stake in the decision. Again, this is something we can keep under review as the retail market matures.

The government would like 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).

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.

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

Procedure on appeals

The appeal will be heard by a group of CMA panel members that includes at least one member of the CMA's specialist utility panel. Members are appointed to the CMA panel by the Department for Business, Energy and Industrial Strategy (BEIS) for up to 8 years. They are appointed through open competition for their experience in competition, economics, law, finance and business. BEIS also appoint a Chair and Deputy Chairs who are known as Inquiry Chairs when they chair regulatory appeals in relation to price controls, modifications to terms of licences, energy code modifications or other utility arrangements. Further information is available on the CMA webpage⁵.

The procedures on appeal will be the same as those for the energy code modification appeals regime in terms of the application processes, the timetable and the requirements around oral hearings, the production of documents and written statements.

Determinations of appeals

The CMA will make its determination on an appeal by considering all matters that Ofwat may or may not have considered when making its decisions to amend a designated code. The regulations will require the CMA may allow an appeal where:

- a) Ofwat failed properly to have regard to its main duties (i.e. those under section 2 of the WIA91 – see table below);
- b) Ofwat failed to properly have regard to the main purposes of the code (e.g. provisions under section 66DA(2) and (3) of the WIA91);
- c) Ofwat failed to give appropriate weight to one of the above grounds;
- d) Ofwat's decision was based, wholly or partly, on an error of fact; or
- e) Ofwat's decision was wrong in law.

⁵ <https://www.gov.uk/government/organisations/competition-and-markets-authority/about/our-governance#cma-panel>

Summary of Ofwat's duties under section 2 of the Water Industry Act 1991

Ofwat's primary duties are to:

- further the consumer objective to protect the interests of consumers, wherever appropriate by promoting effective competition;
- secure that undertakers properly carry out their functions and that they are able to finance their functions, in particular by securing reasonable returns on their capital;
- secure that licencees properly carry out their functions; and
- further the resilience objective to secure the long-term resilience of undertakers' water supply and wastewater systems and to secure they take steps to enable them, in the long term, to meet the need for water supplies and wastewater services.

Subject to these, Ofwat has secondary duties to:

- promote economy and efficiency by undertakers in their work;
- secure that no undue preference or discrimination is shown by undertakers in fixing charges;
- secure that no undue preference or discrimination is shown by undertakers in relation to the provision of services by themselves or other undertakers and licensees;
- secure that consumers' interests are protected where undertakers sell land;
- ensure that consumers' interests are protected in relation to any unregulated activities of undertakers;
- contribute to the achievement of sustainable development; and
- have regard to the principles of best regulatory practice.

These are the duties to which Ofwat has regard when carrying out its functions relating to WSSL code under section 66DA and 117F of the WIA91. Similar duties would be considered if appeals were to be allowed against Ofwat's decisions relating to the NAV regime except these are set out in the bulk supply and mains connection provisions in the WIA91 (e.g. see new section 40(9) as inserted by section 8 of the WA14)

Where the CMA allows an appeal it may do one or more of the following:

- a) quash Ofwat's decision;
- b) refer the matter back to Ofwat to reconsider;
- c) or require Ofwat to make a new decision in line with a direction.

The CMA must notify the parties and Ofwat of its decision and also publish it on the CMA webpage on www.gov.uk

Review

As required by the Enterprise and Regulatory Reform Act 2014, there is provision in the regulations that will require the regulatory framework to be reviewed five years after it comes into force and every five years thereafter.

Generally speaking, Defra will consider updating the regulations when there are relevant changes made to the energy code appeals regime. They will also be updated if new codes are designated going forward.