



Department  
for Environment  
Food & Rural Affairs

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# **Water supply and sewerage licensing regime**

## **Standard licence conditions and the approach to secondary legislation**

**December 2015**



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This publication is available at <https://consult.defra.gov.uk/water/water-supply-and-sewerage-licensing-regime>

Any enquiries regarding this publication should be sent to us at

WSSL Consultation  
Water Services Team  
Department for Environment, Food and Rural Affairs  
Area 3B  
Nobel House  
17 Smith Square  
London  
SW1P 3JR

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# 1. Introduction

The Water Act 2014 (WA14) introduces reforms to the water supply licensing regime (the “WSL”) that will allow 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. “Retail” services incorporate all customer-facing activities such as billing, meter reading and dealing with customers’ enquiries. The reformed WSL will be known as the water supply and sewerage licensing regime (the “WSSL”).

Our reforms will allow all eligible businesses, charities and public sector organisations to switch from any monopoly water company whose area is wholly or mainly in England (“English undertakers”) to another supplier of retail services (the “licensee”) when the retail market opens in April 2017. The same water will be supplied through the same pipes and the wastewater taken away through the same networks, but the customer-facing services may be provided by someone other than the incumbent water company.

This consultation is published alongside drafts of standard licence conditions for the WSSL. Ofwat conducted a consultation on its licensing policy and has published the outcome of that consultation. The Secretary of State, having consulted the Welsh Ministers on conditions applicable to the water supply licence, is required to publish standard licence conditions before Ofwat can start issuing new licences. We are providing stakeholders with a final opportunity to provide comments on the draft standard licence conditions before Ofwat opens the WSSL licence application process, ahead of retail market opening, in April 2016.

WSSL licences will provide the holders with certain rights to provide services to non-household premises. The two licences, one for water supply and one for sewerage, will each include one or more “authorisations” relating to the services that the holder wants to provide. These licences will form an important part of the regulatory framework which also includes ministerial charging guidance<sup>1</sup>, Ofwat’s charging rules and codes produced by Open Water to regulate agreements between licensees and undertakers.

The existing WSL licences will continue to be used for current retail and upstream arrangements in England and Wales until 31 March 2017. WSSL licences will then apply to retail arrangements from April 2017 when eligible non-household customers in the areas of English undertakers will be able to switch suppliers. New WSSL licences will also provide for the continuation of the existing WSL for water supply customers that use 50 megalitres of water in the areas served by undertakers that are wholly or mainly in Wales (“Welsh undertakers”) until such time as the Welsh Ministers may decide to align the regime in Wales with that in England.

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<sup>1</sup> <https://www.gov.uk/government/consultations/water-industry-charging-guidance-to-ofwat>

There are also a number of revisions to secondary legislation that will need to be taken forward in order to open the retail market by April 2017. This document therefore includes details of our approach to introducing and amending relevant secondary legislation.

The WA14 enables Defra to introduce regulations that allow English undertakers<sup>2</sup> to exit the competitive part of the retail market with the consent of the Secretary of State (the “exit regulations”). Those undertakers choosing to exit the non-household retail market will only be able to transfer their non-household customers to a person holding a WSSL licence. Defra has consulted separately on the content of the exit regulations and we are currently considering responses made by stakeholders.

## What happens next?

There is an opportunity for all interested parties to scrutinise and comment on the details outlined in this document and on the final draft of the standard licence conditions. The consultation will run from 17 December for six weeks, ending on 28 January 2016. Respondents that also commented on Ofwat’s licensing consultation and Interim Supply consultation do not need to repeat points made in response to those consultations and should instead provide comments on the latest draft licence conditions.

Once the consultation has concluded, and we have taken account of any comments, we will publish the final version of the standard licence conditions in February 2016. This will provide the standard licence conditions common to all authorisations and specific conditions relating to retail and restricted authorisations. At the same time Defra, having consulted the Welsh Government, will also issue an authorisation to Ofwat that will enable it to grant new licences from April 2016.

Standard licence conditions for wholesale, supplementary and disposal authorisations will be consulted on at a later date.

## 2. How to respond

The consultation period will run from 17 December 2015 to 28 January 2016. You can respond online at <https://consult.defra.gov.uk/water/water-supply-and-sewerage-licensing-regime>. You can also respond via email to: [wssl.consultation@defra.gsi.gov.uk](mailto:wssl.consultation@defra.gsi.gov.uk). The postal address for responses is: WSSL Consultation, Water Services Team, Defra, Area 3B, 17 Smith Square, London SW1P 3JR. Please make sure your responses reach us by 28 January 2016.

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<sup>2</sup> Welsh undertakers are not able to exit the retail market.

### **3. Water supply and sewerage licences**

This part of the consultation document outlines the standard licence conditions for the new water supply and sewerage licences to be granted following the opening of the licence application process in April 2016.

The WSSL standard licence conditions are intended to apply to both the water supply and the sewerage licences. These licences sit within a new legal framework introduced by the WA14 and licensees will be required to comply with several other legal instruments, in particular the Wholesale Retail Code.

#### **Standard licence conditions**

The WSSL standard conditions have been developed by adapting conditions for the existing WSL regime for the new market requirements for retail and restricted retail authorisations. Ofwat consulted on these adaptations and has recently published its decisions<sup>3</sup>. Conditions relating to other authorisations (wholesale, supplementary and disposal) have not yet been consulted on by Ofwat.

The WSSL standard conditions are as complete as they can be pending further consultation in particular on customer protection. The key changes to the draft licence conditions are more fully explained in the Ofwat Licensing Response Document. As described further below, following the Interim Supply Consultation, Condition 11 has been amended and, in anticipation of the introduction of a Customer Protection Code of Practice, a new condition B2 has been inserted.

#### **Condition 11 Notice of Revocation**

In order to ensure that customers and other industry participants are appropriately protected once the interim supply arrangements have been invoked, Ofwat has recommended that shortening the licence revocation timetable to allow it to revoke a WSSL licence with not less than 24 hours' notice as a precautionary measure where there has been an insolvency event. This could, for example, prevent an insolvency practitioner being able to continue to supply water or provide sewerage services without agreeing to pay the associated wholesale charges. This is consistent with Ofgem's energy supply licence revocation powers.

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<sup>3</sup> <http://www.ofwat.gov.uk/consultation/licensing-and-policy-issues-in-relation-to-the-opening-of-the-non-household-retail-market-a-consultation/>

We have also made changes to condition 11, with consequential changes to condition 10, which removes the Secretary of State's role in the revocation of licences. As from 1 January 2016 the Secretary of State will no longer have powers to issue water supply licences, which leaves Ofwat as the sole licensing authority for the WSSL.

## Condition B2 Customer Protection Code of Practice

Since June 2015, a new draft condition requiring retailers to comply with a proposed Customer Protection Code of Practice ("CPCP") has been added to the draft WSSL standard conditions. Ofwat's information notice IN 15/12<sup>4</sup> explained that it was considering how best to protect customers in the extended retail market. A mandatory CPCP may be required to assist in ensuring that there is effective protection in place for customers in the extended retail market, especially for smaller non-household customers such as micro-businesses.

Ofwat has recently opened its consultation<sup>5</sup> on what it considers to be the key customer protection issues for the extended retail market. These issues include the switching process, sales and marketing activities, contractual issues, billings activities and dispute resolution. Ofwat's customer protection consultation proposes measures to address these issues, which may be included in a CPCP, subject to the outcome of the consultation process. To ensure compliance with the CPCP and, therefore, that all customers are adequately protected, a licence condition which requires compliance with a CPCP is necessary.

On this basis the proposed condition is included in the draft WSSL standard conditions which are being consulted on in this consultation. This proposed condition should be read alongside Ofwat's proposals for customer protection detailed in its current customer protection consultation, which is the first step in a two stage consultation process. Ofwat will be consulting further on the detailed drafting of the proposed CPCP and its governance in early 2016.

**Q1: Have you any comments about the proposed standards licence conditions for the new licences? Do you agree with the proposals to change Condition 11 and add a new Condition B2?**

## 4. Water supply authorisations

This section outlines the new authorisations in the new water supply licence and changes to be made to the wider regime for water supply customers.

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<sup>4</sup> <http://www.ofwat.gov.uk/publication/in-1512-opening-a-new-retail-market-for-non-household-customers-%E2%80%92-protecting-customers/>

<sup>5</sup> [http://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap\\_con20151203rmocustomerprotect.pdf](http://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap_con20151203rmocustomerprotect.pdf)

## The retail authorisation

A retail authorisation in a water supply licence will allow the holder to use the supply system of an English water undertaker to provide water supply services to non-household premises. These include:

- its own non-household premises and those of an associate of the licensee (i.e. “self-supply” arrangements); and/or
- eligible premises of its own customers.

English undertakers that wish to exit the retail market will have to transfer their water supply customers to a licensee holding a water supply licence with the new retail authorisation.

The wholesale retail code produced by the Open Water programme will regulate agreements between licensees and English undertakers under the retail authorisation.

## The wholesale authorisation

The wholesale authorisation in a water supply licence allows the holder to introduce water into the supply system of an English water undertaker in connection with its own or another licensee’s retail authorisation. The wholesale authorisation will eventually be the successor to the existing supplementary authorisation in combined WSL licences.

The application process for wholesale authorisations will open at a later date. Ofwat will provide further information on the development of the wholesale authorisation by no later than April 2016.

## Welsh authorisations

A restricted retail authorisation in a water supply licence allows the holder to use the supply system of a Welsh undertaker to provide services to its customer’s non-household premises that meet the threshold requirement. The threshold is 50 megalitres of water per annum. Applications for this authorisation can be made from April 2016. The licensee will not be able to provide services to its own premises, but will not be prevented from supplying those of its associates as long as they are legally separate from the licensee and the threshold requirement is met.

The new supplementary authorisation in a water supply licence allows the licensee to introduce water into the supply system of a Welsh undertaker in connection with its restricted retail authorisation. Unlike with the wholesale authorisation, the person that inputs water into a Welsh undertaker’s supply system must be the same person that provides the retail services, as with the current WSL. Ofwat will provide further information on the development of the supplementary authorisation by no later than April 2016.



These two authorisations preserve the features of the existing WSL within the reformed WSSL regime in the areas of Welsh undertakers. However, agreements under the restricted retail authorisation will be subject to the same wholesale-retail code that is being introduced for the new retail authorisation in April 2017. This means that Ofwat's current access guidance will no longer apply to retail-only arrangements in the areas of Welsh undertakers.

The Welsh Government indicated in its consultation on charging guidance<sup>6</sup> that it intends applying the costs principle to arrangements under these authorisations until it is in a position to provide guidance to Ofwat on Welsh undertakers' charges under the WSSL.

## Customer switching

From April 2017 a loophole will be removed that has meant that customers with so called "cross-border premises" could not switch to a licensee. Cross-border premises are premises that are connected to the supply system of one undertaker but located in the appointed area of another. Customers under the current WSL can only switch if they are connected to the supply system of an undertaker **and** located in that undertaker's area of appointment. The exit regulations will provide for these customers to be transferred to an acquiring licensee as part of an exit. Including these customers' premises in the exit area will allow undertakers to exit completely from the non-household retail market.

The new customer exception regulations<sup>7</sup> were brought into force in November 2005 when the 50 megalitre water supply market was opened. The regulations provide for circumstances in which the owner or occupiers of switched premises change. The licensee is able to continue to provide services to the premises where there is:

- a change in the legal ownership of the customer, provided the premises are transferred to the new owner and the business carries on as before; and
- a structural reorganisation of the customer, provided the premises remain within the same organisation and the business otherwise carries on as before.

In such circumstance the threshold does not need to be re-assessed and the arrangements can therefore continue even if the premises consume less than 5 or 50 megalitres as the case may be. If these regulations were not in place, the premises would no longer be in the market and the undertaker would have to start serving the premises.

These regulations will not apply to the water supply retail authorisation from April 2017 as there will no longer be a threshold requirement to enable customers to switch, but the regulations will still apply to arrangements under the restricted retail and supplementary

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<sup>6</sup> <http://gov.wales/docs/desh/consultation/150824-charging-guidance-to-ofwat-en.pdf>

<sup>7</sup> <http://www.legislation.gov.uk/ukxi/2005/3076/contents/made>

authorisations in the areas of Welsh undertakers and will be needed for any transitional arrangements in the areas of English undertakers.

## 5. Sewerage arrangements

This part of the consultation document describes the new retail authorisation in the sewerage licence and changes to secondary legislation that will be put into place for market opening.

### The retail authorisation

A retail authorisation in a sewerage licence allows the holder to use the sewerage system of an English sewerage undertaker for the purposes of providing retail services (e.g. billing, meter reading, customer services, etc). As with the equivalent water supply authorisation, the holder is able to “self-supply” from April 2017 and/or provide services to other non-household customers.

English undertakers that wish to exit the retail market will have to transfer their sewerage customers to a licensee holding a sewerage licence with a retail authorisation. Customers can, if they choose, be served by separate licensees when switching from an English undertaker. Welsh undertakers will be required to provide sewerage retail services to all customers as at present.

### Exemptions from holding sewerage licences

From April 2017 it will be a criminal offence to provide retail sewerage services to any premises (including household premises) using an undertaker’s sewerage system unless they are provided by that sewerage undertaker or a sewerage licensee in accordance with its licence. This offence mirrors provisions in the current WSL and similar offences in Scotland and in the energy sector.

The Secretary of State is able to make regulations to apply further exemptions for third parties to provide retail services to premises. In the equivalent water supply exemption regulations<sup>8</sup> the following retail arrangements may also be carried out as long as there is no “common carriage” arrangement involved:

- retail services provided to premises by a new appointee (or inset appointee) that obtains a bulk supply via an incumbent undertaker’s network;

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<sup>8</sup> <http://www.legislation.gov.uk/ukxi/2005/3075/contents/made>

- retail services provided to premises by an incumbent undertaker using a bulk supply via the network of a neighbouring undertaker; and
- services provided to premises by owners of private water supplies using the network of an undertaker (this does not include so called water resale arrangements).

If the water supply exemption regulations were not in place it would not be possible for these arrangements to continue. The new appointee would have to set up a subsidiary licensee to serve its non-household customers and its household customers would have to be served by the incumbent undertakers.

We are therefore planning to produce regulations that would introduce a blanket exemption to allow retail arrangements to continue where there is a mains connection arrangement between English sewerage undertakers and between sewerage undertakers and new appointees. These are equivalent to bulk supply arrangements between undertakers where undertakers are able to make arrangements to treat and dispose of wastewater for other undertakers and new appointees.

Defra carried out an informal consultation with English sewerage undertakers to establish whether there were any cross-border mains connection arrangements in place which should also be allowed to continue. This did not reveal whether arrangements between incumbent undertakers currently exist, but the WIA91 and the WA14 provide for these types of arrangements and we therefore propose that we include all mains connection agreements under the blanket exemption.

Our informal consultation also did not reveal any sewerage arrangements similar to those between water undertakers and owners of private water suppliers. However, we would like to invite respondents to notify us of any retail sewerage arrangements that should be exempted and we will consider issuing a further consultation if further exemptions are needed before market opening.

We will not be exempting any upstream arrangements (e.g. where an operator is using an undertaker's network to take wastewater to treat and dispose of sewerage itself on behalf of its customers). This will be considered when upstream reforms are implemented after 2019.

It should be noted that sewerage resale arrangements do not need to be exempted. This is because the reseller (e.g. a management company, landlord, etc) is the "customer" rather than the owners and occupiers of the premises served under the resale arrangement. Arrangements with billing agents (including other undertakers) or brokers do not need to be exempted because the end-user customer is ultimately liable to pay charges to the sewerage undertaker.

## Sewerage arrangements in areas of Welsh undertakers

The regulations will not apply to arrangements made for customers in the area of Welsh sewerage undertakers. This is because the Welsh Government is not planning to introduce retail sewerage competition in the foreseeable future. Third party operators will in the meantime be able to negotiate with Welsh undertakers to access sewerage markets as they can do at present.

**Q2: Are you aware of any retail sewerage arrangements that should be included in the sewerage exemption regulations? Please provide details and indicate whether a blanket or individual exemption should be granted.**

## Appeals against change to sewerage licences

The current WSL enables Ofwat to amend the standard licence conditions if certain conditions set out in section 17J of the WIA91 are fulfilled. One such condition is that specified percentages of licensees (by number or by market share) do not object to the modifications. Under an Order<sup>9</sup> issued in 2005, modifications to standard licence conditions cannot proceed, without a reference to the Competition and Markets Authority (CMA), if objections are made by twenty percent or more of relevant licence holders measured by number or by market share. The Order also specifies how each relevant licence holder will be weighted for the purposes of measuring market share. For licensees who object to an Ofwat proposal to amend their licences, market share must be measured by reference to total volume of water supplied by them to the premises of their customers during twelve months relative to the total volume of water supplied by all licensees.

The WA14 amends section 17J to extend the processes to cover Ofwat's proposals to change standard conditions in sewerage licences. We propose to amend the Order so that a sewerage licensee's market share will also be assessed on the amount of water supplied to the premises they serve. This is because most premises tend not to have wastewater meters and charges for most sewerage customers are determined by the amount of water consumed.

This may not always be the case as the sewerage markets mature. Defra will therefore keep the provisions in the Order under regular review.

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<sup>9</sup> <http://www.legislation.gov.uk/uksi/2005/2033/contents/made>

**Q3: Do you agree that the market share of a sewerage licensee should be based on the amount of water supplied to the premises it serves? If not, what would be an appropriate way to measure market share in the sewerage market?**

## **6. Applications for licences**

This part outlines changes that are going to be made to the application process for new WSSL licences from 1 April 2016.

### **Application requirements and fees**

Currently the application process and fees are set out in regulations<sup>10</sup> that came into force in July and August 2005. In June 2014 the WA14 removed requirements for applicants to publish notices of their applications on their websites or to publicise their application by other means. This was part of a push to reduce regulation on business under the Red Tape Challenge.

The remainder of the application regulations will be revoked on 1 April 2016 and from then the application process and licence fees will be set out in a guidance note to be published by Ofwat. Ofwat will be publishing its guidance note in January 2016.

The process will require some adaptation from the form currently used. Some changes reflect the fact that future licences will also cover sewerage, and the requirement in legislation to create a joint application process in England and Wales, and Scotland.

### **Who may apply for a licence?**

From April 2016, the requirement for new WSSL licencees to be limited companies will be removed for applicants that only require retail authorisations and restricted retail authorisations. This means other types of businesses and foreign companies will be able to apply for licences. Applicants wanting an old WSL licence or a new WSSL water supply licence with either a wholesale or supplementary authorisation will still have to be limited companies registered in England, Wales or Scotland.

As is currently the case with the WSL, undertakers will not be able to hold WSSL licences. Undertakers are free to set up associates that may apply for WSSL licences (e.g. if they want to transfer their non-household customers to a licensee as part of an exit of the retail market).

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<sup>10</sup> <http://www.legislation.gov.uk/ukxi/2005/1638/contents/made>

Ofwat will have wider duties to consult stakeholders before it can issue new water supply licences with wholesale and supplementary authorisations. As well as consulting ministers as is currently the case, Ofwat will also have to consult the Drinking Water Inspectorate, the Environment Agency and Natural Resources Wales.

## **Cross-border applications**

The WA14 includes provisions that will allow applicants that want to enter the English and Welsh, and Scottish markets at the same time to submit a single application pack to either Ofwat or the Water Industry Commission for Scotland (WICS). Introducing a single application pack for licences will support the development of a single market and will reduce administrative burdens on applicants that want to compete in both markets. Each applicant would be able to submit a single application to one of the two regulators and that regulator would forward the application to the second regulator when it is satisfied that it is complete. The applicant would eventually obtain the relevant retail licences from each regulator.

To implement this simplification, regulations are needed to require the regulators to treat applications initially submitted to the other regulator as if they were received directly from the applicants. Defra will be laying the regulations before Parliament in January 2016 and the Scottish Government will at the same time lay an order before the Scottish Parliament. Subject to both Parliaments' procedures, the cross-border licence application process will open on 1 April 2016 in time for the opening of the WSSL licence application process in England and Wales. From that date those that apply to WICS will be able to apply for WSSL licences with the water and sewerage retail authorisations and the restricted retail authorisation in the water supply licence. However, those wanting old WSL licences will still have to apply directly to Ofwat from April 2016.

## **7. CMA code appeals**

The WA14 includes powers for the Secretary of State to introduce regulations that will provide for Ofwat's decisions to amend or not amend designated codes to be appealable to the CMA. The regime that we are minded to introduce will be largely the same as the one provided for code appeals in the energy sector.

Defra will be launching a consultation on the draft regulations in summer 2016. This will initially relate to codes relevant to the retail authorisations and the restricted retail authorisation but will not include the interim supply code and the retail exits code. Both these codes deal with the terms and conditions to be provided to non-household customers under deemed contracts when they are transferred to a licensee as the "supplier of last resort" or at an exit where there is no negotiated contract in place.