EXPLANATORY MEMORANDUM TO

THE WATER INDUSTRY DESIGNATED CODES (APPEALS TO THE COMPETITION AND MARKETS AUTHORITY) REGULATIONS 2017

2017 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations make provision for appeals to the Competition and Markets Authority ("CMA") against a decision by the Water Services Regulation Authority ("Ofwat") to revise regulatory codes governing the non-household water retail market, or not to revise such a code following a consultation on the proposed change. The codes which the Regulations designate as appealable provide for agreements between incumbent water and sewerage undertakers ("undertakers") and water supply and sewerage licensees ("licensees") who compete to offer retail services; only these parties are able to appeal a decision, and only if they are materially affected by the proposed change.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 This entire instrument applies only to England and Wales.

3.3 The instrument applies only to England and Wales because the appeals mechanism set out in the Regulations concern the retail market for eligible non-household customers in the areas of undertakers in England and Wales.

3.4 In the view of the Department, for the purposes of House of Commons Standing Order 83P the subject-matter of this entire instrument would be within the devolved legislative competence of the Northern Ireland Assembly if equivalent provision in relation to Northern Ireland were included in an Act of the Northern Ireland Assembly as a transferred matter and the Scottish Parliament if equivalent provision in relation to Scotland were included in an Act of the Scottish Parliament.

3.5 The Department has reached this view because it considers that the primary purpose of the instrument relates to the regulation of water companies, which is within the devolved legislative competence of the Northern Ireland Assembly and the Scottish Parliament: the primary purpose of the subject matter of the instrument is not within Schedule 5 to the Scotland Act 1998 and is not otherwise outside the legislative competence of the Scottish Parliament (see section 29 of that Act); the primary purpose of the subject matter of the instrument is not within Schedules 2 or 3 to the

Northern Ireland Act 1998 and is not otherwise outside the legislative competence of the Northern Ireland Assembly (see section 6 of that Act).

4. Legislative Context

4.1 Chapter 1 of Part 1 of the Water Act 2014 ("the 2014 Act") amends the Water Industry Act 1991 ("the 1991 Act") by expanding and revising the current water supply licensing regime and adding a sewerage licensing regime.

4.2 Section 37 of the 2014 Act amends the 1991 Act to allow the Secretary of State to make Regulations for appeals to the CMA against a decision of Ofwat to revise a designated code, or not to make a proposed revision following consultation. These Regulations designate two codes that are produced by Ofwat under or by virtue of the 1991 Act, meaning decisions about these codes are appealable to the CMA. The Market Arrangements Code is made under an undertaker's conditions of appointment, which in turn are made under section 11 of the 1991 Act, or a licensee's standard conditions of appointment, which in turn are determined under section 17H and 17HA of the 1991 Act. The Wholesale-Retail Code is made under sections 66DA and 117F of the 1991 Act.

5. Extent and Territorial Application

5.1 The extent of this instrument is England and Wales.

5.2 The territorial application of this instrument is set out in Section 3 under "Other matters of interest to the House of Commons".

6. European Convention on Human Rights

6.1 The Parliamentary Under Secretary of State for the Environment has made the following statement regarding Human Rights:

"In my view the provisions of the Water Industry Designated Codes (Appeals to the Competition and Markets Authority) Regulations 2017 are compatible with the Convention rights."

7. Policy background

What is being done and why

7.1 The Water Act 2014 extended the scope for competition in the market for non-household retail services. These reforms will allow all business, charity and public sector customers in the areas of undertakers wholly or mainly in England to choose their water and sewerage supplier.

7.2 Central to these reforms are a set of regulatory codes produced by Ofwat to govern the arrangements between undertakers and licensees. These arrangements arise because the water supply and sewerage licensing regime enables licensees to use undertakers' networks to provide services to eligible non-household customers. Codes avoid expensive negotiations to establish these relationships and the risk of undue preference or discrimination occurring in dealings between participants, both of which would have acted as a barrier to participation in the market.

7.3 Codes will be living documents and are expected to be frequently amended as a result of changes to legislation, customer expectations and technological advances. 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 Ofwat's code decisions that might otherwise impede the development of well-functioning and fair water markets.

7.4 The Regulations provide access to a fast-track appeal process that is based upon a similar regime already in place in the energy sector, where those that are materially affected by a decision of Ofgem to amend an energy code may apply to the CMA for an appeal. The cases are heard by a group of experts in utility regulation that must resolve the case within a timetable set out in the Regulations. The corresponding process for the non-household water retail market set out in these Regulations benefits the industry, customers and new entrant companies through creating a bespoke, streamlined appeals mechanism, with a lower associated regulatory burden. It will make quicker and more transparent decisions overall.

8. Consultation outcome

8.1 Defra initially indicated it was minded to introduce an appeals approach similar to that for the energy sector in a December 2015 consultation on our approach to secondary legislation for the water supply and sewerage licensing regime. It also indicated which designated codes this would initially relate to the non-household retail market.

8.2 Following further dialogue with the CMA, Welsh Government and Ofwat, Defra formally consulted on its policy objectives, draft Regulations and Impact Assessment between November 2016 and December 2016. We received 13 responses. This comprised of 8 undertakers, 3 licensees, the Consumer Council for Water and the market operator, MOSL. Respondents were strongly supportive of taking forward the approach set out in these draft Regulations. Respondents were split on one question, regarding extending appeal rights to parties in the process of applying for a WSSL. Defra agreed with the argument made by respondents opposed to this, who stated they would be unable to demonstrate material impact and that this would create opportunities for vexatious appeals. Respondents unanimously agreed to the designation of the codes set out in Schedule 1. A summary of responses to the consultation is published at https://www.gov.uk/government/consultations/water-supply-and-sewerage-licensing-wssl-water-code-appeals.

9. Guidance

9.1 The CMA will be consulting upon and issuing rules and guidance on how it will hear appeals. These will be broadly based upon rules and guidance in place for energy code appeals.

10. Impact

10.1 There is no direct impact on charities or voluntary bodies. The Regulations will have a direct impact on undertakers and licensees (businesses) by granting them the ability to appeal to the CMA with regards to a proposed revision by Ofwat, or where an appeal lodged through the mechanism results in changes to the codes governing their arrangements in the market.

10.2 The impact on the public sector over a 10 year period has been calculated as a £0.33 million Net Present Value (NPV) additional cost for the CMA related to the assessment of appeals and a £0.07 million NPV additional cost for Ofwat to appeal-proof decisions. This is against the baseline costs where a High Court judicial review

provides the only route to appeal Ofwat's decision to change regulatory codes. The impact on the High Court in the equivalent period is a saving of £3.46 million NPV.

10.3 The overall net incremental benefit of implementing the Regulations is estimated to be savings of around £5.43m NPV, mostly reflecting the avoided legal costs of a judicial review that would have been incurred by the business raising the appeal and by the High Court.

10.4 A full Impact Assessment has not been prepared for this instrument. One was produced covering retail reforms in advance of the Water Bill entering Parliament in June 2013 and updated and re-published following Royal Assent in May 2014. All the impact assessments are available on legislation.gov.uk alongside the 2014 Act.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses where these are undertakers or licensees who wish to appeal a revision to the designated codes, or where the outcome of an appeal leads to amended codes governing their activities in the market.

11.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to make the decision to appeal to the CMA with regards an Ofwat decision to change codes voluntary. Were they to appeal, the mechanism will benefit small business because it is more streamlined and cost-efficient than if decisions had to be challenged through judicial review.

12. Monitoring & review

12.1 Defra will consider updating the Regulations if relevant changes are made to the energy code appeals regime. They will also be reviewed if it is decided that new water codes should be designated. Such matters will be considered as new water codes are developed by Ofwat and would be subject to a Defra public consultation before any decision is made to designate codes.

13. Contact

13.1 David Jones at the Department for Environment, Food and Rural Affairs Telephone: 020 802 63003 or email: david.jones@defra.gsi.gov.uk can answer any queries regarding the instrument.