

WATER ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: New Regulatory Arrangements, Etc

Section 56 and Schedule 4 Licensing of other water suppliers

193. Certain provisions in section 56 and Schedule 4 are devolved to the Assembly by way of the Transfer of Functions Order. Other provisions make express provision in relation to the Assembly.

194.

Section 56 and Schedule 4: Licensing of other water suppliers.

This section provides that Schedule 4 should have effect.

195. **Schedule 4** covers the licensing of new water suppliers, and inserts new sections 17A to 17R and new sections 66A to 66L into the Water Industry Act.

196. *New section 17A* establishes the licensing of new water suppliers to retail water and/or input water into the statutory undertakers' networks, and sets out the basis on which licensed water suppliers can supply customers.

197. Subsection (1) provides the Secretary of State with the power to grant licences. The Secretary of State can, after consulting the Assembly, authorise the Authority to grant licences on his behalf. A licence will include a retail authorisation and may include a supplementary authorisation. Licences will authorise their holders to carry on the relevant activities in England and Wales.

198. Subsections (2) to (6) detail the two types of authorisation. A retail authorisation (subsection (2)) enables the licence holder to use a water undertaker's supply system for the purpose of supplying water to a customer's premises. A licence which only contains this authorisation is described as a "retail licence". This enables the holder to purchase water from the undertaker to supply to its customers. This must be done through a wholesale agreement with the undertaker. Prospective licensees will therefore be able to apply to offer retail-only services if they do not have, or do not wish to develop, a source of water. Retail services could range from simply contracting with the customer to provide a supply (purchased from the undertaker) and billing them for this supply, to much wider services including water efficiency planning, metering and providing tailored customer services.

199. A supplementary authorisation (subsection (5)) also allows the licence holder to introduce water into the supply system in connection with a supply to customers' premises in accordance with its retail authorisation (but only for that purpose - they will not be authorised to introduce water for supply to anyone else). Licensed water suppliers may have their own sources, or may purchase water from a neighbouring undertaker to import into the 'local' undertaker's supply system through which they are supplying customers. This introduction must be done through an access agreement

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with the relevant undertaker. A licence including this type of authorisation is described as a “combined licence” (subsection (6)).

200. Before a combined licence is granted, there is a requirement for the Secretary of State and the Assembly to be consulted (or just the Assembly if the Secretary of State grants a licence). This is so that the Drinking Water Inspectorate (who exercise functions in relation to drinking water quality currently on behalf of the Secretary of State and the Assembly) are consulted (subsection (7)) so they can give their assessment as to the applicant’s suitability to introduce water into the public supply network.
201. Subsection (3) excludes licensed water suppliers from supplying premises which are defined as household premises, or those that do not meet the threshold requirement. The competition framework set out in this Act applies only to non-household customers using at least the relevant consumption threshold. Premises may only be supplied by one licensed water supplier. The Authority will enforce the eligibility requirements using the enforcement machinery under section 18 of the Water Industry Act which will be applied to licensees. This will allow it to require action to be taken to rectify a breach of requirements.
202. Subsection (8) restricts licence holders to those who are limited companies. It also excludes water and sewerage undertakers from holding a licence, so they must create new associated companies in order to apply for a licence. This is to ensure the activities of undertakers and licensed water suppliers are kept distinct.
203. Subsections (9) and (10) allow the Authority to issue guidance, subject to approval by the Secretary of State following consultation with the Assembly, on factors that will be considered in determining the extent of a premises. An example may be where guidance was needed on the definition of a hospital site with a number of related buildings.
204. *New section 17B* provides for the procedure for the publication and revision of guidance under section 17A(9). Guidance issued or re-issued by the Authority must be published so as to bring it to the attention of persons likely to be affected by it. The Secretary of State, having first consulted the Assembly, must approve revised guidance before issue.
205. Subsection (5) defines the supply system of a water undertaker for the purposes of the new competition arrangements. A licence will authorise use by licensed water suppliers of undertakers’ distribution networks, defined for the drinking water system (potable) as the water mains and other pipes from the undertaker’s treatment works to its customer’s premises. A licence will also be required to use non-potable networks (systems not used to supply drinking water) which are not connected to any potable system. Access to all other facilities (i.e. treatment works of a potable supply system and upstream from this) is outside the licensing regime.
206. Subsections (6) and (7) provide for the designation of undertakers’ treatment works by the Secretary of State after consultation with the Assembly. The Secretary of State will publish a list of those treatment works. There may be a number of different types of treatment works on a system and the list will define the extent of the undertaker’s supply system for the purposes of the licensing regime.
207. *New section 17C* defines ‘household premises’ in relation to section 17A(3)(a). Subsections (1) and (2) define household premises as those in which, or in any part of which, a person has his home, and where the main (principal) use of the premises is as a home. Therefore a large premises with an industrial use but a small caretaker’s flat within it, would not qualify as household premises.
208. Subsections (3) and (4) give the Assembly in relation to supply systems of undertakers wholly or mainly in Wales, and the Secretary of State in relation to the supply systems of all other undertakers, the power to make regulations to decide what will and will not be included in the definition of household premises.
209. *New section 17D* defines the threshold requirement referred to in section 17A(3)(b).

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210. Subsection (2) requires that the licensed supplier estimates, at the time when first entering into an undertaking to supply, that the total quantity to be supplied to the premises annually within the terms of the undertaking is not less than 50 megalitres. This would generally be expected to be the 12 month period following the beginning of supply, but could be another 12 month period if that period were not representative. For example, in order for a new industrial site to contract to be supplied when it is up and running, there might be a case for the expected use when the site is fully operational to be taken into account in the estimate. The Authority's guidance (subsection (3)) will specify the assumptions that might be appropriate in different circumstances. As long as the threshold requirement is met at the time the supply is agreed, a customer can continue to be supplied by the licensed water supplier even if their premises' consumption falls. The threshold requirement is in force at the time of (and each time of) a supply being first agreed between a licensed water supplier and a customer. This is in order not to discourage customers and licensed water suppliers from implementing water efficiency measures.
211. A licensed water supplier is required to follow the Authority's guidance on how it should estimate likely water use. Details on what form this guidance should take (and a mechanism for approval by the Secretary of State in consultation with the Assembly) are provided.
212. The Secretary of State, or for premises supplied by networks of undertakers which are wholly or mainly in Wales, the Assembly, may make regulations regarding the circumstances in which the threshold requirement will not apply, by providing for the circumstances when a licensee will not be regarded as entering into an agreement with a new customer. This power may be used for cases such as corporate reorganisations where a new agreement may be needed even though no real change in the supply relationship has occurred.
213. Subsections (8) to (11) enable the Secretary of State to alter, by regulations subject to affirmative resolution by Parliament, the threshold quantity, after consulting the Authority and such persons, as the Secretary of State considers appropriate. The new threshold will apply only to future agreements and the regulations may provide for it not to apply to undertakings that have been proposed but have not yet been concluded. This might be used, for example, where a determination on a proposed undertaking is with the Authority for resolution under section 17E.
214. Subsections (12) and (13) provide that the Assembly (and not the Secretary of State) will have the power to amend the threshold, for premises supplied using networks of undertakers wholly or mainly in Wales.
215. *New section 17E* enables the Authority to determine, where a proposal to supply is referred to it by a licensed water supplier (or its potential customer), whether a customer is eligible to be supplied with water by the supplier, in accordance with the retail authorisation. This will help customers and licensees to be certain that the supply meets the requirements of section 17A(3).
216. *New section 17F* establishes the application process for companies seeking to become licensed water suppliers and the procedure for the Secretary of State or the Authority, as appropriate, to grant water supply licences.
217. Subsections (1) to (3) provide for applications for either type of water supply licence authorisation (either a "retail licence" or a "combined licence"). They also cover applying for a variation to the existing authorisation; to extend from a retail to a combined licence; or change from a combined to retail authorisation. These subsections also provide for the application process to be prescribed by the Secretary of State, including the times within which representations about the applications can be made.
218. Provision is made in subsection (5) to allow certain aspects of the application process to be disapplied in certain cases. For example, should a combined licensed supplier wish

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to give up the supplementary authorisation, it might not be appropriate for them to go through a full licensing process in order to do so.

219. Subsection (7) lists the bodies to which a copy of a licence or variation should be sent for information when granted. These are the regulatory bodies for the water industry together with the Consumer Council for Water, statutory water and sewerage undertakers and other licensed water suppliers.
220. *New section 17G* allows the Secretary of State (or the Authority acting on his behalf) to include licence conditions in water supply licences.
221. Subsection (1) allows the Secretary of State or, if delegated, the Authority to include any conditions in the licence which seem necessary, bearing in mind their duties under Part 1 of the Water Industry Act (in particular section 2). It also allows for conditions requiring an initial and/or ongoing payment of a licence fee.
222. Licence conditions can be included which need not be connected with the supply of water or introducing water into the public supply network. This would allow the inclusion, for example, of licence conditions which regulated the behaviour of companies due to their association with undertakers.
223. Subsections (3) and (4) allow the inclusion of conditions which require the licensee to comply with directions given by specified bodies (the Secretary of State, the Authority, the Assembly, or the Environment Agency) on specific matters. Conditions can also require the licensed water supplier to do or not do things specified in the licence or only with the consent of a specified body. These provisions also allow for licence conditions which allow the specified body to determine specific questions arising in connection with the licence.
224. Licence conditions can be framed in a way that means they can be triggered (or not) according to specific circumstances, which are included in the condition itself. For example, a licence condition might be triggered when a licensed water supplier had a certain number of customers. This mechanism is in addition to other provisions to modify licence conditions generally.
225. *New section 17H* describes standard conditions for the water supply licence, and the procedure for excluding or modifying a particular standard condition when granting a licence. This system of standard conditions is modelled on that used in licensing in the gas and electricity markets. Standard conditions ensure that all licences of a particular type contain the same licence conditions as far as is appropriate (so that different standard conditions can be included for retail and combined licences). They also allow licence conditions to be modified collectively.
226. The Secretary of State is given the power to determine and is required to publish standard conditions for water supply licences, before the first time either type of licence is granted. Standard conditions may however be modified later by the Authority through the procedures outlined in the following sections.
227. The standard conditions of licences may specify that a provision within a licence may not come into effect until certain conditions or circumstances are satisfied. The standard conditions may also specify under what circumstances a particular condition may be suspended and/or then brought back into operation.
228. Subsection (5) states that standard conditions do not need to be written directly (in full) into a licence, but are incorporated by reference in the licence to those of the published standard conditions which are relevant to that licence.
229. Subsections (6) to (8) allow the Secretary of State or the Authority, when granting a licence, to exclude or modify any of the standard conditions of a particular licence, as considered appropriate to meet that licensed water supplier's circumstances. Before doing so, the Secretary of State (or the Authority) shall consult on the exclusions or

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modifications, giving notice of his (or its) intentions, setting out the impact of, and the reasons for the exclusions or modifications, and allowing for representations.

230. Subsection (9) provides that, during the consultation period, the Secretary of State (after consulting the Assembly) can direct the Authority not to exclude or modify any standard condition.
231. Subsection (10) sets out the general test for excluding or modifying any standard conditions. The granting authority must consider that the change will not unduly disadvantage any licence holder with respect to competing with any other licence holders.
232. Subsection (11) ensures that where a standard condition is modified in part in a licence, the unmodified part of the condition continues to be considered as a standard condition of the licence. This provision is also included at 17I(6), 17O(9), 17P(9) and 17R(3).
233. *New section 17I* sets out the procedure by which the Authority can modify the conditions within a particular licence, with the consent of the licence holder. It mirrors the provisions for modifying individual gas and electricity licences set out in the Utilities Act 2000.
234. Subsection (2) enables the Authority to make changes to any condition in a particular licence, but only with the consent of the licence holder. Where a condition is to be modified, the Authority must also believe that the change is necessary and will not disadvantage the licence holder in competing with other licensed water suppliers or disadvantage other licensed water suppliers.
235. Subsections (3) and (4) set out the procedure for consulting interested parties about the proposed modification.
236. Subsection (5) gives the Secretary of State the power, after consulting the Assembly, to direct the Authority not to make the modification it was proposing to make.
237. *New section 17J* describes how the standard conditions of the water supply licence are modified. This is the mechanism for changing standard conditions for all licences containing the conditions which are being changed. The means that it is not necessary to obtain individual agreement of each licence holder. This mirrors the provisions for the modification of standard conditions in gas and electricity licences set out in the Utilities Act 2000. This is a mechanism to facilitate changes in licence conditions.
238. Subsection (2) gives the Authority the power to make any incidental or consequential modifications it considers necessary to any other relevant conditions of licences when it is modifying standard conditions.
239. Subsections (3) and (4) require that before the Authority makes any modifications under this section, it gives notice of its intentions, setting out the impact of, and the reasons for the modifications, and allowing for representations. These subsections also set out how the notice should be published and to whom copies should be sent.
240. Subsection (5) enables the Secretary of State, within the notice period, after consulting the Assembly, to direct the Authority not to make a change.
241. Subsections (6) and (7) allow the Authority to proceed with the proposed modifications of the standard conditions if, within the notice period, no objections are made by the relevant licence holders. If one or more licence holders object, then the Authority can go ahead if (a) the percentage of the relevant licence holders making objections is below a percentage specified by order and (b) the proportion of relevant licence holders (weighted according to market share) is below another percentage specified by order. The system of weighting for the purposes of (b) will be prescribed in secondary legislation.

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242. Where one or more relevant licence holders object, the Authority can also go ahead with the proposed modifications if the effect is to remove or reduce burdens imposed by existing standard conditions whilst ensuring necessary safeguards are not removed and no licensed water supplier is disadvantaged by the change.
243. Subsection (11) requires that a draft of any statutory instrument containing an order under subsection (6) be approved by both Houses of Parliament using the affirmative resolution procedure.
244. Subsection (12) requires the Authority to publish the modified conditions to existing licences and incorporate them into new licences as it grants them.
245. *New section 17K* sets out the procedure for the Authority to refer proposed modifications of licences to the Competition Commission. This largely parallels the existing procedure for undertakers, as well as the procedure set out in the Electricity Act 1989 and the Gas Act 1986.
246. Subsections (1) to (3) allow the Authority to refer proposed modification(s) to the Competition Commission, effectively asking it to consider the extent to which the proposed modification addresses matters which operate, or may operate, against the public interest. This includes modifications to the conditions of particular licences or the standard conditions. This is expected to be used if licensed water suppliers object to a modification to either the conditions of a particular licence or the standard conditions proposed by the Authority.
247. Subsections (4) and (5) allow the Authority to give its opinion to the Competition Commission on its concerns which the proposed modification is intended to remedy. It may vary a reference once made (subsection (3)) but must make this public. The Authority is also required to make the initial reference public and, in particular, send a copy to the affected licensees, Council, Secretary of State, the Assembly and Chief Inspector of Drinking Water.
248. Once the Secretary of State has received a copy of the reference, he has 28 days to decide whether to direct the Competition Commission not to investigate the reference or to ignore any variation to the reference. Assuming this power of veto is not exercised, the Authority is required to assist the Commission, in particular, by making relevant information available to it.
249. Subsection (9) requires the Competition Commission, in considering the reference, to have regard the Authority and Secretary of State's duties under Part 1 of the Water Industry Act.
250. *New section 17L* sets out the time limits in which the Commission reports on references to the Commission are to be made under section 17K. If the report is not made within the specified time period, then the Authority can choose to disregard it. However, the Authority may extend the reporting period once, if it has received a satisfactory representation from the Commission on why the period should be extended. The section sets out the procedures the Authority must follow when authorising an extension.
251. *New section 17M* applies sections 109-116 of the Enterprise Act 2002 in relation to modification references to the Commission in section 17K. Sections 109-116 set out the Commission's powers to require persons to give evidence and to provide specified documents and information needed. These will be applied to the Commission's investigations on modification references.
252. *New section 17N* sets out the procedure for the Commission to use in reporting on a reference made to it under section 17K.
253. Having considered a reference made under section 17K, the Commission must publish a report on its findings. This report will include conclusions on the questions raised in the reference and, if relevant, details and conclusions in relation to its public interest

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findings. If the Commission concludes that a licence modification would remedy the adverse public interest effects described, it has to specify such a modification (or modifications).

254. If the Commission's report concludes that modifications should be made to water supply licences, the Authority will only act to modify a condition under section 17O, (and the Commission will only be able to veto modification made by the Authority under new section 17P), if two-thirds of the group that made the report is in agreement.
255. Subsection (4) gives the Commission the defence of absolute privilege against the law of defamation for any report made under 17K.
256. Subsections (6) to (8) list three considerations to which the Commission must have regard (as far as is practicable) before disclosing any information under 17K. First, the need to exclude any information that the Commission thinks is not in the public interest to publish. Second, the need to exclude any information that the Commission thinks could significantly harm legitimate business interests of the undertaking to which it relates, or an individual's private interests. Third, the extent to which the disclosure of the information is necessary for the purposes of the report.
257. Subsections (9) to (11) require the Commission to send its report to the Authority which, in turn, sends a copy to various bodies and in due course publishes it.
258. The Secretary of State is given 14 days in which to direct the Authority to remove any material which is against the public interest or commercially sensitive from the report before the Authority makes it public.
259. *New section 17O* sets out the procedure for the modification of licences by the Authority following a report from the Commission.
260. Subsection (1) states that if a report from the Commission concludes that matters specified in the reference act against the public interest and specifies a licence modification intended to remedy the effects described, then the Authority is required (subject to the other provisions in this section) to make an appropriate modification (or modifications) to the conditions of a particular licence or the standard conditions.
261. If the Authority proposes a modification of the standard conditions (under this section) it may also make minor incidental modifications to conditions of existing particular licences as a consequence.
262. Subsection (3) provides that in making modifications under section 17O the Authority is required to have regard to the modifications specified in the report.
263. The Authority must consult publicly on its proposed modification for at least 28 days. The parties consulted must include the Council, the Secretary of State, the Assembly and the Drinking Water Inspectorate. Having considered responses to the consultation, the Authority notifies the Commission of its intention to make the modification, and the reasons for doing so, and sends the Commission a copy of the responses to the consultation.
264. Subsection (8) requires the Authority to make the modification if the Commission does not veto the proposed modification within four weeks of the Authority's notice.
265. Modifications of standard conditions made by the Authority are to apply to existing licences and the standard conditions of future licences.
266. *New section 17P* sets out the Commission's power to veto a modification that the Authority proposes to make to either conditions of particular licences or to the standard conditions, in response to a report from the Commission made under section 17N.
267. If the Commission judges that the Authority's proposed modification(s) do not remedy the adverse effects in its report, this section gives the Commission the power to veto the

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Authority's modification by means of a direction and substitute its own. This parallels the procedure set out in the Utilities Act 2000.

268. The Commission is given four weeks after receiving the proposed modification from the Authority, to veto all or part of the modification. This period may be extended by 14 days by the Secretary of State on application by the Commission.
269. Subsection (3) allows the Commission to veto a proposed modification only if it does not have the desired effect set out in the Commission's report.
270. Subsections (4) to (6) require the Commission, if it vetoes the Authority's proposed modification, to publish a notice giving the reasons for its veto. It must then propose, and consult on, its alternative modification, with a consultation period of not less than 28 days. After considering responses to the consultation, the Commission can make a modification and publish a notice setting this out and its reasons for doing so.
271. Subsections (7) and (8) set out the processes that the Commission undertakes in order to bring any such modifications to the attention of persons likely to be affected by them.
272. Subsections (10) to (11) allow the Authority to make minor changes to existing licence conditions as a consequence of the Commission's modification. In addition, if the Commission modifies a standard licence condition, the Authority is required to make the same modifications to the standard conditions so that the modification is incorporated in all future licences.
273. *New section 17Q* gives the Commission the defence of absolute privilege, in relation to the law of defamation, when publishing information under subsections (4)(a), (6), or (8) of section 17P, but requires that the Commission have regard to certain considerations before publishing.
274. Subsections (3) to (5) list the three considerations to which the Commission must have regard (as far as is practicable) when publishing information under section 17P. First, the need to exclude any information that the Commission thinks is not in the public interest to disclose. Second, the need to exclude any information that the Commission thinks could significantly harm the legitimate business interests of the undertaking to which it relates, or an individual's private interests. Third, the extent to which the disclosure of the information is necessary for the purposes of the notice.
275. Subsections (6) to (10) modify and apply sections 109-116 of the Enterprise Act 2002 for the purposes of the Commission exercising its functions under section 17P. Sections 109-116 set out the Commission's powers to require persons to give evidence and to provide specified documents and information needed for the modification of licences.
276. *New section 17R* mirrors section 17 of the Water Industry Act (as it applies to undertakers and is modified by the Enterprise Act 2002). This allows modification of licence conditions as a result of merger investigations and market investigations under the Enterprise Act.
277. Subsections (1) and (2) provide for the Office of Fair Trading, the Commission or the Secretary of State to modify water supply licence conditions where any of those bodies have made an order as defined in subsection (2).
278. Subsections (3) to (4) contain provisions dealing with modifications to standard conditions similar to those found in section 17O subsections (2), (9) and (10).
279. *New section 66A* sets out the conditions which must be satisfied before a primary water undertaker (as defined in subsection (8)) is required to provide a wholesale supply of water to a licensed water supplier to enable it to supply its customers. This requirement only applies in respect of customers in the undertaker's appointed area.
280. Where a licensed supplier requests an undertaker to provide a supply of water for the purpose of supplying the premises of its customers, the undertaker is under a duty to

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take steps to enable the supply to be made and to provide that supply on certain terms agreed with the supplier or determined by the Authority. The undertaker must take any such steps as may be provided for under the agreement or determination for enabling the supply to be made. These steps may include, for example, connecting a new customer to the main.

281. The duty to provide a supply does not apply if certain conditions are satisfied. The duty does not apply if connecting the premises would result in a contravention of regulations made under section 74. This is to ensure that there is no contamination of the water supply from fittings in a customer's premises. If the premises to be supplied are not a building of some type (e.g. agricultural land) or if the supply is for non-domestic purposes, then the undertaker is in addition not under a duty to supply if it would put at risk its ability to meet all its other existing obligations to supply for domestic and other purposes together with its probable future water supply obligations to supply for domestic purposes. It may also refuse to supply water if it would incur unreasonable expenditure in so doing.
282. Subsection (7) allows the undertaker to recover from the licensee certain expenses incurred in taking the steps referred to in subsection (2) even if the undertaker was not able to make the supply because it could not obtain necessary authorisations or agreements. For example, if the undertaker failed to obtain necessary permissions to lay pipes, it would nevertheless be able to recover the cost of attempting to do so.
283. *New section 66B* sets out the conditions on which water undertakers are required to allow licensed water suppliers holding a combined licence to introduce water to their supply systems.
284. Subsection (1) limits the duty to cases where a request for introduction of water to the supply system is in connection with a specific supply to a customer under the licensed water supplier's retail authorisation. In reality, the water introduced by the combined licensee, having mixed with other water in the undertaker's pipes etc. will not necessarily be the same water that arrives at the customer's premises. In addition, the licensed water supplier's customer must be within the undertaker's appointed area.
285. Subsection (2) provides that the undertaker will also be under this duty where it has agreed (outside the competition provisions in these sections) to treat a licensed water supplier's water so that it can be introduced into the supply system and, in connection with that introduction, the licensed water supplier requests that the undertaker permit the licensee to then introduce water into the supply system for supply to its customers.
286. Subsection (3) places a duty on a water undertaker who receives a request under section 66B to take steps to permit the introduction of water into its supply system and to permit the introduction on certain terms agreed with the supplier or determined by the Authority. These steps may include laying a pipe to connect the licensed water supplier's treatment works (or source in the case of non-potable supply) with the undertaker's supply system. The steps also include making a connection to the customer where required.
287. The duty to provide a supply does not apply if certain conditions are satisfied. Undertakers may refuse a request made by a licensed water supplier for the introduction of water, if this would put at risk specified obligations or in certain circumstances would require unreasonable expenditure in carrying out works. Therefore, undertakers have to be satisfied that any access agreement with a licensee will ensure that appropriate safeguards are put in place in a range of areas. This will include for example water quality matters; undertakers will have to be satisfied that any proposed actions of a licensed water supplier will not adversely affect the quality of water supplied.
288. The duty also does not apply if connecting the premises of the licensed water supplier's customer would result in a contravention of regulations made under section 74 of the Water Industry Act 1991.

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289. Subsection (7) allows the undertaker to recover from the licensed water supplier certain expense in taking the steps referred to in subsection (3), even where the undertaker was not able to make the supply because it could not obtain necessary authorities and agreements (in the same way as sections 66A(7) and 66C(7)).
290. Subsections (9) and (10) allows the Secretary of State (after consultation with the Assembly) to publish a list of treatment works used by licensed suppliers to treat water introduced into the supply system (this is separate to the list of undertakers' treatment works referred to in section 17B(6)). The designation is relevant to undertakers' obligations to take steps to permit the introduction of water into their systems. The duty to take steps in relation to potable networks includes laying pipes to the licensee's treatment works.
291. *New section 66C* sets out the conditions under which an undertaker ('the secondary undertaker') may be required to provide water supplies to licensed water suppliers for the purpose of them supplying water to their customers using the supply system of another undertaker (the primary undertaker) to which the licensee's customers are connected and the conditions under which the primary undertaker may be required to permit the introduction of that water.
292. Subsection (2)(a) places a duty on the secondary undertaker, when requested by a licensed water supplier, to take steps to enable the supply to be made to the licensee and to provide that supply on certain terms agreed between them or determined by the Authority.
293. Subsection (2)(b) places a duty on the primary water undertaker, when requested by a licensed water supplier, to take steps to permit the introduction of the water into its supply system on certain terms agreed, or determined by the Authority. These steps are likely to include, if no appropriate cross-border pipe is already available, laying a pipe to the secondary undertaker's supply system, making the appropriate connections and allowing introduction of the water. The steps also include making a connection to the customer where appropriate.
294. Subsections (4) to (6) set out conditions under which the secondary and primary undertakers may refuse a request by a licensed water supplier to supply water and permit the introduction of that water into the supply system. The duty on both will not apply if either or both of the conditions are satisfied. The duty does not apply if connecting the premises of the licensee's customer would result in a contravention of regulations made under section 74 of the Water Industry Act. This would only affect the primary undertaker's system, but if it does, the secondary undertaker is not under a duty to supply. Neither undertaker will be under a duty if complying with the request would put at risk specified obligations or, in certain circumstances, would require them to incur unreasonable expenditure in carrying out works).
295. Subsection (7) allows either undertaker to recover from the licensee, certain expenses in taking the steps referred to in subsection (2) even where the undertaker was not able to make the supply because it could not obtain necessary authorities and agreements (in the same way as in section 66A(7) and 66B(7)).
296. *New section 66D* determines or provides for the determination of certain matters in relation to the requirements of 66A to 66C.
297. Subsection (1) allows licensed water suppliers to seek a determination from the Authority as to whether a refusal on the part of an undertaker to provide a wholesale supply or permit the introduction of water into its supply system on the grounds of the relevant conditions set out in sections 66A to 66C is justified.
298. Subsection (2) provides that a water undertaker's duties under 66A to 66C shall be performed as agreed between the undertaker (or undertakers in the case of section 66C) and licensed water supplier (subject to the other provisions in section 66D, and sections 66E and 66F) or in the absence of agreement, as determined by the Authority. Where the

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undertaker and licensed water supplier are unable to come to an agreement, the licensed water supplier may ask the Authority for a determination. In this case, the Authority will determine the terms and conditions to apply, and this will form the contract between the parties.

299. Subsection (3) requires the charges payable by licensed water suppliers under the agreement or determination mentioned above to be fixed in accordance with the costs principle set out in section 66E.
300. Subsection (4) requires the Authority to issue guidance on the terms and conditions of agreements mentioned above, including the fixing of charges, between undertakers and licensed water suppliers. This guidance will be binding on undertakers and licensed water suppliers.
301. Subsections (7) and (8) allow the Authority to require the parties to modify or terminate agreements which are not made in accordance with the guidance or the costs principle referred to section 66E. This requirement is enforceable against parties using the section 18 machinery.
302. Subsections (9) and (10) prevent the Authority from exercising its Competition Act 1998 powers to modify agreements which are contrary to the Chapter I prohibition in that Act.
303. *New section 66E* sets out the costs principle referred to in section 66D.
304. Subsection (1) set out the basics of the costs principle. Undertakers are to recover from licensed water suppliers two elements of cost to the extent that those sums exceed any financial benefits the undertaker receives as a result of the supplier using the system to supply its customers. First, the direct costs of providing any wholesale supply to a licensed water supplier or permitting the introduction of water into the supply system. Second, an appropriate amount (defined in subsection (3)) of qualifying expenses (defined in subsection (2)) together with a reasonable return.
305. Subsection (2) defines qualifying expenses as all of the expenses that an undertaker incurs (or has incurred) in performing its statutory functions. This definition therefore includes both historical and future costs.
306. Subsections (3) and (4) define the appropriate amount referred to in subsection (1)(b) as the expenses which the undertaker would have ordinarily recovered from its customers if they had not been supplied by a licensed water supplier. However, any costs that the undertaker can reduce or avoid are not included in this amount.
307. It is possible that, as a result of a licensed water supplier supplying its customers, the undertaker receives some financial benefit. To the extent that there are any such benefits, these are deducted from the two elements of cost set out in subsection (1).
308. *Section 66F* provides supplementary provisions to section 66D.
309. Subsections (1) and (2) require the Authority, before making a determination under sections 66D(1) or (2), (either in relation to the satisfaction of conditions or the terms and conditions on which a supply is to take place) to consult the Secretary of State (in the shape of the Drinking Water Inspectorate which exercises drinking water functions on his behalf) where water is being introduced to a supply system (section 66B or section 66C cases) and the Environment Agency where water is being transferred from one area to another (section 66C cases).
310. Subsections (3) and (4) provide which is the appropriate body to consult depending on whether the undertaker is or (in the case of a supply under section 66C) undertakers concerned are located in England or Wales. The Assembly is consulted in relation to supplies made using supply systems of undertakers whose areas are wholly or mainly located in Wales. The Secretary of State is consulted in relation to supplies made using the supply systems of all other undertakers. Both are consulted in a cross border supply

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case where the two undertakers concerned are not wholly or mainly in the same country (i.e. one is mainly in Wales and the other in England).

311. Subsections (5) to (8) require the Authority to publish its guidance relating to the terms and conditions of agreements referred to in section 66D and to consult such persons as it considers appropriate before it issues or revises such guidance.
312. Subsection (10) provides for any terms and conditions determined by the Authority under section 66D to be treated as if they had been agreed between the parties.
313. *New section 66G* sets out the requirement for the Authority to designate certain introductions of water by licensees as strategic supplies. These are an introduction of water without which there would be a substantial risk that the undertaker would not be able to maintain supplies to its own customers and make supplies for domestic purposes to licensed water supplier's customers. The significance of this designation is that the licensed supplier will be subject to the special administration procedures in sections 23 to 26 of the Water Industry Act.
314. Subsections (1) to (8) allow the undertaker to request that the Authority determines that an introduction of water constitutes a strategic supply, if it believes it to be such. The Authority may also propose to make such a determination without any such request. The Authority shall inform the Secretary of State, the Assembly, and other such other persons, as it considers appropriate of the request or any proposed determination and shall indicate the time within which representations may be made.
315. *New section 66H* covers the situation where a supplier is making two or more introductions of water which, taken together would amount to a strategic supply (though they would not be strategic if taken separately).
316. *New section 66I* makes it an offence to use an undertaker's system to supply the premises of a customer, unless the supply is made by the water undertaker or a licensed water supplier in pursuance of its licence. The Secretary of State or the Assembly (in relation to systems of undertakers wholly or mainly in Wales), or the Authority, may instigate proceedings and a person found guilty may be fined, and any agreement which is found to contravene this prohibition will be void.
317. Subsections (3) and (8) give the Secretary of State, or the Assembly in relation to systems of undertakers wholly or mainly in Wales, the power to specify circumstances where the prohibition shall not apply. This would be used to except an activity that would otherwise be an offence, and might be used where it was found that the prohibition had unintentionally caught a particular activity.
318. *New section 66J* makes it an offence to introduce water into a water undertaker's supply system, except for the introduction by a licensed water supplier in pursuance of its licence, or by another water undertaker under an agreement for a bulk supply. Proceedings in respect of such an offence may be instigated by the Secretary of State, the Assembly in relation to supply systems of undertakers wholly or mainly in Wales or the Authority and a person found guilty on conviction or indictment may be imprisoned for up to two years, or fined (on summary conviction this may be up to £20,000). Any agreement found to contravene this prohibition will be void. As for section 66I, the Secretary of State, and the Assembly (in relation to supply systems of undertakers whose areas are wholly or mainly in Wales), has the power to specify further circumstances where the prohibition shall not apply.
319. *New section 66K* provides for the Secretary of State, by statutory instrument following the negative procedure, or the Assembly in relation to supply systems of undertakers wholly or mainly in Wales (under new section 66L(7) and (8)), to grant exemptions to sections 66I and 66J above. The activities will continue to be prohibited generally, but a person or class of person is exempted, perhaps subject to conditions. This might be used in a case in which a person is carrying out one or more of the activities for which a licence would normally be required but where licensing would be unnecessarily

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onerous, or where a person was found to have been unintentionally caught by the legislation.

320. Subsections (1) to (5) provide for the Secretary of State or the Assembly to consult on an order granting exemptions to individuals or to classes of people, setting out the reasons for the order and terms proposed, and allowing not less than 28 days for representations. An exemption for a particular person must be notified by the serving of a copy on that person, as well as more widely publishing it; exemptions for classes of people must be published to bring it to the attention of persons of that class as well as others who might be affected.
321. An exemption may be granted for a specific period or indefinitely, and it can include conditions which allow the Secretary of State, the Assembly, or the Authority to require any exempted person to comply with particular directions or gain consents or determinations from those bodies.
322. *New section 66L* allows the Secretary of State, by order made by statutory instrument following the negative procedure or the Assembly (in relation to systems of undertakers wholly or mainly in Wales) to vary an order which granted an exemption, or terminate any exemptions, on request of the person to whom it applied (in the case of withdrawing an exemption granted to a person, or in the case of withdrawing an exemption granted to persons of a class, from any person of that class) in accordance with a provision in the order, or if it appears to him or it inappropriate to continue on the current terms.
323. The Secretary of State or the Assembly must consult the Authority and give notice of its proposals, with a period for representations, by, as appropriate, serving a copy of the notice on the person to whom the exemption was granted, or bringing it to the attention of those in the class of persons exempted, or that person within the class to whom the proposed order applies.
324. [Paragraph 4](#) of the Schedule allows the Authority to modify the conditions of appointment of a water undertaker where it considers it necessary or expedient in consequence of the amendments to the Water Industry Act made by this Schedule and Schedule 8. The Authority may also make incidental or consequential modifications of other conditions of appointments which it believes necessary.
325. Before making such modifications the Authority has to consult the company holding the appointment and anyone else it considers appropriate. The Secretary of State can give directions to the Authority in order to ensure that the conditions of appointment are modified in consequence of the amendments made to the Water Industry Act.
326. The powers of the Authority to make such modifications are time limited to a period of two years beginning with the first day of commencement of all of Schedule 4 and Schedule 8.