

**EXPLANATORY MEMORANDUM TO THE  
WATER SUPPLY LICENCE (MODIFICATION OF STANDARD CONDITIONS)  
ORDER 2005**

**2005 No.**

1. This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs (Defra) and is laid before Parliament by Command of Her Majesty.
2. **Description**
  - 2.1 The Water Act 2003 (WA03) amends the Water Industry Act 1991 (WIA91) to permit a company that holds a water supply licence to have access, in certain circumstances, to a water undertaker's supply system for the supply of water to customers. Water supply licences will be issued by the Office of Water Services ("Ofwat"), the economic regulator for the water industry, and will include standard licence conditions. Standard licence conditions will be determined by the Secretary of State.
  - 2.2 Under the WIA, standard licence conditions can be modified through a collective voting procedure. This means that a modification proposed by Ofwat can proceed only if the number of licensees who object to it is below a specified threshold and the market share of the licensees who object is below another specified threshold. This Order determines the level of these thresholds and the measure of market share to be used.
3. **Matters of special interest to the Joint Committee on Statutory Instruments**
  - 3.1 None.
4. **Legislative Background**
  - 4.1 The WA03 amends the WIA91 to extend opportunities for competition for water supply within England and Wales. Among other things, it provides a specific framework for access to the public water supply system, by permitting a licensed water supplier (licensee) to have access to certain parts of a water undertaker's supply system, in certain circumstances, for the purpose of supplying water to customers' eligible premises.
  - 4.2 There will be two types of water supply licences. Retail licences will allow the licensee to purchase water wholesale from water undertakers and to retail it to customers' eligible premises. Combined licences will additionally allow the licensee to introduce water into a water undertaker's supply system for the purpose of retailing it to customers.
  - 4.3 Water supply licences will contain some standard licence conditions which will be the same for all licences. There will be additional standard conditions for combined licences. Section 17J WIA91 provides the procedure for the collective modification of standard conditions. This process avoids the need to obtain the individual agreement of each relevant licence holder to a proposed modification or for a reference to the Competition Commission before a

change can be made. Section 17J(13) WIA91 defines relevant licence holders as the holders of a licence which is to be modified either to include a new standard condition or amend an existing standard condition.

- 4.4 Sections 17J(6)-(8) WIA91 provide for the circumstances in which modifications proposed by Ofwat can proceed. If no objection is made by the Secretary of State, Ofwat can make the modification if:
- no objections are made by relevant licence holders, or
  - objections are made by a proportion of relevant licence holders that falls beneath the specified threshold, and the market share of the licence holders that object falls below another specified threshold; or
  - the effect of the modification is to remove or reduce burdens (without removing any necessary protection or unduly disadvantaging a licensee in competing with other licensees).
- 4.5 Section 17J(6) WIA91 confers upon the Secretary of State the power to set the thresholds that will determine the minimum level of objections from relevant licence holders required to block a licence modification proposal. It also confers upon the Secretary of State the power to set the measure of market share to be used to determine whether or not the combined market share of the relevant licence holders who object to the modification is above the threshold.
- 4.6 This Order determines the level of thresholds and the measure of market share, in exercise of the powers in section 17J(6) WIA91. Both thresholds are set at twenty percent. The measure of market share is based on volumes of water supplied in the year preceding the proposed modification. This is the first use of these powers.
- 4.7 Legally, this Order is a “stand alone” instrument. However, it is one of a number of Statutory Instruments required to implement the new provisions of the WIA91 related to the new water supply licensing regime.

## **5. Extent**

- 5.1 This instrument extends and applies to England and Wales.

## **6. European Convention on Human Rights**

- 6.1 The Minister of State for Climate Change and the Environment, Mr Elliot Morley, has made the following statement regarding Human Rights:

“In my view the provisions of the Water Supply Licence (Modification of Standard Conditions) Order 2005 are compatible with the Convention rights.”

## **7. Policy background**

- 7.1 The new water supply licensing provisions in the WIA were developed in the light of the responses received by Defra and the Welsh Assembly Government (the Assembly) to their joint public consultation on “Extending Opportunities for Competition in the Water Industry in England and Wales” (July 2002).
- 7.2 As part of the implementation of the water supply licensing provisions in the WIA91, Defra, the Assembly and Ofwat published a consultation paper

entitled 'Eligibility, licensing, customer transfer protocol and strategic supplies' (the licensing and eligibility consultation) in October 2004. This consultation paper sought views on draft guidance and a number of the proposed Statutory Instruments to implement the new regime. This included the policy proposals for collective modifications of standard conditions of water supply licences and a draft of this Order. Thirty-four stakeholders responded to this consultation, of which eighteen commented on the proposals related to this Order.

- 7.3 The licensing and eligibility consultation sought views on the level of the thresholds that have to be exceeded by relevant licence holders who object if a proposed modification is not to proceed without individual agreement or a reference to the Competition Commission. The consultation proposed thresholds of twenty percent in both cases. This level of thresholds achieves the right balance between being low enough so that if a significant proportion of licensees (either in number or in market share) object, the modification would not proceed; but not being so low that they give undue power to any licensee to block proposed modifications agreed by a large majority of licensees (in number and in market share). Most respondents supported this proposal.
- 7.4 The licensing and eligibility consultation also proposed that market share is assessed by reference to volume supplied by relevant licence holders, and that the information on volume supplied used to calculate the market share should be historical reflecting the water supplied for the most recent 12-month period as specified by Ofwat in the notice of the proposed modification. These proposals were supported by most respondents.
- 7.5 The consultation document is available on Ofwat's website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk). The Government's response to the consultation on Collective modifications of standard licence conditions will shortly be published in Defra's website at [www.defra.gov.uk](http://www.defra.gov.uk).

## **8. Impact**

No regulatory impact assessment has been prepared in respect of this Order. A regulatory impact assessment in respect of the WA03 was prepared and placed in the library of each House of Parliament during the passage of the Water Bill. This included an assessment of the water supply licensing provisions. Copies can be obtained from Water Supply and Regulation Division, Department for Environment, Food and Rural Affairs, Ashdown House, 123 Victoria Street, London SW1E 6DE or from the Department's website at [www.defra.gov.uk/environment/water/legislation](http://www.defra.gov.uk/environment/water/legislation).

## **9. Contact**

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