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The Water Act 2014

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THE WATER ACT 2014 (THE ACT) IS A major step in the government's liberalisation of the water industry and its provisions, though still awaiting formal implementation in many cases, represent significant opportunities both for companies operating within the industry and commercial water customers. For instance, water supply licences will become more flexible and the rules on mergers within the industry are to be relaxed while, for commercial customers, there will be the potential to change water supplier in pursuit of more advantageous arrangements.

The Act received royal assent on 14 May 2014. In some ways this appears to mark the end of a long process going back to the government's *Water for Life* white paper of 2011 (the White Paper). In others it is just the beginning, as the industry becomes accustomed to the new, liberalised market structure, the new duties of the water regulator Ofwat and the changes to water resources and environmental regulation brought in by the Act. Many major developments are still awaited, as much of the Act simply sets the groundwork for more detailed regulations to be implemented in future.

The focus of the Act throughout its legislative development has been market reform, and this is the area where the Act will likely have most relevance for the water industry. There are other significant developments which will also impact upon a number of businesses and other organisations, such as potential changes to the environmental permitting regime, and other parts of the Act where the full implications remain to be seen, such as the new duty for Ofwat to further the resilience of water supply and sewerage systems.

This article looks at some of the key provisions in the Act and their likely practical impact.

STRUCTURE AND APPLICATION

The Act is the result of almost a year of legislative scrutiny, following the first reading of the Water Bill on 27 June 2013, stemming from the release of the White Paper in 2011.

The Act itself is split into four parts covering the water industry, water resources, environmental regulation and flood insurance,

and largely takes the form of amendments to the Water Industry Act, which will therefore remain the key piece of legislation for the water industry. A significant number of provisions are expressed in the form of regulation-making powers and the manner in which these powers will be exercised (if they are exercised at all) is still unclear. Only a small number of provisions have a commencement date at time of writing and these are noted below – otherwise provisions should be regarded as not yet in force.

The Act mainly applies to England and Wales though some provisions will also apply to Scotland – most notably in making preparations for cross-border licensing.

WATER INDUSTRY

Background

The White Paper drew heavily on Martin Cave's report to government, 'Competition and Innovation in Water Markets' and a key aim of the reforms it proposed was to 'develop a more vibrant and competitive market'. This is an apt summary of the goals of provisions set out in the Act, applying both to the openness of the market to new competition and to the effort to increase customer choice.

Water supply licensing

Water supply licensing distinguishes between two types of services. Upstream services include the network used to transport water and wastewater and also the actual supply of water into that network (the network remains the responsibility of the established water and sewerage undertakers). Retail services, by comparison, comprise the services a water company provides to its customers in the process of supplying the water and include billing, meter reading and the handling of telephone queries.

Currently water supply licences can consist of either a retail licence, a licence to purchase a wholesale supply of water from an undertaker and use its supply system to deliver this to customers (effectively providing a retail service, as the licensee would not themselves be putting water into the network), or a combined licence where the licensee delivers water through the undertaker's network to its customers (a combination of upstream and retail services). It is not possible to be licensed solely to supply upstream services.

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The Act allows for a water supply licence to consist of either or both retail and wholesale authorisations. A retail authorisation allows the licensee to use an undertaker’s supply system to supply water to customers. A wholesale authorisation would permit introduction of water into the system in respect of a specific retail supply, which could potentially – but not necessarily – be provided by the same licensee. A separate provision introduces a new sewerage licensing regime on a similar basis, one effect of which is to give greater scope for development of the market in sewage sludge, of particular relevance to many renewable energy projects utilising biomass in the generating process.

The end goal is to provide greater flexibility in the licensing regime for prospective licensees, the major change being that a licensee would, under the Act, be able to hold a wholesale authorisation without providing commensurate retail services. By way of example, take a company that holds an abstraction licence for its own use (for instance a brewery). If that company has surplus water left over, it could seek authorisation to sell this back into the water network without the need to provide associated retail services.

Once fully implemented, this part of the Act should, in theory, allow new entrants to select the level and type of participation in the water and/or sewerage market. It also sets out powers for the secretary of state to make ‘exit regulations’ which would allow water undertakers whose area is wholly or mainly in England to apply to exit the non-household retail market for that area. This could allow greater flexibility for undertakers as well as clear the field for new licensees. As with other aspects of the Act, this is expressed as a power for ministers rather than a fully-realised regime and the government has yet to

announce details of further regulations in this regard.

Mergers

At present there is an automatic duty for a referral to the Competition and Markets Authority in the event of an anticipated or completed merger between two water enterprises (with an exception where the turnover of water enterprises owned by the acquirer or that are the target of the acquisition does not exceed £10m). The Act sets out additional exceptions to the duty to refer, encompassing both situations where the merger would not prejudice Ofwat’s ability to regulate and also – notably – situations where there may be prejudice but where this prejudice is outweighed by consumer benefits.

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Changing water suppliers

Customers will also have greater freedom to switch between suppliers. Under the current regime certain non-household customers are able to change their water supply but only where they consume at least 5 million litres of water per year (50 million litres in Wales). The Act grants regulation-making powers to the secretary of state and the Welsh ministers to remove this threshold entirely (though as of time of writing the Welsh government plans to retain the threshold of 50 million litres). This provision comes into force from 14 July 2014.

This is certainly something for all commercial organisations to bear in mind. The current threshold is at a level that does not allow for a great degree of flexibility in the market (at the time the White Paper was published, only one customer had changed suppliers in six

years). By removing this threshold entirely the Act should create opportunities both for commercial customers to obtain a better deal on their water supply and for licensees to increase their market share.

New duties for Ofwat and water supply resilience

At present Ofwat’s primary duties are to protect the interests of consumers (wherever appropriate by promoting competition) and to ensure that water companies properly carry out and can finance their functions.

The Act introduces new duties for Ofwat firstly to secure that undertakers do not show undue preference or discrimination in dealing with other undertakers and licensees and secondly to ‘further the resilience objective’. The resilience objective stresses the need for resilience of supply in the face of environmental pressures and increased population growth, and includes active engagement with undertakers in respect of long-term planning, investment, and the taking of measures to manage water resources sustainably and efficiently.

The concept of resilience is in keeping with the overall message of the White Paper, though it remains to be seen what changes this new duty will make to Ofwat’s approach to regulation. The other new duty is perhaps less ambiguous and really serves to set out what would otherwise be an unspoken assumption in the government’s aims for liberalisation of the water industry. The resilience duty comes into effect, in relation to England only, from 14 July 2014.

It may be worth noting, in the context of resilience, that the Act also gives the secretary of state the power to give directions to a water undertaker about the basis on which its water resources management plan is to be prepared (but only with a view to securing the ability of the undertaker to meet the need for supply of water to consumers) and these directions can require the plan to be based on specific assumptions around resilience and security of supplies in drought. The Act also introduces regulation-making powers in respect of the frequency with which such plans are to be prepared. These provisions come into force on 14 July 2014.

WATER RESOURCES

The White Paper put a heavy emphasis on the need to secure water resources in the face of anticipated pressures on supply, but, other than the codification of the resilience objective (as explained above), there is little manifestation of this in the Act.

There are provisions in respect of water abstraction. Most substantively regulation-making powers to be implemented in respect of environmental permitting (see below) encompass water abstraction and impoundment activities. In addition, and at a late stage in passage of the legislation, the House of Lords introduced an amendment requiring the secretary of state to report to Parliament on the progress of arrangements for water abstraction reform within five years of royal assent to the Act. This comes into force on 14 July 2014.

In addition, as part of a governmental trend against compensation for licence modifications made on environmental grounds, the Act withdraws the right of compensation for water and sewerage undertakers when water abstraction or impoundment licences are revoked or varied – a provision which comes into force on 14 July 2014.

Further developments in water abstraction reform

A government consultation on abstraction reform closed in March this year. The consultation proposes reforms that: link access to water to availability (thereby increasing the amount of water for use); encourage efficient management of water and effective water trading by abstractors; ensure a more effective process for review of abstraction licences; and incentivise abstractors to manage risks from growing pressure on water resources.

Defra has indicated its intention to legislate for abstraction reform early in the next parliament, and a precursor to wider reform can perhaps be seen in the Act's water licensing provisions that facilitate supply of surplus water into the network.

Current holders of abstraction licences should be aware of the removal of compensation provisions, especially with regard to any proposed changes to the abstraction regime as a result of future reforms.

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ENVIRONMENTAL REGULATION

The key environmental provisions in the Act relate to the inclusion of various licenses and consents in the environmental permitting (EP) regime. The EP regime has provided operators with a single point of permitting for a number of activities, including waste management licensing, water discharge consents and groundwater authorisations.

The Act gives powers to the secretary of state and Welsh ministers to extend the EP regime to include water abstraction and impounding licences, flood defence consents and fish pass approvals. If such regulations are enacted, these will be incorporated with any other permissions given under a single environmental permit.

The development of the EP regime represents an ongoing effort to simplify and consolidate a number of disparate, broadly environmental, consents into one overarching system. As with other provisions of the Act, the manner of implementation depends on the form of any final regulations (and the power to make these regulations is effective from 14 July 2014). In principle there are advantages, especially for companies or individuals who require a variety of licences or consents under the EP regime as well as one or more of those set out above, both in terms of the application process and the framework for compliance.

FLOOD INSURANCE

The Act allows a flood reinsurance scheme to be established to provide reinsurance to relevant insurers for identified flood risks in order to improve availability and affordability of flood insurance for households. Other provisions of the Act create regulation-making powers in respect of the provision of insurance cover against flood risks. This does not apply to commercial premises but only to household properties subject to high flood risk. This

is controversial and may see commercial premises at risk of flooding being unable to obtain insurance against flooding events.

CONCLUSIONS

The success of the Act will be judged by industry's response to its provisions for market liberalisation and the uptake of the new opportunities on offer. There have been positive early noises, for instance from the industry body Water UK, and the potential is there for a more competitive market, especially if a large number of commercial water consumers take advantage of the opportunity to revise their current supply arrangements. The government has indicated its intention to introduce a start date of 2017 for retail competition with the opening up of the upstream market following later (and not before 2019).

In other areas the provisions of the Act are not quite so extensive, though it remains to be seen how the concept of resilience comes to affect the approach of Ofwat (in particular how the new primary duties interact with the regulator's existing statutory responsibilities) and the nature of government intervention in the preparation of water management plans.

As noted above, there is an ongoing governmental consultation on water abstraction reform and this may pick up on several of the areas raised in the White Paper but not addressed in the Act. We await the outcome of this consultation and details on any resulting legislative plans: to say that the long process of reform of the water industry is over may be premature.

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