

Northumbrian Water Limited

Licence Condition 'R' & 'R3'

Compliance Code

This code applies to the Appointed Northumbrian Water Limited business.

It does not apply to the Northumbrian Water Group Retail WSSL business (Wave Utilities – formerly NWG Business), which has its own licence

Version 11.0

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1. Introduction

We are required by Condition 'R' Para 7(4)(a) of our Instrument of Appointment (Operating Licence) to publish a compliance code that governs our dealings with licensed water suppliers (licensees). This document must comply with the requirements of Ofwat's "Guidance on compliance codes".

Because New Appointments and Variations (NAVs) raise many similar concerns to licensed water supplies under with respect to appropriate behaviour in relation to competitors, we have decided that this Compliance Code should also cover our dealings with potential and actual NAV appointees¹.

This Compliance Code seeks to ensure that Northumbrian Water complies with its legal and regulatory obligations in relation to competition matters. It is important to ensure that not only that we do not engage in practices or behaviours that have as their aim the restriction or obstruction of competition but also that this is not the unintended effect of any practice or behaviour.

Any failure to comply with the terms of Condition 'R' or other relevant competition law has potentially serious consequences, both for Northumbrian Water and, in some circumstances, for the individuals involved.

This Compliance Code must therefore be followed at all times by all staff either directly or indirectly involved in these matters. Any failure by employees to adhere to the provisions of this Compliance Code will be investigated under Northumbrian Water's disciplinary procedures.

Condition 'R3' of our Instrument of Appointment also places certain obligations on us in respect of the Governance and operation of the Market Arrangements Code (MAC) for the Non-household Water Retail Market. For clarity our approach to dealing with these obligations is outlined in this Compliance Code.

2. Background – The development of competition in the water industry

This section is intended to provide a context for the Compliance Code, rather than a comprehensive description of the current and prospective arrangements for competition in the water and sewerage industries.

Currently, there are two main means by which end customers may receive their water and/or sewerage services from providers other than the incumbent supplier:

1. Supplies under the Water Supply Licensing (WSSL) regime;
2. NAV appointments.

The WSSL non household retail market opened in April 2017. There are also proposals by Ofwat to develop upstream (Wholesale) competition. This code will be updated to reflect such changes when they are implemented.

2.1 WSSL regime

The Water Act 2014 allows companies licensed by Ofwat ("Licensees") to supply water to individual non-household sites. A licensee may either provide retail services only, obtaining the water to supply the customer from the incumbent on a wholesale basis or it may, *additionally*, input its own water to the incumbent's supply system to be conveyed to its customer's site. For the latter, the licensee will need a "combined" licence, rather than a retail-only one.

This Compliance Code will be revised as appropriate when any changes to the current regime are implemented. In 2014, Northumbrian Water Group created a retail licensee, NWG Business which has a WSSL retail licence in England. NWG Business merged in 2018 with Anglian Water Business to form a Joint Venture Company (Wave Utilities) owned by Northumbrian Water Group and Anglian

Water Services.

Wave Utilities is a separate business from Northumbrian Water Limited (NWL). It must be treated in the same way as any external WSSL licensee by the NWL regulated business. It must receive the same service and information as any other WSSL licensee, with no preferential treatment.

2.2 NAV appointments

A NAV appointment allows, under certain circumstances, an alternative provider of water and/or sewerage services to serve an area that was previously considered part of the supply area of an existing water only or water and sewerage company.

In order to qualify for consideration by Ofwat for a NAV appointment, the proposed area must satisfy at least one of the following criteria:

1. The proposed supply relates to a single non-household site that uses or is likely to use at least 50 megalitres¹ of water per year – the large user criterion;
2. There are (or will be on the date the site transfers to the new appointee) no existing connections to the incumbent's systems for the relevant (water and/or sewerage) service(s) – the “unserved” criterion;
3. The incumbent agrees to the site being acquired by the proposed NAV appointee – the consent criterion.

It is likely that, as with WSSL, the NAV appointee will obtain its water as a bulk supply from the incumbent. However, in contrast, it should be noted that NAV appointments also allow for the provision of sewerage services and involve redefining the water and/or sewerage supply area(s) of the incumbent to exclude the area in question, with the new supplier assuming all the responsibilities of a water and/or sewerage undertaker.

As with NAV appointments for large users, new suppliers to housing developments are likely to require a bulk supply of water from the incumbent and also bulk discharge arrangements for sewerage (possibly after some pre-treatment). This means that there will be an on-going relationship between the incumbent and NAV appointee beyond the initial transfer arrangements.

3. Relevant legislation and licence conditions

3.1 Competition Act 1998

The Competition Act prohibits the following anti-competitive behaviour:

- An agreement (or other action) by undertakings which has as its object or effect the prevention, restriction or distortion of competition;
- Any conduct which amounts to an abuse of a dominant position.

Northumbrian Water Limited is likely to be dominant in many aspects of water supply within its supply areas and may also be dominant in some aspects of the sewerage market. For a number of service elements, Northumbrian Water Limited currently holds a monopoly, so it must take special care not to abuse its dominant position.

3.2 Water Act 2003

While the Competition Act sets general prohibitions on anti-competitive behaviour and does not relate specifically to the water industry, the Water Supply Licensing regime, introduced by the Water

¹ Currently this threshold remains at 50 megalitres per year

Act 2003, is specific. To facilitate the implementation of the regime, Ofwat added Conditions 'R' and 'S' to water companies' Instruments of Appointment (a.k.a. operating licences).

3.3 Condition 'R'

The main requirements of Condition 'R' are that:

- All negotiations with, and any information received from or about, Licensed Water Suppliers must be kept strictly confidential;
- We must put in place measures to protect commercially sensitive information received from or in relation to Licensed Water Suppliers, so that we do not obtain an unfair commercial advantage;
- Northumbrian Water must ensure that any transactions between Northumbrian Water Limited and any associate company that is itself a Licensed Water Supplier are at arm's length; (at present, NWG Business is such a Licensed Water Supplier).
- We must provide clear information to staff on their individual obligations;
- We must carry out our functions under the WSSL regime fairly and not show undue preference or discrimination between licensees or their customers and our own customers;
- We must have a Compliance Code (this document).

4. Scope of the Compliance Code

The competition legislation and/or the relevant conditions of our Instrument of Appointment are particularly relevant when dealing with Licensed Water Suppliers or potential NAV appointees. We use the term "competitive bids" in this document to cover dealings with both Licensed Water Suppliers and potential NAV appointees and to distinguish between provisions that apply to both from those that apply only to one or the other.

5. Disciplinary procedures for breaches of this Compliance Code

Any breach of this Compliance Code could put Northumbrian Water at risk of being in breach of the Competition Act 1998, the Water Industry Act 1991 and/or its Instrument of Appointment (Operating Licence). Ofwat can impose financial penalties for such breaches of up to 10% of group turnover for a period of up to 3 years.

In addition, for certain offences under the Competition Act, individual employees may be personally liable and, if found guilty, could be fined or, in extreme cases, sentenced to a term of imprisonment.

In the light of the above, any breach of this Compliance Code, unless trivial or immaterial, will be investigated under Northumbrian Water's disciplinary procedures. A serious breach could be regarded as gross misconduct and lead to the dismissal of those involved.

It is therefore important that employees comply with this Compliance Code at all times and that they understand what is required of them. Any questions should be raised initially with your line manager. Any queries that cannot be answered by your line manager should be referred to Economic Regulation.

Monitoring the effectiveness of the code will be carried out annually on a risk based basis.

6. Training & Processes

Training on the requirements of this Compliance Code will be provided to those employees in roles or functional areas where there is a risk of non-compliance.

Specific training will be required for all staff identified in Section 8 – Wholesale, New Development, Legal and Economic Regulation staff. There will also be awareness sessions covering the principles of this code run for the wider set of staff.

NWL has a dedicated Wholesale Compliance Officer to undertake regular reviews and audits to ensure that the principles of the market codes which are also embedded into NWL corporate systems are productive to ensuring compliance with our obligations. Compliance advice is available to all staff via the Compliance Officer.

Systems and Business Processes are designed and built to ensure no undue preference can be applied to any one Party. All service levels applied are agnostic to the specific party involved. Staff throughout the business are encouraged and supported to report, at the earliest opportunity any concerns and an appropriate investigation will ensue.

7. General requirements in relation to information

This section establishes general principles in relation to information and its handling, while section 8 details the more specific requirements of individuals likely to become involved in competition matters.

First, Northumbrian Water must ensure that information received from either licensees or potential NAV appointees is used only for its intended purpose and not to gain any unfair commercial advantage over its competitors. Information must therefore be protected from misuse either within the company or unauthorised disclosure to third parties.

Second, we should only request so much information as is reasonably required in order to respond to any competitive bid.

Third, Northumbrian Water must provide such information as is reasonably required to licensees or potential NAV appointees in order that they may progress competitive bids.

In particular, Condition 'R' provides that undertakers must provide licensees with information reasonably required to:

- Enable them to apply for, negotiate and conclude an access agreement under section 66D WIA91;
- Comply with any condition of their water supply licences or any statutory requirement imposed in consequence of those licences;
- Comply with any reasonable request for information from the Environment Agency.

Condition 'R' also similarly provides that an undertaker can only request such information of a licensee as is reasonably required:

- To carry out its functions;
- To ascertain whether the licensee has sufficient product liability insurance;
- To comply with any condition of its appointment;
- In relation to national security or civil emergencies;
- To comply with any reasonable request for information from the Environment Agency.

The above principles underlie many of the provisions relating the responsibilities and required behaviours specified in the following section.

8. Requirements of this Compliance Code in relation to wholesale or combined supplies under WSSL and NAV appointments

A new domestic or mixed domestic/non-domestic development is currently only eligible – provided it satisfies the relevant criteria – under the NAV appointment arrangements. A non-domestic development, provided it is likely to meet the consumption threshold and other relevant criteria, may *additionally* qualify to be supplied under the WSSL regime – though currently for water only. Thus, New Development personnel may be involved in dealing with sites that are potential candidates for either NAV appointments or supplies under WSSL.

Equally, retailers may be involved with non-domestic sites that transfer to another supplier under either the WSSL regime or NAV appointment provisions.

An appropriate Wholesale manager will typically be the lead contact for both NAV appointments and supplies under WSSL and other members of the Economic Regulation team may also be involved.

Furthermore, where NAV appointments or WSSL supplies are supported, respectively, by bulk or wholesale supplies from Northumbrian Water, there will be an ongoing relationship with the NAV appointee or licensee, including the monthly billing of charges.

From the above, it follows that similar issues regarding appropriate behaviour are likely to arise in the case of both NAV appointments and supplies under WSSL that there will be a considerable overlap in terms of the employees likely to become involved in either situation.

8.1 Roles and responsibilities prior to a business customer switch under the WSSL regime or the granting of a NAV appointment

Wholesale Manager

An appropriate Wholesale Manager must:

- Act as the single point of contact for all enquiries from either licensed water suppliers or potential NAV appointees. This should be primarily through dedicated, confidential email accounts such as wholesale@nwl.co.uk.
- In the case of competitive bids relating to new developments, facilitate the response to enquiries and ensure all parties for a development receive equivalent information, based on their specific requirements and following standard design principles;
- Ensure that not more information is sought from the licensee or potential NAV appointee than is reasonably required by NWL:
 - To carry out its functions;
 - To ascertain whether the licensee has sufficient product and public liability insurance;
 - To comply with any condition of NWL's Instrument of Appointment;
 - In relation to national security or civil emergencies;
 - To comply with any reasonable request for information from a relevant regulator.
- Manage all external and internal enquiries in respect of the WSSL or NAV appointments regimes;
- Manage, log and provide responses to all correspondence with licensees and actual or potential NAV appointees;
- Seek advice and support in respect of supplies under the WSSL or NAV appointment regimes from other teams as necessary but, in the case of WSSL supplies, must not contact retail staff for advice or support regarding specific sites that are the subject of an application in other than exceptional circumstances and when the information cannot be obtained from any other source or the licensee has agreed;

- Check that all information is complete and identify any further information requirements as necessary;
- Must not pass confidential information to any WSSL Licensee or New Development (other than the person or persons therein appointed to deal with the competitive bid);
- In the case of new developments, provide advice and support to the appointed person or persons in New Development dealing the provision of asset information in connection with a competitive bid;
- Advise on regulatory issues as appropriate to facilitate normal dealings and responses to competitive bids;
- If necessary, investigate the source of the information should a retail staff member inform him that they have become aware of a competitive bid from any person other than the customer concerned;
- Calculate access prices or bulk supply prices as required;
- Advise on tariff and income issues, as appropriate; and
- Deal with all correspondence from Ofwat.

Legal Affairs

Legal Affairs must:

- Draft any contract with the licensed water supplier or proposed NAV appointee;
- Manage any correspondence of a legal nature;
- Advise on legal issues, as appropriate, to facilitate both normal dealings and responses to competitive bids.
- Not use their knowledge with the developer or customer to influence the competitive bid in respect of that same site, developer or customer;
- Make a written record if any information comes into their possession regarding a competitive bid and then inform the appropriate Wholesale manager immediately, ensuring not to advise anyone else.

8.2 Roles and responsibilities following a business customer switch under the WSSL regime or the granting of a NAV appointment

NWL will cease to have direct contact with the occupiers of premises that are either supplied by licensees under WSSL or by NAV appointees, except for:

- In the case of WSSL supplies, water fittings regulations (NWL remains the enforcement body). This will not apply in the case of NAV appointments.
- Taking readings from meters and loggers, inspecting, testing and replacing meters and associated apparatus, as required.

Wholesale

An appropriate Wholesale Manager must:

- Manage the contract with the licensed water supplier or NAV appointee, involving others, including New Development, Production, Customer Services, Asset Strategy, Economic Regulation and Legal Affairs, as necessary both when the contract is due for renewal and otherwise.

- Deal with the licensed water supplier or NAV appointee on any matters relating to water supply to the premises or NAV area, as the case may be;
- Act fairly in all its dealings with the licensed water supplier or NAV appointee, showing no undue preference or discrimination as compared to NWL's own customers;
- Collect all monies due in respect of any bulk supplies to or bulk discharges from the premises or NAV area, as the case may be.
- In the case of WSSL supplies only, contact the occupier of the premises directly only in exceptional circumstances:
 - In the event of an incident;
 - If asked to do so by the occupier or potential occupier of the premises, to discuss continuation of supplies following the termination of its arrangements with the licensed water supplier.

In the case of NAV appointments only:

Operations

Operations must:

- Ensure that the required connections at the boundary of the NAV area are made and maintained and that any bulk supply or cross-border discharge is in place;
- Once any bulk supply or cross-border discharge is in place, monitor actual flows against contractual and MDD flows, raising queries and requesting advice from Asset Management, Economic Regulation, Legal Affairs and others, as necessary;
- Manage the bulk supply and, as the case may be, bulk discharge arrangements.

9. Condition R3 MAC Condition

NWL confirms that is a signatory to the Market Framework Agreement and confirms its commitment to comply with the Market Arrangements Code. (MAC). NWL is an active participant in all aspects of the governance and operation of the Market. Specific responsibilities in respect of the requirements of this Condition 'R3' are detailed below;

Head of Wholesale Services

- Will ensure that NWL are appropriately engaged within the governance framework of the market.
- Will ensure that NWL provide support and comment to the Market Panel and Market Operator in respect of modifications and maintenance of the MAC.
- Will ensure that all required staff are provided with "release" letters to ensure independence of action when required within the MAC.

Wholesale Compliance Officer

- Track proposed amendments to the MAC and ensure that NWL appropriately evaluate and comment on change proposals in line with the principle of the MAC and Condition R3.
- Provide support and advice on all compliance matters

10. Changes to this Compliance Code

This Compliance Code will be revised as and when necessary, for example, to reflect any changes to the required behaviours, procedures and responsibilities described herein or to take account of any changes to the existing framework for competition within the water and sewerage industries. It will, in any case, be reviewed at least annually.