



Interim supply code workshop 5 August 2015

Ofwat held an industry workshop on 5 August 2015 to discuss the Interim Supply Code (ISC) and related arrangements. A range of representatives from water and sewerage companies and water supply licensees attended. Ofgem outlined how interim supply arrangements were organised in the energy sector.

The workshop's objective was to discuss the purpose of the ISC, outline Ofwat's developing thinking on key policy areas, and provide an opportunity for industry to ask questions and provide feedback. Ofwat confirmed that the proposals set out at the workshop were not final and that the discussion would inform the scope of the forthcoming consultation on interim supply, which is expected to be published in September 2015.

Session 1 - Introduction and legal framework

- In the introductory session, Ofwat set out how the interim supply arrangements set out in the Water Act 2014 could address situations where licensees ceased to supply premises. They are most relevant when supply ceases in a disorderly manner. Through the ISC, Ofwat aims to achieve continuity of supply, whilst ensuring an appropriate level of consumer protection.

Ofwat noted that the legal requirement for Ofwat to establish an ISC arises from the 1991 Water Industry Act, once amended by the Water Industry Act 2014. Ofwat proposed that changes to the ISC will be consulted upon, but are not expected to be subject to CMA appeal. The application of the ISC to eligible non household customers in England and Wales in both Exited and non-Exited areas was explained.

- Ofwat set out how the ISC sits within the wider legal and regulatory framework for the new retail non-household market arrangements in the sector, and how the ISC interacts with a range of industry codes, regulations, industry appointments and licences.

Session 2 – Deemed contracts

- Ofwat explained how deemed contracts are proposed to exist in certain situations where no formal terms and conditions have been agreed between a supplier and a customer before the supply of services commences, including interim supply. They are a well-established principle in other sectors, such as electricity and gas, and offer a backstop form of consumer protection.
- Ofwat distinguished how deemed contracts are expected to be used in a range of certain situations in the new non-household retail market in England and Wales;
 - ranging from an initial agreed Exit from the retail market by an Undertaker:
 - as a default basis for interim supply (terms required by the Water Act 2014 for interim supply to be published in the wider market on an ongoing basis by all undertakers and licensees and updated from time to time); and
 - deemed contracts where terms and conditions suitable to a particular cessation of supply event could be directed following a particular allocation process.
- Ofwat set out some of the issues for consideration with deemed contracts, including whether there should be a range of general types dependent upon the situation and consistency with price controls.
- Ofwat explained that it intends to hold a workshop in September and publish a consultation in October on the broader topic of deemed contracts and consumer protection to develop these wider issues.
- There was industry discussion around the use of the term “deemed contracts” and how it can be misleading as deemed contracts have different forms and are used in different circumstances. Several participants expressed support for a better term to distinguish the various forms of deemed contract described during the session.

Session 3 - Supplier of last resort arrangements in the energy industry

- Ofgem provided an outline of supplier of last resort (SoLR) arrangements in the electricity and gas markets. The process has only been used on very limited occasions and not since 2008. Ofgem focused its presentation on the insolvency

of a small/medium supplier, briefly discussing how since 2013 it can apply to the courts for special powers when there is a failure of a large supplier.

- In the case of a failure of a small/medium supplier, Ofgem has sought to appoint an Interim supplier as a matter of urgency, and ideally within 2 days. Ofgem explained how the costs incurred between the point of insolvency and the appointment of the interim supplier are effectively socialised to other customers that are not supplied by the failing supplier across the industry, which encourages Ofgem to appoint a new supplier as quickly as possible. Historically, it has been the larger national suppliers who have participated in the process, and Ofgem has only had to consider price offers by these participants when choosing the successful supplier.

Session 4 – Supporting obligations and trigger events

- Ofwat set out how existing proposals for retail market opening, including the Wholesale Retail Code (WRC), licence obligations to maintain Certificates of Adequacy (CoA) and the statutory requirement for schemes of terms and conditions for interim supply, are expected to cover most of the supporting obligations in relation to interim supply. The requirement to check completeness and alignment of those other instruments with the ISC was noted.
- The potential for new industry-wide obligations further to support interim supply arrangements was discussed, in particular the obligation to use all “reasonable steps” to ensure continuity of supply, and for the out-going licensee to supply relevant data to Ofwat before Ofwat decides on the need to use the ISC and the expectation that, with limited exceptions, licensees should be opted-in to be an interim supplier
- The range of circumstances covered by the ISC was discussed. Ofwat set out how the ISC was not intended to cover events such as a disconnection of a customer for non-payment or debt. Ofwat set out its current thinking that the interim supply arrangements would be kicked-off when it determines that a trade sale of some or all of a licensee’s customers is unlikely to occur in an orderly manner, and issues a notice for the revocation of the supplier’s licence. Ofwat discussed the timescales for appointing an interim supplier, and how it intended to complete the process within 30 days (the proposed notice period for revocation under the draft standard licence conditions of the WSSL) but ideally more expediently than this backstop.
- In the breakout session, industry was asked for its views on the type of information that should be provided to support identifying potential interim supply

events, and whether the proposed trigger event was appropriate. Views were also sought on the rights and obligations of parties to avoid disorderly exit and use of the ISC, provide data, and to opt in to the panel of eligible interim suppliers. Industry was asked to express any issues or concerns in respect of deemed contracts in the context of interim supply.

- The industry feedback at the end of the breakout session, and at the Q&A slots at the end of each presentation, generally focused on the trigger event and the urgency of appointing the interim supplier(s). Several industry participants commented that the issuing of a notice of revocation could make the situation worse by effectively making a subsequent trade sale impossible to achieve. The conflicting incentives on parties to encourage or avoid an interim supply trigger event was highlighted, and the interactions with the credit provisions of the WRC were noted. In the context of multiple separate bilateral wholesale contracts and national retail licensing, there was discussion of a wider scope of potential qualifying circumstances than just licensed companies' declaration of insolvency.
- Several industry participants expressed support for a quick interim supply allocation process, to reduce the impact on customers and market participants. Questions were also raised about how wholesalers could recover the bad debt of the failing supplier, and concerns were raised about the respective credit exposures that the interim supplier and affected wholesalers would be obliged to take on.
- There was some support for the panel of eligible suppliers to be kept quite wide, whilst at the same time applying a **de minimis** threshold such that smaller participants are not obliged to join the panel and recognising that not all suppliers may have wholesale contracts with all undertakers. Further details of Ofwat's proposals for this **de minimis** threshold were sought by industry.

Session 5 – What happens when an interim supply event occurs

- Ofwat set out a range of possible processes which could be followed once an interim supply event occurs.
- Regardless of the allocation process, Ofwat (or potentially the MO if required) would provide information on the affected customers to all potential interim suppliers. Each potential supplier would then be obliged to confirm / update their CoA, in relation to their ability to supply the affected customers of the failing supplier or opt-out of that particular process. Ofwat discussed how it was considering giving suppliers the right to restrict the scope of their updated CoA /

their participation in the specific ISC allocation processes (for example, by region or customer class).

- Though each eligible licensee would have published the terms and conditions of their respective deemed contracts before an interim supply event occurred, Ofwat discussed allowing potential eligible suppliers to vary these terms and conditions on a case by case basis, to better reflect the specific risks and opportunities associated with supplying the particular customers of the relevant failing supplier.
- Ofwat explained the backstop administered allocation process, as set out in MAP3. In non-exit areas, undertakers have a duty to continue to supply customers unless Ofwat directs one or more licensees to do so, whilst in an exit region, Ofwat is obliged to direct a one or more eligible licensees to supply with the current proposal in the draft exit regulations being for Defra to require at least one acquiring licensee to be 'opted-in' to be an interim supplier.
- Ofwat explained how a market-based mechanism could provide an alternative to the administered allocation mechanism, and though it is not Ofwat's preference at this stage, it would be exploring the implications of this option in greater detail at the workshop and the subsequent consultation, in response to industry feedback from the earlier licensing consultation.
- Ofwat set out how the greater the flexibility given to different licensees to participate in the allocation process, the more complex any administered or market based allocation process could then become.
- Whilst there was support for a quick appointment process, there was also a desire to allow a reasonably wide range of parties to participate.
- There was a range of industry views on the flexibility to be given to potential participants in a market-based allocation process when submitting terms and conditions for interim supply – some participants supported flexibility in the non-price terms and conditions being offered, whilst others favoured standard sets of non-price terms and conditions to allow a more transparent allocation decision based upon price.
- There was a range of industry views as to the appropriateness of including a market based allocation mechanism for interim supply customers from the outset of further opening of the non-household retail market in England in April 2017. Some participants thought a simple administrative process would be the most suitable at the outset, whilst there was also some support for Ofwat considering the merits of a market-based mechanism on a case by case basis from the

outset. A few industry participants commented on whether Undertakers should participate in the market-based mechanism, with one attendee of the view that it was inappropriate for undertakers to be able to undercut their own published tariffs, while there was also some support for undertaker participation in market-based allocation mechanisms in non-exited areas.

- It was recognised that using a single term “auction” to describe different potential market based allocation mechanisms may be misleading: Ofwat clarified that no such payments from participating suppliers were expected in the ISC process, and that bidders would instead be competing on providing the best terms and conditions for interim supply to customers, having already demonstrated they were qualified to do so through their updated CoA.

Session 6 – Wrap Up and Next Steps

- Ofwat concluded the workshop by outlining its proposed next steps. The proposed consultation will be published in September, and a further industry workshop may then be required to debate the detailed proposals it contained. When consultation responses had been considered and a full draft of the ISC and supporting guidance had been produced, the ISC would then be reviewed by the Interim Code Panel for consistency with the industry codes (and supporting licences). Consumer protection work will progress in parallel.



Retail Market Opening

Interim Supply

5 August 2015

Purpose and objectives

- Describe potential overall Interim Supply (“Supplier of Last Resort”) arrangements
- Set out emerging thinking on scope and nature of the Interim Supply Code (ISC)
- Learnings from other markets
- Highlight interactions with related policy areas
- Stakeholder input to inform scope of forthcoming consultation Interim Supply
- Set out next steps

Proposals presented today are not final and are for discussion to inform Ofwat policy

Policy aims for Interim Supply arrangements

- Address situation where Licensee ceases to supply customers in a “disorderly exit” scenario
- Ensure continuity of customers’ retail services
- Pre-empt disorderly exit as far as possible
- Deliver best Interim Supply price and service offer for affected customers
- Appropriate customer protection
- Appropriate allocation of commercial risk

Morning session

- Purpose, application and governance of ISC
- Wider legal and regulatory context
- SOLR arrangements in energy industry
- Deemed contracts
- Proposed measures to limit or control disorderly exit and support interim supply arrangements
- Trigger events
- Breakout session

Afternoon session

- Process once Interim Supply arrangements triggered
- Range of possible allocation mechanisms
- Breakout session



Overall legal framework for Interim Supply

1991 Act will provide that:

- If water/sewerage supply licensee ceases to supply any premises (where customer has not notified undertaker of alternative arrangements or that it no longer requires supply) then:
 - Undertaker for the area must continue supply; or
 - Ofwat may direct an eligible licensee to provide the service instead
- An eligible licensee is one that has elected to be eligible under the Interim Supply Code

Under the Act Ofwat must issue and maintain a code, which may make provision about:

- Electing to be an eligible Licensee
- Temporarily suspending that election
- Circumstances in which Ofwat's power to direct a retailer to take customer may be exercised
- Determining date on which previous retailer ceased to supply
- Terms and conditions for the supply to the customer to be contained in Eligible Licensee's schemes
- Retailers notifying customers of terms and conditions
- Ofwat giving directions to ensure compliance with code

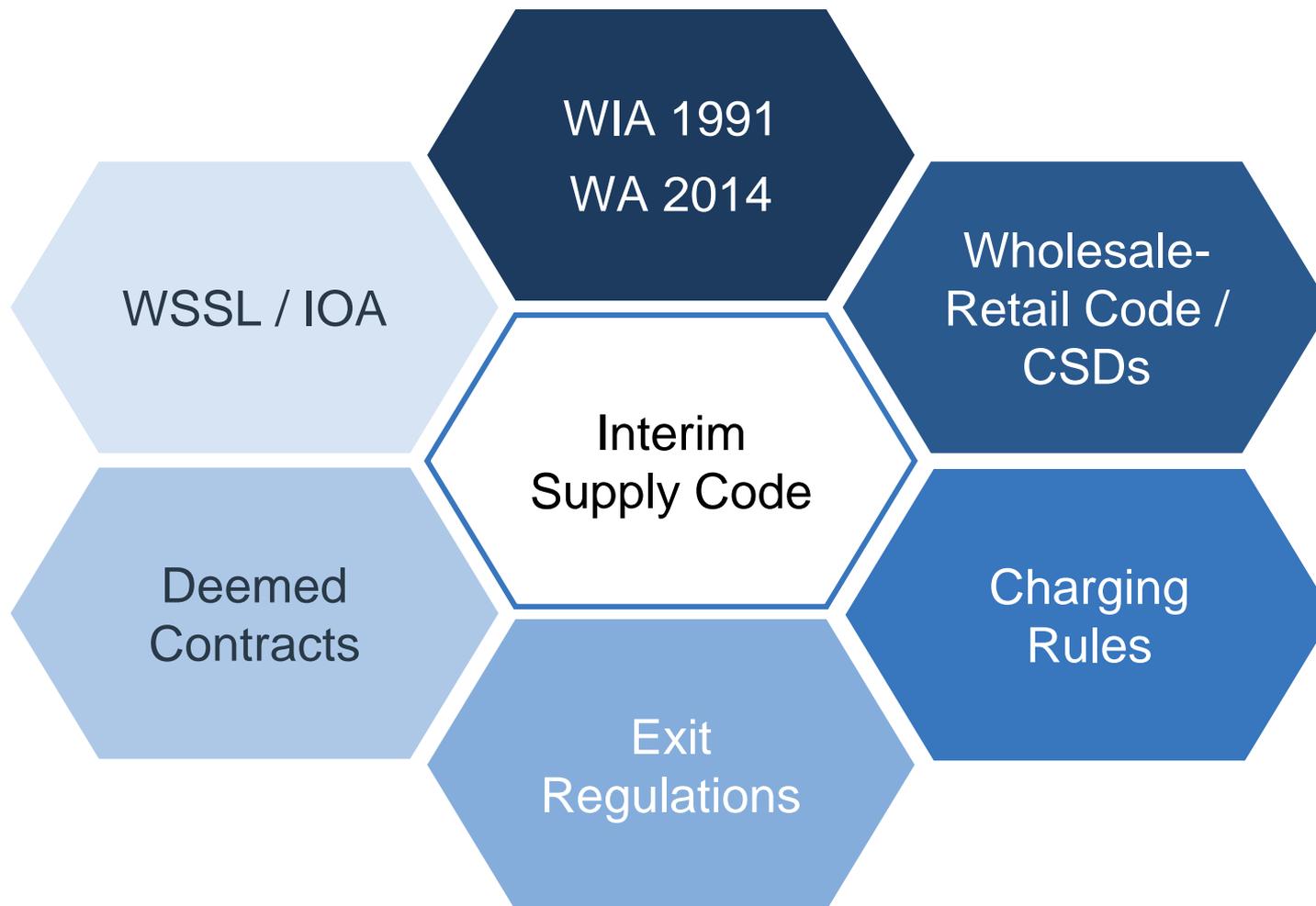
Application

- Eligible NHH Customers of WSSLs in England and Wales
- All WSSLs (potentially subject to de-minimis)
- Exit and non-exit areas
- Shall not apply in respect of non-exited Undertaker's customers (as appointment conditions and special admin apply)
- In time for market opening (April 2017)

Governance

- Establish and modify ISC following consultation, in line with Ofwat's statutory functions and duties
- Changes will be consulted upon, but not expected to be subject to CMA appeal
- Ofwat expect to provide clarifying guidance to accompany ISC

ISC – wider legal/regulatory framework





SOLR arrangements in energy industry

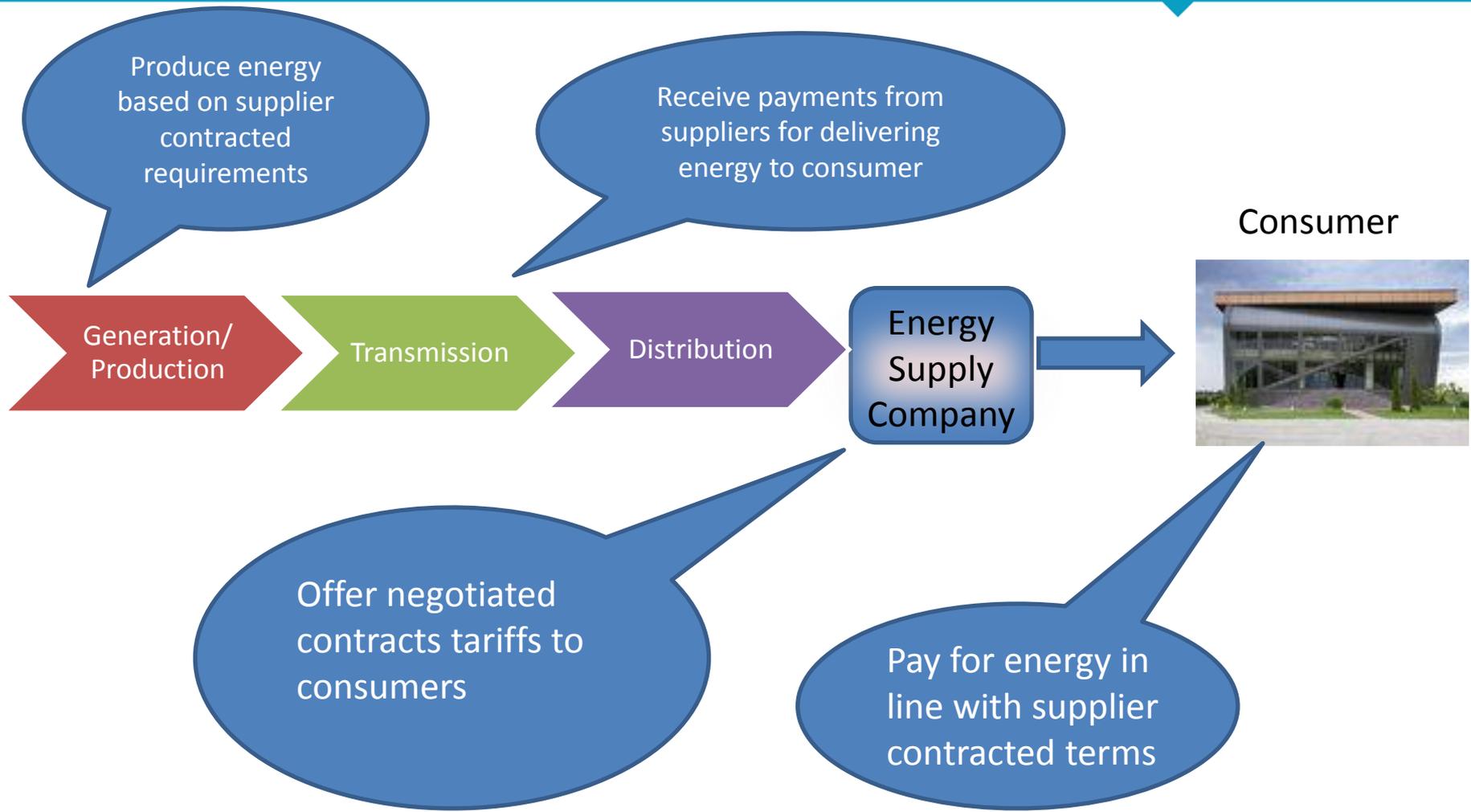
Ofgem Management of Supplier Failure

OFWAT

Jenny Boothe
5 August 2015

ofgem

Non-domestic Energy Market Structure



What is insolvency?

The inability to meet their financial liabilities.

What is the impact on consumers?

Nil – They remain on supply.

What is the impact on other industry participants?

Network companies will not received payment for their services but they are entitled to be paid.....

All other suppliers will pick up unpaid costs.



An urgency to resolve the situation

Ofgem Toolkit:

- 1) Supplier of last resort direction licence condition (SoLR)
- 2) Energy supply company special administration regime (ESC SAR)

SoLR

- Process run wholly by Ofgem with a view to be completed within 48 hours (ideally)
- The failed supplier licence is revoked as a preventative measure.
- Failed supplier portfolio information is gathered.
- Information is gathered from active suppliers to test their interest in the customers of the failed supplier and their willingness to take the customers at a reasonable cost.
- Assessment is made on the responses and a supplier would be chosen or directed to take on the customers if necessary.

ESC SAR

- A regime designed for a larger failing supplier
- Ofgem and DECC apply to the courts for an order that allows an administrator to enable the company to continue to supply its consumers.
- Treasury may be required to provide additional funding.

Ofgem is the Office of Gas and Electricity Markets.

Our priority is to protect and to make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes.

We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.

Interim Supply Components

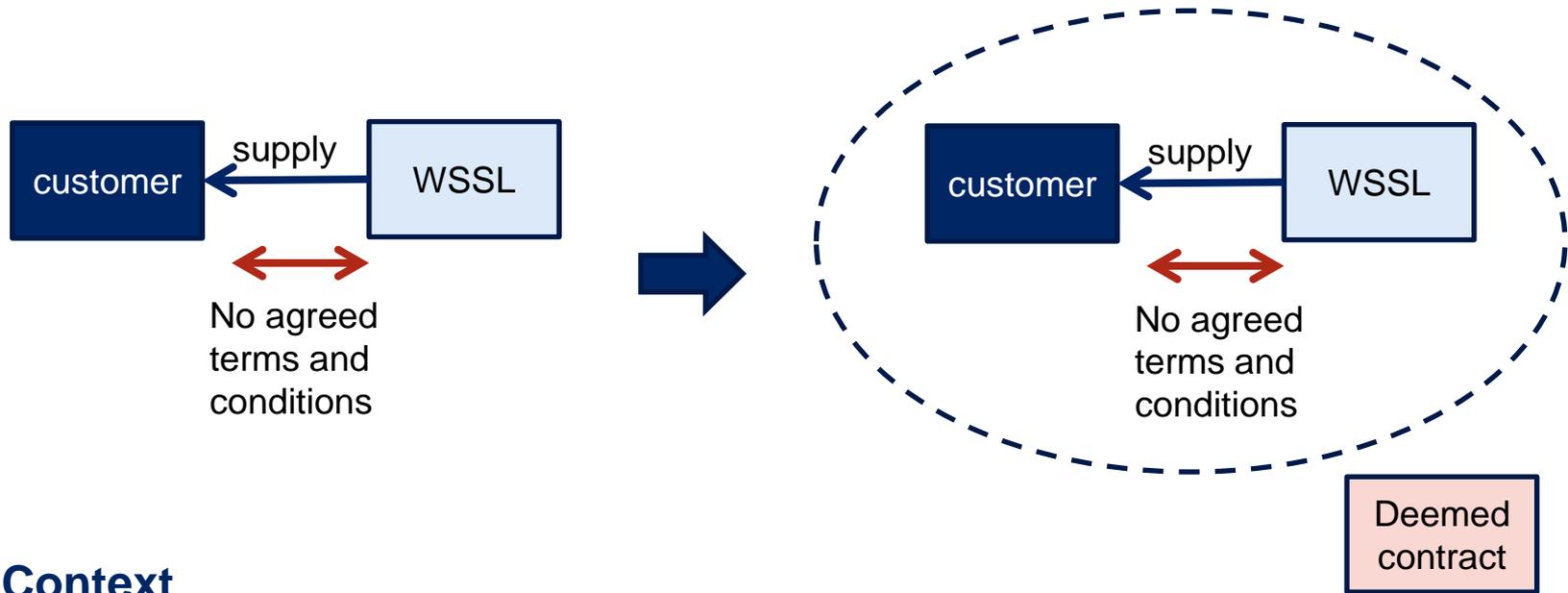
The Interim Supply arrangements will comprise a number of key components:

1	Measures to limit / pre-empt SOLR events
2	Trigger event
4	Provision of notice and information
2	Establishing participation (prequalification and opt-out)
5	Allocation mechanism
6	T&Cs to apply to interim supply
7	Implementation of allocation



Deemed Contracts

Deemed Contracts



Context

- Water Act 2014 provides for deemed contracts in 2 contexts:
 - Retail exit
 - Interim Supply (SoLR)
- Well established principle in other sectors, e.g. gas and electricity
- Scotland's default tariffs perform a similar role
- Offers a backstop form of customer protection

Deemed Contracts: Principles

One of Ofwat's main duties is to protect the interests of consumers, wherever appropriate by promoting effective competition.

Minimum degree of backstop protection

Provide certainty for customers (and suppliers)

Terms and conditions for deemed contracts should be published

Customers should be able to freely access alternative supplier or contract of choice

Customers should be encouraged to engage with the market

When will deemed contracts potentially be used?

Situation	Area where undertaker has exited	Non-exit area
SoLR	✓	✓
SoFR	✓	✗
Gap sites	✓	✗
Customers continue to receive supply but contract expired or terminated	✓	✗
Unoccupied premises which continue to receive supply	✓	✗
Any other situations where supply but no contract	✓	✗

Deemed Contracts: some issues for consideration

Price terms

Non-price terms

Different terms for different situations?

Consistency with price controls

Different approach for different size customers?

We plan to explore these issues in more detail over the next few months:

- Workshop (Sept – date tbc)
- Consultation (Oct – subject to outcome from workshop)



Supporting Obligations and Trigger Events

Potential Supporting Obligations

Existing proposals likely to cover most of the supporting obligations (but may need to check complete and aligned with ISC)

- Wholesale-Retail Code (inc. Interim Supplier Allocation process)
- Certificate of Adequacy
- Maintain published schemes for interim supply
- Monitoring and reporting

Potential new obligations to support Interim Supply arrangements

- Opted-in for Interim Supply (with opt-out right)
- Orderly exit - Obligation to use all “reasonable steps” to ensure continuity of supply on the same or similar terms to those provided by the licensee before seeking restriction or revocation of license
- Outgoing WSSL (including any administrator), undertakers and MO obliged to supply relevant data to Ofwat (by customer type, contract type and region)

Expect above to sit within WSSL, market codes and ISC as appropriate

Proposed Trigger for Interim Supply process

- Ofwat determines that: Retailer expected to lose licence to supply its customers before alternative contractual supply arrangements agreed – i.e. “disorderly exit” from market; and Trade sale(s) unlikely to occur in a way that would safeguard affected customers’ interests
- Any direction will be made with effect from the date of cessation of supply, as determined under the ISC
- Cessation of supply for these purposes shall exclude cessation where not a result of a “disorderly” scenario (e.g. disconnection for debt)



Breakout Session on Obligations and Trigger Events

Issue

1. Do you have views on the type of information that should be provided to support monitoring for the purposes of identifying potential Interim Supply events?

2. Do you have any views on the proposed new obligations to support Interim Supply arrangements:

- Opt-in (with opt-out right)
- Reasonable steps to achieve orderly exit
- Provision of data

2. Is the proposed “trigger” for the Interim Supply process appropriate?

- Retailer expected to lose licence to supply its customers before alternative contractual supply arrangements agreed – i.e. “disorderly exit” from market; and
- Trade sale(s) unlikely to occur in a way that would safeguard affected customers’ interest

3. Do you have any issues or concerns in respect of Deemed Contracts in the context of Interim Supply?



Lunch



What happens when an Interim Supply trigger event occurs

Regardless of allocation approach, Ofwat (or potentially MO if required) provides information to all potential interim suppliers:

- Data collected in via process discussed in a.m.
- Data provided on affected customers and their characteristics:
 - Region
 - Wholesale charge class
 - Contractual status (deemed, or actual with outgoing WSSL, SAR)
- Aggregation to protect customers and business confidentiality
- If market-based allocation, may also need average bill/customer/class (from published ISC T&Cs)
- Timescales for specific process: typically within Ofwat standard 30-day licence revocation notice period

Issue for consideration: which data do potential suppliers need?

What Retail T&Cs will already be published?

Non-exited regions

Cond B caps

Undertaker ISC scheme (WA14)

Other undertaker schemes (rules)

Undertaker SAR

WSSL ISC schemes

Exited regions

Margin safeguards
TBA

Default WSSL ISC scheme

WSSL exit deemed contracts

Other WSSL ISC schemes

Commercial T&Cs (standard wholesale charges)

Commercial T&Cs (SAR wholesale charges)

Exiting WSSL may have unpublished national T&Cs

Pre-qualification: response to Ofwat

- Regardless of allocation mechanism, WSSLs need to confirm (or if needed update) CoA:
 - Ability to supply potential new customers under deemed contracts
 - Ability to discharge ongoing obligations
- Information in Notice on potential interim supply terms: WSSLs could respond by:
 1. Temporarily opting out completely
 2. Confirming capability unconditionally
 3. Qualifying scope in updated CoA (e.g. by region/customer classes/numbers)
- More pre-qualified WSSLs if some form of 3.
- But more conditions mean potential allocation complication and judgement to protect all customers (e.g. if combinatorial bidding)

Issue for consideration: should partial opt-outs be permitted (e.g. by region and/or class of customer)?

In Licensing consultation we asked if should include market-based mechanism:

- Most said *potentially* – but some said maybe not straight away
- General acceptance that administered backstop **also** needed (per MAP3)

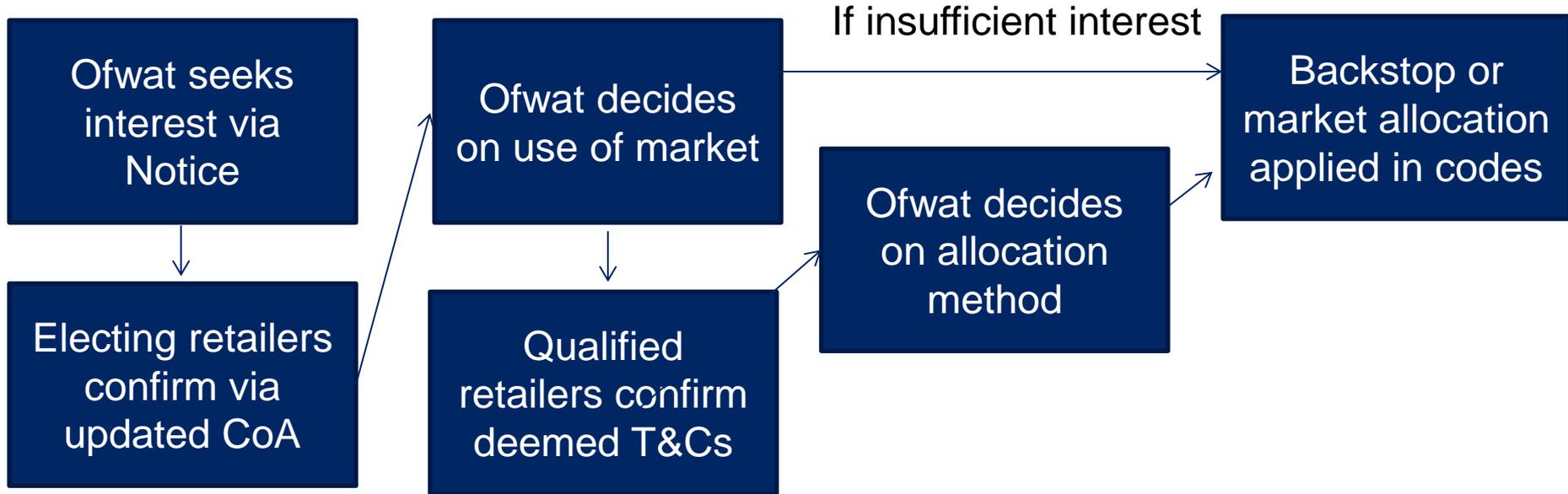
So basic choices are:

1. Market-based **option** available from April 2017
 2. Market-based option only available in later version of ISC
 3. Use administered backstop as **only** option indefinitely
- Respondents wanted more detail on 1. to assess if proportionate
 - So more focus on option 1 today **but not an Ofwat preference at this stage**

Issue for consideration: if the ISC is only a backstop for supply continuity, is there benefit in agreeing any market solution early or deferring?

Conditional Market Mechanism

- Ofwat would assess market-based allocation **on case by case basis**



- Ofwat would decide if in customers' interests to use a market mechanism with ISC criteria
- Can apply criteria on regionally: e.g.
 - Proportion of ISC customers on exit deemed contracts per region
 - Number of qualified [retailers/WSSs] per region and/or
 - Number of qualified WSSs nationally

Given undertakers' specific SoLR duties in WA14 should they be excluded from market-based allocation processes?

Per MAP3 (drawing on Scottish arrangements):

- In non-exit region Undertaker has a duty to supply all or some customers (per SoFR)
- In exit region, Ofwat can direct WSSLs to supply:
 - Could be 100% to designated WSSL subject to exit regulations (per SoFR)
 - Can be allocated to multiple pre-qualified WSSLs per CSD0004
- Only Undertakers and pre-qualified WSSLs considered – having exercised statutory rights to refuse to supply

T&Cs under backstop administered process

- If only Undertaker allocated customers (via deemed contracts), could use:
 - Undertaker's own existing S143 ISC scheme; **OR**
 - Modify e.g. to align to exiting WSSL's ISC terms and conditions..Ofwat could potentially determine exact basis in customers' interest
- If only default WSSL is allocated customers (via ISC deemed contracts), could use its own published ISC T&Cs for these
- If multiple prequalified WSSLs allocated customers randomly, can use
 - Each WSSL's own published ISC T&Cs; **OR**
 - Direct a given set of T&Cs to be used (to avoid postcode lottery for customers).

Confirming proposed T&Cs in Notice might help simple, fair and orderly administrative process: how much pre-specification?

Should any non-price bids be included?

- Included by Ofgem but not used to allocate in practice to date
- Complex judgments given dependency on multiple wholesale T&Cs?

Issue for consideration: should we restrict to price-only bids (at least initially)?

If pre-set non-price, T&Cs used for price bids could be based on:

- Default WSSL T&Cs; or
- Each WSSL's own published ISC T&Cs

Issue for consideration: can customer benefit be easily safeguarded by comparing different pre-published T&Cs?

Regional pre-qualification means regional bids

But very simple price bids still possible (e.g. % variation on default published scheme)

Should separate prices be bid for:

- Each pre-qualified customer type (aligned to wholesale charges)
- Each service (water and wastewater)?

Issue for consideration: is there benefit in simple robust bids, given variety of potential circumstances?

Ofwat would decide on basis of allocation:

- In line with any bids solicited; or
- Via multiple supplier backstop; or
- To directed single suppliers; or
- To Undertaker (where not directed to WSSLs).

All processes can address consultation concerns:

1. Avoid cherry-picking customers
2. Facilitate entrant participation where effective

MO could implement notified basis of allocation

Interim suppliers then would have obligations to notify interim customers:

- Advise change of supplier w.e.f. deemed contract start date
- Opt-out rights of customers (from deemed contract T&Cs)
- Minimum duration of deemed contract supply obligations
 - 3 months for Undertakers in WA14
 - Ofwat can direct for WSSLs



Breakout Session on Allocation Mechanisms

Questions for break-out discussion

Issue

Which data should Ofwat provide to facilitate effective allocation

Should partial opt-out e.g. by region and/or class be enabled?

Should the market allocation option be included in April 2017 ISC?

Should undertakers be excluded from market process?

Should Ofwat pre-specify non-price T&Cs before allocation?

Should market bids be for all-in-area or some **customer class** opt-out be allowed in any bidding?



Wrap-Up and Next steps

Next steps

- Consultation in September on Interim Supply policy issues
- Consider potential consequential impacts:
 - WSSL / IOA enabling conditions
 - Review in light of final Exit Regulations
- Development and consultation on ISC legal text
- ISC will be reviewed by the Interim Code Panel for consistency with MAP
- Further industry workshop may be required to review detailed proposals
- Consumer Protection work will progress in parallel

Feedback

We want to ensure these workshops (and wider engagement) is effective and meets your needs

Please complete and hand back the feedback forms on your tables