

# **Interim supply arrangements: policy conclusions and consultation on draft Interim Supply Code**

## About this document

The UK Government is committed to opening a retail market that will provide choice to eligible non-household customers in England and Wales from April 2017.

This document focuses on our proposals for the introduction of arrangements to address the situation where, in certain circumstances, a water or sewerage supply licensee ceases to supply its customers in the new market, for example as a result of insolvency. These are referred to as the “interim supply arrangements”. These arrangements will ensure continuity of affected customers’ retail services and appropriate protections for customers and other market participants in such an event.

This document summarises the responses to our [November 2015 consultation](#) on these matters and sets out the decisions that we have reached in view of those responses and our policy aims.

This document also describes and seeks views on the draft text of the Interim Supply Code (ISC) which we have published alongside this document. The ISC is a statutory code which will make provision about a number of aspects of how the interim supply arrangements will operate.

This document and the draft ISC should be read in conjunction with the following related documents:

- the relevant provisions of the Water Act 2014, which will amend the Water Industry Act 1991 to establish the overall legal framework for the interim supply arrangements;
- the Wholesale-Retail Code (WRC) and subsidiary documents published by [Open Water](#), as there are many important interactions between the proposed interim supply arrangements, the draft ISC and the proposed terms and processes set out in the WRC; and
- our [November 2015 consultation](#) document, which included detailed descriptions of the regulatory and policy context for the interim supply arrangements and the overall legal framework for interim supply which, for brevity, are not repeated in this conclusions document.

Retail services include activities such as billing and customer services and at the moment, only a limited number of non-household customers across England and Wales can choose their retailer. Most customers must use services provided by their local monopoly water only or water and wastewater companies. The Water Act 2014

will allow eligible non-household customers to choose their supplier of water and wastewater retail services from April 2017. For customers who use the supply system of an appointed company whose area is wholly or mainly in England, the market will be extended to include all non-household customers. For those who use the supply system of an appointed company whose area is wholly or mainly in Wales, the market will not be extended, reflecting the different policy position of the Welsh Government. More information on which customers are eligible is available in [our eligibility guidance](#).

The new market is expected to deliver [about £200 million of overall benefits to customers and the UK economy](#) and research shows that [seven out of ten non-household customers want this choice](#).

Customers will be able to shop around and switch to the best deal. Investors and retailers will have new opportunities for growth. And the [environment will benefit from customers using new water efficiency services](#). Customers are already benefiting from [a similar market in Scotland](#).

Opening the new market is a complex challenge but it is [on track to open in April 2017](#). The design is almost complete, and work is now being carried out to deliver the technical systems, checks and ways of working that are needed to get the market right for customers.

The interim supply arrangements described in this document and the draft ISC form part of a suite customer protection arrangements that will be necessary to ensure that the new retail market operates effectively and in the best interests of customers.

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## Responding to this consultation

We welcome your comments on the draft Interim Supply Code by Friday 4 March 2016.

Please submit email responses to [retailmarketopening@ofwat.gsi.gov.uk](mailto:retailmarketopening@ofwat.gsi.gov.uk), with the subject “**Interim Supply Code Consultation**” or post them to:

Interim Supply Code Consultation  
Retail Market Opening Programme  
Ofwat  
21 Bloomsbury Street  
London  
WC1B 3HF

We will publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## 1. Executive Summary

The Water Industry Act 1991 (WIA91), once amended by the Water Act 2014 (WA14), will establish the overall legal framework for the interim supply arrangements, and provide a number of powers and duties for Ofwat. These include an obligation to establish an Interim Supply Code (“ISC”) which may make provision about a number of aspects of how the interim supply arrangements will be implemented in practice.

Our [November 2015 consultation](#) on the interim supply arrangements described how Ofwat intends to exercise these powers and duties, in order to inform the development of the ISC and related amendments to other legal instruments (such as the Wholesale-Retail Code). We received twenty-two (22) responses to the November consultation.

Section 2 describes our policy objectives for the new retail market, and the process we have followed to reach our interim supply policy conclusions on the basis of those objectives.

Sections 3 to 8 of this document summarise the responses to the November consultation, and set out our policy conclusions on the key issues upon which we consulted. Table 1 below provides a high-level summary of those conclusions.

A number of these policy decisions provide the basis for the draft ISC which we have published alongside this document. Section 9 of this document provides an overview of the ISC and invites comments on the draft text of the code.

Annex 1 lists all of the consultation questions that were included in the November 2015 consultation document. It also signposts the sections of this document in which information about the related stakeholder responses and Ofwat conclusions can be found.

**Table 1: Summary of policy conclusions**

<b>Issue</b>	<b>Proposed approach</b>	<b>Further information</b>
Whether it should be voluntary or mandatory to elect to be an eligible licensee (“opt-in”)	A licensee which is not already obliged to opt-in to the interim supply arrangements (e.g. as a result of being an acquiring licensee in an exit area) shall be free to choose whether they wish to opt-in, and the areas in respect of which they wish to do so. Accordingly we have decided not to introduce any form of mandatory opt-in or market-share threshold test at this stage. We will monitor this matter after market opening and, if we have significant concerns about the sustainability of the pool of interim suppliers, we may reconsider this issue.	Sections 3.1 and 3.2
Opt-in process and timing	To avoid creation of duplicate opt-in processes, a retailer shall be able to opt-in via the processes administered by the Market Operator under the Wholesale-Retail Code in order to be considered as an eligible licensee for the purposes of the interim supply arrangements as a whole. A licensee shall be entitled to exercise its voluntary opt-in right at any time, including e.g. on licence application or at any time when the licensee considers itself sufficiently established to provide an interim supply capability.	Section 3.3
Interim supply trigger events	<p>Licence revocation shall be considered to be a relevant cessation of supply for the purposes of the interim supply arrangements.</p> <p>In order to ensure that customers and other industry participants are appropriately protected once the interim supply arrangements have been invoked, we have also decided to shorten the licence revocation timetable to provide for revocation of a WSSL licence with not less than 24 hours’ notice as a precautionary measure where there has been an insolvency event.</p> <p>Wholesale Contract termination shall be considered to be a relevant cessation of supply for the purposes of the interim supply arrangements, and that the ISC should allow for the reallocation of affected customers in only a single affected area where appropriate.</p> <p>We have also decided that the WRC should be amended to require a wholesaler to gain the prior approval of Ofwat before a Wholesale Contract can be terminated.</p>	Sections 4.1 and 4.2

Issue	Proposed approach	Further information
Provision of information about affected customers	Ofwat will always provide (or procure the provision of) basic aggregated information on the affected customer base, and will also have the flexibility to make additional disaggregated information available where we consider this to be expedient and practicable in view of the specific circumstances of the interim supply event. At a minimum, potential interim suppliers will need to know how many customers would need to be supplied on interim supply schemes of terms and conditions in each region. However, we expect that more granular information on affected customers could be useful, as long as it could be rapidly and robustly generated, including from information within the Market Operator's systems.	Section 5.1
Establishing the base of affected customers	We have decided not to progress a proposal to fix the base of affected customers/premises to be allocated by rejecting any new application to transfer any of the failing retailer's supply points from the date of Ofwat giving notice of the interim supply event. We consider that the potential negative impact on those customers who wished to exercise immediate choice to move to another retailer upon learning that their current retailer is failing is likely to outweigh any potential benefit to the interim supply allocation process.	Section 5.2
Opt-out by wholesaler area and/or service category and/or customer class	We have decided that eligible licensees will generally be permitted to opt-out by area and/or service category. However, it should be noted that there will be some conditions placed on this, as explained below. We have decided not to enable eligible licensees to opt-out on any more granular basis, such as by customer class, as this would increase potential for complexity, delay, and reduced interim supply options for some classes of customer.	Section 6.1
Unlimited opt-out right vs. potential restriction on opt-out	An opted-in licensee will be allowed to opt-out on a case-by-case basis. However, in doing so, the licensee shall be required to explain its opt-out decision with reference to a "Statement of Interim Supply Capacity" which the ISC will require it to provide to Ofwat from time to time (e.g. upon opting-in or upon a material change in circumstances affecting the licensee's capacity to take on additional customers). In order to opt-out down to within the level of its stated capacity, an eligible licensee shall be able to exercise its rights to opt-out in any combination of area and service category.	Section 6.2
Restrictions on opt-out by an acquiring licensee	An acquiring licensee shall not be entitled to opt-out from any obligation to be a backstop interim supplier in a relevant exit area. However, we will keep this matter under review after market opening. This approach will mean that the acquiring licensee shall always be available as the default interim supplier in an exit area, ensuring equivalent protection to customers in an exit area as there would have been had the relevant undertaker not exited.	Section 6.3

Issue	Proposed approach	Further information
Introduction of a market-based allocation mechanism	We have decided that a simple form of market-based allocation mechanism should be introduced for market opening in April 2017, and the draft ISC has been developed on this basis. We consider that a simple form of market-based allocation (as described below) has the potential to deliver better outcomes for customers, is deliverable for market opening and can be designed so as not to introduce significant additional complexity or time into the overall interim supply process.	Section 7.1
Operation of a market-based allocation mechanism	We will assess the need for any market-based allocation process on a case-by-case basis using objective criteria. We intend (in the first instance at least) to seek simple price-only offers where we choose to use market-based allocation, with the non-price terms and conditions remaining as per the eligible licensee's pre-published scheme for interim supply. We have also decided that, initially at least, undertakers shall not be permitted to participate in any market-based allocation process.	Section 7.2
Date of allocation (backdating)	We have concluded that an interim licensee shall be required to continue the supply to a customer with effect from the original date of the relevant cessation of supply by the failing retailer. This is appropriate as it provides for wholesalers and customers each to have continuity of retailer, such that there will be no interruption of valid contracts in place throughout the allocation period. This should ensure the credit risks faced by parties, including wholesalers, remains within the envelope of risks which will already be provided for through the normal regulated industry credit arrangements.	Section 8.1
Terms and conditions under administered allocation mechanisms	The draft ISC requires that an eligible licensee must ensure that its relevant scheme for interim supply complies with a number of principles and requirements, including: <ul style="list-style-type: none"> <li>• that no undue preference is shown to and that there is no undue preference against any affected customers compared with the eligible licensee's other customers;</li> <li>• that the Scheme must be consistent with the eligible licensee's obligations under the 1991 Act and its licence (this will, for example, ensure consistency with any customer code of practice which may be brought into force); and</li> <li>• that there shall be no restriction on an affected customer's ability to switch to another retailer, or to other terms and conditions offered by the eligible licensee.</li> </ul>	Section 8.2
Power to direct eligible licensee's terms and conditions for interim supply	We have decided not to include a power in the ISC to direct all relevant retailers to use comparable terms and conditions for interim supply in each region if the differences in their individual schemes were otherwise likely to risk significant customer prejudice (i.e. "postcode lotteries"), at least initially. We shall keep this matter under review as the market develops.	Section 8.3

Issue	Proposed approach	Further information
Potential new charging rule for Undertakers	We have not concluded on this matter at this stage. The detail of any specific charging rules to support the ISC will need to be consulted on when we have decided upon the basic allocation processes governed by the code. We would expect to complete the statutory consultation for additional rules in good time to enable these to be in place to support the ISC from April 2017.	Section 8.4
Duration of deemed contract for interim supply	We have decided that an interim licensee shall not be entitled to vary or terminate the terms and conditions of its scheme for interim supply as it applies to an affected customer without the consent of that affected customer for a period of three months commencing from the date from which the interim licensee was required to continue the supply.	Section 8.5
Provision of information to affected customers	The draft ISC shall include an obligation on an interim licensee to write to each affected customer allocated to it within five (5) business days in order to provide certain specified information.	Section 8.6
Outstanding service requests	We consider that it will be important to develop an approach to manage outstanding service requests following an interim supplier allocation which balances the interests of customers, wholesalers and retailers. This is a matter for the Wholesale-Retail Code, as this sets out the operational processes and service standards associated with service requests. We will therefore work with the industry, MOSL and the Interim Codes Panel to review this matter further.	Section 8.7

## 2. Our approach and next steps

This section describes the overall approach by which we have developed our interim supply policy proposals and conclusions, and the next steps to implement that policy prior to market opening.

### 2.1 Ofwat policy objectives

In designing the regulatory arrangements for the new retail market Ofwat is required to act in accordance with the guidance it receives from the UK and Welsh Governments, but must always act in accordance with its statutory duties. Based on those statutory duties and the guidance we receive from the UK and Welsh Governments, we have developed the following four key objectives for all of our regulatory work in relation to the opening of the new retail market.

1. The new market arrangements must **promote effective competition** by:
  - not creating unnecessary or avoidable barriers to entry or expansion;
  - not creating any undue discrimination between market participants;
  - ensuring, as far as possible, that there is a level playing field between incumbents and new entrants;
  - encouraging eligible, non-household customers to engage with the market arrangements and support the highest levels of rivalry; and
  - supporting a seamless experience for eligible, non-household customers across England, Scotland and (where applicable) Wales.
2. The new market arrangements will **continue to protect eligible, non-household customers where things go wrong** by providing:
  - proportionate mechanisms that protect customers in the event that they are harmed through their experience of the market arrangements.
3. The new market arrangements must continue to **ensure that wholesalers remain financeable and are able to carry out their functions** by:
  - not constraining the ability of wholesalers to meet their legal obligations; and
  - allowing an efficient wholesaler to finance their functions.
4. The market arrangements must be **efficient and proportionate**. This means they must:

- be designed in a way that is economic and efficient; and
- be proportionate, including for small market participants.

## 2.2 Our policy development approach

In reaching the policy conclusions set out in this document, we have:

- assessed our proposals against a clear and defined set of policy objectives, to ensure an appropriate balance between these;
- fully reflected the relevant provisions within current and future legislation; and
- carefully considered the interaction of these proposals with related policy areas and instruments, including Ofwat's proposals in relation to licensing, broader customer protection measures and charging rules, as well as the draft market codes.

Our proposals have also been significantly informed by our stakeholder engagement on these matters during 2015, including the November consultation and an industry workshop on the interim supply arrangements, as well as prior consultations on the licensing arrangements for the new market.

As well as seeking to reflect the views of industry stakeholders, we have also developed the proposals set out in this document in consultation and co-operation with Defra and MOSL to help ensure consistency across what is an unavoidably complex set of interactions between primary and secondary legislation, licensing arrangements, Ofwat's statutory duties and the new market architecture, commercial arrangements, systems and processes. The new retail market sits within a revised [legal framework](#) comprising Water Act 2014 (WA14) and consequent amendments to the Water Industry Act 1991 (WIA91); together with secondary legislation including retail exit regulations being developed by Defra as well as the Wholesale Retail Code and Market Arrangements Code developed through the Open Water Programme and the Interim Supply Code and Retail Exit Code required under the WA14. As such, it has been important to ensure that the decisions we make are consistent with this framework.

## 2.3 Next Steps

We are now consulting on the draft text of the ISC. Following the conclusion of this consultation we will update the ISC as necessary and re-publish the code by the end of March 2016. This will allow potential WSSL licence applicants to be sighted on the

interim supply arrangements ahead of the licence application process opening in April 2016.

Some of the decisions set out in this document will require further consideration or action, such as to progress consequential amendments to the Wholesale-Retail Code. We will work with the industry to progress these changes, including with MOSL and the Interim Codes Panel.

A number of our decisions are also contingent on the final form of the regulations that will allow undertakers voluntarily to exit the non-household retail market (the “[Exit Regulations](#)”), on which we expect Defra to conclude shortly. This is particularly the case where we have assumed that these regulations will oblige an “acquiring licensee” to be a backstop interim supplier in a particular area following the exit of the relevant undertaker in that area. If necessary we will review the draft ISC further following Defra’s conclusions.

### **3. Electing to be an eligible licensee (“opt-in”)**

The WIA91 will provide that an “eligible licensee” for the purposes of participation in the interim supply arrangements is a licensee with a retail authorisation or a restricted retail authorisation who has elected to be an eligible licensee in accordance with the Interim Supply Code.

In an area where the undertaker has not exited the non-household retail market pursuant to the Exit Regulations, the undertaker in that area will always be obliged to be the interim supplier in the event that there is a cessation of supply unless and until such time as Ofwat directs a WSSL licensee, who is an eligible licensee, to continue the supply instead. In relation to an exit area, the draft Exit Regulations propose that at least one acquiring licensee must elect to be an eligible licensee for the purposes of interim supply (with the exception of self-supply licensees) and that the Authority must direct an interim supplier.

In the November consultation, we therefore sought views on whether it should be optional or mandatory for other WSSL Licensees to make themselves available to be directed by Ofwat to take on affected customers in the event of another retailer ceasing to supply those customers (i.e. to “opt-in”). We also sought views on the process for electing to be an eligible licensee for these purposes.

#### **3.1 Voluntary opt-in**

Under this option, a WSSL licensee that is not already obliged to opt-in to the interim supply arrangements as a result of being an acquiring licensee in an exit area, shall be free to choose whether they wish to opt-in, and the areas in respect of which they wish to do so.

##### **3.1.1 Stakeholder views on this issue**

There was a range of views among respondents to this question.

Around half of the responses supported voluntary opt-in on the basis that retailers will have different market focus and business strategies (including regional strategies) and should therefore be free to choose whether to participate in interim supply, and in which areas. Among these responses it was acknowledged that it was still important to ensure that there was always at least one backstop interim supplier to protect customers. However, it was also suggested that volunteer interim

suppliers would be more likely to provide better service to affected customers than those forced to do so by regulation.

A number of responses considered that there should be some level of compulsion to opt-in, in order to mitigate the risk of there being a very limited pool of potential interim suppliers in some areas. For example, one respondent was concerned that customers could be exposed if the circumstances of a sole backstop interim supplier (acquiring licensee) in an exit area changed, such that it no longer had sufficient capacity to accept new customers (or may even be subject to a disorderly exit itself).

There was strong support among respondents for opt-in (whether voluntary or mandated) to take place on an area-by-area basis. Arguments for this included that the framework for operating in the retail market has been set up on a regional basis and the option of regional opt-in is likely to encourage a greater degree of participation among retailers in any given area.

### **3.1.2 Ofwat conclusions and next steps**

On balance, we have decided to implement this option initially from market-opening, such that it shall be voluntary for licensees (which are not acquiring licensees) to opt-in as an eligible licensee for interim supply.

Given that some retailers may choose to operate in some areas of the country and not others, we have also decided that voluntary opt-in shall be permitted on an area-by-area basis and shall not be required on a national basis.

We consider that these decisions are appropriate as it is our expectation that there will always be an alternative retailer in every region (either the incumbent undertaker or an acquiring licensee) so there is no overriding need to mandate additional retailers at this stage to protect customers. We also note that affected customers will always have the option to seek out the best deal from an alternative retailer and to switch without any barrier or delay. Voluntary opt-in has the advantage of affording WSSL licensees choice. We consider that there is likely to be a commercial incentive for retailers voluntarily to participate, as an interim supply allocation could represent an efficient means of customer acquisition in certain circumstances.

However, we recognise the risk that this purely voluntary approach may not guarantee that customers will always benefit from having access to a number of potential interim suppliers. We will monitor this risk after market opening and, if we have significant concerns about sustainability of the pool of interim suppliers in any area, we may reconsider this issue.

## **3.2 Potential mandatory opt-in obligation**

We sought views on whether, as an alternative to the voluntary opt-in option considered above, there should be a de-minimis regional market share threshold above which WSSL licensees would be obliged to opt-in for the purposes of the interim supply arrangements. We also invited views on the appropriate level of any such threshold.

### **3.2.1 Stakeholder views on this issue**

As noted above, there was some support among respondents for mandatory participation with a threshold test, on the basis that customers could benefit from a larger number of potential interim suppliers and there would be reduced reliance on a single backstop retailer.

There was a range of suggestions as to the level at which any such threshold could be set. For example, one suggested that the largest retailer in any area should always be obliged to opt-in, while a number of respondents suggested a threshold of around 10-20% of market share in any region, based on wholesale charges or total number of customers or supply points supplied.

Respondents also highlighted the potential challenge of establishing an appropriate threshold, given that the size of a market may vary significantly by wholesale area and the threshold would have to be set or adjusted to ensure that each retailer so mandated could reasonably be expected to have the ongoing capability to supply affected customers.

### **3.2.2 Ofwat conclusions and next steps**

As explained above, we have decided to progress the voluntary opt-in approach. Accordingly we have decided not to introduce any form of mandatory opt-in or threshold test at this stage.

In addition to the reasons for this decision set out above, we also have particular concerns that such a form of mandatory participation could potentially increase barriers to market entry for smaller retailers (as it would require increased capacity, financing of credit cover, etc.) and so could negatively impact on the development of competition in the new retail market.

We also consider a threshold test could bring additional complexity and cost that is not demonstrably proportionate at this stage, including the need continually to define, monitor and enforce any applicable opt-in threshold(s).

### **3.3 Opt-in process and timing**

We proposed that the Interim Supply Code should enable a retailer to opt-in via the processes for licensees to opt-in to the Interim Supplier Allocation Process administered by the Market Operator under the Wholesale-Retail Code, in order to be considered as an eligible licensee for the purposes of the interim supply arrangements as a whole.

#### **3.3.1 Stakeholder views on this issue**

Respondents supported the proposal for a single opt-in process and therefore a single list of opted-in retailers being held by the Market Operator.

Some respondents suggested some limitation on the timing and duration of opt-in rights. For example one respondent suggested a one month “lead time” from a licensee electing to opt-in before their status changed in order to avoid speculative opt-in where a licensee suspects an interim supply event is imminent. Some respondents also suggested that opt-in should be an annual process. Others suggested that changes to opt-in status should be permitted at any time.

#### **3.3.2 Ofwat conclusions and next steps**

We have decided to progress opt-in via the Wholesale-Retail Code (WRC), as this has the advantage of avoiding the creation of duplicate opt-in processes. The draft ISC has been developed on this basis. We will also work with MOSL to ensure that the relevant WRC processes as drafted are fully fit for this purpose.

Under our favoured voluntary opt-in option, a licensee shall be entitled to exercise its voluntary opt-in right at any time, including e.g. on licence application or at any time when the licensee considers itself sufficiently established to provide an interim supply capability. However, a licensee will need to be opted-in prior to Ofwat giving notice of an interim supply event in order to receive that notice and be considered as an eligible licensee in respect of that particular event. The draft ISC has been developed on this basis.

## **4. Interim supply trigger events**

The November consultation sought views on the circumstances in which Ofwat should consider the exercise of its power to direct an eligible licensee to continue the supply of affected customers following a retailer failure. The ISC will define the circumstances that will be considered to be a “relevant cessation of supply” for these purposes.

We consider that the interim supply arrangements should only be invoked in extreme circumstances, when a significant number of customers risk losing continuity of retail services without realistic prospect of this being secured in some other way. The cessation of supply trigger for invoking these arrangements and directing an alternative retailer must therefore be defined in a way that achieves this aim.

We therefore proposed that there should be two such circumstances – licence revocation and termination of a Wholesale Contract. We also invited views on a number of issues related to the use of these circumstances as trigger events.

### **4.1 Licence revocation as a relevant cessation of supply**

We sought views on whether the interim supply arrangements should be invoked by Ofwat either giving notice to revoke a licence either in the case of insolvency, or in the case of a serious breach of a licence enforcement order.

We also invited views on whether Ofwat should be able to revoke a licence with not less than 24 hours’ notice in certain circumstances.

Additionally we asked whether stakeholders agreed that a licensee should be prohibited from registering any additional premises where Ofwat intends to revoke its licence.

#### **4.1.1 Stakeholder views on this issue**

There was strong support among respondents for licence revocation being a relevant cessation of supply event for the purposes of the ISC.

There was also strong support for shortening the licence revocation timetable to allow Ofwat to revoke a WSSL licence with not less than 24 hours’ notice. It was recognised that it is important for Ofwat to have the capacity to act swiftly to ensure

continuity of service to customers and limit the exposure of other market participants. However, a number of respondents commented that the circumstances in which a short revocation timetable should be invoked should be defined and limited (e.g. to instances of insolvency only).

All respondents which commented on the matters also concurred that a failing licensee should be prohibited from registering any additional premises once the interim supply processes are commenced, in order to prevent the situation from worsening.

#### **4.1.2 Ofwat conclusions and next steps**

We have decided that licence revocation should be considered to be a relevant cessation of supply for the purposes of the interim supply arrangements and the draft ISC has been developed on this basis. For efficiency, we have also drafted the ISC in such a way as to allow preparations for Ofwat to make an interim supply direction to commence immediately once we have given notice to revoke a licence, albeit the actual cessation of supply shall not occur until the licence is actually revoked (from a future date specified in the revocation notice).

In order to ensure that customers and other industry participants are appropriately protected once the interim supply arrangements have been invoked, we have decided to shorten the licence revocation timetable to provide for revocation of a WSSL licence with not less than 24 hours' notice as a precautionary measure where there has been an insolvency event. This could, for example, prevent an insolvency practitioner being able to continue to supply water or provide sewerage services without agreeing to pay the associated wholesale charges. This proposed provision was included in the [Defra consultation on the draft WSSL standard conditions](#) published in December 2015.

We also agree with respondents that a failing retailer should be prevented from registering additional customer premises once the interim supply arrangements have been invoked. We will work with MOSL to ensure that the registration processes in the Wholesale-Retail Code reflect this requirement.

## **4.2 Termination of Wholesale Contract as a relevant cessation of supply**

We sought views on the proposal that the interim supply arrangements should be invoked upon a Wholesale Contract being terminated in accordance with the provisions of the Wholesale-Retail Code.

We also invited views on a proposal that the current Wholesale Contract termination provisions in the WRC should be amended to require a wholesaler to gain the prior approval of Ofwat before a Wholesale Contract can be terminated.

### **4.2.1 Stakeholder views on this issue**

There was strong support among respondents for Wholesale Contract termination being a relevant cessation of supply event and triggering the interim supply arrangements in such a circumstance.

However, there were significantly divided views on the proposal that prior Ofwat approval should be required before a Wholesale Contract can be terminated. Those who disagreed with this option considered that such additional regulatory intervention in commercial arrangements between Wholesalers and Retailers would be unwarranted. Those respondents who agreed with the proposal saw this as an important protection for customers and retailers as it would ensure that Ofwat's interim supply duties are not invoked without the opportunity for due consideration by Ofwat, could prevent a regional disagreement escalating unnecessarily, and may facilitate an alternative solution that would be better for customers.

### **4.2.2 Ofwat conclusions and next steps**

We have decided that Wholesale Contract termination should be considered to be a relevant cessation of supply for the purposes of the interim supply arrangements, and that the ISC should allow for the reallocation of affected customers in only a single affected area where appropriate. The draft ISC has been developed on this basis.

We have also decided that the WRC should be amended to require a wholesaler to gain the prior approval of Ofwat before a Wholesale Contract can be terminated. This will retain discretion for Ofwat to choose when to invoke the interim supply arrangements. Without such an amendment the current default and termination provisions set out in the business terms of the WRC could lead to the interim supply

arrangements effectively being invoked automatically following the non-payment of wholesale charges by a WSSL in just one region and without adequate notice to Ofwat. We consider that that this may not afford sufficient time to enable customer re-contracting to occur and that it may not be appropriate for a single regional default to trigger the reallocation of a retailer's customers in every circumstance.

Under this approach Ofwat shall take into account the non-payment by a retailer of its wholesale charges in any area(s) in considering whether the situation is sufficiently serious to merit Wholesale Contract termination and the resultant triggering of the interim supply arrangements in respect of the affected area(s). For example, Ofwat will take into consideration the level of risk and exposure that wholesalers would face in the event that the interim supply arrangements were not invoked immediately following such a non-payment, including with reference to the credit cover arrangements in place between the wholesaler and the relevant retailer. We will also take into account the likelihood that some other process such as enforcement action or a trade sale could resolve the situation in a timely manner and might better protect the interests of customers and other market participants.

We will work with the industry, MOSL and the Interim Codes Panel to ensure that the Wholesale Contract termination provisions in the Wholesale-Retail Code reflect this requirement.

## **5. Notice and provision of information**

In the November consultation, we sought views on the proposed process following a relevant interim supply trigger event, including provision of appropriate information to the market and the basis on which an eligible licensee should be able to exercise its right temporarily to suspend its election to be an interim supplier, or signal its willingness and capacity to be allocated affected customers.

### **5.1 Provision of information about affected customers**

We sought views on whether Ofwat should provide basic aggregated information on affected customer numbers by region to eligible licensees.

We also asked whether additional disaggregation of customer numbers, such as by customer class and/or type of existing supply arrangement may be useful and invited views on the most appropriate and practicable basis for any such disaggregation.

#### **5.1.1 Stakeholder views on this issue**

There was broad support among respondents for the provision of as much basic information on the affected customer base as is likely to be practicable in the circumstances. However, there was recognition that time may be of the essence in the event of a retailer failure, and that any information will need to be produced quickly and accurately. Therefore, a pragmatic solution would be to provide information that will be readily available from existing sources, such as the Market Operator's systems and/or the relevant wholesaler(s).

While there was also a reasonable level of support for making some more granular information available if practicable (such as customer class and/or average bill information), a number of respondents expressed some concerns about this. For example, it was suggested that the information provided should only be that required to enable a retailer to assess its capability to service the additional customers and not to "cherry pick" which interim supply event to participate in, or which customers to target. It was also suggested that the provision of additional disaggregated data may introduce delay into the overall interim supply process.

### **5.1.2 Ofwat conclusions and next steps**

We have decided to develop the ISC on the basis that Ofwat will always provide (or procure the provision of) basic aggregated information on the affected customer base, and will also have the flexibility to make additional disaggregated information available where we consider this to be expedient and practicable in view of the specific circumstances of the interim supply event.

At a minimum, potential interim suppliers would need to know how many customers would need to be supplied on interim supply schemes of terms and conditions in each region. However, we expect that more granular information on affected customers could be useful, as long as it could be rapidly and robustly generated, including from information within the Market Operator's systems.

This minimum basic information shall include the area(s) in which the relevant cessation of supply has occurred and the expected number of supply points receiving each service category (water or sewerage) in each area which are to be reallocated. Optional additional information could include, but need not be limited to the number of the relevant supply points subject to a particular wholesale tariff, meter read history and disaggregation such as by size or type of customer.

As explained in section 6.1 below, we are proposing to allow opt-out decisions and to undertake customer reallocation on the basis of areas and service categories only at this stage. We are not proposing to enable opt-out or allocation on any other basis (such as customer class) at this stage and, therefore, there is less direct need for customer class information to be provided. Similarly, since the interim supply is expected to be made via schemes of terms and conditions which can be varied after an initial period, we do not think it necessary to provide additional specific information on individual customers at the outset. Basic information on customer numbers should suffice to allow each eligible licensee to assess the general commercial risks associated with acquiring customers in each event.

## **5.2 Establishing the base of affected customers**

We sought views on whether it would be necessary or expedient to fix the base of affected customers/premises to be allocated pending the completion of an interim supply allocation exercise. This could be achieved by rejecting any new application to transfer any of the failing retailer's supply points from the date of Ofwat giving notice of the interim supply event.

### **5.2.1 Stakeholder views on this issue**

Respondents expressed a range of views on this issue.

Some respondents supported such a temporary switching moratorium, on the basis that this would effectively baseline the information available to potential interim suppliers and make the allocation process more stable and controlled.

However, a majority of respondents did not consider it appropriate to prevent a customer from switching retailer at any time, even if only for a relatively short period. These respondents were of the view that this would not be in the customer's best interests and would be an unnecessary barrier to place in the way of a customer who has chosen to engage with the market. It was also suggested that potential interim suppliers will be able to factor into their considerations the risk that a customer that is allocated to them will have already switched elsewhere (or may choose to do so shortly after allocation).

### **5.2.2 Ofwat conclusions and next steps**

We have decided not to progress this proposal as, on balance, we consider that the potential negative impact on those customers who wished to exercise immediate choice to move to another retailer upon learning that their current retailer is failing is likely to outweigh any potential benefit to the interim supply allocation process.

## **6. Temporary suspension of election to be an eligible licensee (“opt-out”)**

The November consultation explained that an eligible licensee will have the right temporarily to suspend its election as an eligible licensee in respect of a given interim supply allocation event, in accordance with and to the extent permitted by the ISC. This is commonly referred to as the process of “opt-out”. We sought views on the basis upon which an eligible licensee should be able to exercise this right and whether there should be any form of restriction on the right to opt-out in any circumstances.

### **6.1 Opt-out by wholesaler area and/or service category and/or customer class**

We invited views on whether opt-out by wholesaler area and service category should be permitted. We also asked whether opt-out by some definition of customer class should be permitted, and for suggestions as to an appropriate basis for defining these classes.

#### **6.1.1 Stakeholder views on this issue**

There was a significant level of support among respondents for permitting opt-out on an area-by-area basis, on the basis that there would be no benefit to customers in forcing retailers to operate in a particular region or on a national basis which may not be economically or practically viable for that retailer at a given point in time.

There was also support for permitting opt-out by service category (water or sewerage). Some respondents suggested variants on this, such as only allowing opt-out where trade-effluent was provided as this is a specialised service, or that any service category opt-out should only be permitted where the relevant licensee only holds a licence for a single service category.

Some respondents opposed opt-out by area or service category because, for example, they considered that licensees should be compelled to make themselves available as an interim supplier (and so should not be able to opt-out at all) or because they considered that this could lead to some customer disbenefits, such as being allocated different retailers for different services at the same premises.

There was almost no support for permitting opt-out by some definition of customer class. The objections to this option included that this would make allocation overly complex, could introduce delay, may lead to cherry picking and a lack of choice for some classes of customer, as well as place an inequitable burden on the backstop interim supplier (undertaker or acquiring licensee) to take on only the least profitable customer classes.

Some respondents opposed opt-out on any of the bases proposed, considering instead that it should be mandatory for certain licensees (e.g. those above a defined market share) to remain available to provide interim supply.

### **6.1.2 Ofwat conclusions and next steps**

We have decided that eligible licensees will generally be permitted to opt-out by area and/or service category. However, it should be noted that there will be some conditions placed on this, as explained in sections 6.2 and 6.3 below.

We consider this to be in line with our proposals for opting-in on a regional basis. It is also not certain that a mature national market will be in operation soon after market opening. Undertakers' exit decisions will be regional in nature, and not easily projected at this stage. Some retailers may pursue regional or other niche strategies. As a result of these variations, it is quite possible that an eligible licensee may be capable of acting as an effective interim supplier in response to another licensee's failure in one area (given its pre-existing market presence) and not another. This is also consistent with the draft Wholesale-Retail Code, which permits retailers to agree Wholesale Contracts (and therefore to trade) in some regions and not others.

We also consider that permitting an eligible licensee to opt-out of interim supply for either or both of water and sewerage services in specified regions is consistent with the proposed new WSSL licensing regime, which will permit a licensee to hold a licence for a single service category should it so choose.

We have decided not to enable eligible licensees to opt-out on any more granular basis, such as by some definition of customer class, as we agree with the concerns about this described above including the potential for complexity, delay, and an increased risk of reduced interim supply options for some classes of customer.

## **6.2 Unlimited opt-out right vs. potential restriction on opt-out**

We invited views on whether an eligible licensee should be able to opt-out temporarily without any restriction on a case-by-case basis, or whether there should be some level of restriction or condition on opting-out. In particular, we sought views on whether an opted-in eligible licensee should only be entitled to opt-out to the extent that the potential outcome of an interim supply allocation would exceed its stated regional and/or national capacity to provide interim supply to additional customers.

### **6.2.1 Stakeholder views on this issue**

Respondents' views were divided on this issue. However, a majority favoured some form of restriction on the ability of an eligible licensee to opt-out on a case-by-case basis.

Those respondents who did not support any restriction considered that there should be maximum commercial flexibility to opt-out on a temporary basis, even where a retailer has previously indicated capability to take on additional customers. Reasons for this included that such flexibility could encourage more potential interim suppliers to opt-in in the first place, and would allow for circumstances where a retailer finds its capacity constrained in the short term (e.g. where it has recently acquired a large multi-site customer).

Those respondents who supported some form of restriction on opt-out considered that this would be more likely to ensure a robust pool of potential interim suppliers and that this would be in customers' best interests. A number of respondents also expressed the concern that allowing an unrestricted opt-out may lead to cherry picking and a lack of choice for some customers. It was also suggested that retailers which are eligible licensees for the purposes of the interim supply arrangements should be required to provide an interim supply service when called upon, with the only exception being where that licensee is itself in distress.

A majority of respondents were in favour of the form of restriction proposed in the consultation, that an opted-in licensee should be required to remain available to be allocated affected customers up to the level that would be supported by their most recent statement of interim supply capability. It was suggested in the November consultation that this could be an updated Certificate of Adequacy (CoA) or some other statement submitted to Ofwat.

The reasons for supporting such an approach included that it would be in customers' interests to ensure interim suppliers have capacity to perform the role effectively; that a capacity-based mechanism could still allow smaller/niche licensees to participate; and that such an approach would discourage cherry picking of interim supply events.

Some respondents suggested that the CoA may not be the most appropriate basis for any capacity-based restriction, as the key consideration was the licensee's ability to service a high volume of additional customers in an interim supply situation. It was also noted that it could potentially be challenging to validate or evidence a capacity-based opt-out in the timescales available.

### **6.2.2 Ofwat conclusions and next steps**

We have decided that an opted-in licensee should be allowed to opt-out on a case-by-case basis. However, in doing so, the licensee shall be required to explain its opt-out decision with reference to a "Statement of Interim Supply Capacity" which the ISC will require it to provide to Ofwat from time to time (e.g. upon opting-in or upon a material change in circumstances affecting the licensee's capacity to take on additional customers). In order to opt-out down to within the level of its stated capacity, an eligible licensee shall be able to exercise its rights to opt-out in any combination of area and service category.

Given the likely urgency and short time available in a retailer failure situation, we do not propose to undertake any detailed validation of any Statement of Interim Supply Capacity or opt-out decision at the time of the interim supply event. However, we consider that the requirement to provide such a statement, and to explain opt-out choices with reference to this, should encourage the right behaviours and provide a basis upon which Ofwat can review this. The draft Interim Supply Code has been developed on this basis.

We consider that allowing opt-out without any form of conditionality would increase the likelihood of the backstop interim suppliers being called upon and may not secure the best outcome for customers. We consider that the proposed approach provides an appropriate signal that an opted-in licensee should expect to remain available to participate fully and actively in the interim supply arrangements, as this is such an important customer protection mechanism. It will provide some level of certainty to other participants about the likely pool of interim suppliers, balanced with appropriate commercial protection for participating retailers. We also consider that the proposed approach will not prevent a smaller/niche retailer from participating.

## **6.3 Restrictions on opt-out by an acquiring licensee**

The November consultation explained that restrictions on the opt-out right of an acquiring licensee may be required in order to ensure the Government's policy aim of there always being an equivalent level of backstop customer protection in an exit area as there would have been had the undertaker not exited. We invited views on whether an acquiring licensee should be completely prohibited from opting-out in the relevant exit area or whether complete or partial opt-out by an acquiring licensee in the exit area should be permitted on a case-by-case basis, where Ofwat is satisfied that there is a sufficient number of other eligible licensees that remain opted-in in the exit area in relation to the specific interim supply event and that these eligible licensees have the collective capacity to act as interim supplier(s) for all affected customers in that exit area.

### **6.3.1 Stakeholder views on this issue**

While there was some support for an acquiring licensee being able to opt-out in defined circumstances, a majority of respondents considered that an acquiring licensee should not be able to opt-out, at least initially. It was suggested that this would provide an important level of certainty about the protections available to customers following a retail exit by an undertaker.

Some respondents suggested that over time there might be a case for an acquiring licensee to be able to opt out, for example where it has lost significant market share within the exit area, where there has been consolidation among retailers, or if the acquiring licensee is itself in danger of failing.

### **6.3.2 Ofwat conclusions and next steps**

We have decided that an acquiring licensee shall not be entitled to opt-out from any obligation to be a backstop interim supplier in a relevant exit area. However, we will keep this matter under review after market opening.

This approach will mean that the acquiring licensee shall always be available as the default interim supplier in an exit area, ensuring equivalent protection to customers in an exit area as there would have been had the undertaker not exited. We also consider that maintaining this restriction initially is important given the proposed ability for other eligible licensees to opt-out on a case-by-case, and the current uncertainty about the extent to which they may choose to do so in practice.

## 7. Interim supply allocation mechanisms

In the November 2015 consultation, we described the various customer allocation mechanisms that would potentially be available to Ofwat to use on a case-by-case basis when an interim supply event occurs.

The basic allocation choices that shall be available to Ofwat are:

- a) to decide not to exercise our power to direct an eligible licensee(s) in one or more non-exit areas and in respect the affected customers in each such area. In this event the relevant undertaker(s) would be required to supply the affected customers in their area(s); or
- b) to direct an eligible licensee to be the interim supplier for some or all of the affected customers. This could be on a national basis (if the licensee was opted in in all areas) or on a regional basis. This would also be the means by which an acquiring licensee in an exit area would be directed to take on the affected customers as the backstop interim supplier where required; or
- c) to request the Market Operator to allocate the relevant supply points in one or more relevant areas by implementing the “Interim Supplier Allocation Process” in accordance with the relevant provisions of the Wholesale-Retail Code. Broadly speaking under this mechanism an equal number of supply points would be allocated to each opted in retailer for a particular service in each region.

The key issue upon which we sought views in the November consultation related to the basis upon which Ofwat should make a direction under option (b) above and, in particular, whether (and when) we should introduce some form of “market-based” allocation mechanism for this purpose. We also sought views on various aspects of how any such market-based mechanism could work in practice.

### 7.1 Introduction of a market-based allocation mechanism

We sought views on whether it would be beneficial to introduce a market-based allocation process and, if so, whether this should be implemented in time for market opening in April 2017.

A market-based allocation mechanism would provide an opportunity for eligible licensees to offer improved customer terms for interim supply (versus their previously published schemes for interim supply). Ofwat would then allocate the customers to the retailer(s) which offered the best terms. This is similar to the approach used by Ofgem in the energy sector.

### **7.1.1 Stakeholder views on this issue**

There were divided views on whether a market-based mechanism would be beneficial.

A number of respondents did not support the introduction of such a mechanism, on the basis that this could be overly complex and unjustified, at least during the early stages of market development. These respondents considered that, as the interim supply arrangements should only be needed on rare occasions and since the process would need to be quick, a simple administered approach such as that set out within the Wholesale-Retail Code should be sufficient. There was a concern that a market-based allocation mechanism would introduce complexity, leading to an increase in time taken to allocate customers to a new retailer. Another concern expressed was that achieving improved terms via a market-based allocation might discourage customers from engaging further with the market. A number of respondents highlighted the fact that the interim supply arrangements are intended to be temporary and that affected customers would always maintain the ability to switch to a more suitable contract.

While the above responses did not support development of a market-based mechanism at this stage, a number of these respondents did suggest that this was a matter that should be reviewed and that such a mechanism could be introduced at a later date.

A number of respondents did support a market-based allocation mechanism, on the basis that this has the potential to deliver a better outcome for affected customers by exposing the interim supply arrangements to competition and rewarding the more commercially-focused retailers. It was also suggested that a simple market-based mechanism would be sufficient and could still benefit customers. A number of respondents indicated that they would support a market-based mechanism so long as it could be implemented and operated in a straightforward and timely way.

On the question of timing, a number of respondents suggested that a market-based mechanism should be introduced from market opening in April 2017, citing the potential benefits to customers and the view that it would be prudent to have such an arrangement in place as an option for Ofwat to call upon if beneficial in the circumstances.

### **7.1.2 Ofwat conclusions and next steps**

We have decided that a simple form of market-based allocation mechanism should be introduced for market opening in April 2017, and the draft ISC has been developed on this basis.

We consider that a simple form of market-based allocation (as described below) has the potential to deliver better outcomes for customers, is deliverable for market opening and can be designed so as not to introduce significant additional complexity or time into the overall interim supply process.

Since the administered allocation process under the WRC will remain as a fall-back, we will only seek to allocate through the alternative market-based route if it clearly offers further potential customer benefit, on a case-by-case basis.

Where we consider it beneficial and practicable to do so, we will invite “Interim Supply Offers” from eligible licensees in relation to any affected area or combination of areas. Initially we expect that these shall be simple price-only offers (i.e. an offer to discount the price terms within the Eligible Licensee’s pre-published Scheme by a defined amount), with the non-price terms and conditions remaining as per the eligible licensee’s pre-published scheme for interim supply.

The ISC will permit us to issue guidance setting out the expected format and content of Interim Supply Offers and the criteria or other considerations that we will use to select the Interim Supply Offer which we consider offers the best terms for affected customers in each case. The purpose of seeking Interim Supply Offers in respect of a relevant area or combination of areas shall be to allocate all of the affected premises within any such area or combination of areas to a single eligible licensee.

## **7.2 Operation of a market-based allocation mechanism**

We sought views on various aspects of how a market-based mechanism could work in practice, including:

- whether we should assess the need for any market-based allocation process on a case-by-case basis using objective criteria;
- whether we should restrict any market-based allocation decisions to consideration of simple price-based offers, at least initially or whether more complex offers involving variant non-price terms and conditions should also be permitted; and

- whether undertakers should be permitted to participate in a market-based allocation process alongside eligible licensees.

### **7.2.1 Stakeholder views on this issue**

Among those respondents who supported the use of a market-based allocation process, there was broad agreement with our proposal that we should assess the practicality and benefits of this on a case-by-case basis using objective criteria. These respondents considered that market-based allocation should be selected only where it is clear that there are potential benefits for customers over and above the use of the administrative process under the WRC. It was also suggested that an important objective criterion will be that the interim supply allocation can be achieved promptly, particularly where the failing retailer is large. One respondent suggested that market-based allocation should always be the first choice and that a backstop administered allocation procedure should only be used in event that there are no offers available.

There was broad agreement among respondents that any market-based allocation decisions should be restricted to consideration of simple price-based offers, at least initially. It was considered that this would ensure a simple framework which is clearly understood by all parties, make comparison of offers relatively straightforward, and provide adequate protection to affected customers. No respondent suggested that more complex offers involving variant non-price terms and conditions would be practicable or beneficial in the short term.

A majority of respondents considered that, if market-based allocation was to be implemented, there could be benefit in allowing undertakers to participate, if this would potentially result in a better outcome for customers. Other respondents did not support undertaker involvement, on the basis that this would preclude allocation on a national basis and that the market may be more attractive to eligible licensees if undertakers' NHH retail businesses were restricted from participating.

### **7.2.2 Ofwat conclusions and next steps**

We have concluded that we will assess the need for any market-based allocation process on a case-by-case basis using objective criteria, including the number of potential retailers willing to make improved offers, and the level of prior customer engagement in the relevant area(s). For example, where the majority of affected customers in a given region were already on deemed contracts (perhaps because an undertaker had previously only exited quite recently), there would be less evidence

that they had already engaged in the market, and benefitted from it. In these instances, the case for a market-based process for allocating customers on the basis of schemes of terms and conditions for interim supply would be less compelling.

As described earlier, we intend (in the first instance at least) to seek simple price-only offers where we choose to use market-based allocation, with the non-price terms and conditions remaining as per the eligible licensee's pre-published scheme for interim supply. We consider this approach to have the advantage of reducing the level of retailer input to the process, allowing quicker decisions on allocations to be taken. This is also consistent with our policy aim to achieve a proportionate and efficient approach to protect customers within a competitive framework.

We have decided that, initially at least, undertakers shall not be permitted to participate in any market-based allocation process. Undertakers will always have a statutory backstop interim supply duty in non-exit areas. Primarily, we intend to use market-based allocation as an alternative to the default of allocating customers to the backstop provider. Another key consideration is the fact that an undertaker would only be able to make offers in respect of its own area. One of the potential benefits of market-based allocation is that it will allow us to package up affected customers across a combination of areas (or even nationally) if this is likely to achieve an improved outcome relative to allocation within each individual area (as will be the case via the administered allocation under the WRC). As undertakers are only authorised to supply customers within their own area of appointment, involving undertakers would preclude this approach and therefore undermine this potential benefit.

## **8. Basis of interim supply**

The November consultation sought views on the retailer obligations, terms and conditions that would apply in the event of a retailer being allocated affected customers. This included proposals as to how the date from which the interim supply would commence would be established under the Interim Supply Code, the termination provisions that would apply in respect of the interim supply terms and conditions, and obligations on the appointed retailer to provide certain information to its allocated customers. We also sought views on potential powers to allow Ofwat to intervene in the terms of interim supply where expedient to do so.

### **8.1 Date of allocation (backdating)**

In the absence of alternative terms and conditions being agreed between an interim licensee and an affected customer, the interim licensee's applicable scheme of terms and conditions for interim supply shall be the basis upon which it shall provide interim supply to any such affected customer. We sought views on a proposal that an interim licensee would be required to continue the supply to a customer on the basis of these terms with effect from the original date of the relevant cessation of supply by the failing retailer.

#### **8.1.1 Stakeholder views on this issue**

There was strong support for this proposal among all the respondents who commented on this issue. This was considered to be the best option for customers to ensure continuity of retail services. It was also considered essential to ensure that wholesalers are not unduly exposed to the risk of non-payment of wholesale charges.

#### **8.1.2 Ofwat conclusions and next steps**

We have concluded that an interim licensee shall be required to continue the supply to a customer on the basis of these terms with effect from the original date of the relevant cessation of supply by the failing retailer. This is appropriate as it provides for wholesalers and customers each to have continuity of retailer, such that there will be no interruption of valid contracts in place throughout the allocation period. This should ensure that the credit risks faced by parties, including wholesalers, remains

within the envelope of risks which will already be provided for through the normal regulated industry credit arrangements.

## **8.2 Terms and conditions under administered allocation mechanisms**

The terms and conditions of interim supply in particular circumstances are likely to reflect those which have already been set out by the prospective interim suppliers, in their own schemes of terms and conditions published for this purpose. In general these terms and conditions will reflect common wholesale charges in each wholesaler area, so that variations between different published interim supply terms for a given region will be focused on the gross margin and associated non-price terms relevant to the retail services concerned.

We consulted in parallel in November 2015 on our general proposals for the principles that should apply to the price and non-price terms that these schemes should contain as they apply to various circumstances, including interim supply ([“Customer protection in a retail market: Deemed Contracts – a consultation”](#)). Our general conclusions on these matters will therefore be set out in our conclusions on that consultation.

We have reflected our wider policy conclusions on these matters in the draft Interim Supply Code published alongside this document. In particular, the draft code requires that an eligible licensee must ensure that its relevant scheme for interim supply complies with a number of principles and requirements. These include:

- that the price terms within the scheme must be reasonable in the circumstances;
- that there is no undue preference shown to and that there is no undue discrimination against any affected customer compared with the licensee’s other customers of the same class;
- that the Scheme must be consistent with the eligible licensee’s obligations under the 1991 Act and its licence (this will, for example, ensure consistency with any customer code of practice which may be brought into force); and
- that there shall be no restriction on an affected customer’s ability to switch to another retailer, or to other terms and conditions offered by the eligible licensee.

## **8.3 Power to direct eligible licensee's terms and conditions for interim supply**

We sought views on a proposal to retain the power under the ISC to direct all relevant retailers to use comparable terms and conditions for interim supply (based on published schemes) in each region if the underlying differences in their individual schemes were otherwise likely to risk significant customer prejudice under an administrative allocation approach (i.e. "postcode lotteries"). We suggested that we would only exercise this power on a case-by-case basis if published differences indicated it would be in customers' interests, and we would include our intention to do so in notifying eligible licensees of an interim supply event, such that eligible licensees could exercise any opt-out option on an informed basis.

### **8.3.1 Stakeholder views on this issue**

Some respondents supported this proposal as a means to address the issue described above. However, a number of others did not support it, on the basis that this would introduce additional commercial risk for retailers and be counter to the principle of a competitive market with differing retail strategies. It was also noted that affected customers will always be entitled to switch to a better deal without any barrier or delay. It was also noted that this could give rise to additional cost and complexity for a retailer to implement the standardised price terms in its billing system and/or changes to non-price terms in its business processes, and that this could be a potential deterrent to participation in the interim supply arrangements in the first place.

### **8.3.2 Ofwat conclusions and next steps**

We have decided not to include this power in the ISC, at least initially. We shall keep this matter under review as the market develops and in view of any future experience gained from implementing the interim supply arrangements in practice.

## **8.4 Potential new charging rule for Undertakers**

We sought views on the potential need for specific charging rules governing undertakers' interim supply charging schemes, to support the ISC.

### **8.4.1 Stakeholder views on this issue**

There were differing views on this issue among respondents.

Some agreed that there was potentially a need for the development of additional charging rules, and welcomed Ofwat's proposed further consideration and consultation on this matter. One respondent suggested that undertakers should be protected from additional costs of acting as an interim supplier via appropriate charging rules and would welcome a review of the situations that may increase an undertaker's costs in this respect. Another suggested that specific charging rules could ensure customers are not disadvantaged.

Other respondents did not agree that there was potentially a need for any such specific charging rules. The reasons given for this view included that interim supply is only a temporary arrangement, additional charges should not be levied on a customer in an interim supply arrangement, customer acquisition costs will be lower than most other methods, and further charging approaches would create a more complex situation for customers to understand.

### **8.4.2 Ofwat conclusions and next steps**

We have not concluded on this matter at this stage. The detail of any specific charging rules to support the ISC will need to be consulted on when we have decided upon the basic allocation processes governed by the code. We would expect to complete the statutory consultation for any additional rules in good time to enable these to be in place to support the ISC on market opening from April 2017. As with other charging rules and the ISC itself, we will then keep any specific charging rules for undertakers' interim supply schemes under review, and if need be adapt them in line with market evolution (following consultation). For example, the extent of retail exit by undertakers from April 2017 will affect the potential need for using their charging schemes as a basis for interim supply terms in different regions.

## **8.5 Duration of deemed contract for interim supply**

We sought views on the proposal that the duration of an eligible licensee's deemed contract based on its scheme of terms and conditions for interim supply should be three months. The effect of this would be that the interim licensee could not vary or terminate the terms and conditions of its scheme for interim supply as it applies to an affected customer, without the consent of that customer, for a period of three months

commencing from the date from which the interim licensee was required to continue the supply.

### **8.5.1 Stakeholder views on this issue**

There was broad support for this proposal among most respondents, who considered that three months would provide sufficient time for an affected customer to negotiate an alternative contract with the interim supplier, or to switch to an alternative retailer.

Some respondents suggested that a deemed contract for interim supply should not be time-limited. Concern was expressed that, while customers should be encouraged to renegotiate their terms with the allocated retailer or switch elsewhere, a significant number of smaller business customers were unlikely to engage with the market, and that these customers should not be potentially disadvantaged by moving them to less favourable terms and conditions.

### **8.5.2 Ofwat conclusions and next steps**

In an interim supply scenario we believe that applying the interim licensee's scheme of terms and conditions allows for a rapid transfer of customers on reasonable terms from one retailer to another and protects other customers, retailers and undertakers from undue exposure to the failing retailer's costs. They are not a long term solution in a competitive market. However, affected customers should be given a reasonable time to seek an alternative supply arrangement.

We have therefore decided that an interim licensee shall not be entitled to vary or terminate the terms and conditions of its scheme for interim supply as it applies to an affected customer without the consent of that affected customer for a period of three months commencing from the date from which the interim licensee was required to continue the supply. The draft ISC has been developed on this basis.

We consider that three months should provide sufficient time for a customer to seek an alternative deal which better meets its needs, either with the allocated interim supplier or with a different one, whilst being protected by the scheme's terms. This will also be fully consistent with the equivalent statutory interim supply obligations on undertakers, which provide that an undertaker cannot serve notice for three months following the day that the supply by the previous licensee ceased.

The draft ISC also includes an obligation on an interim licensee to make the customer aware of any alternative contract terms available, and to provide information about how such alternative terms and conditions may be obtained.

## **8.6 Provision of information to affected customers**

The November consultation proposed that an interim supplier should have an obligation to provide all customers allocated to it with important information, including:

- what is happening and why, including that the failed retailer is no longer supplying them;
- the interim supplier is their retailer from the date of appointment;
- they are supplied under a scheme of terms and conditions and the duration of the consequent deemed contract;
- the customer has the right to switch to another retailer if they wish to and how they can engage with the market if they wish to switch;
- the charges payable and how those charges are determined;
- contact details of the interim supplier; and
- what will happen to any outstanding complaints.

### **8.6.1 Stakeholder views on this issue**

There was strong support for this proposed obligation and for the information that we suggested should be included.

One suggestion for some additional information was a statement that, as well as being able to switch to an alternative retailer, a customer may wish to discuss with the allocated retailer the availability of better terms than those which are available under the deemed contract.

### **8.6.2 Ofwat conclusions and next steps**

The draft ISC includes an obligation on an interim licensee to write to each affected customer allocated to it within five business days in order to provide the suggested information. As noted above, we have also included a requirement to make the customer aware of any alternative contract terms available.

## 8.7 Outstanding service requests

The November consultation sought views on whether any outstanding service requests that the previous (failed) retailer had initiated with a wholesaler should continue following the allocation of an interim supplier, or whether there should be some alternative treatment of any such outstanding service requests under the Wholesale-Retail Code in these circumstances.

### 8.7.1 Stakeholder views on this issue

A small number of respondents suggested that all outstanding service requests should always be fulfilled by the interim supplier, such that the customer is not disadvantaged or inconvenienced (for example by having to make a repeat request via their new retailer) and that the allocated retailer should be liable for any associated charges. Conversely, a small number of respondents considered that any outstanding service requests initiated by the previous retailer should be terminated with immediate effect in order to protect the wholesaler and the interim supplier.

However, the majority of respondents considered that it may be appropriate for certain service requests to continue, but not others, and that there should be some process by which this can be reviewed and determined on a case by case basis. A number of respondents suggested that different treatment may be required depending upon which of the affected parties may have already paid, or be liable to pay, for a particular service request and/or the nature of the service request. Suggestions and variants included:

- the new retailer should be entitled to re-evaluate all service requests;
- all service requests from a failed retailer should be put on hold until it can be established from the end customer that the service is required;
- where the service is paid for by the wholesaler in any case (such as exchange of a faulty meter) then this should continue;
- asset-related works, such as new connections should continue, irrespective of the retailer;
- where the service has already been paid for by the previous retailer then the wholesaler should undertake the work;
- non-critical works should be held in abeyance until the allocated interim retailer has confirmed the service request remains valid; and
- some categories of service request should continue without being placed on hold, e.g. stop tap or service pipe repairs, water quality complaints or low pressure complaints.

A number of respondents suggested that it may be necessary for related operational performance standards under the WRC to be reviewed to ensure that wholesalers and retailers are not unduly penalised where there is a delay in fulfilling a service request as a result of an interim supplier allocation having been required. It was also noted that there will need to be a clear process for the transfer of service requests and all associated information to the interim supplier.

### **8.7.2 Ofwat conclusions and next steps**

We consider that it will be important to develop an approach to manage outstanding service requests following an interim supplier allocation which balances the interests of customers, wholesalers and retailers.

We consider that this is a matter for the Wholesale-Retail Code as this sets out the operational processes and service standards associated with service requests. We will therefore work with the industry, MOSL and the Interim Codes Panel to review this matter further.

## 9. Consultation on draft text of the Interim Supply Code

This section provides a high level overview and explanation of the structure and content of the draft ISC, which we have published alongside this document. This is intended to aid understanding and consideration of the draft text by stakeholders.

This section also invites views on the proposed text of the draft code.

### 9.1 Overview of draft ISC

#### 9.1.1 Statutory basis and related regulations

The main interim supply provisions in the legislation will be found in sections 63AC to 63AF (in respect of water supply) and sections 110K to 110O (in respect of sewerage services) of the Water Industry Act 1991 (WIA91) to be introduced by sections 31 and 32 of the Water Act 2014 (WA14).

Ofwat is required by each of sections 63AF and 110O to issue a code in relation to supplies of water under section 63AC and sewerage services under section 110L and its power of direction under sections 63AC(3) and 110L(3). The draft ISC is a single code which fulfils for the purposes of both these provisions.

Compliance with the ISC by licensees will be enforced by direction which, in turn, is enforceable under section 18 of the WIA91.

In order to understand fully the provisions within the draft ISC, it is important to read it alongside a number of related provisions within the legislation and other regulatory instruments. This is critical for the following reasons:

- the ISC forms just one part of the overall set of interdependent regulations that will govern the interim supply arrangements;
- the ISC has been drafted in such a way that it does not duplicate powers, rights or procedures where these are already established in other documents. For example:
  - a number of key interim supply provisions will be found in WIA91, including all provisions relating to a relevant undertaker's interim supply duties which are outside the scope of the ISC, but which form important context for the code; and

- the code has been drafted on an assumption that the Exit Regulations due to be finalised by Defra will create an obligation for at least one acquiring licensee to be available as a “backstop” interim supplier in each exit area. Therefore the code does not currently contain any explicit references to acquiring licensees on the basis that any such relevant provisions will sit elsewhere;
- there are a number of process “hand-offs” within the code to related documents. For example, in order to avoid creating duplicate processes, the ISC relies on a number of administrative procedures within the Wholesale-Retail Code; and
- Wherever possible we have sought to use existing defined terms, such as those found within the relevant legislation and within Part 1 of the draft Wholesale-Retail Code (“Objectives Definitions and Principles”).

### 9.1.2 Scope and structure of the draft ISC

The draft ISC is structured into four main parts, a number of which directly reflect the conclusions described in this document, as follows:

1. **Introductory and general provisions**, including defined terms, interpretation provisions, general duties on relevant parties and provisions about how all communications and notices required to give effect to the code’s processes are to be delivered.
2. **Part A (Eligible Licensees)** sets out the procedures for electing to be an eligible licensee for the purposes of the WIA91 (“opt-in”), removal of such an election or the temporary suspension of such an election (“opt-out”). This part also describes the “statement of interim supply capacity” which eligible licensees must produce in various circumstances, and the purposes for which this will be used.
3. **Part B (Procedure following a relevant cessation of supply)** describes the circumstances in which Ofwat’s power to direct an eligible licensee to continue supply may be exercised (“trigger events”). This part also describes how Ofwat will determine the date on which the failing retailer ceased to supply affected customers. It also describes the notice and accompanying information that Ofwat will provide when there is an interim supply event and sets out the basis on which Ofwat may decide to allocate affected customers (including via a market-based mechanism or administered allocation by the Market Operator).
4. **Part C (Basis of interim supply by an interim licensee)** sets out various requirements applying to the terms and conditions under which an eligible licensee may provide interim supply. It also obliges an interim supplier to provide certain important information to its affected customers.

### **9.1.3 Potential additional Ofwat guidance**

The draft code permits Ofwat to issue guidance relating to certain aspects of how the procedures set out in the ISC will be implemented in practice. Any such guidance will not form part of the code itself. For example, we may choose to issue guidance in relation to:

- the form and content of the “statement of interim supply capacity”, in order to provide clarity to eligible licensees and to enable straightforward assessment and comparison of these by Ofwat;
- the criteria or other considerations that we will use to select the most appropriate basis of allocation on a case-by-case basis. For example, this guidance could specify the minimum number of opted-in retailers capable of providing improved offers below which the benefits of a market-based allocation would be difficult to demonstrate (and in which cases we may then choose simply to use the backstop administered process); and
- the expected format and content of “Interim Supply Offers” under the market-based allocation approach, and the criteria or other considerations that we will use to select the offer which we consider to offer the best deal for affected customers in each case. For example, it may be expected that initially these shall be price-only offers (i.e. an offer to discount the price terms within the eligible licensee’s pre-published scheme by a defined amount), with the non-price terms and conditions remaining as per the eligible licensee’s pre-published scheme.

We will give further consideration to the need for, and content of, any such guidance in advance of market opening.

### **9.1.4 Modification of the ISC**

Under the terms of the WIA91, Ofwat will be obliged to carry out periodic reviews of the ISC and, if appropriate, issue a revised code. The draft ISC does not include any specific procedures in this regard. Once effective, any future modifications to the ISC will only be made following consultation, in line with Ofwat’s statutory functions and duties and the scope and powers set out in legislation.

We are considering the processes that we will apply to govern changes to all the statutory codes for the new market (where these are not already specified within the relevant codes) and may issue further guidance on this at a future date.

The WA14 includes powers for the Secretary of State to introduce regulations that will provide for Ofwat's decisions to amend or not amend designated codes to be appealable to the CMA. However, we do not currently expect the ISC to be subject to CMA appeal. Defra will be launching a consultation on the draft regulations in summer 2016. This will initially relate to codes relevant to the retail authorisations and the restricted retail authorisation, but will not include the ISC.

## 9.2 Views sought

We welcome all comments on the proposed text of the draft ISC which we have published alongside this document.

Where you wish to suggest a change to the current drafting, it would be particularly helpful if you could provide specific revised text, marked-up against the published version, in order to help expedite the process of producing the next version of the code.

Please submit your comments on the draft ISC by Friday 4 March 2016.

Please email responses to [retailmarketopening@ofwat.gsi.gov.uk](mailto:retailmarketopening@ofwat.gsi.gov.uk), with the subject **“Interim Supply Code Consultation”** or post them to:

Interim Supply Code Consultation  
Retail Market Opening Programme  
Ofwat  
21 Bloomsbury Street  
London  
WC1B 3HF

## A1 November consultation questions

Table 2 below lists all of the consultation questions that were included in the [November 2015 consultation](#) document. It also signposts the sections of this document where information about stakeholder responses and Ofwat conclusions can be found in respect of each question.

**Table 2: November consultation questions**

Consultation question	Relevant section of this document
<b>Q1</b> Do you consider that it should be entirely voluntary for WSSL licensees (other than acquiring licensees) to elect to be an eligible licensee for the purposes of the interim supply arrangements? What do you consider to be the advantages and disadvantages of such an approach?	3.1
<b>Q2</b> Do you agree that any voluntary opt-in should be permitted on an area-by-area basis?	3.1
<b>Q3</b> Do you consider that there should be a de-minimis threshold above which WSSL licensees will be obliged to elect to be an eligible licensee for the purposes of the interim supply arrangements?	3.2
<b>Q4</b> Do you consider that any such de-minimis opt-in threshold should apply on an area-by-area basis?	3.2
<b>Q5</b> Do you have a view on the level of market share in an area above which a licensee should be obliged to opt-in as an eligible licensee in that area?	3.2
<b>Q6</b> Do you have any comments on the process by which a licensee should elect to be an eligible licensee for interim supply?	3.3
<b>Q7</b> Do you agree that the interim supply arrangements should be invoked by Ofwat either giving notice of its intent to revoke a licence in the case of insolvency or of licence revocation in the case of a serious breach of a licence enforcement order?	4.1
<b>Q8</b> Do you agree that Ofwat should be able to revoke a licence with less than 30 days' (but not less than 24 hours') notice. If so, in what circumstances?	4.1
<b>Q9</b> Do you agree that a licensee should be prohibited from contracting with any new customers or registering any additional premises from the date of Ofwat's notice of intent to revoke the licence?	4.1
<b>Q10</b> Do you agree that the interim supply arrangements should be invoked upon a Wholesale Contract being terminated?	4.2
<b>Q11</b> Do you agree the current Wholesale Contract termination provisions in the draft WRC should be amended such that the prior approval of Ofwat is required before a Wholesale Contract is terminated?	4.2
<b>Q12</b> Should Ofwat provide aggregate information on affected customer numbers by region and class to eligible licensees?	5.1

Consultation question	Relevant section of this document
<b>Q13</b> Would additional disaggregation of customer numbers, such as by customer class and type of existing supply arrangement, be useful? Do you have any views on the most appropriate and practicable basis for any such disaggregation?	5.1
<b>Q14</b> Should Ofwat also provide some average bill information based on published charge schemes to support any market-based allocation process?	5.1
<b>Q15</b> Do you consider that it would be beneficial and proportionate temporarily to prevent any new customer transfer requests pending the completion of an allocation exercise?	5.2
<b>Q16</b> Do you agree that opt-outs by region and service category should be permitted?	6.1
<b>Q17</b> Do you consider that opt-outs by some definition of customer class should be permitted? Do you have suggestions for a simple robust basis for defining these classes?	6.1
<b>Q18</b> Do you consider that an eligible licensee should be able to opt-out temporarily without any restriction on a case by case basis?	6.2
<b>Q19</b> Do you agree that an opted-in eligible licensee should only be entitled to opt-out to the extent that the potential outcome of an allocation would exceed the capacity in its CoA or other statement of capacity, and in such an event should only be permitted to opt-out to the extent required to be within the level of that capacity?	6.2
<b>Q20</b> Do you have any views on the appropriate restrictions on an acquiring licensee being able to opt-out in an exit area in respect of which it is the acquiring licensee?	6.3
<b>Q21</b> Do you agree that we should assess the need for any market-based allocation process on a case-by-case basis using objective criteria on competitive supply prospects and customer engagement? Are there other criteria which would be relevant for such case-by-case decisions?	7.2
<b>Q22</b> Should undertakers be permitted to participate in a market-based allocation process for interim supply?	7.2
<b>Q23</b> Should we restrict any market-based allocation decisions to consideration of simple price-based offers, at least initially, while regionally-based allocation decisions are needed?	7.2
<b>Q24</b> If you consider more complex offers involving variant non-price terms and conditions should also be permitted, please suggest how they could be objectively compared.	7.2
<b>Q25</b> What are the pros and cons of including a market-based allocation process from April 2017 and do you support this?	7.1
<b>Q26</b> Do you agree that the deemed contracts used for interim supply should be backdated to the time of the relevant interim supply trigger event?	8.1
<b>Q27</b> Do you agree that Ofwat should confirm any proposed adjustments to published terms and conditions for use in administrative allocation at the same time as it gives notice of an interim supply event?	8.3

<p style="text-align: center;"><b>Consultation question</b></p>	<p style="text-align: center;"><b>Relevant section of this document</b></p>
<p><b>Q28</b> Do you agree there is a potential need for specific charging rules governing undertakers' interim supply charging schemes, to support the ISC? Do you have suggestions for such rules?</p>	<p style="text-align: center;">8.4</p>
<p><b>Q29</b> Do you agree that the duration of an eligible licensee's deemed contract for interim supply should be three months? If not, please explain the rationale for a shorter/longer term.</p>	<p style="text-align: center;">8.5</p>
<p><b>Q30</b> Do you agree with the information which it is proposed that an appointed interim supplier should provide to its allocated customers?</p>	<p style="text-align: center;">8.6</p>
<p><b>Q31</b> Do you have any views on whether any outstanding service requests that the previous (failed) retailer had initiated with a wholesaler should continue or whether there should be some alternative treatment of any such outstanding service requests under the WRC following an interim supplier allocation?</p>	<p style="text-align: center;">8.7</p>

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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