

# Information notice

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## Update on Open Water funding, resources and governance

This information notice confirms the planned funding, resources and governance arrangements for Open Water.

### Background

The Water Bill is currently being considered by the UK Parliament. Among other things, the Bill includes plans to:

- allow all non-household customers in England to choose their supplier for customer-facing ('retail') water and wastewater services by April 2017; and
- introduce competition into less customer-facing ('wholesale' or 'upstream') water and wastewater services after 2019.

The UK Government estimates that together these changes will deliver £2 billion of benefits to customers and the environment. The new retail market in England needs to work alongside a similar market that already exists in Scotland, so that non-household customers have a seamless experience.

In 2012, the UK Government established a group of key

stakeholders to help prepare for the implementation of the new retail market (the 'High Level Group'). The High Level Group (HLG) established a programme to deliver this work called 'Open Water'.

To ensure that effective market arrangements are implemented on time, Open Water needs to have appropriate resources. In the short term, it will need to deliver the high-level market design of the new retail market and to begin the procurement of the central systems necessary for an effective market, which will eventually be administered by a central market body (the 'market operator'). And, in the longer term, it will need to deliver the opening of the retail market by 2017, and introduce upstream trading arrangements after 2019.

In October 2013, we wrote to licensed monopoly water and wastewater companies, new companies ('new entrants'), and the Consumer Council for Water – the customer representative body in England and Wales – requesting their views on Open Water's future funding, resources

and governance arrangements. In total, we received 21 responses to our letter. We are grateful for the fast responses from all of those who replied at such a busy time.

Below we confirm the planned funding, resources and governance arrangements for Open Water.

### Funding

In our October letter to stakeholders, we asked whether appointed monopoly companies preferred:

- to establish a new company to enable them to directly fund the Open Water programme in 2013-14; or
- for us to request a ring-fenced, special licence fee from them to raise up to £500,000 instead.

There was widespread support from respondents to the first option. So, we will support the licensed monopoly companies – who are funding Open Water – to establish such a company as quickly as possible. This will be called Open Water Market Limited (OWM Ltd).

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water and sewerage sectors in England and Wales.

There were different views from respondents as to whether in the long term the new company should be:

- wound up; or
- able to evolve over time into a market operator and/or governance body to provide continuity in resourcing and decision-making.

Subject to the passage of the Water Bill through the UK Parliament, we consider that there would be benefits from allowing the new company the potential to evolve into the market operator. So, we want to make sure that the company has the flexibility to develop in this way – if that is decided to be appropriate at a later stage.

We have identified three different phases of activity for OWM Ltd as part of the process in developing the new retail market. We did this by:

- working with the Water Industry Commission for Scotland (WICS) – the economic regulator of the water sector in Scotland – and its legal advisers, Shepherd and Wedderburn; and
- building on initial proposals developed by Water UK, the water companies' representative body.

The three different phases of activity are as follows.

- **Phase 1 – prudent preparation ahead of legislation.** OWM Ltd will act as a vehicle to hold funds provided by licensed monopoly companies and to disseminate

funds to Open Water until a date to be determined. This is likely to be no later than two months after the Water Bill becomes law (receives 'Royal Assent').

- **Phase 2 – detailed implementation of the reforms set out in the Water Bill, following Royal Assent.** OWM Ltd will develop a detailed

proposal for how the market documents, including any rules and codes, should look and deliver the underlying market operator infrastructure (systems). Ofwat will be responsible for, and will issue, any codes. We will require licensed monopoly companies to fund phase 2 under a new temporary condition in their licences.

- **Phase 3 – setting up the fully operational market operator.**

As part of implementing phase 2, a decision will be needed as to whether OWM Ltd should develop into the market operator, or whether it will be wound up and a new market operator body established. The fully operational market operator will be funded by fees paid by all market participants.

We will need to carry out further consultation and engagement with stakeholders and market participants to determine precisely how phases 2 and 3 will work.

## Resources

In our October letter, we also asked about the level of resources that Open Water should have over the longer term. We presented two options.

1. Open Water is resourced as it is currently, with staff seconded from companies to carry out work. We called this the 'thin resourcing model'.

2. Companies provide more direct funding to OWM Ltd to enable it to obtain its own resources. We called this the 'thick resourcing model'.

The responses we received showed widespread support for the thick resource model as it was considered to be more transparent and effective. However, some respondents highlighted that maintaining some secondments from companies could help provide Open Water with a greater understanding of the sector.

So we will proceed with a thick resourcing model, with direct funding being provided by market participants. But we will keep the option open for companies to continue to second staff into Open Water if they wish, in addition to any direct funding that they provide.

## Considering costs as part of the price control

Under HM Treasury's 'Managing Public Money' rules, funding Open Water for phase 1 cannot be recovered through our process for setting the prices that licensed monopoly companies can charge their customers (the 'price control'). This is because customers cannot be required to fund developments that may not be required if the Water Bill does not become law in its current form.

While respondents agreed broadly with Open Water's costs for phase 2 being recovered through the price control, concerns were raised that recovering the costs through companies' price controls for wholesale water and wastewater services could result (in part) in household customers paying for the establishment of a new retail market for non-household customers.

While we recognise these concerns and the recent principles of the UK Government in protecting household customers, we do expect household customers to benefit from these market arrangements. For example, efficiencies that companies find in delivering services to non-household customers may also be applied to delivering services to household customers.

A possible way of addressing this issue would be for us to require a ring-fenced charge to be added to all wholesale charges to non-household customers that are eligible to switch suppliers after the opening of the new retail market.

We will provide further guidance on this approach later this year when we consult on draft rules that should apply to licensed monopoly companies' charges. We will do this before our final decisions ('final determinations') on licensed monopoly companies' prices for the five years between 2015 and 2020.

## Governance

There were a range of views from respondents on the proposed governance arrangements for OWM Ltd.

Based on these responses – and the need for a phased approach to establishing OWM Ltd – we propose the following during each of the phases we described earlier.

### During phase 1

During the short period of phase 1 the members of OWM Ltd would include Ofwat, WICS and licensed monopoly companies wishing to join and provide funding for this phase of work. During this phase OWM Ltd would have a simple governance structure involving Board members drawn from the existing HLG members, to avoid any further delays in providing initial funding so that Open Water's work to deliver against its plan can continue in the short term.

### During phase 2

Phase 2 will begin with formal appointments of new Board members to OWM Ltd. For this phase, the non-executive Board members will be chosen to reflect a range of interests including the interests of large and small business customers.

We anticipate that the Board will include non-executive directors elected by both:

- appointed companies that are funding the company; and
- new entrants that will not be funding the company.

The Chairperson will be appointed by Ofwat and WICS.

### During phase 3

It is clear that further work and consultation will be needed to establish the governance of the market operator in phase 3. This includes setting up any panels of market participants needed to govern the maintenance and development of the rules of the market ('market codes'). However, during this phase we expect that we will require all market participants to become members, either through a condition of their licence or through participation in market codes.

### Next steps

We will support the HLG and licensed monopoly companies to set up OWM Ltd as soon as possible over the next few weeks.

In parallel, we plan to begin discussions with licensed monopoly companies to agree the proposed temporary licence condition for phase 2. We will follow this with a formal 28-day consultation about the licence change under section 13 of the Water Industry Act 1991, once Royal Assent has been granted.

### Enquiries

If you have any questions about this information notice or our approach to the funding, resourcing and governance of Open Water please send them to [ruth.gibson@ofwat.gsi.gov.uk](mailto:ruth.gibson@ofwat.gsi.gov.uk).

## More information

[Open Water website](#)

'Managing Public Money', HM Treasury, updated July 2013

[Ofwat's market web pages](#)

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January 2014

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