

31 December 2015

Trust in water

# Consultation on licensing: results and decisions

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## 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 in April 2017.

This document focuses on our proposals for the licensing arrangements for the new retail market. The document summarises the responses to our [June consultation](#) from industry stakeholders and the decisions that we have reached having reviewed these responses.

It should be read in conjunction with the Market Arrangements Code, the Wholesale Retail Code and subsidiary documents published by [Open Water](#). There are many important interactions between the proposed licensing framework outlined in this document and the proposed terms and processes set out in the suite of Open Water documents.

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. A key element of this are the licensing arrangements to support the new market.

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## 1. Executive Summary

Our June consultation on licensing and policy issues highlighted our retail proposals for the future market. This represents a fundamental change to the retail market. The proposals will:

- remove barriers to entry that have stymied competition under the existing framework;
- increase the number of eligible customers over which retailers can compete (other than in Wales);
- include sewerage services as well as water supply; and
- allow companies to compete across England, Wales & Scotland for eligible non-household customers with multiple sites.

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 required under the WA14.

As such, it has been important to ensure that the decisions we make are consistent with this framework. We recognise that time has elapsed since the responses to the consultation, and whilst we presented many of our results to an industry workshop in September, some of the key decisions which we have had to make with Defra and our Board have only recently been confirmed.

We now have decisions and next steps on the five main deliverables that we are focusing on for the licensing framework for retail market opening.

1. **The new licence for retailers, known as the Water Supply and Sewerage Licence (WSSL)** – we have updated the drafting for the standard conditions that we consulted upon in June to reflect a number of the comments received. In preparation for the statutory consultation by Defra, we have also included two additional conditions to enable aspects of the additional work on customer protection. We signalled that these conditions might be required in the June consultation. As required by the industry level-one programme plan, we have now handed the proposed WSSL to Defra and the necessary consultation will be issued shortly.

2. **The application process for WSSLs** – we are working with the Environment Agency and DWI to update the guidance for applications for licences. As indicated in the June consultation, the assessment will continue to be based on managerial, technical and financial competencies. Companies will also be required to pass the market accession tests run by MOSL before the WSSL licence is awarded. Additionally, there will be provision to allow companies to make a joint application for both Scotland and England & Wales. We plan to consult upon this guidance once the consultation on the licence itself has closed and will finalise the guidance before applications open in early April.
3. **Changes required to the Instrument of Appointment (IoA) and WSL which we intend to introduce in March 2016.** To help ensure that wholesalers and retailers are ready for market opening, we propose to introduce a new “readiness” condition requiring companies to take the necessary steps to support market opening. As signalled in the June consultation, we also intend to remove the ban on retailers associated with appointees from trading in the appointee’s area of appointment. We are also requiring companies to update their compliance codes to make sure that the requirements for arm’s length trading and non-discrimination continue to be effective.
4. **Other changes to IoAs** – there are a number of changes to the IoAs which will be required before market opening. We set out our latest thinking on these changes in this document. The majority of these changes will not actually take effect until the point of market opening and so there is some latitude as to exactly when the changes are made. We will set out our proposals for the specific changes to the relevant IoA conditions and the process to be followed during 2016 Q1.
5. **Transition for existing licences** - Existing WSLs will remain active until the start of the new market at which point they will be revoked. We are currently discussing with Defra the process to revoke the old licences as well as to transition the necessary elements of the current supplementary authorisation of the WSL (the combined licence). The supplementary authorisation element of the current combined licence has not been within our focus other than to ensure that those companies with existing combined supply licences are still able to offer customers equivalent offerings. The Water 2020 Programme is developing proposals for future wholesale arrangements, and is considering how the supplementary authorisation and associated licence conditions will be developed in line with those plans. We plan to give clarity on the process and timing for replacing WSL combined supply licences no later than April 2016.

These changes are the core requirements for the new market. There are also a number of special situations where the market arrangements may need to be adapted, in particular for companies with areas of appointment wholly or mainly in Wales, small companies and those seeking to self-supply. Section 5 of this

document sets out our latest thinking regarding each of these. We will be engaging directly with these groups through workshops and consultations to ensure that the new market arrangements are proportionate.

## 2. Our approach

In this section, we describe our overall approach to assessing our licensing and policy decisions. We then summarise the main outputs required from the licensing work and explain how these are covered in the structure of this report.

### 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 Required outputs from licensing work**

In our consultation paper in June 2015, we set out our thinking regarding the requirements for the licensing regime in order for retail competition to become more effective.

With the benefit of the consultation responses and after further development of Ofwat's own thinking, we can focus on the five core deliverables from licensing which were all identified in the June consultation paper. We are now able to give a more detailed picture about the differences in the timing and approach between the five deliverables. These five core deliverables are as follows.

### **2.2.1 New standard conditions for water supply and sewerage licences (WSSL)**

We provided draft text in the June consultation for the majority of the proposed WSSL standard conditions. We have now updated the standard conditions following the June consultation. We signalled in June that there may be additional conditions arising from on-going work on customer protection matters and we have now included two additional conditions arising from this work. These cover the introduction of a customer protection code and changes to licence revocation in the event that a retailer ceases trading and the interim supply code has to be invoked. We have handed the proposed set of WSSL standard conditions over to Defra for the necessary statutory consultation to be undertaken. The WSSL standard conditions will be finalised after that consultation is completed.

### **2.2.2 Revised application process for new retail licences**

As outlined in the June consultation, we intend to develop the WSSL application process as an evolution of the current process for the WSL. Work is underway on the changes to the detail of the application process and the guidance documents in line with the June consultation, with Ofwat working closely with the DWI, EA, and NRW on these.

The application process will open at the end of Q1 2016, and we will publish guidance documents and run a number of workshops for potential applicants during

Q1. We will consult upon the guidance documents for the application process after the consultation on the licence itself has closed.. There will be cross-border provisions to allow a single application to be made for both Ofwat and WICS licences (but the assessment of applications and the licences themselves will remain separate).

### **2.2.3 Priority changes to current WSLs and loA**

There are two policy decisions which require more immediate changes to the loAs and WSLs. These are: a) the introduction of a market readiness condition; and b) confirmation that the in-area trading ban will be removed with important protections on arm's length transactions and non-discrimination remaining in place.

Decisions on these were made at the Ofwat Board in October 2015. We will issue a further consultation on the proposed wording of the changes to the Appointment and WSL in December. We intend to make these changes using our existing amendment powers (s13 and s17j WIA 91). Subject to any feedback from the December consultation, we will issue the necessary formal consultations around the end of January 2016.

### **2.2.4 Changes to the instruments of appointment (loA)**

The June consultation document identified a number of changes to the loA, to align it with the new market arrangements. The amended loA will need to be in place by market opening in April 2017 and we are developing the amendments required for each loA.

The majority of the changes will not have effect until market opening. For example, the existing access codes and customer transfer protocol need to remain in place to ensure that the current market can continue to function. We want to ensure that all the necessary changes have been made well ahead of market opening in order to allow companies to focus on necessary preparations. We will include provisions that switch off or alter the relevant conditions at the point of market opening.

### **2.2.5 Transition arrangements for current retail licenses**

Existing WSLs will remain active until the start of the new market at which point they will be revoked. We are currently discussing with Defra the process to revoke the WSL as well as to transition the necessary elements of the combined supply licence.

The WA14 makes provision for a transition scheme and this is one of our options. We are also discussing the best approach with the Water2020 Programme Team in order to make sure that the transition approach does not impinge upon changes that they will need to implement in future. We plan to give clarity on the process and timing for replacing WSL combined supply licences no later than April 2016.

## 2.3 Structure of this document

The structure of the report is based around the five outputs set out above. The majority of the substantive comments that were received concerned either the issues that were identified as requiring prioritisation (a possible market readiness condition and the removal of the in area trading ban), or the new stapling condition requiring a non-exited undertaker to apply the terms of the WRC between its internal wholesale and non-household retail functions. We cover these three areas in some detail in **Section 3**, explaining both the decisions reached and the process that we intend to follow going forward.

**Section 4** then covers the other elements in the June consultation document, summarising the responses received and how we have taken these on-board in reaching our decisions or identifying the actions arising.

We recognise that the licensing arrangements need to be suitable for all participants, including companies with areas of appointment wholly or mainly in Wales, small companies, and customers that wish to self-supply. **Section 5** provides an update on our thinking on the best approach for each of these special situations.

In addition to the details on the IoAs and Licences, the June consultation also highlighted a number of related topics which may impact on details of the market codes or charging arrangements. In most cases, these are being progressed via other programmes of work within Ofwat but for completeness, we provide a brief summary of the relevant consultations in **Section 6**.

The document also has three appendices. In the first appendix, we summarise the specific responses to each of the questions in the June consultation. As usual, we will also publish the consultation responses on the Ofwat website.<sup>1</sup> The second appendix contains the set of standard conditions that Ofwat have provided to Defra

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<sup>1</sup> There were be a small number of redactions in some of the responses to reflect specific requests made by the respondents.

for the statutory consultation. The final appendix provides a tracked-change version of the standard conditions showing the differences between the version provided to Defra and that consulted upon in June.

## **3. Priority changes**

In the June consultation document, we noted that there may be a need to prioritise more urgent issues, including readiness and in-area trading. Consultation responses confirmed that these two issues should indeed be priorities and also that a number of respondents had substantial comments around the proposals. The other proposal which attracted substantial comment was the requirement for a new condition in the IoAs regarding the conduct of integrated undertakers (sometimes referred to as the stapling condition). In this section we cover each of these three areas, summarising the responses received and the decisions that we have reached.

### **3.1 The in-area trading ban**

The in-area trading ban prevents licensed water suppliers associated with an undertaker, from trading with that undertaker or carrying out relevant activities in the area to which the water undertaker's appointment relates. It was introduced a decade ago in response to concerns that incumbent companies would be able to dominate the newly competitive sectors of the retail market. The Enterprise and Regulatory Reform Act 2013 repealed the original legislative requirement for the ban.

In our June consultation, we proposed that the in area trading ban be removed with the existing arm's length trading provision retained the future WSSL. We also proposed that there should be changes to the IoA in condition R to enable this change. We signalled that we would remove this restriction ahead of market opening, which also requires changing the standard licence conditions of the current WSL.

#### **3.1.1 Responses to our consultation**

Respondents, both appointees and associate retailers, were keen to see the removal of the in-area trading ban as soon as possible. The responses highlighted that this would allow them to decide on their preferred business strategy and plan the necessary preparatory activities efficiently. If the ban were not to be removed, they would be forced to duplicate elements of the necessary preparations thereby increasing costs.

Some retailers based in Scotland agreed that the in-area trading ban should not feature in the new market. However, several expressed strong reservations about the removal of the ban ahead of market opening. In particular:

Suggesting that incumbents would get an unfair advantage in the current market, allowing them to sign up the most profitable customers to long term contracts, stifling competition before the new market starts;

Suggesting that early removal was inconsistent with Ofwat's 2013 Level Playing Field discussion paper which suggested that the removal of the ban may need to be linked to additional measures to prevent discrimination against new entrants; and

The Scottish respondents also highlighted a number of *ex-ante* measures that were introduced in Scotland prior to market opening.

### **3.1.2 Removal of the in-area trading ban**

We have considered the points made by the retailers based in Scotland carefully, but we have concluded that it is in customer's interests overall for the ban to be removed in April 2016.

There are several potential benefits from removing the in-area trading ban ahead of market opening. Removal will allow companies to reduce transition costs and take informed decisions about how to prepare for retail competition. Were the ban to continue, companies might need to duplicate aspects of their preparations for in and out of area activity. Equally, continuation of the ban would act as a barrier to retail exit and we believe that it is important that companies should be able to choose this option if they wish to do so.

The removal before market opening may also stimulate additional retail water competition for the large customers that are already eligible. Presently, only Business Stream is active in providing a national offering for multi-site customers. Nine holders of WSLs would be able to make a national offering after the removal of the ban and there might be additional competition to the benefit of regional large customers as well.

We are satisfied that existing Appointment conditions mitigate the suggested risks raised by some Scottish based retailers. In particular:

- We will require that Appointees update and publish their respective compliance code as required by Paragraph 7(4)(a) of condition R, to ensure that they will be fully compliant with Ofwat's updated [guidance](#) from April 2016. This should ensure that information should only be used for the purposes for which it was obtained, and that sufficient steps are taken to demonstrate associated licensees are shown no undue preference.

- The requirements for arms' length trading and no undue discrimination mean that any Appointee which provides services to its associated retailer on a non-commercial basis would be in breach of its Appointment.
- Appointees must also continue to publish access codes that set out arrangements for all WSL retailers, including associated licensees.

### **3.1.3 Next steps**

We plan to remove the in-area trading ban from the IoA and WSL using existing powers. We will issue a further consultation during December on the proposed changes to Condition R(5.1a) of the Appointment and Condition 7 of the WSL. Subject to any feedback from that consultation, we will then issue the necessary formal consultations around the end of January 2016. After allowing for the formal consultation and notice period for implementation, the removal should be effective at the end of March 2016.

## **3.2 Market readiness condition**

We are recommending a new condition be introduced in both the WSL and IoA. We believe this is necessary to ensure that companies undertake the necessary preparations for retail market opening.

### **3.2.1 Responses to our consultation**

The June consultation asked about the need for, and form of, a possible readiness condition.

Consultation responses showed markedly different views about the need for a condition. The majority of undertakers suggested that a condition was not needed as there were already strong reputational incentives on companies or because they perceived a risk of duplication with the work on readiness and assurance that was being progressed by MOSL and Defra. In contrast, there was strong support from a minority of undertakers and current and potential retailers who suggested that a condition would help build confidence, sending clear signals to customers and other stakeholders about industry commitment, both individually and collectively.

In terms of the form of any condition, there was support from retailers for both a general overarching condition and a requirement to follow a detailed formal transition

plan. However, almost all undertakers argued that a detailed licence or appointment condition is not the best way to achieve the necessary clarity.

### **3.2.2 Proposed simple condition and further consideration of implementation scheme**

We recognise that there is a strong level of commitment amongst companies. However, with the importance of the new market and the benefits that it is capable of unlocking for customers, we think that it is necessary to have a general condition to create additional incentives on companies and reduce programme risks.

We agree with some respondents that a detailed licence or appointment condition is not the best vehicle. If it became necessary to modify the details in such a condition, the process needed to obtain agreement to licence or appointment changes is likely to require more time than is safely available to the programme. Our proposed condition therefore includes more general wording requiring companies to undertake reasonable activities including preparation of data, development of their own systems and processes and participation in programme testing, readiness and assurance activities.

### **3.2.3 Next steps**

We will consult during December on the wording of a new condition for the WSL and Appointment to implement the decision regarding readiness. We will follow the same process as for the removal of the in-area trading ban, using the same consultation to cover both changes.

## **3.3 Stapling**

In the June consultation, we noted the Open Water Programme's recommendation that Ofwat include a condition in the Appointment regarding the conduct of integrated undertakers. The Programme was concerned that without this condition, it was unclear whether the retail part of a non-exited undertaker would be bound by the provisions of the Wholesale-Retail Code (WRC) in the same way as other retailers. In essence a non-exited undertaker would be required to apply the terms of the WRC between its internal wholesale and non-household retail functions.

We agreed that non-exited retailers should be bound by the provisions of the WRC in the same way as other retailers and included in the consultation a proposal for a

stapling condition. The draft condition required non-exited retailers to carry out activities as if there were an agreement pursuant to section 66D of WIA91 between the wholesale and retail businesses as separate and unrelated entities. It also required them to put in place written arrangements and provided for Schedule 8 of the Market Arrangements Code (MAC) to set out some provisions around how the market codes should be interpreted in relation to integrated undertakers.

### **3.3.1 Responses to our consultation**

Responses were generally supportive of the principle of a stapling condition. Some undertakers did however express concern around the legal implications of the proposed drafting. Comments included the following.

- It would be difficult to comply with the condition as drafted without legally separating.
- The condition as drafted appears to apply to all retail activities rather than just those in relation to the contestable market.
- It might prevent shared services and that such sharing is necessary to preserve the current economies of scale and scope that were taken into account in the 2014 Price Review (PR14).
- The proposal would place disproportionate requirements on small companies and new appointees.

### **3.3.2 Our approach**

We continue to believe that a form of stapling condition is needed for the non-exited companies. The intention behind the proposed condition was, and is, solely to ensure that non-exited undertakers are bound by the provisions of the WRC in the same way as other retailers. However, we will further review the drafting and how it works in tandem with Schedule 8 of the MAC in light of the concerns expressed by companies.

We will set out approach in more detail when we consult further on the changes to the IoA, during Q1 2016.

## 4. Standard licence requirements for market opening

In this section, we set out our latest position regarding the more routine areas of licensing change. The structure of this section follows that of the licensing outputs which we illustrated in section 2. The more immediate changes required to the Appointment and the WSL were set out in section 3, so this section covers:

- the new WSSL;
- the revised application process for the new WSSL;
- less immediate changes to Appointments;
- new WSSL or IoA conditions added since the June consultation; and
- transition for existing WSLs.

### 4.1 The new WSSL

Legislation provides for retailers (other than undertakers) who wish to participate in the new competitive market by using an undertaker's supply system to provide water supply or sewerage services to be licensed. The licence is needed for companies wishing to acquire the retail business of an existing undertaker. Water Supply Licences (WSL) have existed since November 2005. The new WSSL standard conditions are based on the WSL standard conditions modified to reflect the broader scope of the new market (sewerage and water retail services for eligible non-household customers) as well as the new market codes and systems that are being developed. Companies wishing to compete nationally for non-household retail customers will require a Water Supply and/or Sewerage Licence (WSSL).

Ofwat consulted on the structure and content of the WSSL in June. This section summarises the responses received and decisions made in respect of the WSSL issues covered in June. We have considered the responses and made a number of changes to the draft standard conditions and these have now been handed over to Defra, who will undertake a statutory consultation.

We also signalled in the June consultation that on-going work on issues around customer protection might lead to the inclusion of additional conditions. That work has now identified two additional conditions for the new WSSL (one of which will also be introduced in the IoA). The details of these are set out in section 4.4.

The table below summarises the areas upon which we consulted, provides a summary of the responses that we received and outlines the approach we have adopted and changes we have made in preparation for handing over the conditions to Defra.

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
Form of the WSSL	The consultation proposed separate, modular retail licences for water and sewerage (Section 4.1).	<p>Overall, the majority of responses supported separate licences for water and sewerage as it would provide flexibility and would be aligned with Scotland.</p> <p>Where responses favoured one single licence, they were generally concerned about the increased administrative burden of two licences or did not see the benefit of separate licences. Some also questioned why a single modular licence could not work.</p>	<p>Having assessed the responses and considered the alternative options, we still think that separate modular licences remain the best option.</p> <p>The drafting of the market codes anticipated that there would be separate licences so this avoids the need for extensive redrafting and also gives consistency with the Scottish market.</p> <p>We note companies' concerns about administrative burden but we think these can be managed. In particular, we will consider how the licence application process, and annual monitoring requirements can be structured to reduce the burden on licensees that wish to hold both water and sewerage retail licences. We are also proposing that the same standard conditions apply in both the water supply and sewerage licences.</p>
Standard conditions of new WSSL	Proposed standard conditions based on current WSL with some modifications to address new market arrangements. (Section 4.2)	In general, responders were supportive of the proposed draft licence text that we published, with some minor comments:	We explain below how we are dealing with the most significant points raised.
		Different water and sewerage conditions: the responses did not identify bespoke conditions for sewerage. However, several responses identified a need to review some conditions to ensure that they worked for sewerage, or proposed minor drafting amendments to the conditions to ensure that they work for both services	<p>We have reviewed the responses and also the conditions in the separate licences in Scotland. We remain of the view that bespoke sewerage only conditions are not needed in the new WSSL.</p> <p>However, we need to make minor drafting amendments to ensure that the conditions work for both water and sewerage licences. For example: to condition 5 (Emergencies and unplanned events).</p>
		Condition 7 – there were a number of comments questioning the relevance of the further obligations to undertakers	We have reviewed condition 7 and have decided that this is not needed for the new market. Under the existing WSL regime, this provision was really intended to cover combined supplies rather than retail only activity. In the new regime, the relationship between the licensee and undertaker are managed through the WRC.

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
			<p>We are discussing with Defra whether we can make use of a transition or qualifying scheme under Schedule 11 of the WA14 to give continuing effect to the additional conditions for combined supplies. We would include condition 7 within such a scheme which means that it can be deleted from the new WSSL.</p>
<p>Standard conditions of new WSSL</p>	<p>Checking whether any of proposed amendments in Table 2 of June consultation document are viewed as non-routine. (section 4.2)</p>	<p>Although some respondents reserved their position, the majority indicated that they agreed that almost all the proposed amendments were routine. One exception to this was the condition relating to area of operations and arm's length transactions.</p>	<p>As discussed in section 3 of this paper, we will shortly be consulting on the specific changes to the WSL and IoA. The comment made was to do with the timing of the removal of the in area trading ban, rather than the standard conditions of the WSSL.</p>
<p>Maintaining customer protection</p>	<p>Changes to the guidance on the use of the certificate of adequacy to make it clearer that it applies across all types of circumstances; and introducing requirements to certify on licence application and material change in circumstances. (Section 4.3.1)</p>	<p>The majority of responses agreed with the principles of our proposed approach. There were requests for additional clarity on a number of points:                      How Ofwat would make use of the certificate?                      What the definition of "material change" would be?                      How the annual certification process would align with other reporting requirements on companies?                      What form of assurance Ofwat would require?</p>	<p>We are reviewing the necessary content of the certificate to ensure it aligns with the changes introduced by the WA14 and we will provide further guidance on the certification process with the WSSL application guidance.</p> <p>We have amended the condition to accommodate a single authorised signatory in certain legal structures.</p> <p>It is important that the certificate of adequacy fits with the rest of the regulatory framework and we will work with the Finance &amp; Governance programme to align processes and information requirements in order to minimise regulatory burden.</p> <p><b>External assurance:</b> We intend to continue with the approach proposed in section 6.2.2 of the consultation and not require third party assurance to be submitted with the certificate. Market participants will no doubt consider what assurance they need to be able to sign the certificate. Participants may also wish to provide evidence of the assurance sought in support of their updated certificate.</p> <p><b>Material change in circumstances:</b> We understand companies are keen to have a clear definition of "material change". However, Ofwat's view is that it is not possible to develop a</p>

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
			<p>universal definition that would apply to every set of circumstances. We are also keen to avoid placing an undue reporting burden on small companies or entrants. As a result, we believe that licence holders are best placed to understand what scale and type of change would be material to the circumstances of their individual businesses and so we have not included a definition within the licence condition.</p>
<p>Enabling the Market Arrangements Code</p>	<p>Proposal for a new licence condition creating obligations to be a party and comply with the MAC (Section 4.3.2) (Note – the same condition would also be included in the IoA)</p>	<p>There was strong agreement to the proposed approach.</p> <p>There were a number of comments on the detail of the proposed condition:</p> <p>A number of respondents suggested that the details of the code principles should be in the codes rather than the licence in order to reduce the need for changes to licences.</p> <p>There were a number of questions about the governance of the MAC and the Market Operator licence.</p> <p>There were a number of comments about the need to ensure that code principles were appropriate for small companies and Wales</p>	<p>We agree with the points made about the risks of having the principles in both the licence condition and codes. The purpose of the drafting was to aid interpretation and we have now removed the statement of principles and refer instead to schedule 1 of the MAC.</p> <p>We have reviewed the code change process and are satisfied that it remains appropriate. In particular, Ofwat is required to review the decisions reached by the code panel, and the presence of independent panel members and an independent panel chair also provide further safeguards against inappropriate changes. We have added a provision for the Panel to add an assessment of impacts on other Retail Market Codes in each code change final report provided to Ofwat, to aid change coordination across the market codes.</p> <p>The Market Operator will be appointed by the parties to the Market Arrangements Code and they will also monitor the performance of the Market Operator as part of that appointment. There is no provision in the legislation for the Market Operator to be licensed.</p> <p>Section 5 of this document provides further detail of our thinking on special situations such as Wales and small companies.</p>
<p>Equivalence of treatment for retailers</p>	<p>We proposed to remove the in-area trading ban, maintain the provision regarding arm's length transactions and</p>	<p>Although undertakers were supportive of the proposed changes, there were some strong objections to the proposals from other respondents. They expressed concerns that removal of the in-area trading</p>	<p>Our detailed views on the provisions regarding the area of operation, arm's length transactions and non-discrimination are discussed in section 3.</p>

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
	introduce a new provision on non-discrimination (Section 4.3.3)	<p>ban ahead of market opening would distort the new market and prevent a level playing field.</p> <p>There were also some queries on the need for arm's length obligations in both the WSSL and IoA; and non-discrimination clauses.</p>	The <a href="#">existing guidance</a> which is applicable to current appointees will be updated for the new market.
New WSSL	Overall comments on proposed changes or areas not covered in proposals (Section 4)	The majority of responses in this area concerned the degree of equivalence between the proposed licence and licences in Scotland and/or the need for additional provisions to counter the perceived market power of appointees	<p>Our proposals in the June consultation document were made after a detailed review of the Scottish licences. There are a number of important differences between the two markets, in particular the presence of a number of large players from the outset.</p> <p>We are satisfied that the additional provisions around non-discrimination and the measures to ensure continuity of supply for customers (supplier of last and first resort), combined with the ever-present requirements of competition law, will provide an environment in which vigorous competition can develop.</p>

## 4.2 Application process

In our June consultation, we set out our vision for the application process for future WSSLs. The current process will require revision to accommodate this new approach. Some changes reflect the fact that future licences will also cover sewerage, and the requirement in legislation to create a joint application process in England and Wales, and Scotland. We have also considered a number of areas in which the different circumstances of the new market may require some further adaptation of the current approach.

We set out in the table below the areas that we consulted on, a summary of the responses we received and the approach we are continuing to develop.

Area of focus	Consultation proposal	Summary of responses	Ofwat decisions or next steps
<p>Application process (Section 6)</p>	<p>We made a number of proposals or asked for views in regards to the future application process:</p> <p>Proposal to continue to base the assessment on three core competencies – financial, managerial and technical (Q19)</p> <p>Proposal to make the granting of a licence conditional on passing market accession testing (Q20)</p> <p>Proposal to require submission of a completed certificate of adequacy with a licence application (Q21)</p> <p>Views were sought about the coverage of sewerage and the role of the Environment Agency (Q22)</p> <p>Views were sought on whether the sponsor role should be maintained, limited or removed (Q23)</p> <p>Proposal to include coverage of customer facing systems in the managerial competency test (Q24)</p>	<p>In general, there was strong support for the proposals made in the consultation document.</p> <p>All respondents supported the continued use of the three core competencies, and there were some helpful suggestions on the areas of detail that the Environment Agency should cover.</p> <p>Almost all respondents agreed that licence grant should be linked to the passing of market accession tests. The small number of counter views concerned timing issues and links to the exit process rather than any opposition on principle.</p> <p>All but two respondents agreed with the proposal to require submission of a completed certificate of adequacy at the time of application.</p> <p>There was strong support for the role of the Environment Agency as well as some requests for additional detail on their role.</p> <p>All respondents suggested that the role of the sponsor be either limited or removed completely.</p> <p>The majority of respondents agreed that it was important for there to be coverage of customer facing systems although there were some reservations expressed about the form or intrusiveness of tests.</p> <p>The majority of respondents agreed that questions of scale were best dealt with via the certificate of adequacy</p>	<p>Given the large measure of agreement to the consultation proposals, we will develop the details of the application process in line with these proposals.</p> <p>In particular:</p> <p>Licence grant will be conditional on passing the market accession tests, although we will review the timescales here to make sure they recognise the timeline for market entry testing;</p> <p>We will require there to be a completed certificate of adequacy submitted with the application. We will provide further detail on the certificate and how its form is amended for applicants who are not limited companies;</p> <p>We will work closely with the DWI, the Environment Agency and Natural Resources Wales to develop the details of the technical competency testing;</p> <p>We will remove the role of sponsor as no respondents thought that it added value for applicants and there were a number of concerns about customer protection impacts</p> <p>We will include some coverage of customer facing systems in the competency tests but ensure that this is proportional for small applicants.</p>

Area of focus	Consultation proposal	Summary of responses	Ofwat decisions or next steps
	Proposal to deal with scale considerations in the certificate of adequacy (Q25)		

### 4.3 Amendments to the Instrument of Appointment

We proposed a number of initial amendments necessary to the conditions of Appointments to accommodate the new retail market. We shared our overall policy direction, and made references to drafting change that would be needed. Overall, there was support for the proposals and many respondents were keen to see the detailed drafting.

We set out three types of changes in the June consultation:

1. **Mechanistic.** Changes that may be needed because interactions with eligible non-household customers will most often be through retailers rather than appointees.
2. **Customer type.** Changes that may be needed to make clear whether conditions apply to households, non-households or both.
3. **Related to equivalence.** Changes that may be needed to demonstrate equivalent treatment of licensees and retail arms of undertakers to ensure a level playing field.

We set out, in the table below, the areas which we consulted on, a summary of the responses we received and the approach we intend to adopt, which will include a full review of all Appointments before developing the draft changes to these Appointments.

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
Condition Q (compensation for interruptions due to drought) – mechanistic amendment	We proposed to amend Condition Q to remove references to non-household customer as the process for compensation exists within the Business Terms of the WRC. (Section 5.1.1)	Respondents agreed in principle to the proposed removal of non-household customers from Condition Q. This agreement is subject to confirmation once detailed drafting is presented.	We will amend condition Q as proposed. We identified a potential gap between the code and the licence definitions with respect to ineligible non-household customers and we are reviewing the best approach to resolve this. There has been a change request for section 2.43 of the Business terms in the WRC submitted to the Interim Code Panel on 15/09/2015 to include provision that where a wholesaler makes a payment in respect of drought interruptions or a GSS standard, these will be passed onto customers by the retailer, promptly and in full.
Condition G (customer complaints) – customer type amendment	We proposed to amend condition G so it only applied to domestic customers. For complaints, we suggested including the necessary provisions within the Operational Terms to inform non-household customers about CC Water and WATRS. (Section 5.1.1)	Respondents were in general agreement to amend condition G and include provisions within the Operational Terms with respect to CC Water and WATRS. Some respondents referred to the differing terminology of “domestic customers” and “non-household” customers.	We will amend condition G, as proposed. There is an Operational Terms change request for Heading I and Process F5 submitted to the Interim Code Panel on 15/09/2015 to include provisions for the retailer to inform its non-household customers about CC Water and WATRS. We agree that there is a potential gap between the code and the licence definitions with respect to ineligible non-household customers and we are reviewing the best approach to resolve this.
Condition I (leakage) – customer type amendment	Condition I obliges the appointee to take steps to compensate customers when a leak is identified and the customer repairs it. Part H of the WRC has a process to apply for an allowance as a consequence of a leak and provides for the retailer to claim payments from the wholesaler. The consultation asked whether	There was no clear consensus of views regarding condition I. A number of respondents thought that the licence condition should remain unchanged in order to maintain the obligation for customers In contrast, other respondents thought that the obligations should be included in the WRC. Some responses suggested that the code provisions should be strengthened. However,	We will maintain the condition in its current format. This will ensure there is sufficient protection for customers but allow Retailers the ability to offer retail product differentiation.

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
	further amendments of the code arrangements and/or Appointment condition may be needed to maintain the obligation. (Section 5.1.1)	others suggested that since management of leakage could be an area of retail product differentiation, changes were not required.	
Condition F6 (Arm's length trading)	Amend the condition to ensure that it is clear the obligation covers transactions between wholesale and retail, including those following a retail exit (Section 5.1.2)	<p>There were few comments from respondents on this condition. Those who did respond agreed with the principle that the arm's length requirement should apply.</p> <p>Respondents suggested that since the obligation already covers the relationship between the Appointed Business and any Associated Company, no change was needed.</p>	We will maintain the position set out in the consultation document, as we consider an amendment is needed to ensure that there is clarity that the obligations apply to between the wholesale and retail business.
Condition F6.A2A (Certificate of adequacy)	We proposed to introduce a separate certificate of adequacy for non-household retail. (Section 5.1.2)	<p>There was broad agreement with the proposal, including strong support from licensees not associated with undertakers. Some respondents were concerned that the change would create additional regulatory burden on undertakers.</p> <p>Two responses also suggested that if a separate certificate for non-household retail was introduced, then it should be carved out of the existing obligation.</p>	<p>We will require a separate certificate of adequacy for non-household retail for undertakers who have chosen not to exit.</p> <p>We note companies' concerns about increased regulatory burden arising from the introduction of a separate certificate for non-household retail. However, we think it is important that all non-household retail companies should face similar obligations. We will work with the Finance &amp; Governance programme to align information requirements and submission timetables where possible in order to minimise regulatory burden.</p> <p>We agree that non-household retail can be removed from the existing obligation to produce a certificate for the whole appointed business once a separate certificate is introduced.</p>

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
Condition R1-3 (Access code for WSL)	R1-3: Proposed to amend condition to remove access codes for retail only licensees or to delete the provisions if the obligation on access codes for combined supply sits within a transition scheme.	<p>Respondents generally agreed for the proposed amendments for retail only licensees.</p> <p>There was also support for the removal of the obligation for combined supplies as long as it sat in a transition scheme. A number of respondents were keen to have greater clarity on a transition scheme for combined supplies and one requested for the obligation to remain in the IoA.</p>	In the next section we provide some further explanation regarding a possible transition scheme for WSLs
Condition R5.1 (In-area trading ban)	Amend wording to remove in area trading ban and maintain requirement for arm's length transactions	As noted in the section on the related WSSL change, there was strong support for the removal of the in-area trading ban. However, there were also a number of concerns about the timing of its removal.	We discuss our approach regarding the in-area trading ban in section 3.
Condition R5.3 (Relationship with licensees)	Removal of existing obligation to inform Ofwat if relationship with licensee changes.	The majority of responses were in favour of the removal of this obligation. Some responses were concerned with the removal of the obligation and queried how Ofwat could effectively use its <i>ex-post</i> powers without the information.	We will remove the obligation from condition R. The removal of this obligation from the IoA in no way alters the obligation on companies to comply with competition law. We consider that companies are best placed to understand and manage the risks around their relationships with licensees.
Condition R7-9 (Obligations around information)	Proposed to remove obligations with regard to information sharing as now covered by the WRC and MAC.	Responses supported the removal of this obligation as long as there were replacement provisions in the WRC and the MAC, and provided that combined supplies are dealt with in the transition scheme.	Given the responses to the proposal, and that confidentiality and information sharing are covered in part 2 of the WRC, we consider the equivalent obligations no longer needs to remain within IoA.
Condition S (Customer Transfer Protocol)	We proposed to amend or remove the condition depending	Responses agreed with the proposal to remove the customer transfer protocol, and one response noted that it will	We will amend condition S to remove the obligation.

Area of focus	Consultation proposal	Summary of responses	Ofwat decision or next step
	on the form of transition scheme for combined supplies.	need to be retained for combined supplies in the absence of an alternative.	We are developing further details on a possible transition scheme for combined supplies.
Condition N (Licence fees)	We proposed to introduce separate fees for non-household retail where the undertaker has decided not to exit.	Respondents supported a separate licence fee as long as it was not in addition to the current fee, i.e. cost neutral to undertakers.	<p>We will introduce a separate fee for non-household retail. However, it is not necessary to amend condition N to introduce a separate fee. It would only be necessary if we were proposing to introduce the fee outside of the condition N cap.</p> <p>Based on the collective responses and the desire that the fee should not be in addition to the current fee, we do not plan to amend condition N.</p>
New Condition to Enable the Market Arrangements Code	<p>Proposal for a new licence condition creating obligations to be a party and comply with the MAC (Section 4.3.2)</p> <p>(Note – the same condition would also be included in the WSSL)</p>	<p>There was strong agreement to the proposed approach.</p> <p>There were a number of comments on the detail of the proposed condition. However, since the condition will be similar in both the IoA and WSSL, the points were covered in section 4.1 of this document.</p>	<p>The following areas were considered:                      Removal of the principles from the licence condition;                      Review of the code change processes; and                      Appointment and performance of the Market Operator.</p> <p>Please see Section 4.1 of this document for details of the proposed condition that will be included in both the current WSL and IoA.</p>
Other proposed changes to the conditions of Appointment	Q16 and Q17 of the consultation document asked whether any additional changes to the IoA were required and whether there were any areas that have not been covered, respectively.	<p>A few areas were identified, which are dealt with in other sections.</p> <p>Proportionality with respect to smaller companies.</p> <p>“No worse off” condition for inset appointees, where an incumbent has exited the retail market.</p>	Proportionality with respect to smaller companies and “no worse off” conditions has been covered in Section 5 of this response.

## 4.4 Other areas highlighted in responses

### Obligation to maintain an investment grade credit rating

One response, suggested that non-household retail should be carved out of an appointee's obligation to maintain at all times an "Issuer credit rating which is an investment grade rating" (condition F, paragraph 6.A6). The obligation also extends to any associate company as an issuer of corporate debt.

On the face of it this proposal is attractive and would appear to provide a visual level playing field with water supply licensees. However, credit ratings are attached to the legal entity (e.g. the holding company or the corporate family), not different parts within the entity. Therefore, we see little benefit of carving out non-household retail from the obligation on the Appointee as it will not change the minimum obligation on the non-exited Appointee. In addition, while associate licensees could be caught under the obligation on Appointee's associate companies (as an issuer of corporate debt); it is highly unlikely that a licensee would become an issuer of corporate debt. Overall, we consider there is little benefit of carving out non-household retail from the obligation under condition F6.A6, and that it is not necessary for retail market opening.

## 4.5 Additional licence conditions added since the June consultation

We signalled in the June consultation that on-going work on issues around customer protection might lead to the inclusion of additional conditions. That work has now identified two additional conditions for the new WSSL (one of which will also be introduced in the IoA).

[IN 15/12](#) published in early September 2015 explained that we are currently considering how best to protect customers in the retail market. In particular, it explained that our initial view was that a mandatory Code of Practice may be required to provide effective protection for customers, especially smaller non-household customers such as micro-businesses. Following a number of industry workshops and other discussions with stakeholders, we remain of the view that a mandatory code will be required. We are currently consulting on a number of the specific [customer protection issues](#) for the retail market relating to the customer's switching journey (including, for example, sales and marketing activities and contractual issues), together with our proposed measures to address these, which would form the basis of the proposed Customer Protection Code of Practice.

To make sure that customers of all retailers are protected under the Code of Practice, we propose to use a licence condition to require retailers (appointed companies and WSSL retailers) to comply with it. On this basis, we have included a draft condition in the draft WSSL conditions submitted to Defra (see Appendix 2), which should be read alongside our proposals in our customer protection consultation. We intend to include a similar condition within the IoA. This is the first step in a two stage consultation process. There will be a further consultation on the detailed drafting of the proposed Customer Protection Code of Practice, and the process for modifying it, in Q12016.

The second additional condition in the WSSL concerns the potential need to revoke the licence on much shorter notice than usual in the event that the interim supply arrangements have to be invoked. In order to ensure that customers and other industry participants are appropriately protected once the interim supply arrangements have been invoked, we consider that there is merit in shortening the licence revocation timetable to allow Ofwat to revoke 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 a receiver being able to continue to supply water or provide sewerage services without agreeing to pay the associated wholesale charges. This would also be consistent with Ofgem's energy supply licence revocation powers. This was the subject of a specific question in the consultation on interim supply that recently closed. Consultation responses agreed with the need for such a provision, and so in order to provide as complete a picture as possible for the statutory consultation on the WSSL, we have included this additional condition in the draft WSSL conditions submitted to Defra (see Appendix 2).

## **4.6 A possible transition scheme for existing WSLs**

The existing WSL regime will need to be terminated to be replaced by the WSSL regime and current thinking is that the combined supply version of the current WSL will need to be transitioned pending the introduction of the wholesale authorisation. The processes for these activities are currently being developed, and are likely to be included in a transition scheme under Schedule 11 WA14.

Key issue	Consultation proposal	Summary of responses	Ofwat decision or next step
Transition arrangements for retail only WSL	We proposed that existing licence holders would apply for the new WSSL using a simplified application process. A transition or qualifying scheme under Schedule 11 of WA14 would be used, using a section 91 WA14 order to revoke current licences at the start of the new market. (Section 7.1.1)	All respondents supported the proposed approach. There were a number of requests for additional detail and clarification on timelines.	We will follow the approach outlined in the June consultation document. We have started work on the development of the revised licence application process.
Transition arrangements for current combined WSL	We proposed a transition scheme to continue to give effect to the supplementary authorisations in the current combined licence. (Section 7.1.2)	Respondents were in broad agreement with the proposal, supporting the use of a transition scheme. There was some difference of view regarding the changes that may be needed to access code guidance and the customer transfer protocol. A number of respondents were keen that arrangements for combined supplies were identical to those for retail only customers. However others suggested that revising the current access codes would be the most pragmatic approach.	We are likely to follow the approach outlined in the June consultation document. We will develop further details on the proposed transition arrangements regarding combined supplies as part of the on-going work on the licence application process and transition. This additional detail will help make clear whether all of the necessary provisions can be incorporated in the transition scheme or whether there may need to be some residual obligations within the IoA. We will provide a further update on the transition arrangements no later than April 2016.

## **5. Special situations: Wales, small companies and self-supply**

We are aware that the licensing arrangements need to be fit for purpose for all participants, including small companies, companies whose areas are wholly or mainly in Wales, customers who use their systems and licensees with a restricted retail authorisation, and customers that wish to self-supply. This section provides an update on our thinking in these special situations.

### **5.1 Special situation: Wales**

The Welsh Government has decided that competition should not be extended further to non-household customers who use the supply systems of Dŵr Cymru and Dee Valley (for either customers located in Wales or England). Therefore we raised the question regarding the extent to which companies operating wholly or mainly in Wales are required to engage with the new market arrangements and to ensure a proportionate approach to the implementation of those arrangements. We held a workshop to discuss issues for Dŵr Cymru, Dee Valley and other relevant companies on 16 July. MOSL also held a cross border workshop on 27 August regarding changes to the codes to reflect cross border arrangements.

We are also aware that if the Silk Commission's recommendations on devolution are taken forward, then the legislative boundaries for water and sewerage policy would be redefined along national instead of company boundaries. This would impact on non-household customers of Dŵr Cymru and Dee Valley in England, and Severn Trent Water's customers in Wales. However, the timing of such changes (if made) could come after the start of the new retail market in April 2017.

#### **5.1.1 Responses to our consultation**

Respondents were in agreement that companies wholly and mainly in Wales operate in the market. Some suggested that participation should be proportionate to the size of the eligible market in Wales and not impose unnecessary burden on companies whose areas are wholly and mainly in Wales. The Welsh Companies expressed concern over meeting "Level Playing Field" requirements when they are unable to retail exit from the market.

A number of cross border issues relating to ineligible and eligible services were identified in responses and at the workshop held in Wales on 16 July. These were addressed at a MOSL codes workshop on 27 August.

### **5.1.2 Our approach**

We support the view that companies wholly and mainly in Wales operate in the market. We believe that proportionality can be achieved by engaging with the Market Operator systems, including through the low-volume interface.

We are also looking at conditions of appointment regarding the conduct of integrated undertakers, through the review of the stapling condition. The WA14 does not provide for companies wholly and mainly in Wales to exit non-household retail. Any future provision would be a matter for the Welsh Government.

A cross border workshop was held on the 27th August and changes were proposed to the codes. These were issued under the reference WRC 0007 to the Interim Code Panel on 22 September.

We note that the Welsh Government issued charging guidance on 24 August and we will incorporate this into our charging rules going forward.

In the event that it is decided to implement changes arising from the Silk Commission's recommendations, further work will be needed to understand how best to implement the details of the required changes and the timescales required to do so.

## **5.2 Special situation: small companies**

It is important the non-household customers of small companies are able to participate in the new market. However, it is also important that a proportionate approach is taken to ensuring companies take part in and comply with the new market arrangements.

We did not make specific proposals in this area but asked for suggestions on the best approach to ensure that new market arrangements are proportionate for small wholesaler companies and small retailers.

### **5.2.1 Responses to our consultation**

Responses to the consultation question were mixed. Where there was support for a proportionate approach it was mainly expressed in terms of system interface requirements.

In addition, a few responses expressed concern about level playing field issues if a different approach was allowed for small retailers. New appointees were generally supportive of a different approach for small wholesalers. They raised a number of concerns about how the new market arrangements would work with existing inset competition and our approach to regulating new appointees. We set these concerns out in more detail below.

### **5.2.2 Our approach**

Based on the responses we do not propose a different approach for small retailers (to that already included in the market codes).

We consider the proposed amendments to the conditions of appointment are also relevant to small wholesalers, and do not increase small wholesaler's risk or introduce additional complexity.

The new market arrangements do mean that wholesalers will have to undertake some preparations in the following areas:

- preparing and providing customer data;
- exchanging information via the market operator; and
- understanding and complying with the market codes.

We think the requirements in these areas are inherently proportional to company size, as the amount of work is largely driven by the number of non-household customers which the wholesaler serves.

However, there are a number of areas in the code which currently may not take into account where a new appointee will sit between incumbent wholesalers and new retailers in the operational processes. We have proposed to MOSL and the Interim Code Panel that this issue is addressed in Schedule 8 of the MAC.

### 5.2.3 Other areas highlighted in responses

#### New appointees and small companies

Within the consultation responses and company workshops, new appointees and other small companies raised a number of concerns about how the new market arrangements would work in relation to their particular arrangements.

A new appointment occurs when we appoint a company for the first time to provide water and/or sewerage services for a specific geographic area. New appointees can either use their own resources to serve customers or alternatively purchase services from the incumbent undertaker. Therefore within a new appointee's area, there are potentially three different entities involved in the provision of water and sewerage services to the non-household customer: the incumbent wholesaler; the new appointee; and the non-household retailer.

The companies queried the following.

- Whether the large 18 undertakers had been funded for market readiness at PR14.
- How could new appointees and small companies satisfy Ofwat's expectations around arm's length trading and the stapling condition given their size?
- How the "no worse off" principle for new appointments will work with the new market arrangements.
- Wholesale tariffs for water and sewerage services.

**PR14 funding:** Appointees were not funded for market readiness at PR14. The only funding for retail market opening was in relation to licence fees to cover the cost of the Open Water programme.

**Arm's length trading:** Small companies and new appointees were concerned about how they could comply with obligations around arm's length trading without legally separating.

We consider there are a range of tools appointees can use to comply with these obligations and which do not require legal separation. Companies need to understand the risks that they face which will reflect both their specific policies and procedures and their position within the relevant market.

**The "no worse off principle":** We regulate new appointees slightly differently to the existing appointees. Instead of setting price controls for each new appointee (as we do for other undertakers), we require new appointees to fix their charges at no

greater than the incumbent undertaker's relevant charge. This is set out in condition B of their IoAs and is to ensure that customers are "no worse off" than if they had remained with the incumbent undertaker.

As a result of the WA14, we have identified a number of consequential amendments to condition B of the new appointees' IoAs, which we think are necessary to ensure that the condition continues to work once Government commences the WA14. These amendments will:

- remove references to the WIA91 that will no longer be relevant once the WA14 is commenced and take into account other changes in the Act;
- provide for setting end user charges where the incumbent company has not exited retail;
- provide for setting end user charges where the incumbent company has exited retail; and
- provide for setting wholesale charges.

We will engage with the new appointees on these amendments.

### **Wholesale tariffs:**

Through our discussions with new appointees, some have expressed concern about the price at which they buy services from the incumbent undertakers. We understand that in some cases there has been little or no difference to the maximum price which new appointees are allowed to charge their end use customers. Additionally, we understand some new appointees are concerned about how they will be required to set wholesale charges and whether it will be sufficient to cover their efficiently incurred costs.

We consider that the introduction of wholesale price controls for incumbent undertakers and the obligation on them to publish wholesale charges will provide new appointees with an improved negotiating position for services. We are continuing to consider these issues alongside our work on charging and the consequential amendments we have identified above.

## **5.3 Special situation: Self-supply**

As part of our thinking on how best to make sure the licence framework delivers an effective market for customers, we considered what modifications may be needed to the conditions of the proposed WSSL for those customers wishing to self-supply.

The conditions we suggested that required modification or removal in the June consultation were:

- conduct of licensee;
- certificate of adequacy;
- provision of information;
- arm's length transactions; and
- supplier of last resort/Supplier of first resort.

We also highlighted that further consideration on licence fees was required.

### **5.3.1 Responses to our consultation**

There was strong support for our proposed approach to self-supply licences; however, there were a number of concerns raised about how they will work. The responses covered the following.

- Some respondents suggested that the certificate of adequacy be maintained in order to provide some protection to the wholesaler.
- Whether the definition of “Persons associated with a licensee” regarding self-supply licences provided a loophole to supply ineligible premises through the “self-supply” licence.
- Whether wholesalers would need to take meter reads to validate the information from the licensee.
- Revenue risk if the self-supply licensee failed to pay or submitted an inaccurate meter reading.
- Revenue risk of the self-supply licensee failed to pay or submitted an inaccurate meter reading.

### **5.3.2 Our approach**

Based on the responses, we will introduce conditions for inclusion in a “self-supply” WSSL licence which is authorised to supply only its own premises or those of its associates based on our proposals in the consultation document.

In our wider review of the Certificate of Adequacy we do not believe this is necessary for self-supply. We believe the credit terms, disconnection rights and the ability to suspend the retailer for non-payment afford sufficient protection to the wholesaler.

We have reviewed the definition of “persons associated with a licensee” and we are satisfied that the same eligibility criteria apply for self-supply licensees and therefore there is no scope for ineligible premises to be supplied under a self-supply licence.

Regarding revenue risks that may arise if a self-supply licensee failed to pay wholesale charges, we recognise that the code provisions for disconnections to be managed by retailers will need some adaptation. Section s61(ZA) of the Act allows disconnection by a water undertaker in some circumstances if money is owed to it by occupiers of those premises. Further discussion with MOSL is needed as to whether this covers all the situations in which code adaptations may be required.

## 6. Related key issues

Our June consultation paper raised a number of significant issues that, while not being core to delivering the licensing outcomes, are related. These related topics include:

- Interim Supply Code;
- Supplier of First Resort;
- developer services;
- additional customer protection issues; and
- charging.

These areas of work have been the subject of separate consultation exercises and/or other forms of engagement with stakeholders since the June licencing consultation. In this section we summarise our latest thinking on the aspects of these areas of work with the most immediate relevance for the responses to the June licensing consultation and the development of the licenses.

### 6.1 Interim Supply Code (ISC)

We recently consulted on proposals for the introduction of arrangements to address the situation where a water or sewerage supply licensee ceases to be able to supply its non-household customers (['Interim supply arrangements in relation to the opening of the non-household retail market – a consultation'](#)). The consultation has now closed and Ofwat will be publishing its conclusions in due course. As explained in section 4.4, consultation responses agreed that there was a need to revoke the licence on much shorter notice in the event that the interim supply arrangements have to be invoked. So in order to provide as complete a picture as possible for the statutory consultation on the WSSL, we have included this additional condition in the draft WSSL conditions submitted to Defra (see Appendix 2).

### 6.2 Supplier of First Resort

Our June consultation described the Supplier of First Resort (SoFR) arrangements, which are necessary to ensure that eligible premises are served by a licensee where the customer has not otherwise contracted directly with a licensee of its choosing. This is an important customer protection backstop and ensures that all customers will be able to receive retail services in the new market. It is also important for the orderly operation of the market, as critical market processes such as customer

switching, meter reading and maintenance of data quality also rely on there always being an active retailer responsible for every customer and premises in the market.

The draft WRC includes processes to allocate all premises without an identified retailer (known as gap sites) sequentially across retailers that have opted-in to that process in the relevant area. This process therefore provides a useful starting point for our SoFR policy.

Our policy in this area also needs to be consistent with the UK Government's policy on retail exits, which is to ensure equivalent protection in this respect in both regions where the incumbent Undertaker has chosen to exit from the non-household market and regions where it has not. The latest version of the draft exit regulations<sup>2</sup> achieves this by requiring acquiring licensees in a retail exit area (i.e. those retailers that have acquired part or all of the exiting Undertaker's business) to opt-in to the SoFR arrangements in that area.

We sought views on the circumstances in which a retail supplier should either be obliged to participate in the SoFR arrangements, or be able to opt-out (or not opt-in).

Those respondents who commented on these issues generally emphasised the importance of achieving an appropriate balance between necessary customer protections and autonomy for market participants to operate their businesses as they see fit. There was therefore broad agreement that:

- there should always be at least one retailer in each area which is responsible for serving gap sites, whether this is an exit area or not; and
- other retailers should be entitled to voluntarily opt-in or opt-out for the purposes of gap sites, reflecting the fact that retailers will have a range of strategies, such as focusing on particular segments or regions.

A small number of respondents suggested that there should be some form of specific criteria for opt-in or opt-out based on, for example, the size or capability of the retailer, or its geographic or customer segment focus.

Ofwat considers that the best way to protect customers in the new retail market is to ensure that the market arrangements are effective, with high levels of competition among licensees. However we recognise the importance of ensuring that any

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<sup>2</sup> See: Consultation on Draft Regulations: 'The Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations', Defra, July 2015

customer which cannot, or chooses not to, find a retailer should still be able to receive a retail service.

We note that in non-exit areas the incumbent Undertaker will continue to be responsible for being the backstop retailer. We also note that the exit regulations will ensure that in an exit area there will always be at least one retailer with this duty, including where the acquiring licensee has subsequently exited the market. These companies will have to opt-in to the gap site allocation arrangements under the WRC in order to be compliant with these SoFR obligations.

In view of the above and in light of the views expressed by consultation respondents, we do not propose that any other licensee should be obliged to opt-in to the SoFR arrangements at this stage. We also do not propose that there should be any explicit criteria for a retailer being able to voluntarily opt-in, beyond meeting the general requirements for market participation (including holding a licence, passing market entry and having a Wholesale Contract in every area in which it serves customers).

We consider that there will be a natural commercial incentive for many retailers to elect to participate in the SoFR arrangements as an efficient means of acquiring new customers. We also consider that establishing additional de-minimis thresholds or other tests would potentially introduce unnecessary complexity and administrative burden to the licensing and market arrangements.

This position does not require any changes to the gap site allocation processes set out in the draft market codes because retailers that are not otherwise obliged to opt-in can simply elect not to do so. Similarly, it will be for Licensees to ensure that they do not voluntarily opt-in if this would not be permitted within the scope their retail authorisation (such as in the case of self-supply licensees).

Relevant to the SoFR arrangements is our recent consultation on the terms of the deemed contracts that will apply in a range of scenarios, including where a retailer takes on a customer as the supplier of first resort in an exit area ([‘Customer protection for the non-household retail market: deemed contracts – a consultation’](#)).

### **6.3 Developer services**

In our consultation proposals we set out our approach of allowing developers to have access to developer services via existing channels and also under the Operational Terms of the WRC to have access to retailers and wholesalers in the new market arrangements.

Some respondents commented that there are a number of options already open to developers in this market and so have questioned the validity of introducing supply services to developers into this market. It is our intention to ensure that only non-household premises are registered with the Market Operator at the appropriate point in the process in order to participate effectively in the non-household retail market. We believe the proposals as set out meet these objectives.

Some respondents asked for further clarification on “incumbent customer facing developer services”. Responsibility under the WIA91 for developer services sits with the “undertaker”. The provisions underpinning these duties do not fit easily with the “retailer” and “wholesaler” definitions being used for the purposes of the separate non-household retail market. Consequently, customers of the developer services have a right to approach any part of the undertaker to access these services, and cannot be required to go to the retailer and/or wholesaler. Companies can however channel such service requests once they enter the business through their customer facing entry point(s).

Some respondents queried whether there was a conflict between the proposals in the consultation document regarding the interface with Self-Lay Organisations and wholesalers and the recent decision document we published when accepting commitments from Bristol Water under the Competition Act 1998.<sup>3</sup>

We do not think there is a conflict. Some of the terminology and the more detailed separation of activities in the structure in the Bristol Water commitments differ from that used for the non-household retail market proposals because they were derived in response to a specific competition concern in the developer services market. We believe that companies should determine the best way to structure themselves while achieving compliance with competition law. Our decision document for the Bristol Water case makes clear that its commitment regarding its organisational structure should not be viewed as a sector-wide solution. Whilst the issues raised by this case are relevant to all water companies, there are a range of solutions (structural and otherwise) that companies could consider to both demonstrate their compliance with competition law and provide a good customer experience.

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<sup>3</sup> [http://www.ofwat.gov.uk/regulating/casework/det\\_ca98201503brl.pdf](http://www.ofwat.gov.uk/regulating/casework/det_ca98201503brl.pdf)

One area of concern set out by respondents was the inclusion of “building water” in the non-household retail market, particularly if this meant that household premises being built would be put into the market during construction only to be removed when they became occupied and therefore ineligible for the non-household retail market. We are proposing therefore, that water for construction and site welfare purposes (including the testing of water fittings) would meet the criteria for an eligible supply and therefore should be included in the market. (For premises connected to the supply system of undertakers whose supply system is wholly or mainly in Wales, there would be a threshold requirement for building water.) This could be a workable arrangement as the Building Water SPID would be removed from the Market Operator systems when the construction on the development site is complete.

## 6.4 Other customer protection issues

We published an information note ([IN15/12](#)) earlier this year setting out our latest thinking in this area. We have held a number of workshops and other discussions with stakeholders during the last few months, and propose further engagement with stakeholders, including customer representatives, about these issues. As a priority, we are considering some particular areas of customer protection ahead of market opening. We have already consulted on some of these areas. We recently consulted on:

- Further provision in relation to the guaranteed standards of service applicable to licensees and undertakers, so that all eligible non-household customers remain protected if they switch to a different retailer.
- Default contracts which could apply in certain situations where there is a supply to the customer but terms and conditions have not otherwise been agreed. These are referred to as ‘deemed contracts’.

We are currently consulting on our proposals for further regulatory measures to [protect customers](#) in relation to various switching, sales, marketing and contractual issues. In this area, we consider that a licence condition to require all retailers to comply with the proposed Customer Protection Code of Practice is necessary and have suggested appropriate drafting in the WSSL which we handed over to Defra.

## 6.5 Charging rules

The WA14 sets out a new ‘charging rule’ framework, whereby Ofwat will set rules that companies must comply with in setting their charges. This replaces the old

framework under which there was a requirement for ex-ante approval of charging schemes by Ofwat each year.

In our June consultation we highlighted a number of issues on charging rules as we believed it would be beneficial ahead of specific consultation on charging rules. These are important issues for retail market opening, though are not core to our licensing decision making. There were three charging issues highlighted: charging under special agreements; early publication of wholesale charges; and completeness of wholesale charges schemes.

- Regarding charging under special agreements, the majority of responses agreed that special agreements should be contestable in principle; however there were concerns around the complexity associated with their set up.
- Regarding early publication of final charges, proposed in early January, companies largely supported the proposals. However companies expressed concerns were expressed regarding early publication of indicative charges, proposed for July a year earlier.
- While there was general support for completeness on wholesale charges scheme, respondents still argued, that some non-standard charges or some charges not covered by the price control cannot be on the charges scheme and therefore there is a need to define a minimum list of non-primary charges that must be specified on the scheme.

In September we published a [consultation on charges scheme rules for 2016-17 and future developments](#), and have recently published our views on these topics in the [final charge scheme rules and summary](#) of responses.

## 7. Important process considerations

In section 2, we described the core deliverables of the licensing workstream in support of Retail Market Opening. As part of this work we have been considering the best approach to implementing the required changes.

There are two mechanisms for delivering change:

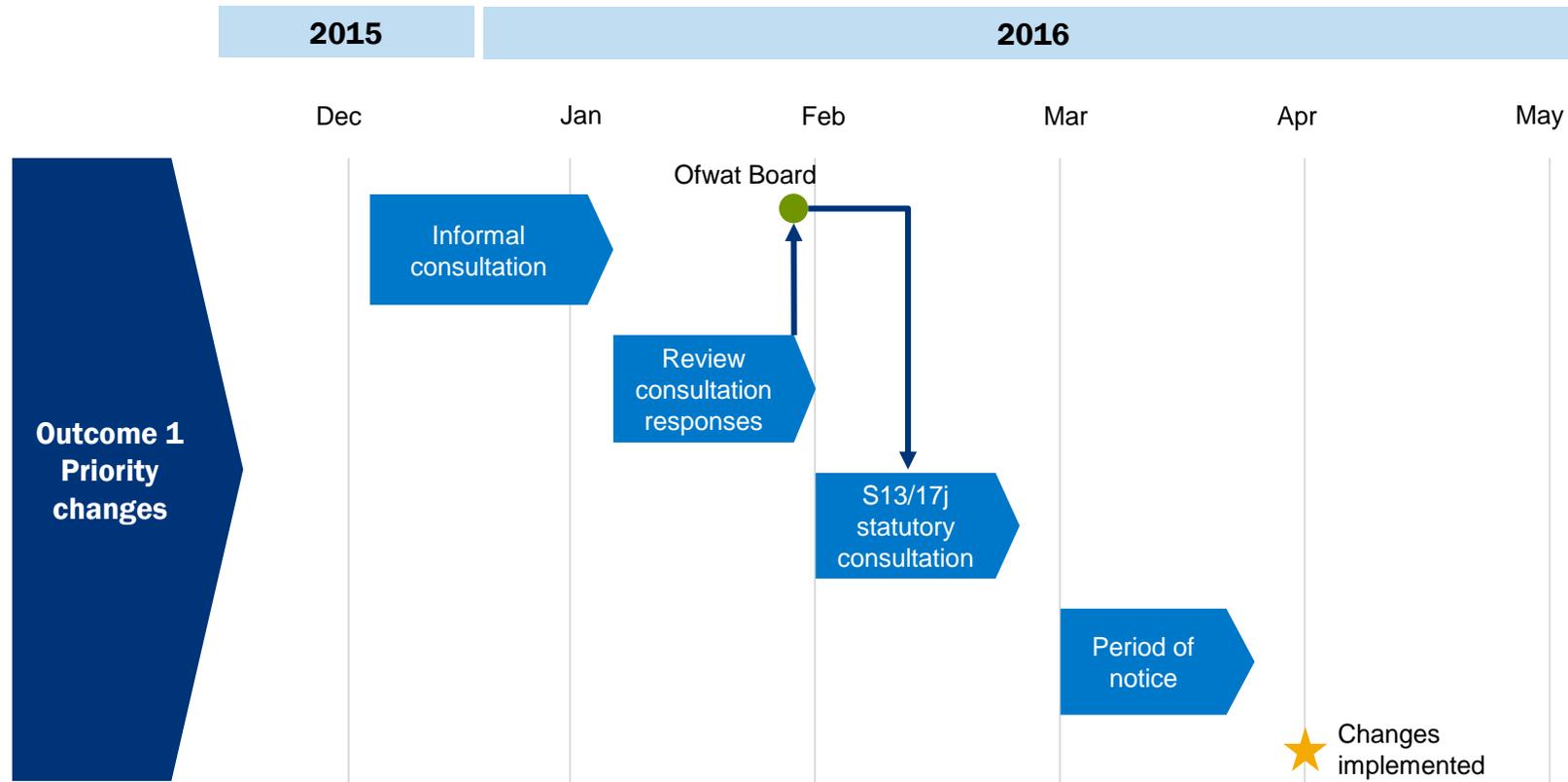
- The first is the existing formal process using existing powers (section 13 WIA91 for the IoA and 17J WIA 91 for the WSL). To bring about changes using this mechanism requires a high degree of consensus. For changes to the Appointment, each Appointee has to consent to those changes. For changes to the WSL, 80% of licensees (determined by market share) must agree. In the event agreement is not reached, a CMA referral could be made if Ofwat is satisfied that the changes are necessary in the public interest.
- The second option makes use of new powers available under the s55 Water Act 2014. This process requires that in each instance, the changes are necessary or expedient in consequence of provision made under Part 1 of the WA2014 (the “s.55 test”).

Responses to the consultation highlighted a preference for the use of section 13/17J to make changes to the Appointment and WSL. However, as we signalled in the June consultation, we consider that the appropriate mechanism will depend upon the circumstances of each particular modification and the circumstances of the overall RMO programme.

The tables below summarise the core licensing deliverables and the current thinking regarding the approach to implement changes.

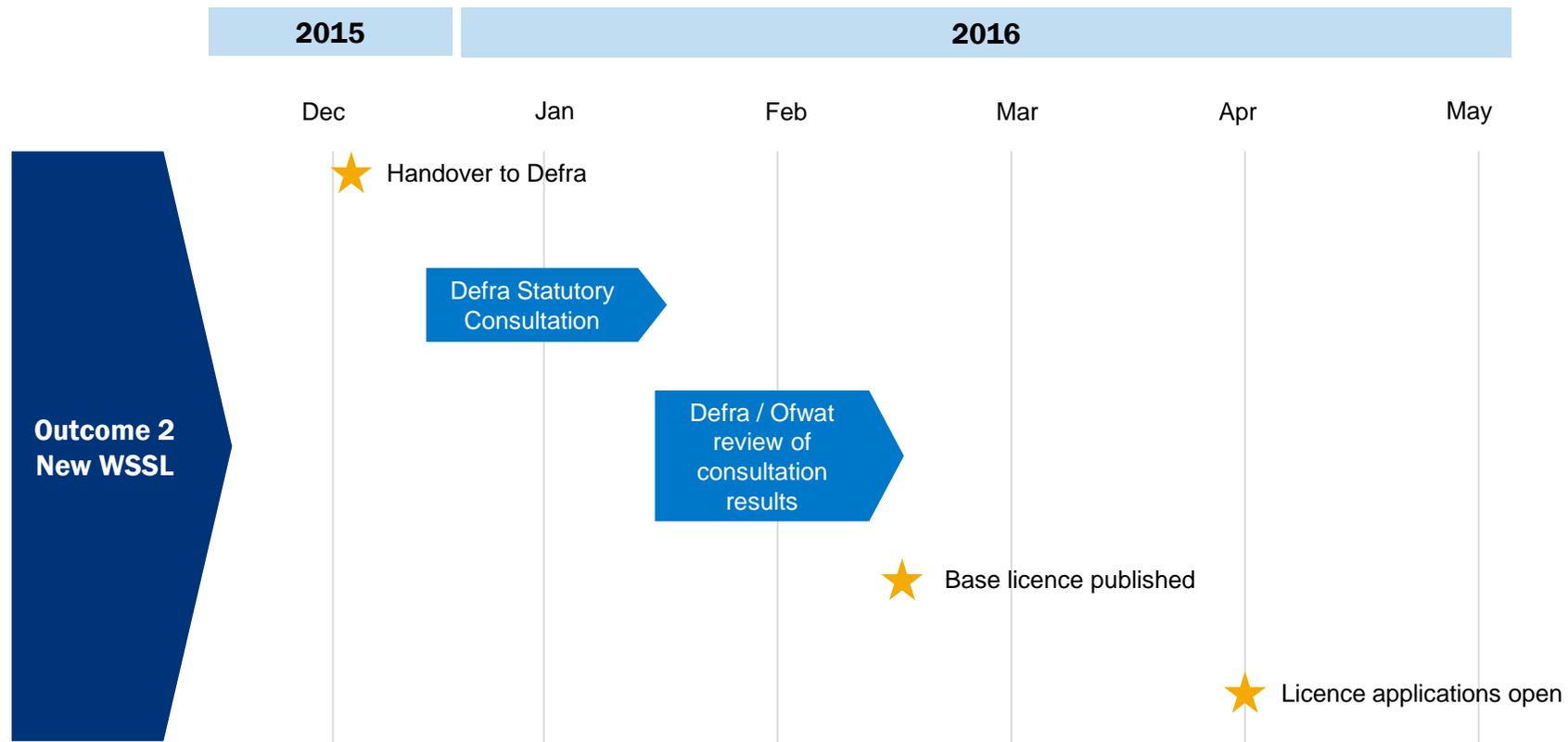
Deliverable	Summary on approach to implementation
1. Priority changes to IoA and WSL	Priority changes are required to create the conditions prior to market opening that enable preparations. Our current intention is to use the existing s13 and s17j powers to make these changes. Responses to the informal consultation which we will issue in December will help confirm the feasibility of this approach.

### Timeline for priority changes



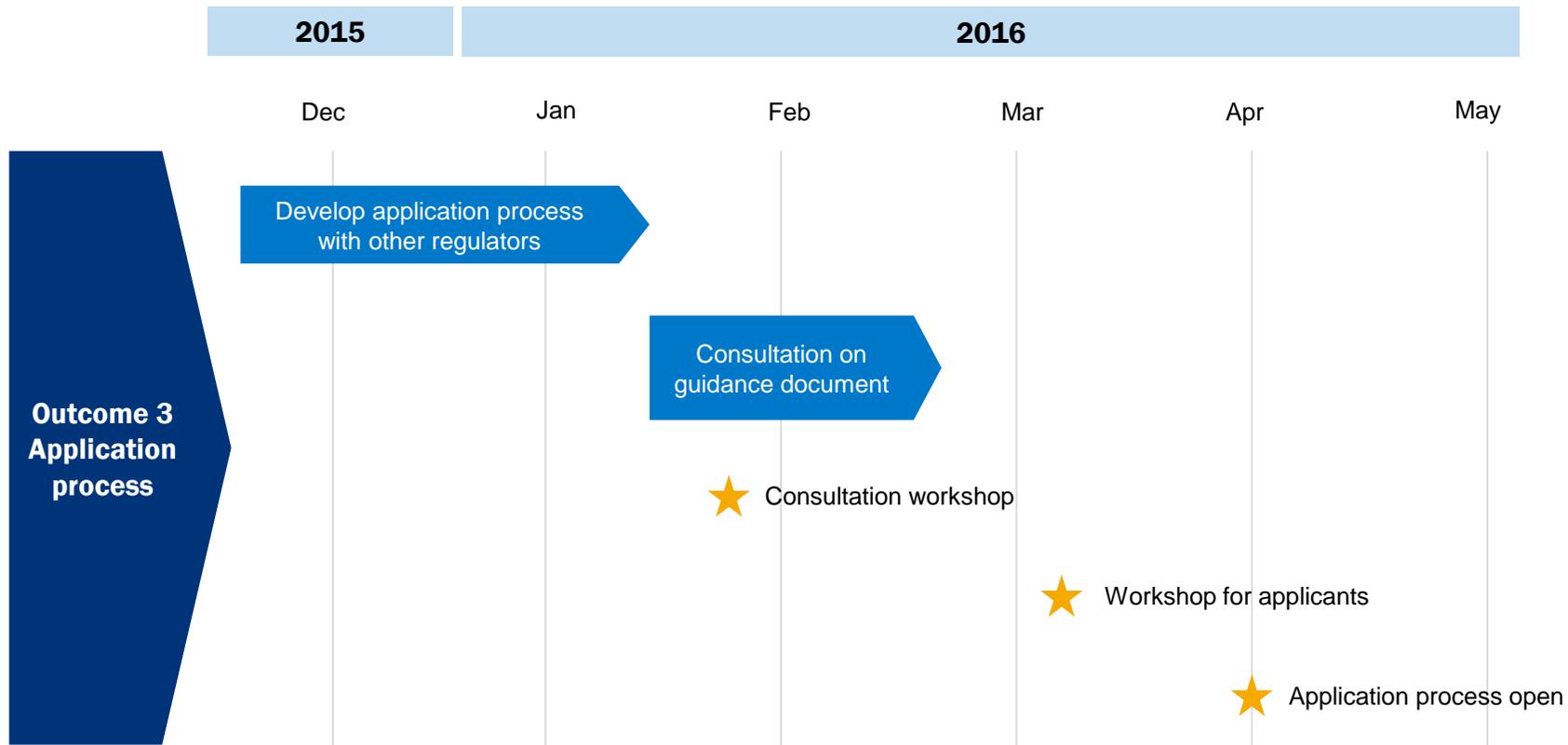
Deliverable	Summary on approach to implementation
2. New WSSL	We have handed over the WSSL standard conditions to Defra for the statutory consultation. We will then finalise the WSSL following that consultation, prior to the standard conditions being designated by the Secretary of State and the Application Process going live in April 2016.

**Timeline for the new WSSL**



Deliverable	Summary on approach to implementation
3. Application process for WSSL	We are currently finalising the process with WICS, EA, DWI and Defra and we will consult on draft guidance in January. Companies will be able to make applications for a WSSL from April 2016. There will also be provision for a common point of entry to the application process for England and Wales and that for Scotland.

### Timeline for application process



<b>Deliverable</b>	<b>Summary on approach to implementation</b>
4. Other changes to loA	<p>The amended loA will need to be in place by market opening in April 2017 and we are developing the amendments required for each loA.</p> <p>We will set out our proposals for the specific changes to the relevant loA conditions and the process to be followed during 2016 Q1. We will also provide a further update regarding the proposed stapling condition at this point.</p> <p>This is an area in which we think that there may be merit in using a s55 approach as it would maximise the period available for consultation before the changes were made. However, we will confirm our thoughts on this as part of the proposals in Q1 2016.</p>
5. Transition scheme	<p>We are currently developing the process for terminating existing WSLs and are considering the best route for combined supplies.</p>