

**Priority changes to Instruments of
Appointment and Water Supply Licences for
non-household retail market opening
– consultation**

About this document

This consultation sets out the changes to the text of the following.

- The Instrument of Appointment (IoA) of appointed monopoly water only and water and sewerage companies in England and Wales ('appointees') and, where applicable, companies that have successfully applied for an appointment to replace the existing appointed water and or sewerage company at a particular site ('new appointees'). Collectively appointees and new appointees are referred to as 'undertakers'.
- The water supply licence (WSL) of existing companies licensed to compete to supply large users with water ('licensed water suppliers').

The purpose of the changes are to:

- remove the ban on licensed water suppliers associated with appointees from trading in the appointee's area of appointment; and
- introduce a new 'readiness' condition requiring undertakers and licensed water suppliers to take the necessary steps to support the opening of the new retail market.

This document follows on from our recent results document '[Consultation on licensing: results and decisions](#)' which was published on 9 December 2015. In that document, we identified five main deliverables required for the licensing framework for non-household retail market opening and explained the next steps that we intended to follow. This consultation concerns the next steps on IoA and WSL. We intend these changes to apply to all undertakers including, where applicable, new appointees.

Retail services include activities such as billing and customer services. At present, only a limited number of the largest 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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Responding to this consultation

We welcome your responses to this consultation by 5 February 2016. Please submit email responses to retaillicensing@ofwat.gsi.gov.uk, or post them to:

Retail Market Opening Programme
Ofwat
21 Bloomsbury Street
London WC1B 3HF.

If you wish to discuss any aspect of this document, please contact Christian Speedy on 0121 644 7744 or by email at christian.speedy@ofwat.gsi.gov.uk.

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this consultation on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished.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

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

Consultation questions

Throughout this consultation, we raise a number of questions, which we have summarised here. As well as responses to these specific questions, we welcome views from stakeholders on any of the issues raised in this consultation.

Consultation questions

Q1: Do you agree with the proposed drafting changes to the IoA and WSL in removing the in-area trading ban? If not, please explain why not and your proposed alternatives.

Q2: Do you agree with the proposed new readiness condition to be added to the IoA and WSL? If not, please explain why not and include your proposed alternatives.

Q3: Do you have any comments about the use of existing s13 and s17J Water Industry Act 1991 (WIA91) powers to introduce the new readiness condition?

1. Immediate licensing changes

In our [consultation on licensing and policy issues relating to non-household retail market opening](#), we noted that there may be a need to prioritise certain licence changes before April 2017 in order to create the market arrangements necessary for market opening.

We identified that some changes to Instrument of Appointment (IoA) and the Water Supply Licence (WSL) should be prioritised and implemented in advance of market opening. In particular, we identified two specific changes:

- The current market arrangements ban licensed water suppliers associated with appointees from trading in the appointee's area of appointment. Legislation has repealed the need for this regulation. We set out our proposal for the removal of this obligation from both the IoA and WSL.
- In order to ensure market participants are ready for market opening we propose to create a new condition requiring both wholesalers and retailers to take necessary steps to prepare for market opening. We set out proposals for an additional condition to be added to the IoA and WSL.

The need for, and the general form of, the changes was discussed in the June consultation. The results document published in December summarised the responses received and set out the reasons behind our decisions to make both of these changes. This consultation gives an opportunity to comment on the detailed drafting of the proposed changes to the relevant conditions before the necessary formal consultation on the changes is issued. We intend these changes to apply to all undertakers including, where applicable, new appointees.

We encourage stakeholders to respond on these proposals. Subject to responses to the questions in this consultation on the proposed drafting of the changes and the way in which these changes should be made, we intend to use the existing s13 and s17J WIA91 powers.

2. Removal of the in-area trading ban

The in-area trading ban prevents licensed water suppliers associated with an appointees, from trading with that undertaker or carrying out relevant activities in the area to which the water undertaker's appointment relates. It was introduced by the Water Act 2003 as an additional duty 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 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 for the future Water Supply and Sewerage Licence (WSSL). We proposed to remove this restriction ahead of market opening, which means changes are required to Condition R of the IoA and condition 7 of the WSL.

Responses to our June licensing consultation

Generally, appointees and licensed water suppliers associated with appointees, were keen to see the removal of the in-area trading ban as soon as possible. A number of respondents 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 stated that they would be forced to duplicate elements of the necessary preparations for retail market opening, 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
- highlighting a number of ex-ante measures that were introduced in Scotland prior to market opening.

Our decision to remove the in-area trading ban

We have considered the points made by the retailers based in Scotland carefully, and 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. We accept that 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 could act as a barrier to retail exit and we believe that it is important that companies are 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 which might also help create additional competition to the benefit of regional large customers.

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 codes (as required by Paragraph 7(4)(a) of condition R in their IOA), to ensure that they will be fully compliant with our updated guidance. This should ensure that information is only to be used for the purposes for which it was obtained, and that sufficient steps are taken to demonstrate that associated licensed water suppliers are shown no undue preference.
- The requirements for arms' length trading and no undue discrimination mean that any appointee which provides services to a licensed water supplier associated with it on a non-commercial basis would be in breach of its Appointment.
- Appointees must also continue to publish access codes applicable to all WSL retailers, including licensed water suppliers associated with the appointee.

The removal of the in-area trading ban creates the possibility that a licensed water supplier associated with an appointee which held a combined supply licence, could seek to make use of the supplementary authorisations in the current combined licence within that undertaker's area of appointment. Since no companies are

currently making active use of the supplementary authorisations in any locations, this scenario is unlikely to arise. However, as part of the additional work on the details of the transition arrangements for the current combined WSL that we signalled in the results document published in December, we will consider whether additional transitional provisions are needed in these circumstances.

Proposed modification to IoA condition R.5

We propose the following modification, to each IoA where applicable, which would remove the IATB from the relevant undertaker's appointment:

Anti-competitive behaviour

5 (1) *If and for so long as the Appointee is related to any licensed water supplier -*

~~(a) it shall not without the consent of the Authority sell (or otherwise make available) to that licensed water supplier any water, or any of its other assets; and~~

~~(b) otherwise,~~ *it shall ensure that every other transaction between the Appointed Business and that licensed water supplier is at arm's length.*

Proposed modification to WSL standard condition 7

1.1 The following modification, made to the WSL Standard Conditions, would remove the IATB from the licences of all licensed water suppliers:

Area of operation and arm's length transactions

7.—(1) ~~The Licensee shall not at any time—~~

~~(a) carry on any relevant activities in the area to which a water undertaker's appointment relates, or~~

~~(b) without the consent of the Authority sell water (or otherwise make it available) to a water undertaker, or~~

~~(c) otherwise enter into any transaction with a water undertaker except at arm's length, if at that time the Licensee is related to that water undertaker.~~

Consultation questions

Q1: Do you agree with the proposed drafting changes to the IoA and WSL in removing the in area trading ban? If not, please explain why not and your proposed alternatives.

3. Introduction of readiness condition

We have decided to introduce a new condition in both the IoA and WSL to help ensure that wholesalers and retailers undertake the necessary preparations for market opening.

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 to prepare for retail market opening 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 was not the best way to achieve the necessary clarity.

We propose to include a new simple condition

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 activities including preparation of data, development of their own systems and

processes and participation in programme testing, readiness and assurance activities.

This approach also means that the same condition can apply for the Welsh companies. A more detailed appointment condition would be likely to require adaptation for companies in Wales.

Proposed new condition for the IoA and WSL

We propose the following addition to the IoA conditions and WSL standard conditions. The elements in square brackets show the two small differences in detailed wording that are required between the IoA and the WSL. In both cases, the first is for the WSL condition and the second for the IoA condition.

CONDITION [Z]: RETAIL MARKET OPENING

1.2 General Obligations

The [Licensee][Appointee] shall take such steps and do such things as are within its power and which are or may be necessary or expedient to ensure that it is ready for the opening of the Competitive Market on and from the Go Live Date including, without limitation:-

- (a) developing company specific market assurance and readiness plans;
- (b) identifying and gathering relevant data in relation to all Eligible Premises and supply points [to which it currently provides services][in its area], ensuring this data is accurate and ensuring it is in a form capable of being transferred to any central systems and/or any market operator established to operate the Competitive Market; and
- (c) testing and trialling any systems and processes to be put in place for the Competitive Market,

1.3 Expiry of this Condition

This condition shall cease to have effect on the Go Live Date or such earlier date as the Authority may specify in a direction for the purposes of this condition generally.

1.4 Interpretation

In this Condition:

“**Competitive Market**” means the provision of retail water and sewerage services to Eligible Premises

“**Go Live date**” means the date determined by the Secretary of State as the date when Competitive Market opens

Consultation questions

Q2: Do you agree with the proposed new readiness condition to be added to the IoA and WSL? If not, please explain why not and include your proposed alternative suggestion.

Q3: Do you have any comments about the use of existing s13 and s17J WIA91 powers to introduce the new readiness condition?

4. Next steps

Our objective is to give clarity that these changes will be made as soon as we can. Responses to this consultation will influence the exact timing of the necessary steps and how quickly we can issue the notices under section 13 and 17J of the WIA91 for the required period of formal consultation.

We are currently considering the detailed timing of the steps that we are required to follow. Our intention is to start the period of formal consultation no later than the beginning of March 2016. This would allow the formal consultation to conclude by the end of March and the changes to be implemented in April 2016.

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

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