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Trust in water

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

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About this document

On the 8 January 2016, we published a consultation on proposals to modify licences with two changes required for non-household retail market opening. Those proposals are to:

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

We received 18 responses to the consultation: nine from Water and Sewerage Companies; three from Water Only Companies; one from a holder of a New Appointment and Variation; two from holders of Water Supply Licences; one from a Scottish retailer not licensed in England & Wales; the Consumer Counsel for Water and the Welsh Government.

This document summarises the responses which we have received, confirms the licence changes we intend to make and the way in which we propose to implement these changes.

In addition to the responses received, we have also consulted with the Welsh Government and we will be holding a workshop in early March on the application of the proposed market framework for small companies and Welsh companies.

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Executive summary

Our consultation on the priority changes highlighted proposals to modify licences in order to remove the in-area trading ban and to introduce an obligation for market readiness. The modifications will require changes to both appointees' Instruments of Appointment (**IoA**) and licensees' Water Supply Licences (**WSL**).

Removal of the in-area trading ban

The modification will allow both retailers and wholesalers to prepare for market opening in April 2017 by removing restrictions on operations for appointees with associated licensees. If the in-area trading ban remained in place, retail associates of appointees would be unable to provide a national service to current eligible customers between now and April 2017 (i.e. (a) those who use the supply system of an appointee whose area is wholly or mainly England and to whom the total quantity of water estimated to be supplied annually by the licensee is not less than 5 Ml; and (b) those whose use the supply system of an appointee whose area is wholly or mainly in Wales and to whom the total quantity of water estimated to be supplied annually by the licensee is not less than 50Ml).

Early removal of the in-area trading ban provides clarity to appointees and should allow them to make decisions such as whether to enter into an outsourcing agreement to allow their related licensee to take responsibility for making the necessary preparations for market opening. Continuation of a ban could also act as a barrier to retail exit[1], and we believe that it is important that appointees are able to choose this option if they wish to do so. The removal of the ban ahead of market opening also lowers transition costs by avoiding the need for both appointees and associated WSLs to separately undertake preparatory activities for the new market.

We received comments from licensees not associated with appointees expressing concern regarding the potential for appointees to show undue preference to an associated licensee. They expressed some concern that the appointment and licence provisions in respect of arm's length transactions and the prevention of undue discrimination may not be sufficiently effective.

[1] Defra's retail exit regulations: https://consult.defra.gov.uk/water/retail-exits-reform

Following the removal of the in-area trading ban, we will rely more heavily on our existing tools regarding the behaviour of appointees and licensees. As well as their wider obligations under competition law, appointees' compliance codes explaining how they manage the risks of undue preference or misuse of information will become increasingly important. We are publishing an information notice alongside this document providing additional clarification on appointees' obligations regarding these compliance codes which each appointee must produce in compliance with Condition R of their instrument of appointment.

Overall, we are satisfied that our current regulatory tools provide sufficient safeguards and we will now issue the formal consultations to modify the IoA and WSL using section 13 and 17J of the Water Industry Act 1991 (**WIA91**).

The removal of the IATB will not have any practical effect for customers or licensees who use the supply system of appointees whose area is wholly or mainly in Wales. The removal of the IATB does not impact in any way on the scope of the eligible market; it will continue to be for customers using over 50Ml of water and for water retail services only. Neither of the Welsh appointees has an associate licensee, nor do the provisions for retail exit apply in Wales.

New Appointments and Variations (**NAVs**) do not have Condition R 'switched on' in their instruments of appointment and do not have associated retailers. As such, these modifications will not have a practical impact on NAVs.

Introduction of a new obligation for market readiness

The introduction of a readiness condition will create a legally enforceable obligation requiring companies to support preparations for market opening. The proposed condition will help create collective confidence amongst industry participants, sending important signals that all other companies are taking the steps they need to support effective market opening.

The condition also requires companies to support the Open Water assurance process and allows Ofwat to introduce additional assurance on company readiness. In particular, as advised in the meeting with industry CEOs on 3 February 2016, Ofwat are proposing a targeted review of market readiness in Q3 2016 (as set out in our published draft forward programme) to inform the October 2016 Open Water assurance letter and the start of the shadow operation of the retail market.

The drafting of the readiness condition is designed to be proportionate in that the level of effort required by each individual appointee to meet its obligations will,

largely, be dependent on the number of eligible customers for which they currently have responsibility. Since the scope of the competitive market in Wales is not changing and will continue to reflect the current 50Ml threshold, the preparations required by Welsh companies are not extensive.

Companies made a number of comments on the condition proposed in the consultation. The concerns focused on whether the condition required an unbounded level of effort, would result in appointees being exposed to risks outside of management control and set a standard of data accuracy that was not achievable.

We have considered the points made in the various responses carefully. We recognise that achievement of 100% data accuracy may not be a realistic goal. So we propose to modify the readiness condition to ensure it is targeted at the outcome that must be achieved, specifically that each company's data is sufficiently accurate to enable the effective functioning of the market.

However, we are not persuaded that making the other modifications suggested would be in customers' interests. The proposed condition already states that each company must only take steps or do such things as are **within its power,** and we consider that this adequately addresses the concerns regarding risks arising from external circumstances.

Regarding the concerns about the level of effort, the revised wording on data accuracy should in itself help deal with a large part of these concerns. Further, Ofwat has clear public law duties to act reasonably and proportionately. So, in the event of any discussion around failure to comply with the readiness condition, Ofwat would be duty bound to consider the reasonableness and proportionality of the actions taken and the effort expended by the company when determining if that company was in breach of its obligations.

Finally, regarding the concerns that the condition does not specify what companies must do or the perceived issues with definitions of terms, we remind companies that one of the objectives of the readiness condition is to ensure that each company determines itself what is required to meet its obligations, rather than waiting to be being told what to do.

Implementation

In order to ensure that the required condition can be implemented in a timely and consistent way, we propose to make use of the new powers in Section 55 of the Water Act 2014 (**WA14**). We have published a formal consultation to this effect, and

section 4 of this document provides a summary of the detailed timeline that we propose to follow.

Structure of document

This document is structured as follows:

- Section 2 discusses the responses we received regarding the removal of the in-area trading ban, the steps we are taking to address the concerns raised, and the decisions we are now taking.
- Section 3 discusses the responses we received regarding the introduction of the readiness condition, the steps we are taking to address the concerns raised, and the decisions we are now taking.
- Section 4 discusses the next steps in taking forward these decisions.

1. Introduction

In our consultation on licensing and policy issues relating to non-household retail market opening published in June 2015, 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 removal of the ban on licensed water suppliers (**licensees**) associated with appointees from trading in the appointee's area of appointment (the **in-area trading ban**). 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.
- The introduction of a new condition requiring appointees and licensed water suppliers to take the necessary steps to support the opening of the new retail water market (the **readiness condition**). 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 2015 summarised the responses received and set out the reasons behind our decisions to make both of these changes. We confirmed our intent to remove the in area trading ban and introduce the readiness condition as priority changes.

In January 2016, we consulted on the detailed drafting of the proposed changes to the relevant conditions. We asked for views on the drafting, as well the approach for implementing the required licence change for the readiness condition. This gave stakeholders an opportunity to comment on the drafting and approach before we issued the necessary formal consultation on the changes.

2. Removal of the in-area trading ban

2.1 Background

The in-area trading ban (**IATB**) prevents licensed water suppliers (**licensees**) from trading with a related undertaker, or carrying out relevant activities in the area to which the water undertaker's appointment relates. Relevant activities include any activities authorised by a WSL. Put simply, licensees that are related to an undertaker may currently only supply business and other non-domestic customers outside that undertaker's geographic area.

The Water Act 2003 (**WA03**) placed a statutory duty on both Ministers and Ofwat to ensure that licensees did not carry on any activities in the area of undertakers with whom they were connected. The ban was introduced to prevent incumbent companies dominating the newly competitive sectors of the non-household retail market.

The statutory duty in the WA3 was subsequently repealed by the Enterprise and Regulatory Reform Act in 2013 (**ERRA13**). Further, DEFRA's retail exit consultation in December 2014 set out the benefits of removing the IATB and stated that Ofwat would consult on removing the ban from licences.

2.2 Why do we need to remove the IATB for Retail Market Opening?

The IATB was a policy tool implemented in consequence of the statutory duties arising from WA03. These duties were repealed under ERRA13.The IATB prevents the market design envisaged by the WA14 and it is therefore necessary to remove the IATB in advance of market opening in April 2017.

The modification will allow both retailers and wholesalers to prepare for market opening in April 2017 by removing restrictions on operations for appointees with associated licensees. If the IATB remained in place, retail associates of undertakers would be unable to provide a national service to current eligible customers between now and April 2017.

Early removal of IATB provides clarity to undertakers and should allow them to make decisions such as whether to enter into an outsourcing agreement to allow their related licensee to take responsibility for making the necessary preparations for

market opening. Continuation of a ban could also act as a barrier to retail exit[2], and we believe that it is important that undertakers are able to choose this option if they wish to do so. The removal of the ban ahead of market opening also lowers transition costs by avoiding the need for both undertakers and associated WSLs to separately undertake preparatory activities for the new market.

We consider that any concerns around the possibility of undue incumbent advantage will be dealt with through other licence conditions, including conditions requiring compliance codes that all undertakers must have in place.

2.3 Our consultation

In our consultation, we proposed that the in area trading ban be removed as soon as the necessary changes to the IoA and WSL were agreed. In doing so we explained that we considered there to be sufficient safeguards in place in the conditions of appointees. We explained that:

- Paragraph 7(4)(a) of condition R of the IoA requires each appointed company to have in place a compliance code which adheres to our compliance 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 that set out arrangements for all licensed water suppliers, including associated licensees.

In our consultation, we proposed drafting changes to the IoA and WSL to remove the ban and asked whether stakeholders agreed.

[2] Defra's retail exit regulations: https://consult.defra.gov.uk/water/retail-exits-reform

2.4 Responses to our consultation

Sixteen out of eighteen responses, including all of the appointees were keen to see the removal of the in-area trading ban as soon as possible and did not make any comments regarding the drafting.

However, Business Stream (who hold a WSL) and Clear Business Water (a retailer based in Scotland and active in the existing Scottish retail water market) made a number of comments on level-playing field issues. In particular they raised concerns that new entrants would be disadvantaged due to the perceived ability of appointees to favour an associated retailer. When considering the current arrangements, they highlighted several specific areas:

1. Concerns over whether companies are and will be compliant with our compliance guidance and Condition R obligations;
2. Concerns over the scope of our existing compliance guidance and proposals to modify this (by making it more prescriptive); and
3. Proposals to modify sections of Condition R itself – adding in requirements for companies to publish their compliance codes and have these approved by company boards

We provide further detail and our considerations of the issues arising below.

2.5 Concerns over whether companies are and will be compliant with our compliance guidance and Condition R obligations

The existing compliance guidance, issued in 2008, was developed under the existing market arrangements. Limited market activity has meant that compliance codes may not have been an area of focus to date for appointees.

However, all appointees are obliged, under condition R and through the associated compliance guidance, to produce compliance codes. We intend to remind appointees of these obligations, emphasising their increasing importance as the IATB is removed and the retail market becomes more active. In particular, we will encourage companies to develop transparent and robust frameworks for managing the risks associated with showing undue preference towards associated retailers.

As part of our work on developing our regulatory accounting guidelines we will also be clarifying our expectations to appointed companies in respect of how they should report, in their regulatory accounts, the services they provide to associated licensees to ensure greater clarity is available in this area.

2.6 Concerns over the scope of the existing compliance guidance and proposals to modify

Specific concerns were highlighted over the ability of appointees to provide services (e.g. meter reading and billing services) and information to associated retailers in a manner that is not transparent. The concerns highlighted that whilst associated retailers might have access to these services, third parties would not on an equivalent basis, providing potential for appointees to show undue preference / discrimination.

We consider that these are risks which each appointee will need to manage carefully through their internal processes and their compliance codes, paying due regard to how they are able to demonstrate that there is no undue preference / discrimination. We comment further on the importance of the compliance codes in section 2.4 below.

Appointees should review the interactions that take place between themselves and any associated retailers to ensure these are performed on an arm's length basis and do not result in any commercial preference.

2.7 Proposals to modify sections of Condition R itself – adding in requirements for companies to publish their compliance codes and have these approved by company boards

As well as having concerns about the detailed content of the codes, Business Stream also expressed concern about the process around the governance of compliance codes. In particular, they suggested that a number of additional requirements should be added:

- A requirement to publish the compliance code in Condition R itself, (although the compliance guidance does already encourage publication);
- A requirement for board approval when an appointee revises its compliance code; and
- A commitment by appointees to revise their compliance codes within a specified time period should they become out of date.

Business Stream suggested that we make changes to Condition R of the IoA to incorporate these additional obligations.

We are sympathetic to the direction of these suggestions although we are not minded to change Condition R at this stage. We expect appointees to recognise the

increased importance of their compliance code following the removal of the IATB, and to develop a transparent governance process that helps provide trust and confidence for third parties. However, as we explain in the next section, we will further review Condition R and the compliance code guidance as part of the work to complete the changes to the IOA necessary for market opening.

2.8 The importance of compliance codes

We have recently taken the opportunity to review our compliance guidance and after consideration we have concluded that it does not need to be changed at this time. The current requirements on appointees for arm's length trading and no undue discrimination should prevent any misuse of information, or service provision on a non-commercial basis.

Further, in advance of the various codes that will govern the market post-April 2017, any transfers involving customers who use over 5Ml of water (i.e. customers who are already able to choose their retail water supplier), must continue to follow the published access codes and make use of the necessary customer transfer protocol.

We are publishing an information notice alongside this document which further clarifies the scope and purpose of our compliance guidance and how and when we expect appointees to update their compliance codes and what these codes should cover. It emphasises the increasing importance of compliance codes after the removal of the IATB and that codes must provide enough information to demonstrate that companies are complying with the relevant obligations.

Although we consider that our compliance guidance does not need to be amended at this time, stakeholders should note that this will be kept under review. The transparency and quality of appointees' compliance codes will be an important factor in determining whether further Guidance is required.

2.9 Our decision to remove the in-area trading ban

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

The removal of the IATB will not have any practical effect in Wales. The removal of the IATB does not impact in any way on the scope of the eligible market which will continue to be for customers using over 50Ml of water and for water retail services

only. Neither of the Welsh undertakers has an associate licensee, nor do the provisions for retail exit apply in Wales.

We are issuing a formal consultation to implement the changes using Section 13 (IoA) and Section 17J (WSL) powers immediately.

2.10 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 appointee'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.

2.11 Proposed modification to WSL standard condition 7

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.

3. Introduction of readiness condition

3.1 Background to the new condition

Retail market opening is a large scale industry change programme that has so far successfully been delivered through the Open Water programme. Through this programme, industry codes and company requirements have been developed largely through the collective efforts of the companies. Undoubtedly, there is an eagerness across companies for the new market to be successfully implemented.

There are a number of steps that companies need to take prior to market opening to ensure that new market will function effectively. While we recognise that companies, both individually and collectively, believe that there are already incentives in place to ensure those steps are taken, we believe that without a formal obligation there is a risk that a small number of companies rely on the actions of others, fail to take the necessary steps and thereby jeopardise the collective effort of the industry to date.

In our consultation on priority changes, we therefore proposed a general licence condition for both appointees and licensees that obliges them to take the necessary steps required to:

- Provide company specific market assurance and readiness plans;
- Gather accurate data on customers in the form required by the market operator's system; and
- Test relevant systems and processes and participate in the necessary industry trials.

3.2 Why do we need to introduce a market readiness condition for retail market opening?

The introduction of a licence condition for companies to be ready for retail market opening will create a legally enforceable obligation, supporting the programme requirements as well as the Open Water Assurance Framework. The benefits of the condition are that:

- It creates an obligation on industry participants to take preparatory steps to ensure that they are ready for the opening of the competitive market in April 2017;

- It helps create collective confidence amongst industry participants, sending important signals to companies that all other companies are also taking the steps they need to support effective market opening;
- It requires companies to support the Open Water assurance process and allows Ofwat to introduce additional assurance on companies' readiness. In particular, as advised in the meeting with industry CEOs on 3 February 2016, Ofwat are proposing a targeted review of market readiness in Q3 2016 (as set out in our published draft forward programme) to inform the October 2016 Open Water assurance letter and the start of the shadow operation of the retail market; and
- It sends an important signal to customers about the industry's collective commitment that the retail market will be ready on time.

In our consultation, we asked for views on the drafting of the proposed condition as well as the route for implementation.

3.3 Consultation responses regarding drafting

Responses to the consultation provided differing views on the condition:

- Although there was a greater level of support than during the June 2015 consultation, a number of the appointees were still not fully persuaded that the condition is required, highlighting that there are reputational incentives in place for them to be ready for market opening alongside other obligations through the market and company readiness and assurance processes.
- However, the majority of these respondents still recognised the potential value of a condition and identified specific suggestions for the drafting of the condition should Ofwat decide to proceed.
- Several respondents expressed support for the principle of the condition but also expressed concerns with the implications of the proposed drafting.
- A couple of the responses supported both the principle and the proposed wording of the condition.

Across respondents there were a variety of different suggestions regarding the drafting. These suggestions focused on three principle concerns:

1. Concern that the condition creates an unbounded effort requirement with exposure to risk outside the control of the company

The proposed condition states that appointees / licensees should "**take such steps and do such things as are within its power**". Companies expressed concern that

this means that the consequential effort requirement has a high threshold with no limit on costs.

There was also concern that risks outside their control, such as deliverables from third parties or policy decisions, will impact their ability to meet the readiness condition.

Many of the suggested drafting changes sought to qualify the degree of effort e.g. …companies must take **reasonable** steps.

2. Concern that the condition creates a requirement for accuracy in data that may not be achievable

The proposed condition states that appointees / licensees should be "**ensuring … data is accurate**". Responses highlighted that this implies that 100% of companies' data is required to be 100% accurate, something that might not be possible or reasonable for Ofwat to require.

Respondents suggested wording to address some or all of these concerns by qualifying the degree of data accuracy e.g. …data is **reasonably** accurate.

3. Concern that not all terms were well defined

A few companies highlighted specific terms in the condition which they believe are not sufficiently well defined, such as "**eligible premises**", "**relevant data**", "**systems**" and "**supply points**". Companies suggested that uncertainties around the detailed definitions would make it difficult for them to comply with the readiness condition.

3.3.1 Our proposed amendments to the condition as drafted in the consultation

We have considered the points made in the various responses carefully. We recognise that achievement of 100% data accuracy may not be a realistic goal. So we propose to modify the condition to ensure it is targeted at the outcome that must be achieved, specifically **that data is sufficiently accurate to enable the effective functioning of the competitive market.**

However, we are not persuaded that making the other modifications suggested would be either necessary or in customers' interests. The condition already states that companies take steps or do such things as are **within its power,** and we consider that this adequately addresses the company concerns regarding risks arising from external circumstances.

Regarding the concerns about the level of effort, the revised wording on data accuracy should in itself help deal with a large part of these concerns. Further, **Ofwat has clear public law duties to act reasonably and proportionately**. So when deciding whether to take enforcement action Ofwat would be required to act reasonably and proportionally when determining if that company was in breach of its obligations. The level of action and effort taken by the company would be relevant when taking this decision. This approach is in line with our published Approach to Enforcement.

Finally, regarding the concerns that the condition does not specify what companies must do or the perceived issues with definitions of terms, we remind companies that one of the objectives of the readiness condition is to ensure that each company determines itself what is required to meet its obligations rather than waiting to be being told what to do. By way of example, the work required on data or systems may differ between companies depending on the quality of their current data. So the condition focuses on the outcomes that must be achieved, but it is, necessarily, for each company to assess what this means in detail for its own individual preparations.

Regarding some of the concerns expressed, we further highlight that:

- "**Eligible Premises**" are premises other than household premises (as such term is defined in s17C of the WIA91) and which may be identified as eligible to be supplied with water and/or provided with sewerage services by a water supply licensee and/or a sewerage licensee in accordance with any Eligibility Guidance. We have now defined this term in the readiness condition.

- The readiness condition makes reference to "**any central systems and/or any market operator established to operate the Competitive Market**" because there is not yet an official market operator or central system in England and Wales. We expect companies to look at the documents which are in the public domain and will form the legal framework at market opening and ensure that they are able to comply with them at market opening.

- References to "**supply points**" will need to be consistent with the definition required for the central system, most likely to be SPIDs.

- Companies themselves can determine whether they wish to interact with the market via the low or high volume interfaces, providing only that they satisfy the requirements of the MOSL entry assurance process and (if relevant) the application process for the new Water and Sewerage Supply Licence.

We consider that the revised condition gives a good basis to progress market readiness, particularly as the provision is intended to act as a backstop.

3.3.2 Proposed new condition for the IoA and WSL

We now 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. For clarity, the changes compared to the previous version of the draft condition are shown in red.

CONDITION [Z]: RETAIL MARKET OPENING

1.1 **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 sufficiently accurate to enable the effective functioning of the Competitive Market 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,

1.2 **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.

1.3 **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

"**Eligible Premises**" means premises other than household premises which will be eligible to be supplied with water by a water supply licensee and/or provided with sewerage services by a sewerage licensee from the Go Live Date

3.4 Responses to our consultation regarding implementation

We asked stakeholders if they had any comments about the use of our existing powers under section 13 and section 17J of the WIA91 to introduce the new readiness condition. In response:

- The majority of companies' expressed support for the use of the existing powers.
- Some companies expressed the desire for a further informal consultation.
- One company indicated that we should use the responses to gauge whether it would be preferable, given the challenging timetable, to use our new powers under section 55 of the WA14.

Following our review of the responses to this consultation, it is our view that it is expedient to implement the new condition using our powers under section 55 of the WA14.

3.4.1 Why we are proposing to use section 55

We consider that using section 55 is critical for the readiness condition to be implemented effectively. It is important that companies perform the necessary preparatory steps in a timely and consistent manner to support the effective preparations and trialling of the market before it goes live in April 2017.

Consistency across companies

We were pleased to see in their **first assurance letters** that most market participants are making good progress in their preparations for market opening.

However, in order to maintain that momentum all market participants need confidence that all other market participants are taking the appropriate steps to be ready. The failure of one or more participants to be ready could delay the opening of the entire market, particularly if that failure prevents the company concerned from interacting with the market systems, making it difficult for customers to switch. As a

result, it is important that all companies have the same readiness condition and obligations.

Timeliness

We are entering a critical phase of the market opening programme where companies need to provide their data to MOSL and prepare their systems ready for the start of shadow market operation in October 2016.

There are a number of different strands to the assurance framework for market opening that companies will need to support. The overall Programme Assurance Framework (which is completed by companies, MOSL, Ofwat and DEFRA) provides crucial evidence to inform the Secretary of State's decision making powers on market opening. Further, the MOSL market entry assurance process tests whether companies have provided the essential data and can interact with central systems.

To supplement these strands of work, Ofwat is intending to undertake a targeted review of company readiness between July and September 2016. To undertake this review we will need to start collecting data in May 2016 and so it will be important that the market readiness condition is introduced in a timely manner.

The use of section 55 will allow us to introduce the market readiness condition with both a level of consultation that ensures good governance of the process and the necessary certainty on the implementation date. As we explain in Section 4 below, during the period of formal consultation there will be an option for companies to participate in a formal face to face meeting with us should they wish to present additional evidence regarding the revised condition. Subject to such evidence, any other responses to the formal consultation and the views of both the Secretary of State and Welsh Ministers, it should be possible to have the condition in place by mid-April 2016.

We are issuing a formal consultation to implement the changes using Section 55 powers of the WIA91 immediately.

4. Next steps

As we have highlighted in the sections above, we are commencing immediately the formal consultations to make the necessary modifications to IoAs and WSLs.

4.1 Removal of the IATB

The removal of the IATB will follow the standard formal consultation process using section 13 and section 17J of the WIA91. Companies wishing to respond to the formal consultation should do by **5 April 2016**.

Subject to appointees and licensees' agreement to our proposals, we will amend all IoA and WSL licences by the end of April 2016.

But if we cannot secure agreement from appointees and licensees, we can use our powers under section 14 of the WIA91 to refer the matter to the Competition and Markets Authority. The Competition and Markets Authority would then be free to decide whether the modification should be made and, if so, in what form.

4.2 Introduction of new market readiness condition

We are implementing the licence modifications for readiness using our powers under section 55 of the WA14. This formal consultation closes on **24 March 2016**.

Alongside the opportunity to make representations though a formal consultation response, we will be giving all appointees, licensees and other stakeholders who wish to present any further evidence that they have in light of the decision we have taken to introduce the revised readiness condition the opportunity to do so face to face. These will be formal meetings which will follow a structured set of questions and from which a formal note will be agreed and published on the Ofwat website. These meetings will be held on 14 and 15 March 2016 in London.

We believe it is appropriate for a shorter consultation period in light of existing consultations, our targeted process of formal face to face meetings and the requirement to complete consultation prior to the pre-election period in Wales during April and May.

The Secretary of State and, in relation to Welsh appointees, Welsh Ministers have powers to veto our proposed changes made under section 55. Assuming they do not

exercise these powers, we will amend the relevant instruments of appointment and the water supply licenses to insert the new condition by mid-April.

The formal consultation document sets out the process we will follow in more detail.

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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