

Interim supply code explanatory note

About this document

This document provides a high level overview and explanation of the structure and content of the Interim Supply Code (ISC) which we have published alongside this document.

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1. Background

The UK Government is committed to opening a retail market that will provide choice to eligible business, charity and public sector organisations (non-household customers) in England and Wales from April 2017.

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

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 retailers. However, from time to time, companies in competitive markets fail, for example as a result of direct insolvency or insolvency of a parent company. This applies as much in relation to water markets as it does to other markets. A key difference between water and other sectors of the economy is that water and sewerage services are generally regarded as essential utilities. It is therefore common in such markets for there to be special legal and administrative safeguards which can be invoked in the event of any such failure.

Whilst we do not anticipate that retailer failure will be a regular occurrence, we cannot predict with any degree of certainty the frequency upon which this may happen. Further, the specific circumstances surrounding a retailer failure may vary considerably, including the number, location and types of customers affected, and the terms and conditions under which the supply was being provided. The interim supply arrangements set out in the ISC have therefore been designed to be sufficiently flexible to ensure the most appropriate and efficient response to a specific retailer failure event.

The interim supply arrangements will only apply where a **WSSL licensee** ceases to supply an eligible customer. These interim supply provisions do not relate to cessations of supply by an undertaker: this would still be covered by a special administration regime. Nor do they cover a retail exit situation, where it is expected that the Exit Regulations and any transfer schemes pursuant to those regulations will ensure continued supply.

The Water Industry Act 1991 (WIA91), once amended by the Water Act 2014 (WA14), will establish the overall legal framework for the interim supply

arrangements, and provide a number of powers and duties for Ofwat. These include an obligation to establish an Interim Supply Code¹ (“ISC”) which may make provision about a number of aspects of how the interim supply arrangements will be implemented in practice, including:

- how and when Ofwat will exercise its powers to direct an alternative retailer to continue supply for affected customers of a failed retailer;
- appropriate mechanisms and procedures to allocate affected customers; and
- the terms and conditions under which the alternative retailer must continue supply.

Sections 63AC and 110L oblige the relevant undertaker to continue the supply of water and/or sewerage services to the premises affected by a licensee’s cessation of supply unless and until Ofwat issues a direction to another licensee (an “eligible licensee”) to continue that supply.

2. Statutory basis and related regulations

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

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

Sections 63AF and 110O of the WIA91 will provide that the ISC may make provision about:

- electing to be an eligible licensee;
- temporarily suspending that election;
- circumstances in which Ofwat's power to direct a licensee to take a customer may be exercised;
- determining the date on which the previous retailer ceased to supply;
- terms and conditions for the supply to the customer to be contained in an eligible licensee's scheme(s);
- retailers notifying customers of the relevant terms and conditions; and
- Ofwat giving directions to ensure compliance if we consider that a licensee is not acting in accordance with the ISC.

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

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

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

outside the scope of the ISC, but which form important context for the code;
and

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

3. Scope and structure of the ISC

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

3.1 Introductory and general provisions

This section of the code includes defined terms, interpretation provisions, general duties on relevant parties and provisions about how all communications and notices required to give effect to the code's processes are to be delivered.

3.2 Part A (Eligible Licensees)

This part of the code sets out the procedures for electing to be an eligible licensee for the purposes of the WIA91 ("opt-in"), removal of such an election or the temporary suspension of such an election ("opt-out). The WIA91 will provide that an "eligible licensee" for the purposes of participation in the interim supply arrangements is a licensee with a retail authorisation or a restricted retail authorisation who has elected to be an eligible licensee in accordance with the Interim Supply Code. Part A of the ISC therefore enables the following approach:

- a licensee which is not already obliged to opt-in to the interim supply arrangements (e.g. as a result of being an acquiring licensee in an exit area) shall be free to choose whether they wish to opt-in, and the areas in respect of which they wish to do so;
- a licensee shall be able to opt-in via the processes administered by the Market Operator under the Wholesale-Retail Code in order to be considered as an eligible licensee;
- a licensee shall be entitled to exercise its voluntary opt-in right at any time;
- eligible licensees will generally be permitted to opt-out by area and/or service category.
- an opted-in licensee will be allowed to opt-out on a case-by-case basis. However, in doing so, the licensee shall be required to explain its opt-out decision with reference to a "Statement of Interim Supply Capacity" which the ISC will require it to provide to Ofwat from time to time (e.g. upon opting-in or upon a material change in circumstances affecting the licensee's capacity to take on additional customers). In order to opt-out down to within the level of its stated capacity, an eligible licensee shall be able to exercise its rights to opt-out in any combination of area and service category.

Part A of the code also describes the required content of the “Statement of Interim Supply Capacity” and the purposes for which this will be used.

3.3 Part B (Procedure following a relevant cessation of supply)

Part B of the ISC describes the circumstances in which Ofwat’s power to direct an eligible licensee to continue supply may be exercised (“trigger events”). These are defined in the code to include: revocation of the previous Licensee’s licence in circumstances other than where the Licensee has consented to the revocation; and termination of a Wholesale Contract in accordance with the provisions of the Wholesale-Retail Code.

Part B also describes the notice and accompanying information that Ofwat will provide when there is an interim supply event. This comprises certain key information about the affected customer base that must always be provided (e.g. number of supply points and the wholesaler areas in which these are located). The code also permits Ofwat to provide additional information where practicable (e.g. tariff details and meter read history of the affected supply points).

Part B sets out the basis on which Ofwat may decide to allocate affected customers. The allocation options available to Ofwat and set out in the ISC include:

- to decide not to direct an eligible licensee(s) in one or more non-exit areas and in respect the affected customers in each such area. In this event the relevant undertaker(s) would be required to supply the affected customers in their area(s);
- to direct an eligible licensee to be the interim supplier for some or all of the affected customers on the basis of a simple market-based allocation approach whereby “Interim Supply Offers” are sought from relevant Eligible Licensees. This could be on a national basis (if a licensee was opted in in all areas) or on a regional basis; and
- to request the Market Operator to allocate the relevant supply points in one or more relevant areas by implementing the “Interim Supplier Allocation Process” in accordance with the relevant provisions of the Wholesale-Retail Code. Broadly speaking under this mechanism an equal number of supply points would be allocated to each opted in retailer for a particular service in each region.

3.4 Part C (Basis of interim supply by an interim licensee)

Part C of the ISC sets out various requirements applying to the terms and conditions under which an eligible licensee may provide interim supply. It also obliges an interim supplier to provide certain important information to its affected customers.

Where the interim supply is to be made by an eligible licensee pursuant to a direction by Ofwat, the terms and conditions which apply, in the absence of agreed terms and conditions between the retailer and customer, are those to be set out in a scheme published pursuant to s63AE (as regards interim water supply) and/or s110N (as regards interim sewerage services) of the WIA91. All licensees that have elected to be an eligible licensee must make, and from time to time revise, such a scheme(s) for interim supply. Part C of the ISC requires that an eligible licensee must ensure that its relevant scheme for interim supply complies with a number of principles and requirements. These include that:

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

4. Potential additional Ofwat guidance

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

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

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

5. Modification of the ISC

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

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

6. Further information

If you have any questions about this process or this document please email responses to retailmarketopening@ofwat.gsi.gov.uk, alternatively please feel free to contact us using the details provided below:

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