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Trust in water

# Deemed Contracts: policy conclusions and consultation on draft Retail Exit Code

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## About this document

This document sets out our approach to the terms and conditions that are to apply in certain circumstances where the customer is receiving a water supply and/or wastewater service, but no contract has otherwise been agreed between the retailer and the customer. These terms and conditions, once applied to the particular customer relationship concerned are referred to as 'deemed contracts'.

This document should be read alongside our conclusion on the proposed arrangements for interim supply ('Interim supply arrangements: policy conclusions and consultation on draft Interim Supply Code'). In those circumstances, a scheme of terms and conditions would apply to the relationship between the customer and the new retailer until the affected customers are able to choose to move to a different contract or retailer.

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 monopoly companies. The Water Act 2014 will allow eligible non-household customers to choose their supplier of water and wastewater retail services from April 2017. Retail services include activities such as billing and customer services. For non-household customers of companies based wholly or mainly in Wales, only those customers using more than 50 million litres of water each year are able to choose their water supplier, and this will continue. The new market will be the largest retail water market in the world and deliver about £200 million of overall benefit to customers and the UK economy and research shows that seven out of ten of non-household customers want this choice.

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 will be to ensure that non household customers are appropriately protected in the retail market.

Deemed contracts will set out the terms and conditions for customers in certain defined situations. We set out our decisions based on our consultation in October 2015 on price and non-price terms and conditions for deemed contracts, which will be reflected in the drafting of the Retail Exit Code. We are also consulting on the drafting of the Retail Exit Code, which will give effect to those decisions.

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## 1. Executive summary

In October 2015, we consulted on deemed contracts. The introduction of Schemes of Terms and Conditions upon which deemed contracts will be based will make sure that non-household customers who are affected by retail exit or by their licensed supplier ceasing to supply them have contractual terms and conditions after the retail market for non-household customers opens in April 2017. Deemed contracts will set out the terms and conditions for customers in certain defined situations where they have not had an opportunity to engage with the market. In the consultation we set out our approach to both the price and non-price terms and conditions for deemed contracts.

We have developed our conclusions after our October consultation.

We have concluded that a key principle is that customers should not be locked into a deemed contract, as we want customers to be able freely to engage with the market. This underlies our decisions in this document. Customers would be able to switch away from the deemed contract at any point (either to different contractual terms with the same retailer, or to a different retailer), and there will be requirements on retailers to ensure that customers are clearly informed of the fact that they are being supplied on the terms and conditions in a Scheme and thus on a deemed contract and their rights to switch.

Under the draft exit regulations being developed by Defra there is a requirement for us to produce a Retail Exit Code, which may, among other things, set out the provisions for the terms and conditions to be included in Water Supply and Sewerage Service Licences (WSSLs') schemes produced for customers affected by retail exit. We have developed a draft Retail Exit Code based on the conclusions of the deemed contracts consultation and the version of the draft exit regulations on which Defra consulted last year. We include a draft of that code in this document, on which we are consulting.

**Table 1: Summary of policy conclusions**

Issue	Proposed approach	Further information
Whether provisions for licensees to offer terms in Supplier of First Resort situations where there has not been an exit (which will not be covered by the Retail Exit Code or the Interim Supply Code) are necessary.	We do not believe provisions for licensees to offer terms in Supplier of First Resort situations where there has not been an exit (which will not be covered by the Retail Exit Code or the Interim Supply Code) are necessary as there is a statutory duty on the undertaker to fulfil that role.	Section 4.9
Approach to the setting of price terms for customers transferred during the retail exit process.	We continue to consider that the customer should be no worse off at the point of Exit. We have decided that the acquiring WSSL retailer should offer the relevant retail tariff applicable to the customers at the point of transfer in its scheme of terms and conditions.	Section 3.1
Approach to setting price terms for other customers on deemed contracts.	We have decided that for Small and medium-sized enterprises (SME's) customers that have not been transferred, they should merit a degree of protection similar to customer who were transferred as part of the Exit process and that prices should be linked to the tariff that would have applied to them had the undertaker for that area decided not to exit. For non-SME's we do not consider such protection as necessary. We have decided that the principle of no undue preference could apply to them.	Section 3.2
Exclusion of the costs of promotional, marketing and advertising activities in the charges being levied under the deemed contracts.	We have decided that it would be inappropriate to exclude the reasonable costs of marketing activities where they are efficiently incurred.	Section 3.2
Provision of information about affected customers	We have decided that retailer should inform the customer that they are on a deemed contract as soon as practicable, but no later than two months of the contract starting.	Section 4.5
Whether there should be no minimum term for customers on deemed contracts and whether a review point should be built into the arrangements so that	There can be no minimum fixed term, so that customers are able to move to a different contract or a different retailer at any time. We also decided that there should be no formal review point, as the wider work	Section 4.1

Issue	Proposed approach	Further information
customers have to make an active decision after a certain period on the deemed contract	on customer protection is looking at how to alert customers that they are on deemed contracts.	
Whether a customer should be required to give notice for the termination of a deemed contract and whether three months is adequate notice if retailer wishes to terminate the deemed contract	The customer would not be required to provide notice before requesting a switch. The retailer's ability to terminate will be restricted and in the limited circumstances in which an acquiring licensee can terminate, the acquiring licensee must provide 3 months' notice.	Section 4.2
Whether a retailer should be allowed to impose termination fees for deemed contracts	Customers cannot be required to pay a termination fee when they switch to a different retailer or contract	Section 4.3
Information	Reminders that customer that a deemed contract, and information on alternatives is being looked at in the wider work on customer protection. Consideration is being given to including this on invoices.	Section 4.5
Billing twice yearly	We have decided that it would be inappropriate to bill the customer twice a year, as some customers may only be billed on an annual basis, but the supplier should frequently remind the customer that they are on a deemed contract.	Section 4.6
Back-billing	We are continuing to consider back-billing as part of our wider customer protection work, and will make sure that deemed contracts align with any wider measures.	Section 4.7
Additional terms for micro-businesses	We consider that Small and medium-sized enterprise (SME) customers that appear in a retail area, e.g. are not transferred, merit a degree of price protection similar to customers who were transferred as part of the Exit process. We do not at this point intend to impose any special non-price terms for micro-businesses.	Section 4.8

## 2. Our approach

In this section, we describe our overall approach to assessing our decisions.

### 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.

### **3. Price terms – responses and conclusions**

Price terms are key to ensuring that customers on a deemed contract are treated fairly and are not paying an unreasonable price for their service. Customers on a deemed contract have not actively agreed to the terms, and although we expect many customers to then engage with the market and choose to move onto terms and conditions that are more preferable to them, we know from the experience in other sectors that some customers may not engage with the market, and so will remain on the deemed contract. This is likely to be more of an issue in the early stages of the market, when customer awareness may be low. In addition, a large proportion of non-household customers might be on deemed contracts, at least initially, depending on how many appointed companies exit the market.

There are three broad circumstances where deemed contracts will be required.

1. When customers are transferred from the appointed company to a WSSL retailer as part of the exit process.
2. For customers in an area where the appointed company has exited. This includes various situations where the customer might not have agreed terms and conditions, and other situations where the customer requests us to direct another WSSL retailer to take over the supply.
3. Interim supply.

In our October consultation, we sought views on the price terms that would apply in each of the above scenarios, recognising the differing circumstances may be applicable at the point of Exit and post Exit.

#### **3.1 Retail exit**

##### **3.1.1 Our consultation document**

Under the retail exit process appointed companies can transfer their eligible non-household customers to an acquiring WSSL retailer (or a number of retailers), which could be an associated WSSL, or an unrelated WSSL. In our consultation document for these customers we proposed to link the price terms under the deemed contract at the exit date to the default tariff in place immediately before the exit takes effect. This would affect customers who had not negotiated a contract which was to take effect on or prior to the exit date.

We sought views on whether the terms should relate to the published retail tariffs, or the default tariffs set out in the price control final determination documents.

Specifically, we proposed that the acquiring WSSL retailer should offer price terms based on the lower of the default tariff and the relevant published retail tariff for customers at the point of transfer, with an ability to adjust afterwards to reflect any changes in the wholesale charges over time.

### **3.1.2 Stakeholder views on this issue**

There was broad agreement among respondents with the principle that customers should be no worse off in the event of a transfer due to retail exit.

Most respondents considered that the price terms for customers transferred during the retail exit process should be based on the retail tariff the customer received at the point of exit. This would guarantee that customers prices do not change, ensuring stable and predictable bills which fairly and adequately reflect the cost of providing the service.

One respondent noted that default tariffs are not charges, but are a series of average revenue controls that determine the average retail cost that a class of customer pays. Default tariffs are translated into a range of fixed and variable charges by companies which means that within the class of customer some will pay less than the average retail cost and some will pay more, but on average the class of customer is charged in-line with the default tariffs.

One respondent raised concerns on whether there was sufficient clarity on exactly how prices under a deemed contract would then change going forward.

There was support for aligning the price with the current price controls, but there was an expectation that the competitive nature of the market should be the main determining factor without any need for price controls on WSSLs beyond 2020.

### **3.1.3 Ofwat conclusions and next steps**

We continue to consider that the customer should be no worse off at the point of exit. We have therefore decided that the acquiring WSSL retailer should offer the relevant retail tariff applicable to the customers at the point of transfer in its scheme of terms and conditions. This would ensure that customers' bills do not have to change if there is exit, consistent with the principle that customers should be no worse off. We

consider that this should be the maximum charge and companies can offer lower tariffs if they wish.

We have given further consideration to how retail tariffs should change in the future. We consider that the same principle that customers should be no worse off should apply. Consequently maximum charges should be adjusted in the same way as they would have had if exit had not occurred, i.e. in line with the changes that would have applied under the price control, rather than simply changes in wholesale charges. We consider that this should provide more clarity to companies on how charges are expected to evolve.

We consider that there should be no presumption that these price protections for customers at the point of transfer will continue indefinitely as we expect the market to develop over time. Consequently at the end of the next non-household price control period, Ofwat will review each of these price terms to identify whether they are still relevant or need to be adjusted.

For the avoidance of doubt we do not expect customers who have already negotiated a contract, or are on a special agreement to require a scheme of terms and conditions.

## **3.2 Post exit**

### **3.2.1 Our consultation document**

In our consultation document for customers moving onto deemed contracts in an area where the appointed company has exited (scenario 2) we proposed that there should be an obligation on WSSL retailers to take all reasonable steps to ensure that the price terms of each of its deemed contracts are not unduly onerous.

We proposed that in assessing whether a price term is unduly onerous: The terms of a deemed contract would be considered unduly onerous if for any class of customer, the revenue derived from supplying water and/or wastewater services to the premises of the relevant class of customers significantly exceeds the retailer's costs of supplying water and/or wastewater services to such premises. Also the charges levied under the provisions of a deemed contract should be stable and predictable. This would enable customers to plan ahead with greater certainty.

We also sought views on whether it was appropriate to include the costs of promotional, marketing and advertising activities of the retailer in the charges being

levied under the deemed contracts, as the customer has not expressly agreed terms and conditions with the retailer. In the case of Interim Supply, we proposed that any reasonable costs for acquiring customers should be factored into prices.

We also proposed that we would monitor the situation going forward to ensure suppliers were fairly treating customers on deemed contracts.

### **3.2.2 Stakeholder views on this issue**

Some respondents raised concerns that the definition of not unduly onerous was open to interpretation. There was support for our proposal to include the test that the margin for a particular class of customer should not exceed the margin for the whole customer base. But respondents were keen to understand more about how the terms would be defined, particularly what might constitute reasonable cost. Many respondents did not consider that the costs of promotional, marketing and advertising activities of the retailer should be reflected in charges.

One respondent suggested that in their terms the retailer should include how they would change prices and unit rates to reflect the revisions to the wholesalers' tariffs and changes to their own costs of supplying retail services.

### **3.2.3 Ofwat conclusions and next steps**

To determine the appropriate level of price protection for customers, we have considered the potential risks around how the non-household market might develop. To inform our decision, we have considered the recent evidence from the energy market investigation (CMA 'Energy market investigation: Provisional Findings' July 2015). For Small and Medium Sized Enterprises (SMEs), in the electricity and gas market the CMA found evidence that average prices have been substantially above the levels that would be expected in a well-functioning competitive market<sup>1</sup>. For example margins from retail sales in the electricity market for SMEs were on average 8% over the period, which was significantly higher than those on sales to domestic customers or industrial and commercial (I&C) customers<sup>2</sup>.

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<sup>1</sup> Paragraph 189: Energy Market Inquiry: Summary of provisional findings, July 2015

<sup>2</sup> Paragraph 25: Energy Market Inquiry: Summary of provisional findings, July 2015.

We have therefore decided that SME customers that have not been transferred merit a degree of protection similar to customers who were transferred as part of the exit process. Consequently for SME customers prices under a deemed contract should be no higher than the tariff that would have applied to them had the undertaker for that area decided not to exit. For the period beyond 2017-18 these charges should be adjusted on an annual basis as if the relevant non-household control applied.

In the draft retail exit code we have proposed that SMEs are defined based on the number of employees. We are conscious that this issue is being considered in parallel by the work on the customer code of practice and we would expect to review this definition based on the work that is being undertaken there.

As with transferred customers we consider that there should be no assumption that these price terms should endure indefinitely. Consequently at the end of the next non-household price control period, Ofwat will review these price terms to identify whether they are still needed or require adjustment.

For non-SME's we do not consider such protection as necessary as larger customers are more likely to engage with the market. We have considered whether we should continue with our consultation proposal that price should not be unduly onerous. We agree with consultation responses that this term might be open to interpretation. The term was seeking to provide protection on both relative and overall prices. We have therefore decided to replace this term with two terms:

- That prices should be reasonable; and
- That prices should offer no undue preference or discrimination.

When considering whether charges are reasonable we expect to take account of the reasonable efficiently incurred costs of promotional, marketing and advertising activities of the retailer as these costs are likely to be incurred by new entrants and competitors and so ensures comparability across different companies.

Consistent with our consultation proposals we intend to monitor the situation going forward to ensure suppliers are fairly treating customers on deemed contracts.

## **4. Non price terms – responses and conclusions**

Deemed contracts are a form of backstop protection, so customers must be aware and informed of the terms on which they are receiving their supply. Customers must be free to engage with the market and have choice to switch away from the deemed contract to a different contract or a different retailer. There should be no barrier to customers participating in the competitive market.

In the October consultation, we therefore sought views on a number of non-price terms that would form the principles to be applied in developing the terms and conditions in the schemes to be published by water and/or a sewerage licensee. We also sought views on whether extra protection for smaller customers (for example, Small and Medium-sized Enterprises (SMEs), or the very smallest non-household customers that are sometimes referred to as ‘micro-businesses’) would be required. Default standards of service would apply through GSS when those regulations are made.

### **4.1 Duration**

We sought views on whether having no minimum fixed term period for a deemed contract would be appropriate. We also sought respondents’ views on whether there should be a formal review point which forced customers to engage with the market.

This would result in customers actively making a decision about whether to remain on the terms of the deemed contract or to seek a different contract with the same retailer or a different retailer. If a review point was seen to be appropriate, we suggested review point could be 12 months after the commencement date of the deemed contract.

#### **4.1.1 Stakeholder views on this issue**

All respondents agreed that there should be no minimum fixed term period for a deemed contract on the basis that customers should be able to switch as early as possible, as they had not entered into a negotiated contracts.

Most respondents did not believe that a review point in the arrangements was necessary, since customers would be informed and reminded on a regular basis of their right to switch to a different contract and or supplier. Some respondents

supported a formal review point, as long as it would not compel customers to migrate to a negotiated contract.

#### **4.1.2 Ofwat conclusions and next steps**

We have decided that generally, there should be no minimum fixed term period for a deemed contract, as there should be no barrier for the customer to engage with the market and seek other terms and conditions that are more preferable to them. Although there could be benefit from having a formal review point, we believe it may not be necessary, as it is intended that customers will receive information and regular reminders that better terms suited to their needs may be available. We will monitor this after market opening and, if we have significant concerns we may reconsider the introduction of a formal review point.

### **4.2 Notice period for termination**

We proposed that the customer should not have to give notice before they are able to switch to a different retailer. We also invited views on where a supplier wished to terminate a deemed contract, whether three months' notice would constitute a reasonable timeframe for it to do so.

#### **4.2.1 Stakeholder views on this issue**

The majority of respondents agreed that customers should not be required to give notice of their intention to terminate a deemed contract. Some respondents opposed the proposal on that the basis that having a notice period for the customer would give the supplier a reasonable chance to bill a customer prior to the contract being terminated. One respondent suggested that 5 day notice period from the customer would be adequate, whilst minimising the barriers to switching, whilst another respondent suggested a 30 day period.

There was broad support for requiring the supplier to give 3 months' notice should the supplier wish to terminate a deemed contract.

#### **4.2.2 Ofwat conclusions and next steps**

We have decided that the customer should not be required to give any notice of their intention to switch to a different retailer. This would ensure the smooth functioning of

a competitive market. We have also decided that it would be appropriate for the supplier to give 3 months' notice to terminate a customers' deemed contract. This would give the customer adequate time to engage with the market.

## **4.3 Termination fees**

We proposed that retailers should not impose any sort of termination fees where a customer decides to terminate a deemed contracts, as it could constitute a barrier to switching.

### **4.3.1 Stakeholder views on this issue**

All respondents agreed that retailers should not impose termination fees for deemed contracts, as it would discourage customers, in particular small businesses, from seeking to negotiate contracts.

### **4.3.2 Ofwat conclusions and next steps**

We have decided that the customer should not be required to pay any termination fees where it decides to terminate a deemed contract. A deemed contract should only be a temporary measure and the customer should be encouraged to engage with the market and negotiate with its existing or an alternative retailer. Any form of termination fee could constitute a barrier to switching. We propose not to allow termination fees for deemed contracts and this is reflected in our draft Retail Exit Code.

## **4.4 Notification**

We proposed that where a customer in an Exit area is placed on a deemed contract it should be notified as soon as reasonably practicable, but no later than two months from the start of the contract and that the information should be set out in writing and in clear and plain English.

### **4.4.1 Stakeholder views on this issue**

Most respondent agreed that notification should happen no later than two months after the start of the deemed contract. Clarification was sought as to whether the act

of writing to a customer constituted notification. Some respondents raised concerns that any mandated communication over and above normal customer communications, such as the issuance of bills may increase retailer costs.

#### **4.4.2 Ofwat conclusions and next steps**

We have decided that notification should happen as soon as reasonably practicable, but no later than two months after the start of the deemed contract. We expect that this information is provided in writing and in clear and plain English.

As the customer has not necessarily intentionally chosen to enter into a deemed contract, a retailer must make reasonable endeavours to inform the customer that they are on a deemed contract and provide customers with details of the terms and conditions of the supply in a timely manner. As a point of clarification, written communication with the customer would constitute notification.

### **4.5 Information requirements**

We proposed that where a retailer supplies water and/or wastewater services to a customer's premises under a deemed contract, it should regularly provide:

- reminders to the customer that they are on a deemed contract;
- information of other terms available to the customer that may be different from the terms of deemed contracts; and
- information on how the customer may opt for such contracts.

This information should be set out in writing and in plain English.

#### **4.5.1 Stakeholder views on this issue**

There was broad support for the principle that customers should receive should regular communication to remind them that they are on a deemed contract. Some respondents were of the view that one way of doing this could be through the billing process. Some concerns were raised that there may be limit to the amount of information that can sensibly be passed to the customer in or with a bill.

## 4.5.2 Ofwat conclusions and next steps

We would expect where a retailer supplies water and/or wastewater services to a customer's premises under a deemed contract, it should regularly provide reminders to the customer that they are on a deemed contract, and provides information of other terms available to the customer that may be different from the terms of deemed contracts, and information on how the customer may opt for such contracts.

Whilst information could be provided to the customer via the billing process, it may not be appropriate to rely solely on this form of communication, as some customers may only be billed infrequently. This is being looked at through the wider work on customer protection.

## 4.6 Billing frequency

We proposed that where a customer's premises is billed under a deemed contract, the supplier should regularly provide reminders to the customer that they are on a deemed contract, and provides information of other terms available to the customer that may be different from the terms of deemed contracts, and information on how the customer may opt for such contracts.

One of the easiest ways to engage with customers is through the billing process. This is because billing and payment is effectively a call to action for a customer and so they are more likely to engage with any material and information provided within this process. As such, Ofwat suggested that this was one way in which retailers could provide information to the customer.

The additional advantage to undertaking communication in this manner is that it should avoid creating additional costs for retailers. We proposed that all customers should be billed twice a year.

### 4.6.1 Stakeholder views on this issue

There were a range of views on whether there should be a mandate for billing customers on deemed contracts twice annually. Some Respondents agreed that it would be appropriate to do so, whilst other argued that the same frequency as the customers were on prior to Exit should apply.

Some customers, unmetered ones in particular may only be billed annually on the basis of assessed consumption and there was a preference that this should be

retained. Customers are used to receiving bills at this frequency. One respondent suggested that if customers receive regular and accurate bills, this will help to prevent debts from accruing and reduce the need for back billing which could block customers' ability to switch.

Generally respondents agreed with the principle that customers should receive should regular communication to remind them that they are on a deemed contract and through the billing system was a sensible way of doing it. One respondent raised a concern that there may be a limit to the amount of information that can sensibly be passed to the customer in or with a bill about what is on offer from other retailers. As the customers are businesses we would expect internet connectivity. We suggest customers are directed to websites where they can obtain information about potential suppliers with links to individual retailers and the terms and conditions available.

#### **4.6.2 Ofwat conclusions and next steps**

The billing cycle is an important aspect of the communication between the retailer and its customers and so is an important way of informing the customer that better terms and conditions may be available, encouraging them to engage with the market.

Across the water industry there is a mix of billing cycles, with some customers billed annually and some more frequently. There are concerns that if retailers were required to bill on a very frequent basis, for example monthly, this would increase costs and significantly reduce supplier's margins. We are therefore not proposing to have a mandate for billing twice annually.

### **4.7 Back billing**

We proposed that for Retail Exit there should be no back-billing beyond the start of the deemed contract, as there should be a clear incentive for billing related issues to be resolved prior to the point of transfer.

#### **4.7.1 Stakeholder views on this issue**

There were a range of views on whether it would be appropriate to disallow back-billing beyond the start of the deemed contract. Some agreed that whilst customers on a deemed contract should not be back-billed by their retailer beyond the date of

commencement of the deemed contract, it should not prevent an exited undertaker from back-billing its former customer for a period prior to the date of exit.

Some argued that as a matter of principle, customers should pay for services they have received, whether on a deemed contract or otherwise. It was highlighted that the arrangement at the point of retail exit will be dependent on the statutory transfer scheme and any contract between the wholesaler and the retailer, which determines the ownership of assets and liabilities and arrangements for dealing with issues relating to the pre-exit period.

#### **4.7.2 Ofwat conclusions and next steps**

We are continuing to consider the issue of back-billing in the non-household retail market in the wider work we are doing on customer protection, and will make sure that the arrangements for deemed contracts align with any wider customer protection measures.

### **4.8 Micro-businesses**

We sought views on whether there should be special non-price terms for micro-businesses within deemed contracts, as exists in the GB energy sector.

#### **4.8.1 Stakeholder views on this issue**

There was limited support for having additional non-price terms for smaller customers including micro-businesses. Most respondents were of the view that having different deemed contracts for different customer categories could cause confusion.

It was suggested that the provision of information such as annual water consumption to household customers could also be used to help encourage smaller non-household customers to make informed choices when they negotiate a contract and minimise the risk of remaining on deemed contracts.

#### **4.8.2 Ofwat conclusions and next steps**

We have considered whether it would be appropriate to have additional non-price terms for microbusinesses. We believe that non-price terms should apply across the

sector, irrespective of company size. However, we do believe that a greater degree of price protection is required for SMEs in certain circumstances (see section 3.2.2).

## **4.9 Supplier of the first resort**

Where the appointed company remains in the market, it must act as the default retailer for non-household customers within its area of appointment, unless the customer is registered with a different retailer. Where it does so, the supply is provided on a statutory basis, so deemed contracts are not required. But the situation for WSSL retailers would be different, as they would require a contract with the customer. Under the current proposals for Gap Site Allocation as set out in the draft Wholesale-Retail Code:

- where a gap site is identified by the appointed company, the appointed company will register the relevant supply point(s) with the Market Operator; and
- Where a gap site is identified by a WSSL retailer, the appointed company will register the relevant supply point(s) with the Market Operator by identifying the WSSL Retailer as the retailer for those supply points.

We sought stakeholder views as to whether we needed to consider some other form of regulation to provide for deemed contracts in this situation.

### **4.9.1 Stakeholder views on this issue**

There was mixed views among respondents about whether a Supplier of the First Resort was required in areas where has not been a retail exit. Some argued that since the appointed company has the statutory duty to fulfil that role, no arrangements would be required.

#### **4.9.2 Ofwat conclusions and next steps**

Where new non household sites appear in a non-exited area, it is possible for either the appointed company or another retailer to seek to bring the site within the market, but the appointed company must be the one to actually register the site. If the appointed company initiates the action, it will become the retailer on statutory terms and if a licensed retailer initiates the action, it is likely that it will already have concluded a retail contract with the customer and could reasonably expect to be registered as the retailer for the relevant site. The customer still has the protection of being able to conclude supply arrangements with the first retailer or seek a different competitive supply as soon as it wishes. We retain the view that it is highly unlikely in practice that a retailer would seek to register a gap site without first concluding a contract with the customer, as the retailer would then be liable for all wholesale charges in respect of that supply from the date of registration, with no means to recover these from the customer. We therefore are not proposing that a deemed contracts would be required.

## **5. Consultation on the draft text of the Retail Exit Code**

This section provides a high level overview and explanation of the structure and content of the draft Retail Exit Code which we have published alongside this document. This is intended to aid understanding and consideration of the draft text by stakeholders. This section also invites views on the draft code.

### **5.1 Overview of draft Retail Exit Code**

#### **5.1.1 Statutory basis and related regulations**

The Water Act 2014 allows Defra to make regulations to provide for retail exit – that is, for an appointed company to apply for permission to transfer all its non-household customers to one or more WSSL retailers, which could be an associated WSSL retailer, or an unrelated WSSL retailer. Defra consulted on its proposed policy in December 2014, and has recently consulted on the draft Exit Regulations. The retail exit applications process is expected to take place in the second half of 2016, with the Secretary of State deciding on applications in December 2016.

Draft Regulation 27 of the draft exit regulations requires that all licensees providing or proposing to provide services in relation to a retail exit area must make and keep under review a scheme setting out the terms and conditions that will apply in all cases where these have not been negotiated with a customer on an individual basis.

Regulation 28 places a requirement on Ofwat to issue a code setting out the basis for schemes produced under regulation 27. Compliance with the Retail Exit Code by licensees will be enforced by direction, which, in turn is enforceable under section 18 WIA91.

The code has been drafted based on the draft exit regulations which will be finalised by Defra in due course. A further iteration of the code may be required to reflect any changes.

#### **5.1.2 Scope and structure of the draft Retail Exit Code**

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

- 1. Introductory and general provisions**, including 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.
- 2. Provisions about Schemes of Terms and Conditions for Transferred Customers.** This section sets out the principles upon which the price and non-price terms for the Schemes of Terms and Conditions, will be developed by Acquiring Licensees. The Schemes will apply to customers that were part of the exit process only.
- 3. Provisions about Schemes of Terms and Conditions for Eligible Area Customers.** This section sets out the principles upon which the price and non-price terms for the Schemes of Terms and Conditions, will be developed by Licensees in an Exit area (for example these principles would apply where a site has not been registered previously; or where a contract terminated or expired.
- 4. Provision of information to Customers.** This section sets about the provision of information to customers of the Licensee, when they are places on a Scheme of Terms and Conditions.

### **5.1.3 Modification of the Retail Exit Code**

Under the terms of the draft exit regulations, Ofwat will be obliged to carry out periodic reviews of the Retail Exit Code and, if appropriate, issue a revised code. The draft Retail Exit Code does not include any specific procedures in this regard. Once effective, any future modifications to the Retail Exit Code will only be made following consultation, in line with Ofwat's statutory functions and duties and the scope and powers set out in legislation. We do not expect the Retail Exit Code to be subject to CMA appeal. We are considering the processes that we will apply to govern changes to all the statutory codes for the new market (where these are not already specified within the relevant codes) and may issue further guidance on this at a future date.

## **5.2 Views sought**

We welcome all comments on the proposed text of the draft Retail Exit Code which we have published alongside this document.

Where you wish to suggest a change to the current drafting, it would be particularly helpful if you could provide specific revised text, marked-up against the published version, in order to help expedite the process of producing the next version of the code.

Please submit your comments on the draft Retail Exit Code by 12 noon on 7 March 2016.

Please email responses to [retailmarketopening@ofwat.gsi.gov.uk](mailto:retailmarketopening@ofwat.gsi.gov.uk), with the subject **“Retail Exit Code Consultation”** or post them to:

Retail Exit Code Consultation  
Retail Market Opening Programme  
Ofwat  
21 Bloomsbury Street  
London  
WC1B 3HF

If you wish to discuss any aspect of this document, please contact John Kennedy on 0121 644 7598 or by email at [john.kennedy@ofwat.gsi.gov.uk](mailto:john.kennedy@ofwat.gsi.gov.uk).

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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