

Consultation on Ofwat's section 13 and 17J proposal to modify company licences – removal of the in-area trading ban

About this document

The purpose of this document is twofold:

1. Modification of Condition R of the Instrument of Appointment

This document invites comments on our proposal to modify condition R of the appointment of water undertakers. The proposed modification will remove the prohibition to sell or otherwise make available water or any other assets to a related licensed water supplier.

Under section 13 of the Water Industry Act 1991 (WIA91), we are able to modify the conditions of a company's appointment if it agrees to the modification we are proposing to make.

This document and the attached appendix is a Notice under section 13 of the WIA91.

2. Modification of Condition 7 of the standard licence conditions of the Water Supply Licence

This document invites comments on our proposal to modify condition 7 of the licence of licensed water suppliers. The proposed modification will allow licensees to carry out relevant activities in the area of a related water undertaker.

Under section 17J of the Water Industry Act 1991, we are able to modify the standard licence conditions of the Water Supply Licence (WSL) if no licensee has objected or those who have objected represent less than 20% by volume of water supplied by all licensees in a 12 month period prior to issuing the Notice.

This document and the attached appendix is a Notice under section 17J of the WIA91.

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Responding to this consultation

We invite stakeholders to comment on our intended modifications by **5 April 2016**. You can email your responses to retaillicensing@ofwat.gsi.gov.uk or post them to:

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

If you wish to discuss any aspect of this document, please direct your enquiry to Tim Griffiths on 0121 644 7610 or by email to tim.griffiths@ofwat.gsi.gov.uk.

We will publish responses to this document on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

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

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.

The Water Act 2014 (**WA14**) will remove the consumption threshold¹ in the non-household retail market and allow all eligible customers to choose their supplier of water and wastewater retail services from April 2017.

In this market, holders of the new Water and Sewerage Supply Licences (**WSSL**) will be able to provide nation-wide retail services. To help ensure that wholesalers and retailers are ready for market opening, we intend to remove the IATB from the Instrument of Appointment (**IoA**) and the standard licence conditions of the Water Supply Licence (**WSL**). This will allow all licensees to provide national services leading up to April 2017.

¹ From April 2017 the consumption threshold for eligibility will be zero in England and 50Ml in Wales.

2. What are the modifications that we are proposing and why are they needed?

The IATB was a policy tool implemented in consequence of the statutory duties arising from WA03. These duties were repealed under ERA13. 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.

To implement the removal of the IATB we are proposing to modify condition R of the instrument of appointment (IoA) of all appointed water and sewerage and water only companies in England and Wales, and condition 7 of the standard licence conditions for all licensees. These modifications will allow related appointees and licensees to trade in the relevant area of appointment.

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 (i.e. (a) those who use the supply system of an undertaker 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 MI; and (b) those whose use the supply system of an undertaker 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 50MI).

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 exit², 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.

The removal of the IATB will not have any practical effect for customers or licensees who use the supply system of undertakers whose area is wholly or mainly in Wales.

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

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 50MI 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.

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.

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. We have already engaged with stakeholders on our proposal and considered carefully the points made by those stakeholders on the removal of the IATB, particularly the points made by retailers currently operating in the Scottish non-household retail market, and we have concluded that it remains in customer's interests overall for the ban to be removed in April 2016.

3. Next steps

We would like responses to this document, including formal acceptances by undertakers and licensees, to our proposals by **5th April 2016**.

Subject to undertakers 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 undertakers 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.

Appendix A: Proposed modification of conditions

This draft sets out an illustrative example of what condition R of the IoA and condition 7 of the WSL would look like following our proposed modifications. The purpose of this example is to help to show the effect of the proposed modifications. It does not necessarily show the exact wording that will apply for each undertaker.

Proposed modification to IoA condition R

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

Anti-competitive behaviour

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

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

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

Proposed modification to WSL standard condition 7

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.

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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Printed on 75% minimum de-inked post-consumer waste paper.
March 2016

ISBN 978-1-910739-47-1

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