

# **Consultation on Ofwat's section 55 proposal to modify Instruments of Appointment and Water Supply Licences – market readiness**

## About this document

This document invites comments on our proposals to modify all existing Instruments of Appointment (**IoA**) and Water Supply Licences (**WSL**) by the addition of a retail market opening readiness condition (the **readiness condition**). The introduction of a readiness condition for companies to be ready for the opening of the new retail market in April 2017 creates a legally enforceable obligation, supporting the programme requirements around preparation and loading of data and other preparations for shadow operation as well as the Open Water Assurance Framework.

Under section 55 of the Water Act 2014 (**WA14**) the Water Services Regulation Authority (**Ofwat**) may modify the conditions of an appointment and the conditions of a licence under Chapter 1A of Part 2 of the Water Industry Act 1991 (**WIA91**) where it considers it necessary or expedient to do so in consequence of provision made by or under Part 1 of WA14.

The requirement under section 55 is that we consult the holders of IOAs and WSLs which we propose to modify, together with the Secretary of State, Welsh Ministers and anybody else we think is appropriate. This document is that consultation.

Although there are no statutory provisions with regard to the length of the consultation period, we are bound by our wider public administrative law duties. In the circumstances of the particular modifications proposed in this consultation, Ofwat considers 21 days to be appropriate and proportionate in view of the:

1. Prior consultation on this matter;
2. Minor modifications to the proposed condition following that consultation; and
3. Need to complete the process prior to the pre-election period in Wales.

Subject to responses from stakeholders and the necessary confirmation that SoS and Welsh Ministers do not wish to oppose the changes, we will modify the appointments and licences by **mid-April 2016**.

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## Responding to this consultation

We invite stakeholders to comment on our intended modifications by **24 March 2016**. You can email your responses to [retaillicensing@ofwat.gsi.gov.uk](mailto: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](mailto:tim.griffiths@ofwat.gsi.gov.uk).

We will publish responses to this document on our website at [www.ofwat.gov.uk](http://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. The proposed readiness conditions

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.

### 1.1 The benefits of the condition

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 other companies are taking the steps they need to support effective market opening;
- It requires companies to support the Open Water assurance process and also 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.

## **1.2 Consultation to date**

We first consulted on the principle of a readiness condition in June 2015. We received a range of responses from stakeholders with some concerned about the need for a formal licence condition and whether it would provide sufficient clarity on the requirements. Having taken those views into consideration, we developed a general condition and the Ofwat Board approved our approach in October 2015. We then communicated this decision to stakeholders as part of the consultation results document in December 2015.

In January 2016 we undertook a further consultation on the proposed drafting of the licence condition itself. We received a number of comments in response and consequently we have decided to modify the wording of the readiness condition. Section 3 below explains how we have altered the wording of the condition in response to these comments. Following approval from the Ofwat Board on the revised form of condition and the proposed implementation approach, we are now consulting on the revised condition using our section 55 powers.

## 2. The importance of timeliness and consistency

For the market readiness condition to be effective, 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.

### 2.1 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.

### 2.2 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 consultation that ensures good governance of the process and the

necessary certainty on the implementation date. Certainty on the implementation date for all affected appointees and licensees is important given that one of the benefits of the readiness condition stated above is collective confidence among industry participants that they are subject to the same obligations at the same time and are incentivised to comply with those obligations.

As we explain in Section 5 below, during the period of formal consultation, there will be an opportunity for companies to request further engagement 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 introduce the condition in April 2016.



### 3. The revised condition takes account of industry views

Responses to our informal consultation provided differing views regarding 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, namely that the condition:

- Creates an unbounded effort requirement with exposure to risk outside the control of the company;
- Creates a requirement for accuracy in data that may not be achievable; and
- Does not have all terms well defined.

#### **We propose to make one amendment to the condition as drafted in the informal 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.**

We did not consider that other modifications were 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 certain legal 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.

We set out below some further detail on our interpretation of the condition:

- **“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 included this as a defined 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 interact with the market via the low or high volume interfaces, providing that they satisfy the requirements of the MOSL entry assurance process and (if relevant) the application process for the new Water supply and sewerage licence (WSSL). Companies should ensure their readiness based on the appropriate interface.

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.

## 4. The application of Section 55 of the WA14

Sections 55(1) and (2) of the WA14 allow Ofwat to modify the conditions of appointment of a company appointed under Chapter 1 of Part 2 of the WIA91 (i.e. an instrument of appointment) or a licence under Chapter 1A of Part 2 of the WIA91 (currently the Water Supply Licence or WSL but, in due course will include the new water supply licences and sewerage licences or WSSLs), **“where it considers it necessary or expedient to do so in consequence of provision made by or under”** Part 1 of the WA14. This power may only be exercised within two years of the date the provision in question comes into force.

There are three specific provisions where we consider it to be expedient, as a consequence of those provisions to introduce the readiness condition. We also consider that the introduction of the readiness condition is both necessary and expedient as a consequence of general provision made in relation to the non-household retail market implemented by Part 1 of the WA14 as a whole. The specific provisions are:

- Sections 1(3) and 4(3) of the WA14 which, by giving effect to Schedules 2 and 4 of the WA14, introduce the new sections 66D-66DC and sections 117E-117H of the WIA91 and allow Ofwat to issue codes setting out the procedures and terms and conditions for agreements between undertakers (wholesalers) and water supply and sewerage licensees (licensed retailers), i.e. the wholesale retail code.
- Section 1(1) of the WA14 which introduces water supply licences with retail authorisations which are not subject to the threshold requirement in s17D WIA 91, and section 4(1) of the WA14 which introduces sewerage licences, both of which would lead to a significant expansion of the non-household retail market and as a consequence of which it would be expedient to require some preparations to be made.

### 4.1 The industry codes are not yet active

The draft wholesale retail code sets out the rules that apply to the agreements made between undertakers and new WSSL licensees. This includes arrangements for payments, transfer of customer data and operational processes.

The wholesale retail code does not become fully 'live' until April 2017. Nevertheless, it is critical that companies are taking steps now to ensure that they can comply with the code when it is issued, in particular by ensuring that their customer data and

systems/operational processes will be consistent with the wholesale retail code and are suitable for market opening.

This is why there are several phases to the Open Water programme in terms of design and build (up to April 2016), testing (April to October 2016) and shadow operation (October 2016 to March 2017). During this transition period to market opening it is important that companies make sufficient progress on market readiness. This is why DEFRA has introduced an assurance framework, MOSL has introduced a market and company readiness plan and we are planning a targeted review of company readiness.

For the market to operate effectively it is important that all parties achieve market readiness, and are confident that other parties are doing the same. The market readiness condition provides parties with the assurance that, if companies are not making sufficient progress on market readiness, Ofwat can take enforcement action. It therefore complements and supports the existing market readiness assurance processes.

## **4.2 The expansion of the non-household retail market**

The effective removal of the threshold requirement for licensees who use the supply system of undertakers whose areas are wholly or mainly in England and the introduction of the sewerage licences will lead to many more customers being in the non-household retail market. The market is forecast to increase from its current size of around 20,000 customers, to around 1.2 million customers from April 2017. As the number of customers in the market increases the need for common data requirements and seamless customer transfer and payment arrangements increases.

Although the threshold requirement will remain for licensees who use the supply system of undertakers whose areas are wholly or mainly in Wales, the relevant Welsh companies will still need to participate in the new market arrangements and will need to ensure that they can meet the customer data, system and process requirements of the market, albeit in a proportionate way given the lower the number of customers that they have in the market. These changes are important for Welsh companies to ensure that the way they interact with the system will not disadvantage them, and will not place themselves inadvertently at risk of potential Competition Law implications. We therefore consider that it will be important that the market readiness condition is introduced for companies in Wales as well as England. The increased scale and scope of requirements necessitate the introduction of a market operator and the associated market arrangements. They also necessitate a transition period

while companies get themselves ready for market opening. Given the enlarged market and the scale of the changes to the regulatory framework brought about by that enlargement, we consider it is expedient to allow for a transition period to that new framework and for that transition period to be underpinned by conditions in instruments of appointment and WSLs to ensure that all parties are making appropriate progress on market readiness.

We therefore consider that a market readiness condition should be introduced for all appointees and licensees, regardless of whether they are considered Welsh or English.

## 5. Next steps

In adopting section 55, Ofwat must consult:

- (a) the company holding the appointment or, as the case may be, the person holding the licence;
- (b) the Secretary of State;
- (c) Welsh Ministers; and
- (d) such other persons as Ofwat thinks it appropriate to consult

The WA14 does not prescribe the form of the consultation required. We consider that section 55 powers enable us to develop a consultation that is different to those used under the existing powers and is proportionate and appropriate for the nature of the modifications being proposed. As such, we have designed a consultation process that we think is appropriate for the proposed readiness condition and builds upon the previous rounds of consultation on this condition, having considered the Cabinet Office's Consultation Principles<sup>1</sup>.

These Principles state that consultation should: be clear and concise, have a purpose, be informative, only be part of the process, last for a proportionate amount of time, be targeted, take account of the groups being consulted, be agreed before publication, facilitate scrutiny and not generally be launched during local or national election periods.

### 5.1 Our consultation process

We have already consulted on the introduction of a readiness condition twice: firstly on the principle and form of condition; and secondly on the detailed wording of the condition. As highlighted above, we are proposing a revised condition to address the concerns identified through these consultations.

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<sup>1</sup> <https://www.gov.uk/government/publications/consultation-principles-guidance>

We believe that the revised condition will be supported by most stakeholders. The RMO Management Group (Ofwat, Defra and MOSL) share the view about the need to introduce a market readiness condition to build mutual confidence that all trading parties were making appropriate efforts to be ready for market opening.

Additionally, given the nature of the modifications proposed in this consultation and the proposed length of the consultation, 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.

Companies will also have an opportunity to make representations through the formal responses to this consultation. This consultation closes on **24 March 2016**. We believe it is appropriate for a 21 day consultation period in light of existing consultations, our targeted process of response hearings and our desire to complete consultation and obtain a decision from the Welsh Government as to whether or not they will direct Ofwat to modify or not to implement a modification under section 55(8) or section 55(9) WA14 prior to the pre-election period in Wales during April and May.

The Secretary of State and, in relation to Welsh undertakers, 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 in April.



## Appendix A: Proposed condition on market readiness

This draft sets out an illustrative example of what condition would look like following our proposed modifications. The proposed structure of the condition is the same in both the Instrument of Appointment and the WSL.

### Draft licence condition for the IoA – Retail Market Opening

#### CONDITION [Z]: RETAIL MARKET OPENING

##### 1.1 General Obligations

The 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 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

## Draft licence condition for the WSL – Retail Market Opening

### CONDITION [Z]: RETAIL MARKET OPENING

#### 1.1 General Obligations

The Licensee 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, 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.

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**“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

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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