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Trust in water

Response document – consultation on Ofwat’s statutory notices to modify company appointments and licences to include the market readiness condition

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About this document

The introduction of a readiness condition requiring companies to make the preparations necessary for market opening will provide important support to the opening of the new retail market in April 2017. It creates a legally enforceable obligation, supporting the programme requirements around preparations for data, shadow operations and the assurance framework.

Ofwat issued a [formal consultation](#) on the proposed readiness condition on 3 March. This was the third-stage of consultation on the readiness condition. This document sets out the results of that consultation. We summarise the responses received, how we have considered the points made in the responses and the decision that we have reached.

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1. Background to the formal consultation on the readiness condition

The introduction of a readiness condition requiring companies to make the preparations necessary for market opening will provide important support to the retail market opening programme. It creates a legally enforceable obligation, supporting the programme requirements around preparations for data, shadow operations and the assurance framework.

The benefits of the condition are that:

- it creates an obligation on each individual industry participant to take preparatory steps to ensure that they are ready for the opening of the competitive market;
- 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 indirectly requires companies to support the Open Water assurance process and also allows Ofwat to introduce additional assurance on company readiness; and
- it sends an important signal to customers about the collective industry commitment that the market will be ready on time.

We issued a formal consultation on the proposed readiness condition on 3 March. This was the third-stage of consultation on the readiness condition and followed earlier consultations in [June 2015](#) and [January 2016](#). The formal consultation stated that, as a result of feedback on the previous consultation, we had amended the wording of the proposed condition to refer to data being “sufficiently accurate to enable the effective functioning of the Competitive Market”. The consultation explained that since Ofwat has certain legal duties to act reasonably and proportionately, we did not consider that it was necessary to qualify the wording regarding the level of effort that the companies needed for their preparations.

The proposed condition requires each appointee and licensee to support the testing and trialling of the new market and also to take such steps as are within their power to ensure that they themselves are ready. The condition is principles based and we intend to apply it proportionately. The scale and nature of preparations required is largely determined by the number of eligible premises for which an appointee or licensee holds data and the business strategy that the appointee or licensee wishes to pursue.

While we recognise that companies individually and collectively consider that there are already incentives in place to take those steps, without a formal obligation there is a risk that a small number of companies rely on the actions of others and do not take the necessary steps, jeopardising the collective goodwill of the industry and potentially impeding the successful opening of the market.

2. Summary of consultation responses

We received responses from all 36 companies that currently hold water and sewerage Appointments or Water Supply Licences. As expected given the previous rounds of consultation and the changes made to the draft condition, there was a broad measure of support for the condition proposed in the formal consultation. All the responses stated that they supported the new condition or would not object to its introduction. Table 1 below summarises the responses from both appointees and holders of water supply licences.

2.1 Additional comments from some companies

Although all responses indicated either that the respondent supported the new condition or would not object to its introduction, it was also clear that some respondents were less enthusiastic on the merits of the new condition than others. Respondents made a number of additional comments about various aspects of the readiness condition.

- Some respondents suggested that the condition duplicated existing incentives and sanctions;
- Some respondents suggested that the condition duplicated the assurance framework that has been established;
- Several respondents emphasised the need for proportionality and clarity on arrangements for small companies;
- One respondent suggested further consideration of wording to refer to companies only being required to take reasonable steps;
- One respondent expressed concern over how the condition may be imposed, especially during shadow operation.

We explain how we have considered these additional comments in the next section.

Table One (Part A): Summary of responses from appointees

Company	Headline response	Additional comments
Anglian Water Services Limited	Accept the proposed condition	-
Dŵr Cymru	Will not object to being added	Given assurance programme, do not think it is necessary or appropriate
Northumbrian Water Limited	Supportive of Ofwat stance and appreciative of changes made	-

Company	Headline response	Additional comments
Severn Trent Water Limited	Accept the proposed changes	Condition appears an unnecessary duplication of existing incentives and sanctions
Southern Water Services Limited	Completely accept such a condition is necessary	Concerns over how the condition may be imposed, especially regarding shadow operation
South West Water Limited	Accept - supportive of changes	-
Thames Water Utilities Limited	Much that we can support but some residual concerns - due consideration when finalising wording	Suggest qualification on reasonableness - concerns relate to the requirement that the condition applies to all eligible premises, any central systems and any MO
United Utilities Water Limited	No objections to condition in line with formal consultation	-
Wessex Water Services Limited	Confirm acceptance	-
Yorkshire Water Services Limited	Proposed new condition acceptable	Agree with revised wording
Affinity Water	Cautious about accepting	Concerned about unbounded commitment to do things yet to be specified
Bournemouth Water Limited	Accept - supportive of changes	-
Bristol Water plc	Happy with wording and approach	-
Cholderton and District Water Company Limited	No comment	-
Dee Valley Water plc	No objection to inclusion of condition as proposed	Note ongoing dialogue with Ofwat/MOSL on proportionality w.r.t. WRC compliance
Portsmouth Water Limited	On balance accept the proposed changes	Some reservations remain regarding the level of effort that the condition could require
South East Water Limited	We accept the proposed new condition	-
South Staffordshire Water plc	Supportive of proposals and formally accept	-
Sutton and East Surrey Water Plc	We accept that appointment will be modified	Still consider condition to be unnecessary, but support consultation and modifications made

Table One (Part B): Summary of responses from Water Supply Licensees and small appointees

Company	Headline response	Additional comments
Avon Valley Water Limited	Accept – supportive of changes	-
Anglian Water Business (National) Limited	Accept new condition	-
Kelda Water Services (Retail) Limited	Accept new condition	
NWG Business Limited	Supportive of Ofwat stance and appreciative of changes made	-
Peel Water Limited	No issues and consent to changes	-
Scottish Water Business Stream Ltd	No issues with form of condition proposed	-
Source for Business	Accept – supportive of changes	-
Sutton and East Surrey Water Services Limited	Do not object to introduction of the condition	-
Severn Trent Select Limited	Accept the proposed changes	-
Thames Water Commercial Services Limited	Common view with TWUL response	As for TWUL
United Utilities Water Sales Ltd	Do not object to introduction of the readiness condition	
Water 2 Business Limited	Happy with proposals	-
Albion Water Ltd	No objection to market readiness duty	Concerned about speed of Ofwat response to licence application necessary to ensure our readiness
Independent Water Networks Ltd	No objection	
SSE Water Ltd	No objection	-
Peel Water Networks Ltd	Accept proposed condition	Essential that Ofwat takes reasonable and proportionate approach regarding small companies
Severn Trent Services (water and sewerage) Ltd	Accept the proposed changes	-
Veolia Water Projects Ltd	Accept that condition will be imposed	Want clarity on what readiness for an Inset means from MOSL

Note: No responses were received from stakeholders who are not already Appointees or Licensees

3. Our consideration of the additional comments

The following chapter sets out the further issues raised by stakeholders in the consultation and our responses. Overall we are satisfied that none of the issues raised by consultees require us to change the wording of the condition and so we consider that we should introduce the condition unamended from the version we most recently consulted on. The condition we consulted on in March was an amended version in response to stakeholder concerns regarding the requirement for data accuracy. We recognised that 100% data accuracy was not a realistic goal and what was required was that the data should be sufficiently accurate to enable the effective functioning of the competitive market. We also added a definition to aid interpretation.

3.1 Duplication of existing incentives and sanctions

A small number of companies commented that while accepting the proposed condition, they remained of the view that the condition effectively duplicated reputational incentives on companies.

Although we recognise that companies are showing strong commitment to the retail market opening programme and the assurance letters indicate a positive overall picture regarding anticipated readiness, we believe that the programme is of sufficient importance for customers to justify a formal condition. We remain convinced that the condition will help send a positive signal to customers, help ensure that companies can have confidence in their peers and help reduce the overall programme risks.

3.2 Duplication with the assurance framework and necessity of the condition

One company commented that they considered that the readiness condition duplicates the assurance framework.

We consider that the condition complements and underpins the assurance framework. If the condition were not in place, there would be no sanction were a company to decide not to complete the assurance letters. The assurance framework is a monitoring device, but does not itself create obligations to undertake the required preparations. The obligations to prepare will come from the readiness condition.

In addition we continue to consider that the condition provides other benefits such as allowing Ofwat to introduce additional assurance on company readiness and by providing an obligation on each company, helping to create collective confidence that all companies are taking the appropriate steps required to support effective market opening. In addition we consider that the market readiness condition is necessary and expedient for the implementation of the business, charity and public sector retail market introduced by the Water Act 2014 for the reasons set out in the formal consultation.

3.3 Need for proportionality and clarity on arrangements for small companies

A number of companies commented on the importance of making sure that small companies or those with few eligible customers were not unduly burdened by the necessary preparations and the new market arrangements.

We are keenly aware of the issues facing companies with only a few eligible customers. The drafting of the proposed condition has been designed to be proportionate, as the scale and nature of preparations required is largely determined by the number of eligible premises for which an appointee or licensee holds data and the business strategy that the appointee or licensee wishes to pursue.

On 11 March 2016, we held a workshop with small companies or those who only have a few eligible customers, for example companies whose areas are wholly or mainly in Wales. Subsequent to the workshop, we [consulted](#) further on the possible approaches to derogations or amendments to the code provisions. We are open to consider proposals for amendments or derogations to the codes on the basis of proportionality and have arranged a series of further workshops to discuss this with MOSL and small companies and those whose areas are wholly or mainly in Wales.

3.4 Modification of wording to refer to companies only being required to take reasonable steps and do reasonable things

One company suggests that the wording of the proposed condition should be modified to limit the obligation to reasonable steps. Other companies expressed some continued reservations that the wording used could create an unbounded commitment on companies.

We have considered the points made in the responses, but do not consider that the wording of the proposed condition should change. As we set out in the consultation

document, we consider that the condition must focus on the outcome to be achieved (i.e. market readiness), rather than the inputs required (i.e. the level of effort) as:

- Firstly, the preparations required by each company will depend both on the quality of their starting position and their chosen approach to the new market. So there cannot be a “one size fits all” view of what the preparations should be. It must be for each individual company to work out what it needs to do.
- Secondly, experience from similar programmes in other industries demonstrates that testing can sometimes identify the need for changes to systems, industry codes or even policy positions. Ofwat recognises that there may be a practical limit to what companies can achieve in the event that such circumstances arise, especially at short notice. That is why we emphasised in the consultation that Ofwat is required by law to act reasonably and proportionately. We also noted that the level of effort taken by a company would be relevant when taking any decision regarding enforcement. However, in the event that changes were to be required, we do expect companies to respond to these. The relevant test must be whether companies have done what is required, not whether they consider they have done enough to show reasonable efforts. As previously stated we will apply the condition proportionately and any enforcement action will be reasonable in the circumstances.

3.5 Concerns over how the condition may be enforced, especially during shadow operation

One company sought clarity during the consultation period on whether failure to be fully ready for shadow market would constitute a breach of the condition. They viewed this as a much greater risk than readiness at Go Live.

The intention of the condition is to create strong incentives to be ready for market opening “on and from the Go Live date”. However, we cannot fetter the discretion on enforcement of licence conditions to say that we will not consider enforcement dialogue until Go Live.

As we set out in the consultation document “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”. The consultation document also observed that “The market readiness condition provides parties with the assurance that, if companies are not making sufficient progress on market readiness, Ofwat can consider

enforcement action. [The condition] therefore complements and supports existing market readiness assurance processes.”

During the transition to market opening, in the event that it became necessary to have conversations with companies on their progress towards readiness for market opening, we anticipate that such conversations would include a degree of focus on the remedial steps that companies were following to ensure that they could still achieve readiness on and from April 2017. This could include requirements on companies to provide action plans to address any issues, together with independent assurance of that plan, should it be necessary. Ultimately non-compliance with obligations in appointment and licence conditions could result an enforcement order and a financial penalty in line with our [statement of policy with respect to financial penalties](#). The market entry assurance process established by MOSL already contains provision for both remedial assurance and planned re-assurance for example. Further details on our approach to enforcement are set out in our [enforcement guidance](#).¹

¹ We recently consulted on our enforcement guidance. The consultation document can be found [here](#).

4. Introduction of the condition and next steps

While it is clear that companies retain varying degrees of enthusiasm for the readiness condition, overall there is a high degree of acceptance and support for the change. As set out above we have considered each of the points raised by respondents and continue to consider that the proposed wording of the condition is appropriate.

As explained in Section 1, we consider that the condition brings a number of important benefits for customers, companies and the retail market opening programme.

Under section 55 (s55) of the Water Act 2014 (WA14) the Water Services Regulation Authority (Ofwat) may modify the conditions of appointments and the conditions of licences where it considers it necessary or expedient to do so in consequence of provision made by or under Part 1 WA14. The requirement under s55 is that we consult the Appointees and Licensees whose Appointments and Licences are proposed to be amended, together with the Secretary of State, the Welsh Ministers and anybody we think is appropriate. The Secretary of State or Welsh Ministers can issue a direction pursuant to s55(9) WA14 not to make the proposed amendment or a direction under s55(8) to make the modification subject to further modification. Defra has confirmed that it does not wish to issue either direction. There has recently been an election for the Welsh Government which has created practical difficulties for Welsh Ministers to indicate whether or not they want to issue either direction. We continue to consider that the condition is required for both England and Wales. Given the practical difficulties with getting a decision from the Welsh Ministers, and the importance of a timely introduction of a condition, we have decided to introduce the condition for companies whose areas are wholly or mainly in England only at the current time. We therefore intend to proceed to implement the proposed condition by issuing the notices to relevant companies. We will continue to look to implement a market readiness condition for companies wholly or mainly in Wales in due course.

After due consideration of the responses, we will be implementing the readiness condition unamended in the Appointments of undertakers whose areas are wholly or mainly in England and the Licences of all Water Supply Licensees. We will be writing to each company to notify it of this modification and our reasons for making the change. The modification will be effective from 27 May 2016.