

Retail Market Opening – proposed changes to the
Instruments of Appointment (IoAs)

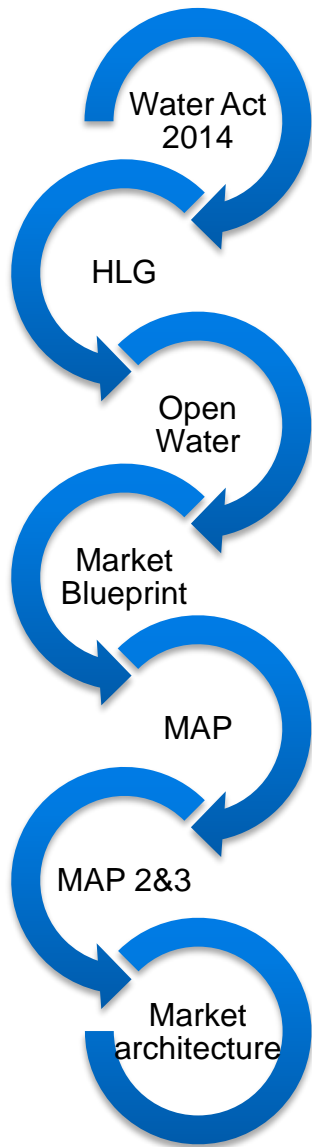
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May 2016



| Time | Item |
|---|--|
| 10:00 | Welcome, introduction and context |
| | Reminder of how licence obligations fit in the market architecture |
| Block 1 – new conditions | |
| 10:25 | Summary of proposed new conditions |
| 10:50 | Discussion on proposed new conditions, and potential derogations |
| 11:20 | Break (10 mins) |
| Block 2 – changes to existing conditions | |
| 11:30 | Proposed changes to existing conditions |
| 12:15 | Discussion around our proposals, and the interaction with the WRC |
| 12:55 | Next steps |
| 13:00 | Close |

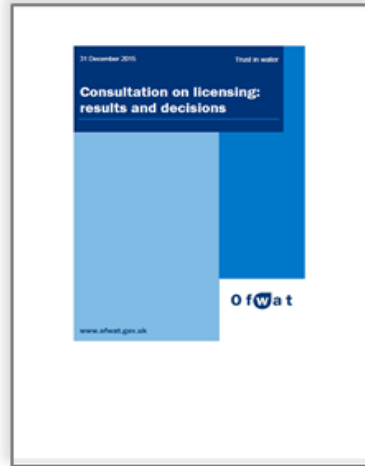
Introduction and context



- The industry has been on a significant journey since legislation was passed
- Open Water programme created to deliver the necessary codes, central systems and detailed arrangements
- Much of the design and development of the market architecture is complete - 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
- In parallel, we are considering the necessary licensing arrangements to facilitate this
- Need to ensure that the market arrangements as a package are appropriate for all participants and reflect the policy objectives of the relevant Governments



Wider licensing consultation in June 2015 included proposals about changes to the IoAs



Results from that consultation and further proposals published in December



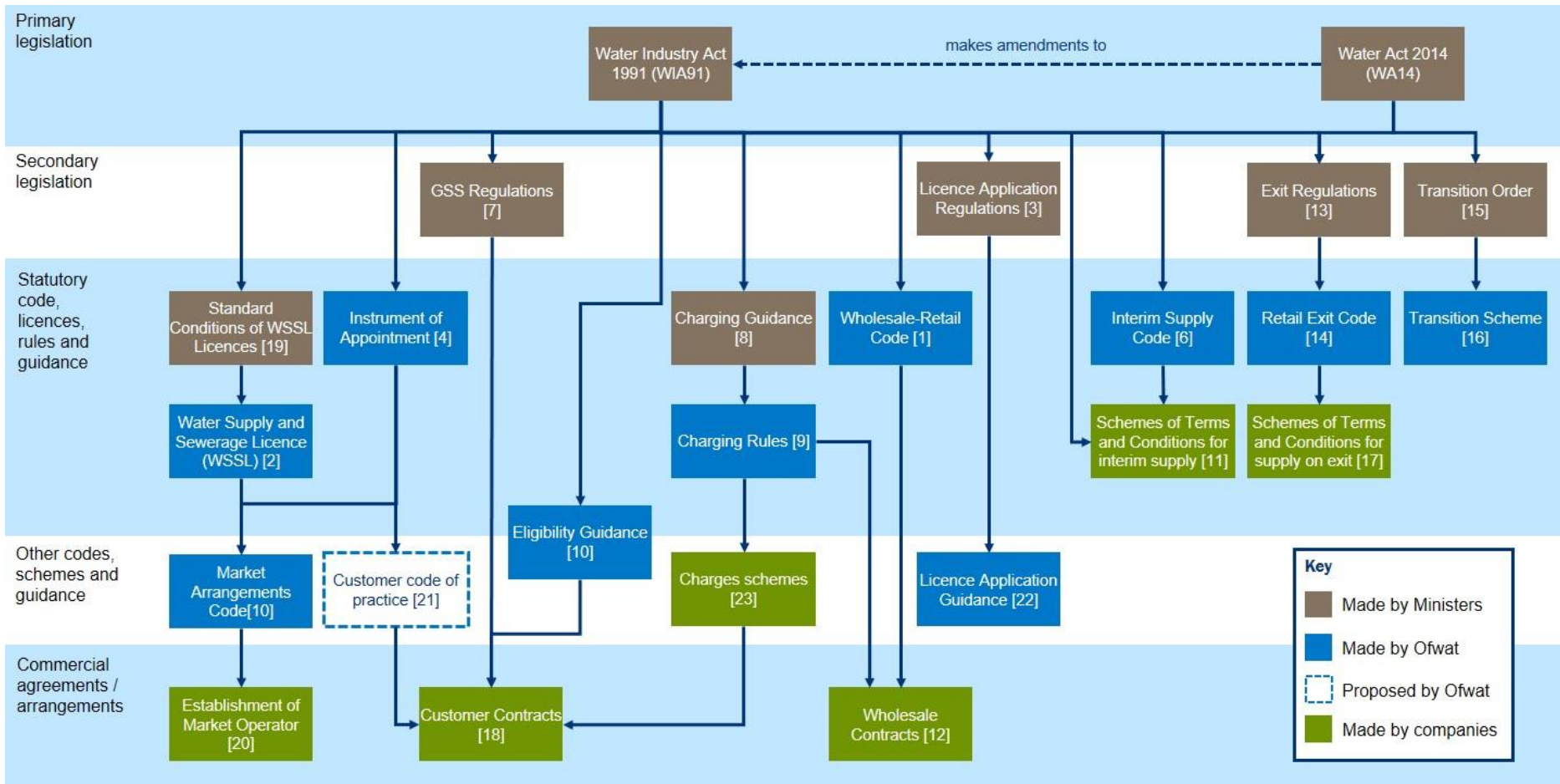
Priority changes taken forward first (market readiness and in-area trading ban)



Current consultation on proposed further changes to the IoAs - May 2016

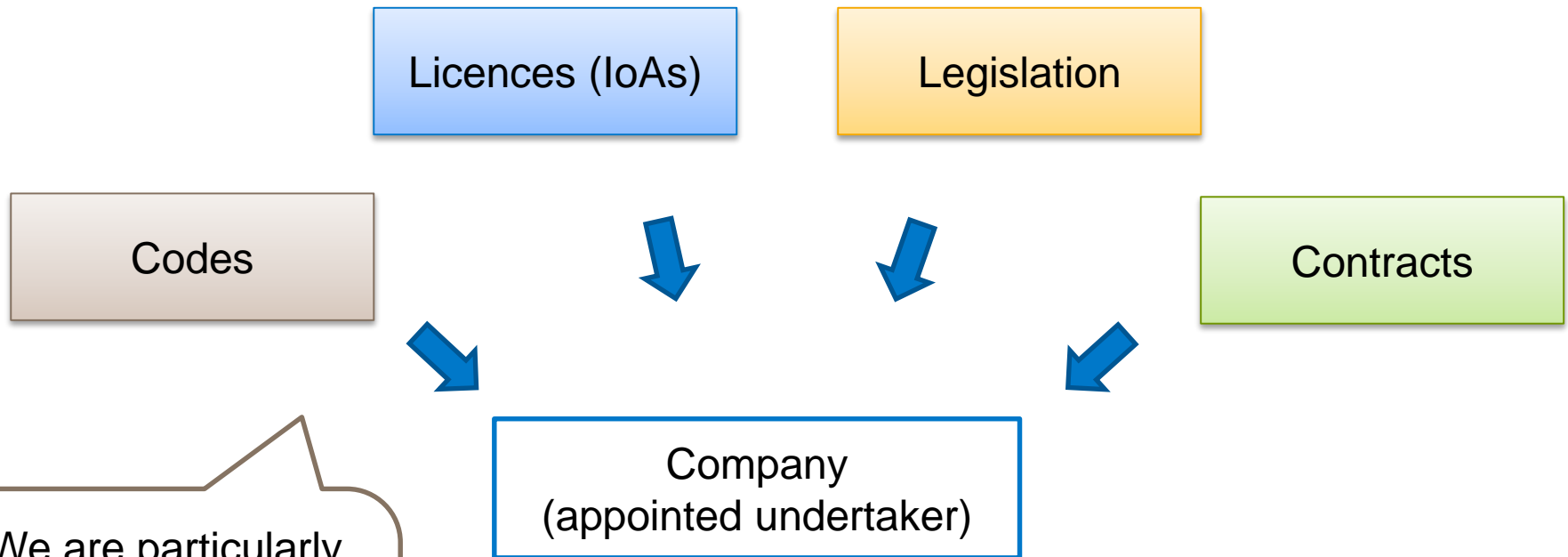
Reminder of how the licence obligations fit
in the market architecture

The legal architecture for the new market



Licence obligations form part of a much wider framework of obligations...

Company obligations will arise from a number of different sources....



We are particularly focusing on the interaction between the codes and the licences

... so we need to make sure that they fit together well



Market Arrangements Code, signed by all wholesalers, retailers and the market operator

- Market Operator membership, duties and board/constitution
- Panel set up and membership, and change process
- Market Operator budget and cost sharing

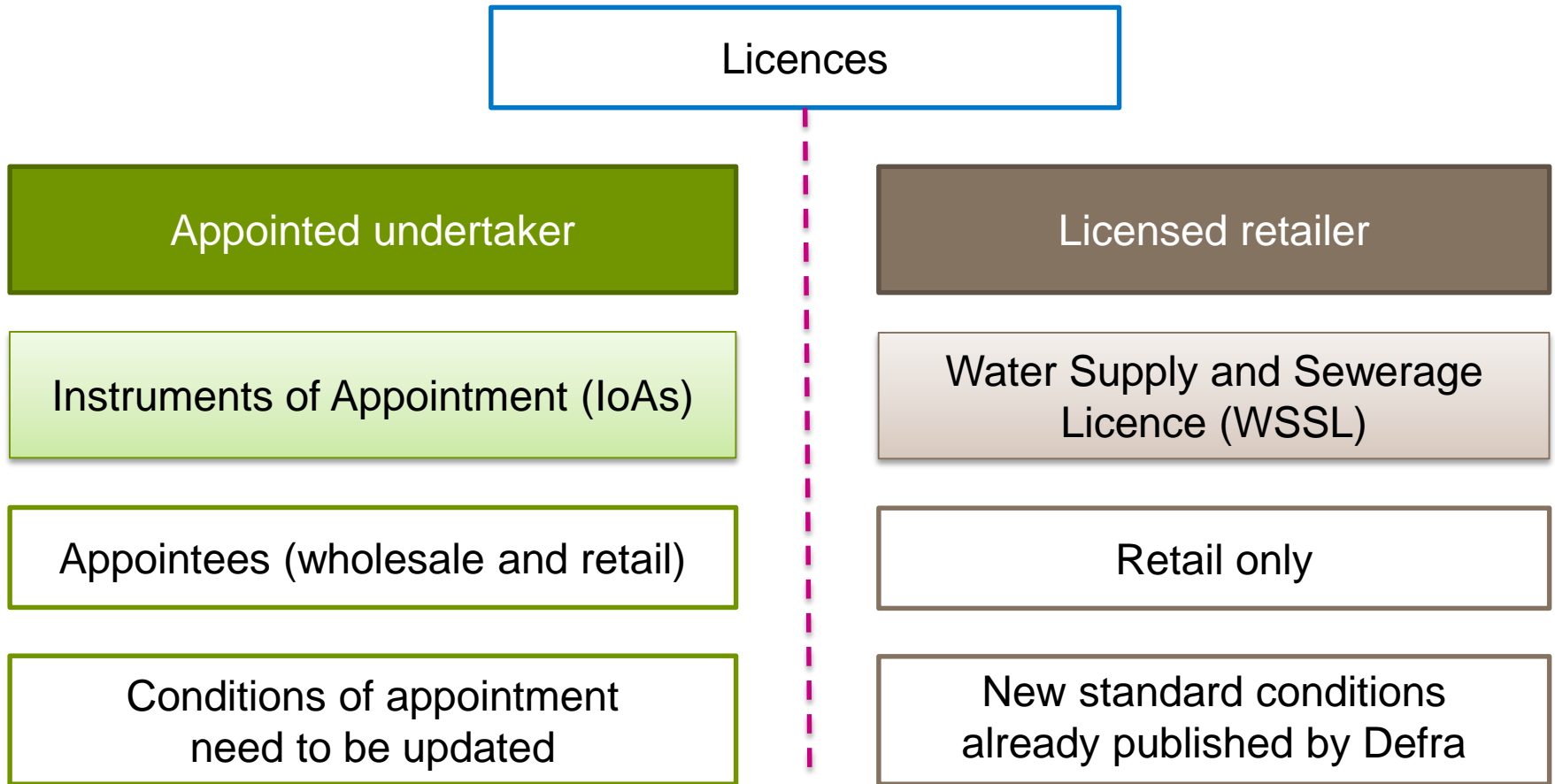
Wholesale-Retail Code, statutory code supported by the wholesale contract

- Part 1 – Objectives, Definitions, Principles
- Part 2 – Business terms
- Part 3 – Operational terms
- Part 4 – Market terms
- Part 5 – Code Subsidiary Documents (CSDs)
- Part 6 – Operational forms

In particular, we need to consider possible overlap between the WRC and certain licence obligations

Wholesale Contract, signed by wholesaler and retailer

- Glue that binds things together
- Made under S66D/S117E of 1991 Act
- Short and simple bilateral contract: incorporates terms and conditions set out in the Wholesale-Retail Code



The principle of equivalence suggests that obligations relating to retail activities should be broadly similar between WSSL retailers and appointed undertakers to help achieve a level playing field

| | WASC | WOC | New appointee (water) | New appointee (sewerage) | New appointee (Water and sewerage) |
|---|------|-----|-----------------------|--------------------------|------------------------------------|
| Wholly or mainly in Wales? different Gov policy position inc 50 MI threshold remains / no sewerage | | | | | |
| Retail exit? (if wholly or mainly in England) | | | | | |

We are also considering issues of proportionality for small companies/those in Wales with limited numbers of eligible customers

New appointees: some provisions are dormant until 'trigger' event

Proposed new conditions

| | |
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| Condition | MAC Condition |
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| Details | <p>Required to give effect to the Market Arrangements Code (MAC), as the MAC will not be a statutory code (unlike the WRC).</p> <p>A similar condition is already included in the Water Supply and Sewerage Licence (WSSL) standard conditions.</p> |
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| What it means for companies | <p>Companies required to be a party to and comply with MAC. Includes various requirements about the content of the MAC (including provisions about market governance, the market operator and funding of the market operator), so companies would need to make sure that the MAC continues to comply with this framework in the future.</p> |
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| Change in obligations? | Yes |
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| Condition | ‘Stapling’ Condition |
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And/or amend existing F6

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| Details | The Wholesale Retail Code (WRC) will be a statutory code setting out the rules for all the market interactions between wholesalers and retailers. This condition would give effect to the WRC for companies that have integrated wholesale and retail businesses. |
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| What it means for companies | For all non-HH retail market interactions between their wholesale and retail businesses, companies would be required to comply with the rules set out in the WRC. They would have to act as if their retail business were a separate licensee, subject to any agreed derogations to the WRC. (Only part of non-HH business in Wales) |
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| Change in obligations? | Yes |
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Condition

Customer protection condition

Details

This condition would give effect to the Customer Protection Code of Practice (CPCoP).

A similar condition is already included in the Water Supply and Sewerage Licence (WSSL) standard conditions.

What it means for companies

Companies would be required to comply with the provisions of the CPCoP, which covers non-HH retail activities.

(In Wales, some of the provisions of the CPCoP may not be relevant, as they are targeted at micro-businesses)

Change in obligations?

Yes



Discussion on our proposals for:

- MAC condition
- Stapling condition
- Customer protection condition

Do you have any comments on our proposals to insert these conditions into the IoAs?

In relation to the proposed stapling condition, are there any particular areas where derogations (to the WRC) may be required?

Proposed changes to existing conditions

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| Condition | Condition S CTP |
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| Details | This existing condition requires companies to use the Customer Transfer Protocol (CTP) for switching customers in the current WSL retail market. The CTP will be replaced by the new market arrangements under the WRC and MAC, so will no longer be needed. |
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| What it means for companies | Companies will no longer use the CTP for switching customers, but will use the new arrangements set out in the WRC and MAC instead. Note: this is also required for combined supply. A separate consultation on the new wholesale authorisations (which will replace combined supply licences), is planned for summer 2016. |
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| Change in obligations? | Yes |
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| Condition | Condition R1-4 Access codes |
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| Details | This existing condition requires companies to have an access code. As above, this will be replaced by the new market arrangements under the WRC and MAC, so will no longer be needed. |
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| What it means for companies | Companies will no longer need to have an access code, but will use the new arrangements set out in the WRC and MAC instead. Note: this is also required for combined supply. A separate consultation on the new wholesale authorisations (which will replace combined supply licences), is planned for summer 2016. |
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| Change in obligations? | Yes |
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| Condition | Condition F6 A Certificate of adequacy |
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| Details | This condition requires companies to provide a certificate of adequacy covering the whole business. We propose to carve out a separate obligation to provide a certificate of adequacy for the non-HH retail business, so that appointed companies have the same obligation as licensed retailers. |
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| What it means for companies | Companies would be required to provide two separate certificates of adequacy – one covering their non-HH retail business, and one covering the rest of their appointed business. Note: in Wales, only part of the non-HH retail business would be covered by the separate certificate of adequacy, due to the retention of the 50 ML threshold. |
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| Change in obligations? | Yes |
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| Condition | Condition Q Drought payments |
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| Details | This existing condition requires companies to make drought payments to their own customers. As this obligation relates to the company's wholesale obligations, we propose to extend it to cover all affected retail customers |
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| What it means for companies | Companies would be required to pass on any drought payments to affected customers of other retailers via the relevant WSSL retailer, as set out in the business terms of the WRC. |
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| Change in obligations? | Minor |
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| Condition | Condition G Customer code |
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| Details | This existing condition requires companies to have a code of practice and comply with certain provisions to protect customers, some of which only cover HH customers |
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| What it means for companies | There is no change in company obligations – we are simply proposing to separate the obligations covering non-HH customers from the obligations covering HH customers, so that it is clearer to companies where the relevant obligations sit. |
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| Change in obligations? | No |
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| Condition | Condition I Leakage adjustments |
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| Details | This existing condition requires companies to make a leakage adjustment in certain circumstances after a meter has been installed. |
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| What it means for companies | Companies would be required to pass on any leakage adjustment to affected customers of other retailers via the relevant WSSL retailer. We propose to update the WRC to include this. |
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| Change in obligations? | Minor |
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| Condition | R7-9 Information provision |
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| Details | The provisions of this existing condition overlap with the provision of the WRC as they regulate the provision of information between an appointed company and a licensed retailer. |
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| What it means for companies | There would be no change in company obligations. We propose to review and if necessary update the WRC to address any possible inconsistencies. |
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| Change in obligations? | No |
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Condition

(All)
Terminology

Details

The instruments of appointment need to be updated to reflect changes in legislation

What it
means for
companies

We propose to amend the instruments of appointment to reflect changes in the legislation. For example, references to WSLs will need to be updated to WSSLs. Most of these changes to terminology will be minor housekeeping changes, but some would change the obligations, for example, as WSSLs include sewerage as well as water supply.

Change in
obligations
?

Possibly –
to reflect
changes in
legislation

Other relevant considerations



Interaction with retail exit timeline

We cannot wait until the formal decisions on retail exit are made.

So we propose to use 'sunset' and/or 'sunrise' clauses as necessary to limit the application of the retail market provisions to those remaining in the retail market.

Process for modifying IoAs

We are considering using s55 Water Act 2014 to make the changes.

We can use s55 where the changes are necessary or expedient as a consequence of the relevant provisions of the Act.

Similar provisions were used to introduce the WSL regime in 2005.



Discussion on our proposals for amending existing conditions:

- Removing CTP and access codes
- Drought payments
- Leakage adjustments
- Certificate of adequacy
- Customer code
- Information provision
- Terminology

Do you have any comments on our proposals to amend these conditions?

Do you have any comments on our proposals for handling the interaction with the retail exit timetable by using 'sunset' and/or 'sunrise clauses as necessary?



31 May - deadline for responses to the current consultation

June – further discussion with small and Welsh companies

June – Ofwat's analysis of responses, finalise proposals

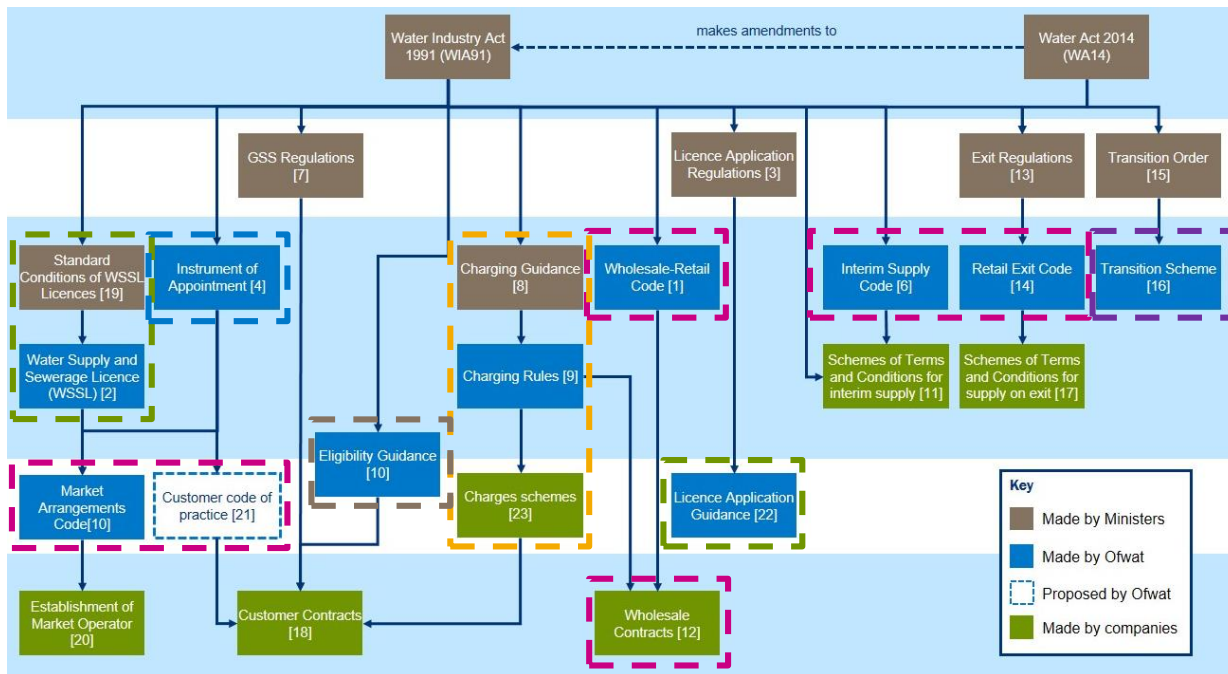
July – 28 day statutory consultation

August – Implement changes



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Appendix



Codes (& wholesale contracts)

The mechanism by which Ofwat will regulate the various agreements that undertakers make with other parties. The contents will vary from code to code but, generally, they may contain standard terms and conditions, principles for agreeing terms, or principles for how negotiations shall be run. See appendix for further guidance.

Wholesale contracts are regulated contracts between wholesalers and retailers.

Charging

Includes: Charging Guidance, Charging Principles and Charging Rules

Eligibility

Are customers in England and Wales are eligible to switch their water and wastewater retailer.

Licences

Includes guidance and WSSL, WSL and self supply licences.

Instrument of Appointment

An appointment made by the Secretary of State or the Authority for a company to provide water or sewerage services in part of England or Wales. The Instrument of Appointment imposes conditions on the relevant appointed company which Ofwat enforces.

Transition Scheme

A temporary regulatory structure under a Transition Order to transfer existing holders of water supply licences, including combined licences, to the new legal framework.

Charging

Charging rules

The mechanism by which Ofwat controls the charges that undertakers may impose on various parties. Ofwat must issue charging rules to cover undertakers' charges to their direct customers for water or sewerage services (through charges schemes) as well as charges to licensees for "use" of the water or sewerage networks.

Charging principles

A statement of high level principles published by Defra alongside the Water Bill that will underpin the development of the future charging guidance and give a broad indication of Government policy on charging issues.

Charging guidance

The mechanism by which the Government will inform the content of Ofwat's charging rules (see below). The Government will publish overarching statutory guidance in April 2015 that will set out its approach to regulating charges. The Government may also issue more detailed guidance that relates to individual areas such as the water supply and sewerage licensing (WSSL) regime, which will sit below the high level guidance.

Charging Scheme

Tariffs setting out retail and wholesale charges that incumbent water companies charge their customers.

Codes

Interim Supply Code

Code to be issued by Ofwat under sections 63AF and 110O of the WIA91 which regulates what happens to the customers of a licensee which ceases to supply them. It will establish a process for licensees to opt in to be interim suppliers, and to be allocated customers if there is a cessation of supply.

Retail Exit Code

Code required by the Exit Regulations (13), pursuant to section 47(3) WA14, setting out the contract terms which will apply where customers are transferred to an eligible licensee under the scheme made by the Exit Regulations. Ultimately this is enforceable by Ofwat under the WIA91 (section18).

Market arrangements code

Non-statutory code, to be established by conditions in Water Supply & Sewerage Licences and instruments of Appointment, to set up arrangements for how the market will operate, including the setting up of a panel to help oversee the codes of practice and any changes.

Customer Protection Code of Practice

A proposed code of practice expected to be established pursuant to a condition of Water Supply & Sewerage Licences (2) and Instruments of Appointment containing key customer protection obligations

Wholesale Retail Code

Code to be issued by Ofwat under sections 66DA and 117F of the WIA91 which sets out the rules (including business terms, operational terms and market terms) which are to apply to agreements ('wholesale contracts') between undertakers (who operate water and/or sewerage systems) and licensees (who use those systems to supply water to customers).

Wholesale Contract

A defined contract between the Retailer and the Wholesaler on standardised terms and conditions which sets out the services the Wholesaler will provide to the Retailer and the commercial terms on which they will be provided.

Eligibility

Eligibility Guidance

Guidance on assessing whether customers in England and Wales are eligible to switch their water and wastewater retailer.

Supplementary Guidance

Supplementary Guidance on assessing whether customers in England and Wales are eligible to switch their water and wastewater retailer. Providing further examples and clarifications.

Licences

Licence Application Guidance

This guidance is designed to assist those applying for water supply licences and/or sewerage licences (collectively referred to as WSSLs and either one of them as a WSSL as the context requires) from April 2016.

Self-Supply Licensee

A customer with a WSSL that provides retail services to its own premises and/or those of its associates in the areas of appointed companies wholly or mainly in England (for example, subsidiaries or partners).

WSSL

Water Supply and Sewerage Licences as defined in the WIA91

WSL

Water Supply Licences