

15 July 2016

Trust in water

# Proposals to modify Instruments of Appointment under section 55: a consultation

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## About this document

This document invites comments on our proposals to modify all existing Instruments of Appointment to introduce three new conditions and amend some of the existing conditions, in advance of the expanded retail market for business customers which is opening in April 2017.

Under section 55 of the Water Act 2014 (WA14) the Water Services Regulation Authority (Ofwat) may modify the conditions of an appointment under Chapter 1 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.

This consultation fulfils our requirement under section 55 to consult the holders of the IoAs that we propose to modify, together with the Secretary of State, Welsh Ministers and anybody else we think is appropriate.

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, we consider 28 days to be appropriate and proportionate in view of the:

- Prior consultation on this matter;
- The nature of the modifications; and
- The fact that 28 days is the minimum period for a consultation to modify Instruments of Appointment through the different, but broadly equivalent, process set out in section 13 of the WIA91.

Subject to responses to this consultation, including any statutory response from the Secretary of State or Welsh Ministers received within the consultation period, we plan to modify the Instruments of Appointment by the end of August 2016. The finalised conditions would only take effect when the retail market opens.

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## Responding to this consultation

We invite stakeholders to comment on our intended modifications by **12 August 2016**. Please 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  
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If you wish to discuss any aspect of this document, please direct your enquiry to Ruth Gibson on 0121 644 7528 or by email to [ruth.gibson@ofwat.gsi.gov.uk](mailto:ruth.gibson@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. Introduction and summary of proposals

### 1.1 Background and purpose

The WA14 will allow eligible business, charity and public sector customers (business customers) to choose their supplier of water and wastewater retail services from April 2017. For customers who use the supply system or sewerage system of a regional monopoly water company (appointed company) whose area is wholly or mainly in England, the market will be extended to include all business customers. For those who use the supply system of an appointed company whose area is wholly or mainly in Wales, only business customers using more than 50 Ml of water each year will be able to choose their water supplier, reflecting the different policy position of the Welsh Government.

There are two type of regulatory instrument for the expanded retail market: the new retail licences known as Water Supply and Sewerage Licences (WSSLs), and the instruments for appointed companies, which are called the Instruments of Appointment (IoAs).

As part of the preparations for the retail market, we need to make some changes to the IoAs. At the moment, an IoA covers both the retail and wholesale activities of appointed companies, but when the expanded retail market opens those appointed companies whose areas are wholly or mainly in England may apply to exit from the business retail market. If an appointed company exits, they would no longer need obligations in their IoA relating to their retail activities, although they would remain subject to obligations that are relevant to their role as a wholesaler in the market.

Defra has already consulted on, and published, the [Standard Conditions](#) of the WSSL, which will place a number of obligations on licensed WSSL retailers. For appointed companies, we have already made some changes to the IoAs to reflect two priority issues ([market readiness](#) and the [removal of the in-area trading ban](#)), as those changes were needed more quickly. We now propose further changes to the IoAs to facilitate the opening of the expanded retail market in April 2017 for business customers. This consultation document describes the proposed changes and explains why we need to make them.

## 1.2 Aim of the proposed changes

We propose to modify the IoAs of appointed monopoly water only, and water and sewerage, companies in England and Wales ('appointees'). This includes, where applicable, companies that have successfully applied for an appointment to replace the existing appointed water and or sewerage company at a particular site ('new appointees'). The proposed changes will affect appointees whose areas are wholly or mainly in England. They will also affect appointees whose areas are wholly or mainly in Wales as those appointees will also need to interact with the new market arrangements, although their numbers of eligible customers will be limited because of the retention of 50MI threshold.

We propose to modify the IoAs as set out in this consultation to prepare for the opening of the retail market in April 2017. Although we propose to modify the IoAs by the end of August, subject to responses to this consultation, the changes would only be effective at market opening.

The changes will:

- Help **establish the new market framework** by requiring all appointees to comply with the provisions of the proposed Market Arrangements Code (**MAC**) and the Customer Protection Code of Practice (**CPCoP**). The changes will also require appointees which do both wholesale and non-household retail activities to apply the provisions of the proposed Wholesale-Retail Code (**WRC**), which will govern the behaviour and interactions of wholesalers and retailers in the market, between their wholesale and retail businesses;
- **Remove obligations** relating to the current arrangements for the existing Water Supply Licensing (WSL) regime that will no longer be required for the retail market after April 2017. These are the requirements for appointees to comply with the Customer Transfer Protocol (CTP) for the transfer of supplies to premises of eligible customers, and to have an access code - although some elements will need to be retained in relation to introductions of water;
- Introduce a new requirement for a **separate Certificate of Adequacy** for appointees' non-household retail businesses, so that appointees face similar obligations to licensed retailers – although we propose to exempt appointees with small numbers of eligible customers from this requirement;
- **Update definitions and other terminology** to reflect changes in legislation and to facilitate the insertion of the proposed new conditions; and
- **Extend the obligation to make drought payments** to all affected customers, regardless of whether they are customers of the appointee or a licensed retailer.

## 1.3 Summary of proposals

**Table 1 – Proposed new conditions**

Condition	Proposed approach
MAC condition	This will give effect to the <a href="#">MAC</a> . As it is not a statutory code, we need to give effect to the MAC via the retail Water Supply and Sewerage Licences (WSSLs) and IoAs. A similar condition is already included in the WSSL <a href="#">Standard Conditions</a> . We propose to insert the MAC condition into the IoAs for all appointees.
Stapling condition	This will require appointed companies which do both wholesale and non-household retail activities (integrated appointees) to apply the provisions of the <a href="#">WRC</a> , which governs the behaviour and interactions of wholesalers and retailers in the market.
CPCoP	This will require appointees to comply with the recently published <a href="#">CPCoP</a> . A similar condition is already included in the WSSL <a href="#">Standard Conditions</a> .

We also propose to amend some of the existing conditions.

**Table 2: Proposed amendments to existing conditions**

Condition	Proposed change
Terminology	Some changes to Condition A and Condition R will be required to reflect the legislative changes, and to update the definitions to reflect the other changes proposed in this consultation.
Condition S	To modify Condition S as the CTP will be replaced by the new market arrangements set out in the <a href="#">MAC</a> and <a href="#">WRC</a> for the retail market. We propose to retain the relevant parts of the CTP in relation to introductions of water under new water supply licences with (English) wholesale or (Welsh) supplementary authorisations. We also propose to retain the access code provisions in paragraphs 1-4 of Condition R in relation to such introductions of water by moving them into Condition S. We will explain those proposals in more detail as part of our separate consultation on introductions of water under the new water supply licensing scheme, which we plan to publish shortly.
Condition R 1-4	To remove appointees' obligations to have an access code in relation to the retail market, as the retail market element of access codes will be replaced by the new market arrangements set out in the <a href="#">MAC</a> and <a href="#">WRC</a> . We propose to retain the relevant aspects of the access code provisions in relation to introductions of water under new water supply licences with (English) wholesale or (Welsh) supplementary authorisations. We intend to do so by moving the relevant obligations that are currently set out in paragraphs 1-4 of Condition R into a modified Condition S. We will explain those proposals in more detail as part of our separate consultation on introductions of water under the new water supply licensing scheme, which we plan to publish shortly.
Condition F6	To create a new obligation for a separate certificate of adequacy for the (eligible) retail business of the appointee. This will be carved out of the existing obligation to have a certificate of adequacy for the whole appointed business. To be proportionate, this change will not apply to

Condition	Proposed change
	appointees with small numbers of eligible customers i.e. new appointees, appointees wholly or mainly in Wales, and Cholderton and District Water.
Condition Q	As the obligation to make drought payments relates to the appointee's role as a wholesaler, we propose to extend the obligation to make the payments to all affected business customers, regardless of whether they are customers of the appointee's own retail business or customers of a WSSL retailer. WSSL retailers would be required to pass on the payment to the customer in accordance with paragraph 2.4.3 of the business terms in the <a href="#">WRC</a>

## 1.4 Consultation process to date

We initially consulted on proposals to amend the IoAs in June 2015, as part of our wider licensing proposals in preparation for retail market opening. Since then, we have developed and refined our proposals with input from appointees and other stakeholders through a process of consultation over a number of months. In the meantime, the [Standard Conditions](#) for the WSSLs have been finalised and published, which include some conditions that are nearly identical to some of the conditions that we propose to insert in the IoAs.

In May 2016, we published a consultation on changes to all the IoAs ([May consultation](#)) and held workshops to discuss our draft proposals, including workshops for appointed companies with small numbers of eligible customers (including new appointees, and those whose systems are wholly or mainly in Wales).

As a result of comments received in response to the May consultation and during discussions at the workshops, we reviewed and updated our proposals and published a further consultation ([June consultation](#)) to provide appointed companies and other stakeholders with an additional opportunity to comment on the updated draft text for the IoAs. We received ten responses to the June consultation, with some suggestions for improving the draft text further.

Having considered all the comments and suggestions, we have reviewed and refined our proposals and this consultation sets out the changes to the IoAs that we propose to make under s55 of the WA14.

## 1.5 Structure of this document

The rest of this document is set out as follows:



- Chapter 2 provides details of the three new conditions that we propose to insert in all IoAs;
- Chapter 3 provides details of the proposed amendments to some of the existing conditions in the IoAs;
- Chapter 4 explains that we propose to make this changes under s55 of the WA14;
- Chapter 5 discusses the interaction with the retail exit timetable; and
- Chapter 6 outlines next steps.

Detailed draft text for all the proposed changes is provided in the Appendix. We have marked up the text to show where it has been amended to reflect previous comments.

## 2. Proposed new conditions

### 2.1 MAC condition

We propose to insert a new condition into the IoAs to require all appointees to give effect to, and comply with the MAC.

The draft MAC is a multi-lateral code that will apply to all market participants, regardless of whether they are acting as a wholesaler or a retailer. It contains provisions that set out how the parties will work together to govern the market and will be an essential part of the new market [legal framework](#). Among other things, it will help to establish the market operator that will facilitate the effective operation of the market. Unlike some of the other codes that form part of the legal framework for the retail market, the MAC will not be a statutory code. So we need to give effect to it using a different legal tool. We propose to do this by inserting a new condition in the IoAs, as we have done for WSSLs, requiring companies to be a party to, and comply with, the MAC with certain minimum requirements for the content of the MAC.

### Responses to date

Responses to our earlier consultations have all been very supportive of the proposed MAC condition, with widespread recognition of the important role it will play in giving effect to the MAC. But some responses have suggested that the drafting of the MAC condition could be improved.

Firstly, it has been suggested that the drafting may require appointees to do things that are beyond their control, and it was suggested that the word 'reasonable' should be inserted to qualify the steps that appointees would be expected take.

It was also suggested by some respondents to our earlier consultations that the drafting could be shortened considerably, to streamline the condition and avoid duplicating some of the content of the MAC. Some responses pointed out the apparent inconsistency between the draft MAC condition and the proposed Customer Protection condition (see below), as the draft Customer Protection condition is much shorter, and does not duplicate any of the provisions that are set out in the [CPCoP](#), unlike the draft MAC condition.

## Final proposals

We have considered the concerns raised about appointees being obliged to do things that are beyond their control, and the suggestion that the word ‘reasonable’ should be added to the draft condition. As the draft text already limits the appointee’s obligations to only take steps ‘within its power’, we do not consider that the drafting needs to be amended 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 proportionately when determining if that company was in breach of its obligations. The level of action and effort taken by the company, with consideration of what steps were reasonably within its power, would be relevant when taking this decision. This approach is in line with our published [Approach to Enforcement](#).

We have considered very carefully whether the draft condition could be amended to remove some of the detailed obligations. As announced in our [forward programme](#), Ofwat’s overall strategic direction for licences and IoAs is towards a more principles based, simplified approach, and a separate project is being established to identify possible opportunities to modernise and simplify IoAs. With that in mind, we have challenged ourselves to consider whether the detailed provisions in the draft MAC condition are completely justified.

We have considered why the MAC condition is required. In part, it will help to create the legal framework and give effect to the MAC on an enduring basis, as the MAC is not a statutory code. This is important, as it is only when the Framework Agreement has been signed by the original parties that the MAC will take effect. By inserting an obligation in the IoAs and WSSLs, we are indicating that appointees and licensees will be required to sign the Framework Agreement that will give effect to the MAC as a multilateral agreement. The first part of the draft condition will do this, as well as requiring appointees and licensees to comply with the provisions of the MAC on an ongoing basis.

Additionally, we want to use the MAC condition to confirm certain essential elements of market governance, including the code change process. It is necessary for the MAC condition to do this ahead of market opening, so that the essential market governance arrangements balance the interests of market participants at the outset and cannot be changed or removed without Ofwat having an opportunity to veto the change or change the conditions of relevant undertakers or licensees.

This is different to the Customer Protection condition, which simply requires appointees to comply with the provisions of the [CPCoP](#) already issued by Ofwat, rather than to give effect to it. Also, the code change process for the [CPCoP](#) is a

different process involving consultation between Ofwat and interested stakeholders, including WSSL retailers and appointees, rather than using the Panel to balance the interests of market participants. So it is not necessary to include more detailed provisions in the Customer Protection condition, in contrast to the proposed MAC condition.

Once the retail market has opened and the market governance arrangements are properly embedded, we intend to review the MAC condition as part of our project on simplifying IoAs, with a view to stripping out, where appropriate, some of the more detailed provisions as part of our move towards a principles based approach to licences and IoAs. At that stage, we would hope to be able to place greater reliance on our veto of any proposed code changes to protect the interests of customers.

One further response suggested that if we intend to do this anyway, it appears to undermine our justification for inserting the longer version of the MAC condition in the IoAs in the first place. We disagree. As drafted, the MAC condition will play a key role in creating the legal framework for the market, ahead of market opening. But once that legal framework is in place and firmly embedded after the market has opened, we anticipate that there may be an opportunity to review whether these provisions are still required at that time, as part of our longer term objective to improve and simplify the IoAs.

## **2.2 Stapling condition**

We propose to introduce a new condition for appointed companies which do both wholesale and non-household retail activities (integrated appointees). This will require integrated appointees to apply the provisions of the WRC to interactions between their wholesale business and their retail business for eligible business customers. This condition is referred to as the stapling condition.

### **Responses to date**

During our earlier consultations, there was full support for this proposal in principle, although some responses suggested changes to improve the proposed drafting. In particular, some responses raised concerns that the absolute nature of the drafting could be problematic given that an integrated appointee is one legal entity. We have since amended the draft text to address this point. Other comments raised concerns about the definition of retail activities, and suggested that the initial drafting of the condition was too wide and could apply to other retail activities, rather than just the non-household retail activities as intended. We updated the draft text to be clear that

only non-household retail activities relating to eligible customers would be covered by the provisions. For appointees whose supply systems are wholly or mainly in Wales, this restricts the application of the condition to retail activities relating to those customers using more than 50 Ml of water each year.

Other responses pointed out that Condition B is not applicable to new appointees, so references to the definitions of wholesale and retail activities in Condition B would not be effective. To address this, we proposed to copy the definitions from Condition B directly into the stapling condition, so that the Stapling Condition would be consistent for all appointees. Although it has been pointed out that the draft text is subtly different from Condition B, we do not consider that it is inconsistent. We propose to continue with this approach, unless any unintended consequences are identified.

During the most recent consultation on the updated draft text, two further issues were raised. One appointee requested us to amend the draft text to be clear when the obligations would begin. Another appointee queried the reference to derogations in Schedule 8 of the MAC, as it is possible that not all relevant derogations would be included in that Schedule.

## **Our final proposals**

We have considered whether to insert a 'sunrise' clause that would state when the stapling condition would take effect (for example, 'this Condition [X] is effective from the Retail Market Opening Date'), but we do not consider that such a clause is necessary. The effect of the stapling condition is to require appointees to apply the obligations in the WRC to the interactions between its wholesale business and retail business in respect of eligible business customers. As the WRC will not take effect until retail market opening in April 2017, appointees would not be obliged to apply it before then.

## **Possible Code Derogations**

We have also considered the comment about derogations. An agreed derogation would permit an appointee to not comply with certain specified code provisions for either an indefinite or definite time period, or in some cases would never apply at all.

There are two different, but potentially overlapping, reasons why derogations may be required. The first is based on the fact that an integrated appointee remains one legal entity, so there may be some provisions of the codes that cannot reasonably be

applied because of its status as one legal entity. We expect such derogations to be very limited. The second is based on the principles of proportionality. We could not reasonably expect appointees with very small numbers of eligible customers to take all the same steps as a much larger appointee, although we would still expect any requests for derogations on the grounds of proportionality to be exceptional, compelling and evidence-based.

As part of the consultation, we asked stakeholders for their views on potential derogations from the WRC and/or MAC for small appointees and/or those based wholly or mainly in Wales with limited numbers of eligible customers. Responses were mixed. The majority of respondents agreed that there may need to be derogations, although some of these responses emphasised that there must be a compelling reason for any derogations and that they must not disadvantage others. A couple of the larger companies stated that derogations would be unnecessary.

In developing the stapling condition we have acknowledged that it may not be appropriate for an integrated business to apply all the provisions of the WRC to the interactions between its wholesale and retail businesses. The extent to which provisions will not apply is set out in Schedule 8 to the MAC and these are referred to as derogations in the MAC condition.

In particular, we consider that some derogations may be required for those appointees with smaller numbers of eligible customers, especially new appointees and those whose supply system is wholly or mainly in Wales, on the grounds of proportionality. We agree that any derogation should not provide a company with a competitive advantage, but rather recognise that the relative burden placed on various sizes of competitors must not be unduly onerous. We are currently taking this forward through a series of workshops with small companies to develop a framework for possible derogations. We plan to discuss our proposals with representatives on the Interim Code Panel before any derogations are taken forwards.

We agree that it is possible that any agreed derogations may not necessarily always be included in Schedule 8 of the MAC. It is possible that we may approve additional derogations to the WRC for one or more appointees – especially those appointees with small numbers of eligible customers – either before or after the market opens, and any such derogations would exempt the affected appointee from complying with the terms of the WRC to the extent set out in that derogation, including between their wholesale and (eligible) non-household retail businesses. To the extent derogations in addition to those set out in Schedule 8 of the MAC are agreed with individual appointees they will be implemented by reference to the derogations in Schedule 8.

The draft text of the proposed Stapling condition is included in the Appendix.

## 2.3 Customer protection condition

As part of the preparation for the retail market, we have considered how to appropriately protect customers in the expanded market. The best way to protect customers is to make sure that the market works effectively in the best interests of customers, but we have also considered whether additional protections may be required in certain areas. Following a lengthy consultation process, we recently published the [CPCoP](#), which among other things, includes provisions on sales and marketing activities, contracts and billing. We propose to insert a new condition in the IoAs to require appointees to comply with the [CPCoP](#). A similar condition is already included in the WSSL standard conditions.

### Responses to date

Responses fully supported the proposed condition, although some comments on the drafting were received.

One respondent suggested amending the condition in the IoA so that it is clear that the [CPCoP](#) cannot be extended or amended in such a way that it has material adverse financial (or other) consequences for companies without the agreement of companies, and to introduce an appeal mechanism to guard against such a move.

During the consultation process, including in the workshop discussions, the different approach to the customer protection condition and the MAC condition was queried and discussed. Most recently, one appointee suggested that the draft Customer Protection condition should be amended to reflect the approach taken with the MAC condition, to include provisions about the code change process. It was suggested that such provisions could refer to the statutory consultation process to modify conditions of the IoAs.

There were also some concerns expressed about proportionality for appointees whose supply systems are wholly or mainly in Wales, although it was noted that if the obligation only covers eligible customers (i.e. in Wales, only business customers using more than 50Ml each year would be eligible), protections aimed at micro-businesses would not apply in practice. One appointee whose supply systems are wholly or mainly in Wales requested that the draft condition be updated to limit its application to eligible customers.

## Our final proposals

We consider that placing a restriction as suggested on the extension or amendment to the [CPCoP](#) could potentially fetter our discretion to act in line with our statutory duties in the future, for example to further the consumer objective and to secure that the functions of appointees are properly carried out, and that they are able to finance their functions. We note that the governance arrangements and modification procedure set out at paragraph 5 of the [CPCoP](#) requires us to consult on our proposal to accept, reject or amend each change proposal and provide details of the reasons for the decision reached, and we have certain legal duties to act reasonably and proportionately. We do not agree that a lack of consent should be used in this way to prevent future changes where there is a compelling justification for the change to protect customers.

We have considered the suggestion about introducing an appeal mechanism. The WA14 includes powers for the Secretary of State to introduce regulations that will provide for Ofwat's decisions to amend or not amend designated codes to be appealable to the CMA. We understand that Defra will be launching a consultation on the draft regulations in summer 2016. We understand that this will initially relate to the MAC, WRC and Wholesale Contract but will not include the [CPCoP](#). We will keep this matter under review.

We have also considered the issue of proportionality, and whether there could be an exemption from the proposed customer protection condition for small appointees or those whose systems are wholly or mainly in Wales. We consider that proportionate and appropriate customer protection is essential for the retail market, and have already targeted some of the protections at the smallest business customers, so we do not propose to provide an exemption, especially as all WSSL retailers, including even the smallest new entrants, will be required to comply with the provisions of the [CPCoP](#).

We updated the draft text of the condition slightly in the June consultation to be clear that it only applies to eligible business customers, in recognition of the concern raised by appointees whose supply systems are wholly or mainly in Wales. Although the application of the [CPCoP](#) as currently drafted is limited to eligible business customers, we recognise that the [CPCoP](#) may evolve in the future, so there is a justification for using the customer protection condition in the IoAs to restrict the application of the [CPCoP](#) to eligible customers. The issue does not apply for WSSLs, as their customers will only be eligible business customers, so no change would be required for the WSSL standard conditions.



As explained in relation to the MAC condition above, the MAC condition and the customer protection condition have been drafted to meet different objectives. The reasons for drafting the MAC condition to include more detailed provisions on the code change process do not apply to the customer protection condition to the same extent. As explained in our separate [decision document on the CPCoP](#), the CPCoP already includes provisions relating to its own modification (following detailed consultation, including on whether to include the code change process in the code or in the WSSL/loA conditions), so we do not propose to include any additional provisions in the condition.

The proposed Customer Protection condition is included in the Appendix.

### **3. Proposed amendments to existing conditions**

In addition to the proposed new conditions outlined above, we propose to update some of the existing conditions in the IoAs to reflect the new market arrangements. Responses to our earlier consultations fully supported our proposal to amend some of the existing conditions.

Please note: as there are some small variations in drafting and content between the IoAs for different appointed companies, it is important that appointed companies consider how the proposed changes may affect them. In particular, appointees should identify where specific changes should be amended (or not apply) due to the non-standard nature of the provisions in their IoA.

In the rest of this chapter, we discuss other changes to the IoAs that may be required.

#### **3.1 Condition A and terminology**

We propose to update the terminology in the IoAs to reflect changes in legislation and in the Appendix we highlight areas on a generic IoA where the terminology would be updated. Note: this is provided as an example for the purposes of this consultation. As there are differences between the IoAs, appointees need to consider the proposed changes against their own IoA.

The proposed changes would insert new defined terms into Condition A to reflect changes to legislation and to define the necessary additional terms used in our proposed amended text as set out in this consultation:

“2014 Act” – “Water Act 2014”

“Licensee” – “the holder of a water supply licence and/or a sewerage licence granted by the Water Services Regulation Authority under section 17A and/or under section 17BA of the Water Industry Act 1991”

“Eligible premises” – shall have the meaning given in the Wholesale-Retail Code

“Retail market opening date” – means the date determined by the Authority as the date when the retail water and sewerage market for Eligible Premises opens

“Wholesale-Retail Code”- the code issued by the Water Services Regulation Authority pursuant to sections 66DA and 117F of the Water Industry Act 1991.

## Responses to date

Responses supported our proposal to update the terminology, although we received comments from a couple of appointees about the drafting. In particular, one appointee suggested that the definitions should refer to the loA rather than the WRC; retail exit should be defined; and there is inconsistent use of capitalisation throughout the loAs.

One appointee suggested that Condition R needs to be updated so that the provisions reflect the introduction of sewerage competition, as Condition R was originally drafted in relation to water supply only. This would include updating the references to the WIA91. In addition, a concern was raised that the condition as currently drafted would not reflect the situation of appointees whose appointment has been granted for water supply only.

## Final proposals

Although we agree that the loA drafting should refer to definitions in the loA as a preference, in this instance there is an advantage in referring to the WRC, as it is more likely that the WRC definition may change as the WRC can be changed more easily than the loA. So it makes sense for the loA to reflect the definition in the WRC where relevant.

We agree that there is inconsistent use of capitalisation in the loAs, and we propose to deal with this through the simplification project as it affects other conditions too. We do not propose to define “Retail Exit”, as the term is not used in the loA. Sunset provisions use “Exit Date” which is defined.

We agree that Condition R needs to be updated to reflect properly the changes in legislation that have extended the retail market to sewerage in addition to water supply. This includes amending the drafting to be clear that Condition R does not place obligations on water only appointees in relation to sewerage retailers.

Updated draft text for Condition A and Condition R is included in the Appendix.

## 3.2 Condition S and R 1-4 – removing access code and CTP

We proposed to remove these provisions completely for the business retail market with effect from market opening. They will be replaced by the new retail market arrangements as set out in the WIA91 as amended by the WA14, and the draft MAC

and WRC, which means that the CTP and access code provisions will no longer be required for the retail market. We explained that these provisions may need to be retained for the water input element of combined supply licences, at least for a transitional period.

## **Responses to date**

Responses fully supported our previous proposal to remove these for the purposes of the retail market, but recognised that relevant aspects may need to be retained in relation to introductions of water as part of the transitional arrangements to replace the current combined supply licences.

## **Final proposals**

We have considered this further, and now confirm that we propose to retain the relevant aspects of the CTP and access code provisions set out in Condition S and paragraphs 1-4 of Condition R in relation to introductions of water by holders of new WSSLs. New WSSLs with (English) wholesale and/or (Welsh) supplementary authorisations will replace combined supply licences in the new market. We consider that the clearest and simplest way of retaining the relevant provisions will be to pull them together into a modified Condition S. It seems sensible for all the relevant provisions in relation to introductions of water (access codes and the customer transfer protocol) to be brought together in one licence condition. This will also make it easier to make any necessary future changes when full upstream competition is introduced and the transitional restrictions on the wholesale authorisations of new water supply licences are removed.

We plan to publish a separate consultation on our proposals in this area within the next few weeks before finalising the necessary modifications.

### **3.3 Condition F6 Certificate of adequacy**

We propose to create a new obligation for a separate certificate of adequacy for the business customer retail business of the appointee, carved out of the existing obligation to have a certificate of adequacy for the whole appointed business.

## Responses to date

The majority of responses to our earlier consultations agreed with our proposal, although there were some comments on the drafting. Two new appointees requested an exemption on the grounds of proportionality. One other appointee agreed with the rationale, but raised concerns about how it could be enforced. The drafting comments focused on the definitions of the wholesale and retail businesses, and pointed out that as previously drafted, the provisions only covered the business customer retail and wholesale businesses, and seemed to suggest that residential retail would not be covered by either certificate of adequacy.

## Final proposals

It was not our intention to omit residential retail from the requirement to provide a certificate of adequacy, and we have revised the draft text to be clearer on this point, and this is included in the Appendix. We are satisfied that the proposed new obligation could be enforced as currently drafted.

We propose to provide an exemption to companies with limited numbers of eligible customers on the grounds of proportionality. We are considering a threshold of 5,000 eligible customers, with the intention that this threshold would align with the threshold for possible code derogations, once that framework has been finalised and agreed. This would exempt new appointees, appointees wholly or mainly in Wales, and Cholderton and District Water Company Limited. We would do this by not modifying F6 in their IoAs, so that the existing condition would remain unchanged.

## 3.4 Condition Q – drought payments

As the obligation to make drought payments relates to the appointee's role as a wholesaler, we proposed to extend the obligation to make the payments to all affected business customers, regardless of whether they are customers of the appointee's own retail business or customers of a WSSL retailer. WSSL retailers would be required to pass on the payment to the customer in accordance with paragraph 2.4.3 of the business terms in the WRC.

## Responses to date

Responses supported this proposal. A couple suggested that some safeguards may need to be put in place to ring-fence the payments for customers, in case the retailer

becomes insolvent, to prevent the wholesaler being required to pay twice. It was noted that drought incidents can be widespread, affecting many customers, which could increase the risk of a retailer getting into financial difficulties.

## **Final proposals**

We agree that we need to make sure drought payments for affected customers are passed on to those customers. As the provisions of the IoAs do not apply to retailers, we would need to find another way to implement any such safeguards, if we decide that they are required. The WRC is the most likely instrument for this. We will continue with the drafting proposed in the May consultation to update Condition Q in the IoAs, and we will also separately consider whether any amendments to the WRC and/or WSSL standard conditions may be required.

The proposed draft text is included in the Appendix.

## **3.5 Condition G – customer condition**

Our considerations around this condition have been different to the other proposals set out in this consultation, as we did not propose to alter the obligations under Condition G ahead of retail market opening, but we had considered amending the drafting of the condition to provide greater clarity to appointees on which provisions only apply to residential customers, and which apply to business customers too.

## **Responses to date**

All respondents who commented on this proposal agreed that the drafting of the condition could be improved, subject to sight of the proposed draft text before it is finalised. A few suggestions on the drafting were received. These focused on terminology and signposting CCWater's role. There were differing views about whether the protections should be in the [CPCoP](#) or in the IoAs. It was suggested that protections for ineligible business customers would need to be in the IoAs, as the [CPCoP](#) only protects eligible customers, which is correct. In addition, the [CPCoP](#) only applies to retail activities, so any protections that relate to wholesale activities would need to be retained in the IoAs. We also note that some of the more recently issued IoAs (for example, Severn Trent Services and South West Water) have included an updated version of Condition G, which incorporates provisions from Condition H too.

## Final proposals

We continue to hold the view that the drafting of Condition G needs to be updated, and we have considered how best to take this forward. As explained above in relation to the MAC condition, we are starting a new project to consider simplifying and streamlining IoAs. The first phase of that project is expected to be completed within the next 12 months. Even if we decide to amend Condition G ahead of market opening, we would expect it to be reviewed again as part of that project over the coming months. We have considered whether there are possible benefits from updating the drafting of Condition G in the short term, ahead of market opening, which would justify the time and effort (including from appointees and other stakeholders) to unpick and redraft the condition at this stage. The three options for updating condition G are summarised in the table below:

**Table 3: Summary of options for amending condition G**

Option	Comments
1. Amend Condition G to separate out the protections for business customers ahead of market opening	Fairly complex and more resource intensive to implement (for both Ofwat and appointees). Producing separate provisions for business customers would result in detailed provisions which are likely to be further amended during the process to simplify and streamline IoAs.
2. Amend IoAs to replace conditions H and G with the more recent version of Condition G (included in IoAs recently issued to South West Water and Severn Trent Services)	This is potentially a middle option, which could be implemented more easily, but the updated condition does not separate out business customers, so there may not be much benefit. It is likely to be further amended during the process to simplify and streamline the IoAs.
3. Amend Condition G as part of the wider project to simplify and streamline IoAs and licences where possible.	Would only need to be amended once, and would better align with our strategic direction of travel for IoAs, as we are moving towards a more principles based approach.

Having considered the options, we do not consider that there would be any real benefit from amending Condition G ahead of retail market opening, given that it may need to be further updated in line with our overall approach to IoA simplification within a few months of market opening. So, we propose to review and potentially amend condition G through the separate project to simplify and streamline IoAs, rather than amending it twice. As we have reminded appointees through this process of consultation that some provisions of Condition G do apply to business customers as well as residential customers, we are satisfied that it can remain as currently drafted ahead of market opening.

Comments in response to the June Consultation supported this proposal. We would be interested to know, as part of the scoping of the simplification project, if respondents think that the clarifications we are referring to would not be appropriate to handle in a project for the simplification and streamlining of IoAs.



## **4. Application of section 55 WA14**

Sections 55(1) and (2) of the WA14 allow Ofwat to modify the conditions of an appointment of a company appointed under Chapter 1 of Part 2 of the WIA91 (i.e. an instrument of appointment) or of 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 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.

We consider that the introduction of these new conditions, and the proposed amendments to the existing conditions, are both necessary and expedient as a consequence of general provision made in relation to the business customer retail market implemented by Part 1 of the WA14 as a whole.

### **4.1 The expansion of the business customer retail market**

The effective removal of the threshold requirement for licensees who use the supply system of appointed companies whose supply systems are wholly or mainly in England and the introduction of the sewerage licences will lead to many more customers being in the business customer 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 new and effective market arrangements increases. The proposals set out in this consultation are required to give effect to the detailed market rules (codes) that will govern the new market arrangements, as well as removing some of the existing arrangements that will no longer be required. The proposed changes will remove some areas of duplication and facilitate the move from regulated access to negotiated access. Responses to our earlier consultations have been supportive of the need to make these changes in preparation for the expanded retail market.

Although the threshold requirement will remain for licensees who use the supply system of appointed companies whose supply systems 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 limited number of eligible 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, nor will it inadvertently create competition law

risks. The increased scale and scope of requirements necessitate the introduction of a market operator and the associated market arrangements. We therefore consider that these new conditions, and amendments to existing conditions, should be introduced for all appointees, regardless of whether they are in England or Wales. Using section 55 will help to provide greater consistency between the IoAs, and certainty of implementation.

## 5. Managing the interaction with the retail exit timetable

As we need to make the modifications to the IoAs before any retail exit decisions are taken by the Secretary of State, we propose to use sunset clauses to limit some of the obligations that are only applicable to the retail activities of those appointees that remain in the business retail market.

The earlier responses supported this proposal. We therefore propose to use a form of sunset clause to limit the application of the stapling condition, the customer protection condition and the requirement for a separate certificate of adequacy to those appointees that remain in the business retail market. The sunset clause will only be required for those appointees whose supply system is wholly or mainly in England, as appointees whose supply system is wholly or mainly in Wales are not able to exit the market. Proposed text is included in the Appendix. The remaining proposed changes would apply to all appointees, as they relate to wholesale activities. The table below summarises the application of these proposals for appointees depending on whether they exit or not, or if they are wholly or mainly in Wales.

**Table 4: Summary of proposals showing the different position for appointees depending on whether they exit or not, or are wholly or mainly in Wales**

Appointees wholly or mainly in England		Appointees wholly or mainly in Wales
Exit	No exit	Exit not permitted
MAC condition	MAC condition	MAC condition
Stapling condition switched off	Stapling condition	Stapling condition (business customers using more than 50 MI only)
Customer protection condition switched off	Customer protection condition	Customer protection condition (business customers using more than 50 MI only)
Terminology changes	Terminology changes	Terminology changes
Retain the relevant aspects of the CTP and access code provisions set out in Condition S and paragraphs 1-4 of Condition R in relation to introductions of water only	Retain the relevant aspects of the CTP and access code provisions set out in Condition S and paragraphs 1-4 of Condition R in relation to introductions of water only	Retain the relevant aspects of the CTP and access code provisions set out in Condition S and paragraphs 1-4 of Condition R in relation to introductions of water only
Separate certificate of adequacy provision switched off	Separate certificate of adequacy required - exemption for small companies	Exemption – no requirement for separate certificate of adequacy
Updated condition Q	Updated condition Q	Updated condition Q

## 6. Next steps

Appointed companies and other stakeholders, including the Secretary of State and the Welsh Ministers, are invited to **respond to this consultation by 12 August 2016**. Subject to the responses to this consultation, we plan to modify the IoAs by the end of August 2016.

The new and amended conditions would only take effect at market opening, planned for 3 April 2017.

For those companies (whose supply system is wholly or mainly in England) planning to apply to the Secretary of State for permission to exit the business customer retail market under the process set out in the WA14, the proposed 'sunset' clauses would mean that the relevant conditions would never take effect for them. We plan to review, and if necessary, remove any such dormant conditions after the market has opened when the retail exit decisions have been confirmed. This may be shortly after market opening for those companies that decide to exit ahead of market opening, or at some point in the future for any other companies that later decide to apply to exit.