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Trust in water

# Direction to Supply: consultation

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## About this document

This document seeks views on our proposals for the introduction of arrangements to ensure that, following the exit of an appointed company from the business, charity and public sector retail market, eligible customers in an exit area can secure a retail supplier. These arrangements are referred to as the 'direction to supply arrangements'.

At the moment only a limited number customers across England and Wales can choose their water retailer and most customers must use services provided by the monopoly appointed companies.

The Water Act 2014 (WA14) will allow eligible customers to choose their supplier of water and wastewater retail services from April 2017.

For customers who use the supply or sewerage system of an appointed company whose area is wholly or mainly in England, the market will be extended to include all business, charity and public sector customers. For those who use the supply or sewerage system of an appointed company whose area is wholly or mainly in Wales, the market will not be extended, reflecting the different policy position of the Welsh Government. More information on which customers are eligible is available in [our eligibility guidance](#).

Once the new retail market is open, holders of instruments of appointment whose areas are wholly or mainly in England will be able to exit the business, charity and public sector retail market. This will mean that those appointees will no longer be able to provide retail services to customers in their area and so, for example cannot automatically be allocated new or gap site customers. The direction to supply arrangements will ensure that all eligible customers in an exit area will have access to a retail supplier regardless of whether they have engaged with the market.

As retail exit is not possible for appointed companies whose areas are wholly or mainly in Wales, the direction to supply arrangements will not apply to customers or licensees who use the supply or sewerage system of appointed companies whose areas are wholly or mainly in Wales.

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## Responding to this consultation

We invite stakeholders to comment this consultation document and the accompanying proposed guidance by 31 August 2016. You can email your responses to [retailmarketopening@ofwat.gsi.gov.uk](mailto:retailmarketopening@ofwat.gsi.gov.uk) or post them to:

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

If you wish to discuss any aspect of this document, please direct your enquiry to John Kennedy on 0121 644 7598 or by email to [john.kennedy@ofwat.gsi.gov.uk](mailto:john.kennedy@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.

## Consultation Questions

**Q1** Do you have any comments on the process by which a licensee should apply to be an eligible licensee for Direction to Supply?

**Q2** Are there other scenarios where it may not be appropriate for an Acquiring licensee to not be included in the List?

**Q3** Are there other factors which the Authority should consider when assessing whether an Acquiring licensee should be removed from the List?

**Q4** Do you agree that an administrative approach should be used and if so, should the approach for the allocation of gap sites as specified in the WRC also apply in other circumstances, where a Direction to Supply is required?

**Q5** Do you agree with the proposed approach for managing the List and carrying out the allocation?

## 1. Executive summary

The WA14 allows Defra to make regulations to provide for retail exit – that is, for an appointed company whose area is wholly or mainly in England to apply for permission to transfer all its eligible customers to one or more retailers that hold a Water Supply and/or Sewerage Licence (WSSL). An appointed company could transfer its eligible customers to an associated WSSL retailer (i.e. one which is part of the same overall corporate group), or an unrelated WSSL retailer (the licensee that has acquired transferred customers after an undertaker has exited the retail market is known as an Acquiring licensee). WSSL holders will be able to offer retail services across the whole business, charity and public sector market.

Under existing arrangements, new eligible customers who request a supply of water or provision of sewerage services receive these services directly from the appointed company<sup>1</sup>. Where that appointed company however, decides to exit the business, charity and public sector retail market, the appointed company will no longer be able to provide retail services. Although it is expected that in most cases eligible customers will choose their own retailer in the competitive market, there may be instances where this is not the case. To ensure that all eligible customers in an exit area can continue to be provided with retail water supply and or sewerage services, new arrangements need to be put in place.

The Water and Sewerage Undertakers (Exit from business, charity and public sector Retail Market) Regulations 2016 (the “Exit Regulations”) make provision for such arrangements, requiring Ofwat to direct a licensed retailer to provide the required services in certain circumstances. A list of eligible licensees is also required from which Ofwat could select a licensed water and or sewerage services supplier in each case. We refer to the licensees on this list as the Supplier of First Resort or “SoFR” Pool.

Our proposals cover:

- how WSSL licensees can participate in the Direction to Supply arrangements by becoming part of the SoFR Pool;

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<sup>1</sup> An undertaker/appointed company is a company that has statutory powers and duties to supply water and/or sewerage services to premises within an appointed geographical area under the Water Industry Act 1991. It is also responsible for maintaining and operating the public water supply and/or sewerage networks.

- how Acquiring licensees, WSSL licensees, including licensees who are not self-supply licensees, can be removed from the SoFR Pool; and
- our proposed approach to allocating licensees to customers.

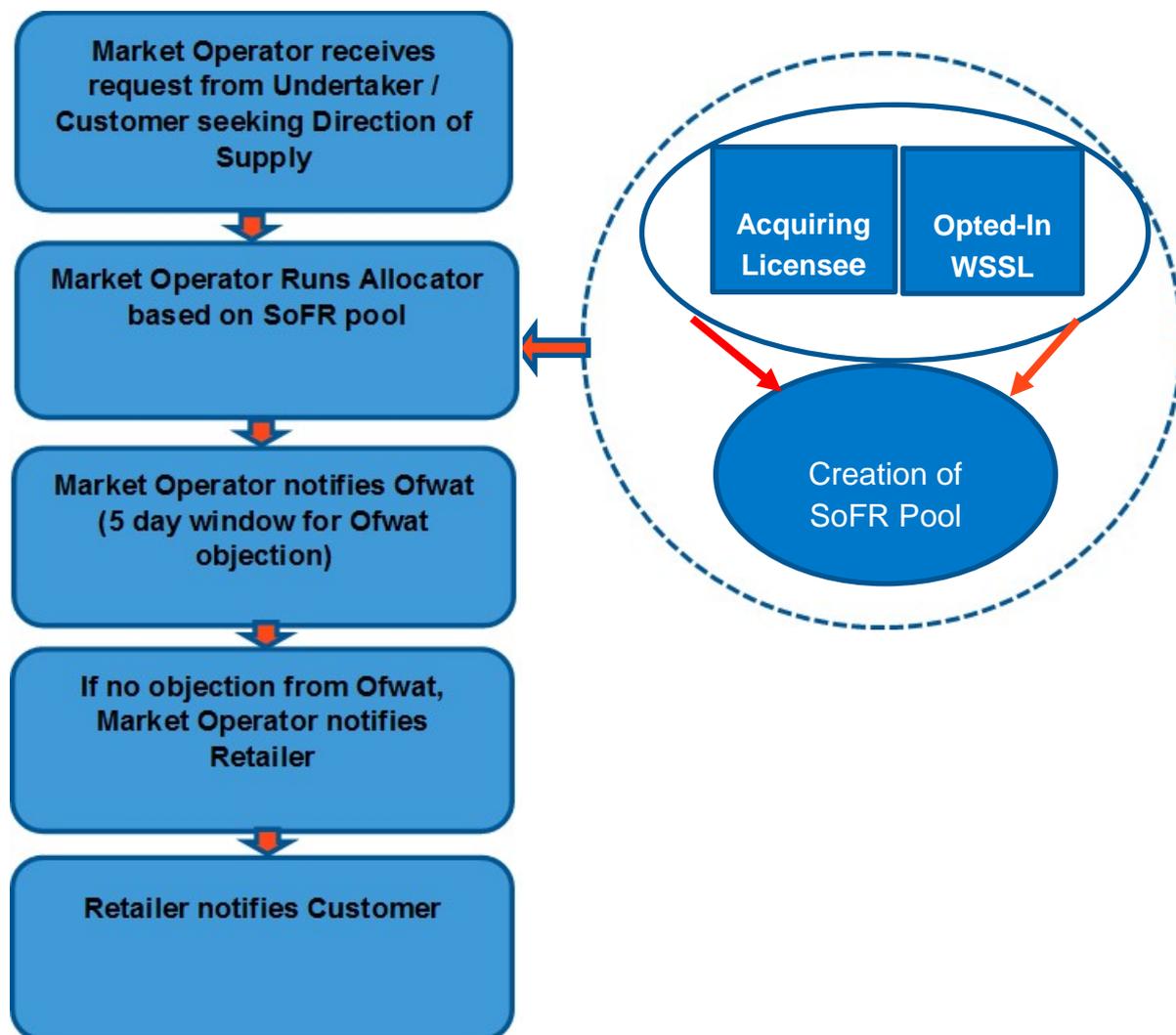
For the inclusion of WSSL licensees in the SoFR Pool, we propose notification by means of the completion of a simple form.

For the removal of WSSL licensees, other than acquiring licensees, from the SoFR Pool, we propose completion of a simple form. In order for Acquiring licensees to be removed from the SoFR Pool, we propose that further evidence be submitted with the form to demonstrate, by reference to the licensee's strategy, why Ofwat should permit the removal.

For the allocation of customers to licensees, we propose that customers be allocated on a sequential basis, with the process being carried out by the Market Operator. This is consistent with stakeholder engagement to date. There has been a "Gap Site Allocation Process" included as part of the Wholesale Retail Code for some time and we see no reason to diverge materially from that process.

The Exit Regulations make provision for the terms and conditions under which customers are supplied by a supplier appointed under the Direction to Supply arrangements to be a scheme of terms and conditions unless they explicitly agree other terms. Our [Retail Exit Code](#) makes provision in relation to these schemes of terms and conditions.

**Table 1: Direction to supply process flow chart**



## **1.1 Next Steps**

The responses to the proposals set out in this document from stakeholders, together with any evidence in support as considered appropriate will help us to refine our proposed approach to Direction to Supply arrangements.

Once we have considered responses to this Consultation and the accompanying Guidance and subject to any need to consult on alternative proposals, we will issue a conclusions document and publish our Guidance on Direction to Supply in autumn 2016.

## 2. Legal and regulatory framework for Direction to Supply

This section sets out the legal and regulatory framework underpinning the requirement for a Direction to Supply.

The WA14 contains provisions that enable the Government to introduce regulations to allow appointed companies to exit to the competitive retail market with the consent of the Secretary of State. The regulations, the Water and Sewerage Undertakers (Exit from the Non-household Retail Market) Regulations 2016 (the 'exit regulations') were laid in Parliament in June 2016. A number of these regulations relate to a Direction to Supply.

Regulations 36-42 (inclusive) and 51-57 (inclusive) set out the processes to be followed if exited appointed companies receive requests for retail services from owners or occupiers of eligible premises. These requests would be received in relation to new premises; newly eligible premises or premises which have not otherwise been registered. Where a retail exit has happened and an appointed company receives a request for the provision of a water supply and/or sewerage services from an eligible customer, it must inform the customer making the request that it has exited the retail market and explain that the customer needs to arrange for a licensee to provide a retail service and the consequences of failing to do so. If, after 22 working days, the undertaker has not received notification that a licensee has agreed to serve the premises, it must notify Ofwat. Ofwat is then required to direct an 'eligible licensee' (a licensee participating in the SoFR Pool) to take on the eligible customer.

The Exit Regulations state that the licensee directed to serve the new customer must do so on their scheme of terms and conditions unless the customer has negotiated a contract with the licensee.

Exit regulations 31-35 (inclusive) and 46-50 (inclusive) allow transferred customers (i.e. those eligible customers which have been transferred from an appointed company to an acquiring licensee as part of a retail exit) who have switched away from the schemes of terms and conditions (either as a result of switching supplier or negotiating new terms with an acquiring licensee) to apply to Ofwat to be allocated to a licensee and placed on that licensee's scheme of terms and conditions (or other terms and conditions agreed with that licensee). Ofwat is required to direct a licensee to supply the customer from the SoFR Pool.

Regulations 43 and 58 require Ofwat to maintain lists of eligible water supply and sewerage licensees (which we refer to as the SoFR Pool) for each exit area. The

acquiring licensees for that area must be included within the SoFR Pool unless they are a self-supply licensee or Ofwat has decided not to include them. Ofwat can only decide not to include an acquiring licensee in the SoFR Pool at the request of an acquiring licensee if:

- there would still be at least one Acquiring licensee in the SoFR Pool; and
- Ofwat is satisfied that it is appropriate for an Acquiring licensee to be moved from the SoFR pool on request.

Regulations 44 and 59 require Ofwat to publish guidance about:

- how it will use its powers to direct licensees to provide retail services to eligible customers, in particular the criteria it will use to determine which licensee to direct; and
- how it will maintain the relevant lists of eligible licensees, in particular the inclusion of licensees in the SoFR Pool and their removal.

## **3. Proposed arrangements for a Direction to Supply**

This section sets out and seeks views on our proposals regarding:

- the application for inclusion in the SoFR Pool and how licensees can be removed from the SoFR Pool; and
- our proposed approach to allocating licensees to customers.

### **3.1 Participation in the Direction to Supply Arrangements**

#### **3.1.1 Backstop supplier of Direction to Supply (Acquiring licensees)**

As stated above, the Exit Regulations require all Acquiring licensees (i.e. the licensee that has acquired transferred customers after an undertaker has exited the retail market) to join the SoFR Pool unless they are a self-supply licensee or their removal would leave at least one Acquiring licensee in the SoFR Pool and Ofwat is satisfied, based on strategy of an Acquiring licensee, that it would be appropriate for that licensee not to be included in the SoFR Pool.

Therefore, we expect the exit process to be used to identify the Acquiring licensee(s) to be included in the SoFR Pool.

#### **3.1.2 Applications from other WSSL licensees**

As with the development of a pool of suppliers for interim supply, we consider that customers would benefit from having access to a number of potential suppliers as this would reduce reliance on a single retailer. We have therefore given consideration to how to facilitate applications from WSSL licensees (which are not Acquiring licensees) for the SoFR pool. The Exit Regulations require Ofwat to include in the SoFR Pool any WSSL licensee with a retail authorisation that has applied to be included and has not applied to be removed.

The licensee would complete a simple form to be submitted to Market Operator, signalling their intent to opt-in to the SoFR pool and would also complete the process set out in the Wholesale-Retail Code, Code Subsidiary Document, 'Trading Party Administration and Notification process'[CSD0006](#) to ensure that the central system is updated accordingly.

## 3.2 Removal from the list

We propose that where an Opted In retailer for the purposes of the Direction to Supply allocation process, wishes to be no longer included on the List for the purposes of Direction of Supply, the retailer can opt out by notifying the Authority and the Market Operator at the same time, that it that it no longer wishes to be included on the list.

There may be instances, where it is appropriate to remove a retailer from the list either permanently or temporarily, for example because of insolvency and so we propose that we deem there to have been notification of removal in these circumstances. We note that this is already accommodated in the process set out in the Wholesale-Retail Code, Code Subsidiary Document, 'Gap Site Allocation' [CSD0005](#).

While it is a simple and straightforward process to remove WSSL licensees (which are not Acquiring licensees) from the List, for an Acquiring licensee such requests will need to be considered, as it important that the pool remains sustainable.

An Acquiring licensee strategy may change over time, for example, it may decide to focus on the high volume customer market or a particular type of business only and therefore wish to be removed from the SoFR Pool. We need to consider how we might address this going forward.

We propose that an Acquiring Licensee who wishes the Authority to consider its removal from the List because of a change in their strategy should provide supporting evidence to satisfy the Authority that it would not be appropriate for it to be included in the List. Such supporting evidence could include:

- a) Proof that the licensee's customers all fall within a narrow class of customers;
- b) Proof that the licensee's customers all fall within defined geographical area;
- c) Proof that the licensee's systems have changed such that it is no longer capable of supplying customers other than a narrow class of customer; and
- d) Evidence to show that customers would not be disadvantaged by the retailer's removal from the List.

In assessing any request by an Acquiring Licensee for removal, the Authority could take into account the following criteria:

- a) being satisfied that the Licensee is no longer capable of serving customers other than a narrow class, or a more defined geographical area.
- b) being satisfied that customers will not suffer; and
- c) confirmation from the Market Operator that the evidence about the licensee's customer base and systems capability is correct.

### Consultation question

Q1 Do you have any comments on the process by which a licensee should apply to be an eligible licensee for Direction to Supply?

Q2 Are there other scenarios where it may not be appropriate for an Acquiring Licensee to not be included in the List?

Q3 Are there other factors which the Authority should consider when assessing whether an Acquiring Licensee should be removed from the List?

## 3.3 Direction to Supply Allocation Mechanisms

### 3.3.1 Allocation approach

There are two broad approaches to the allocation of customers to retailers which we have considered:

**Administrative approach:** In the draft Wholesale Retail Code (WRC) there is an administrative approach for allocating customers of gap sites to retailers. The process is an administrative one and takes account of a scenario where there are a number of eligible suppliers.

This is detailed in the Wholesale-Retail Code, Code Subsidiary Document, 'Gap Site Allocation' [CSD 0005](#). Customers are allocated on a sequential basis from the list of eligible suppliers. In limited circumstances, there may be discretion involved, for example when the next licensee on the list is only authorised to supply water only but the customer needs water supply and sewerage services and so the allocation will go to the next licensee on the list who can offer both services. This approach could apply to all scenarios where Ofwat can issue a Direction to Supply, rather than just gap sites.

**Market mechanism:** This could entail prospective retailers being given an opportunity to offer different terms and conditions from the schemes of terms and conditions. The relevant customers would then be allocated to the retailer(s) which offered the best price and non-price terms of supply for customers.

The objective of our policy is to allocate single customers that arise in an exit area to retailers. We anticipate that this would happen on a frequent basis. We propose that an administrative approach be taken for the allocation of customers. As it is a

random process, we consider that it is fair and non-discriminatory and incentivises customers to engage with the market. Whilst there may be merits in considering a market mechanism in the case of an Interim Supply event, we do not consider it a useful approach in the case of Direction to Supply. For the Direction to Supply, Ofwat will be dealing with individual premises rather than the potentially large volumes of premises which could require allocation in some Interim Supply events. Therefore we do not consider that it would be proportionate to incur the costs of competitive allocation given the small benefits that could accrue to individual customers and it does not incentivise those customers to directly engage with the market.

### Consultation question

Q4 Do you agree that an administrative approach should be used and if so, the approach for the allocation of gap sites as specified in the WRC, should also apply in other circumstances, where a Direction to Supply is required?

### 3.3.2 Maintaining the list of suppliers and the allocation process

We have considered a number of ways in which the process of running the allocation mechanism and issuing the Direction to Supply could be managed. We outline the three main options that we have considered below. In assessing each option we have been mindful of the following matters.

- Evidence from the market in Scotland suggests that there could be significant volumes of customers that will require allocation to retailers. On average, Scottish Water processes between 600-700 gap sites per month. Although the market arrangements in Scotland incentivise the identification of gap sites, it is considerably smaller than the new market in England and Wales. Therefore, we consider that we need to have a system which is capable of dealing with a large numbers of requests for directions to supply efficiently.
- In the draft Wholesale Retail Code (WRC) there is already a mechanism for allocating customers of gap sites to retailers. The process takes account of a scenario where there are a number of eligible suppliers in some of the circumstances anticipated by the Direction to Supply arrangements. This should be familiar to the sector, as it was widely consulted on through the Open Water programme and we do not wish to disrupt the WRC processes unnecessarily at this stage of the programme.
- The Market Operator will be developing a system to allocate gap sites, as specified in the draft WRC. It would be efficient to use such a system, with appropriate checks and balances rather than develop a new system.

With this in mind, we have considered the following options.

### **Option A**

- Ofwat would maintain a list of eligible licensees independent of the Market Operator's list maintained under the Wholesale-Retail Code, Code Subsidiary Document, 'Gap Site Allocation' [CSD0005](#) and the Wholesale-Retail Code, Code Subsidiary Document, 'Trading Party Administration and Notification process' [CSD0006](#).
- A customer would request or an appointed company would notify the Authority, seeking a Direction to Supply.
- Ofwat's guidance would set out how the allocation would operate (our preferred option, i.e. an administrative approach is set out above)
- Ofwat would run the allocation process in line with the guidance; and
- Ofwat would issue a direction to the chosen supplier.

### **Option B**

- The Market Operator would maintain a list of eligible licensees on behalf of Ofwat in line with the Wholesale-Retail Code, Code Subsidiary Document, 'Gap Site Allocation' [CSD0005](#) and the Wholesale-Retail Code, Code Subsidiary Document, 'Trading Party Administration and Notification process' [CSD0006](#).
- Ofwat's guidance would set out how the allocation would operate (our preferred option, i.e. an administrative approach is set out above.)
- A customer would request or an appointed company would notify the Market Operator of the need for a Direction to Supply.
- The Market Operator would follow the allocation process set out in Ofwat's guidance.
- The market operator would notify Ofwat of the proposed allocations using the required process.
- Ofwat will consider the submission and, within a short period of time following receipt of the market operator's proposed allocation, will authorise the market operator to inform the supplier of the direction. Ofwat will put in place relevant administrative arrangements with the Market Operator to ensure communications run as efficiently as possible.
- The Market Operator would issue a notice to the supplier on behalf of Ofwat through the communication channels anticipated in the WRC.

### **Option C**

- Ofwat will set out in its guidance the way in which the list of eligible licensees should be maintained and will provide the List to the Market Operator.

- Customers and appointed companies would apply to Ofwat and copy the Market Operator in on their application, so the market operator will have the information available to commence the allocation process quickly.
- Ofwat's guidance would set out how the allocation would operate (our preferred option i.e. an administrative approach is set out above)
- The Market Operator would follow the allocation process set out in our guidance to select a retailer.
- Once the allocation process is complete, the Market Operator would send the details of the outcome to Ofwat.
- Ofwat will decide whether or not to issue a direction in accordance with the notification from the Market Operator and will notify the supplier with its direction.

Option B is our preferred option for managing the maintenance of the list and allocating the customers to suppliers as it balances the capability of the central system being developed, the well understood processes already consulted upon in the WRC and the need for Ofwat to have appropriate oversight of the process as required by the Exit Regulations.

#### Consultation question

Q5 Do you agree with the proposed approach to managing the list and carrying out the allocation?

### 3.4 Basis of supply under Direction of Supply

Under the Exit Regulations, customers allocated under a Direction to Supply, will be placed on Schemes of Terms and Conditions unless they agree price and non-price terms with their new supplier. The Retail Exit Code already sets out the principles upon which the price and non-price elements for the Schemes of Terms and Conditions will be developed by licensees. Different price terms will apply to small and medium-sized enterprises (SMEs) and non-SMEs. The relevant sections of the [Retail Exit Code](#) are: Section 4 'Provisions about Schemes of Terms and Conditions for Eligible Exit Area Customers who are SMEs' and Section 5 'Provisions about Schemes of Terms and Conditions for Eligible Exit Area Customers who are not SMEs'.