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Trust in water

# Statutory transition scheme for retail market opening: response document

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## About this document

This document explains further our plan to use a statutory transition scheme made in accordance with the provisions of section 91 and Schedule 11 of the Water Act 2014 (WA14) to help prepare for the opening of the expanded business retail market in April 2017. The transition scheme is referred to as a qualifying scheme in Schedule 11. In this document we summarise the responses to our '[Retail market transition arrangements](#)' consultation and explain our planned approach to the transition scheme, ahead of a further consultation on the draft scheme in February 2017.

At the moment only a small number of business customers across England and Wales can choose their water retailer and most customers must use services provided by regional water companies. The UK Government is committed to opening an expanded retail market in April 2017 that will provide choice for all eligible business, charity and public sector customers (business customers) who are supplied using the supply system and/or sewerage system of appointed companies whose areas are wholly or mainly in England. The current 50 MI threshold will be retained for customers who are supplied using the supply systems of appointed companies whose areas are wholly or mainly in Wales, and competition will be maintained for water supply only, reflecting the policy position of the Welsh Government.

A new [legal and regulatory framework](#) is being put in place to facilitate the retail market, and provide the necessary market governance. Appointed companies whose areas are wholly or mainly in Wales will also be affected by the changes as they will need to interact with the new market arrangements, although their numbers of eligible customers will be limited because of the retention of the 50 MI threshold. The planned transition scheme would also have effect for companies whose areas are wholly or mainly in Wales.

As part of the transition from the current legal and regulatory framework to the new market arrangements, we need to make sure that certain elements of the current framework that will no longer be required, are revoked or otherwise 'switched off'. Included in those elements are the existing retail and combined licences, known as Water Supply Licences (WSLs), as they will be replaced by the new Water Supply Licences and/or Sewerage Licences (WSSLs).

Earlier in the year, we consulted on our proposals to do this using a statutory transition scheme. Responses to that consultation broadly agreed with our proposed approach, and the rest of this document explains how we have considered the views of stakeholders, before setting out our planned approach and next steps.

We had previously intended to move straight to the consultation on the draft transition scheme, but as we received mixed responses regarding old section 66D agreements (defined in paragraph 11 of schedule 11 to the WA14) we have been considering how best to deal with these. In particular, we have discussed the issues with Defra, as there is an interdependency with Defra's 8th Commencement Order for the WA14.

We understand that Defra intends to include provisions relating to old section 66D agreements in its 8th Commencement Order, which means that we do not need to include these provisions in our transition scheme. The [7th Commencement Order](#) provided the powers we need to use the transition scheme to implement our other proposals, and was in effect the section 91 WA14 order required by schedule 11, so we can now prepare the draft scheme for further consultation.

In the meantime, we have considered the responses to the earlier consultation and have reached a number of decisions on the content of the scheme. This document informs stakeholders of our decisions on the content of the scheme, as set out in more detail below. We will produce the draft transition scheme for consultation in February 2017.

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## **1. Executive Summary**

### **1.1 Background**

The WA14 will allow all eligible business customers to choose their supplier of water and wastewater retail services from April 2017. Opening the expanded business retail market requires new systems, rules and processes to enable eligible business customers to engage with the market, and for new retailers to enter the market. These rules and processes are contained in the various codes which have been developed as part of the new [legal and regulatory framework](#).

Under the new retail market arrangements, water and wastewater retail services will be provided by either a regional water and/or sewerage company holding an Instrument of Appointment (IoA) (appointed company) - covering both wholesale and retail activities - or a licensed retailer holding a Water Supply and/or Sewerage Licence (WSSL) (all of which are referred to as market participants). Current licensed retailers hold Water Supply Licences (WSLs), which will be replaced by WSSLs under the WA14, and this is one of the areas where we need to manage transition effectively.

The transition from the current smaller market to the expanded retail market is a fairly complex one. A number of activities must be carefully managed so that there is a seamless transition from the existing retail market arrangements to the new market arrangements, without causing any disruption or confusion for customers or water and wastewater companies. It is particularly important that we manage effectively the transition from the existing regulatory and legal framework to the new one, to avoid either (i) an overlap between potentially conflicting instruments or processes; or (ii) a period when neither framework has effect, as both of these scenarios would cause confusion and legal uncertainty.

### **1.2 Proposed approach to transition**

A seamless transition is extremely important for both customers and market participants, as it is essential for the effective operation of the expanded market from April 2017.

We are currently working with our Open Water programme partners, Defra and MOSL, to develop and implement the wider transition arrangements, which include:

- Giving effect to the new legal and regulatory framework, including the various codes; and
- Establishing or appointing the bodies that will play a key role in the market governance framework (the Market Operator (MO) and Panel).

The [Open Water programme update](#) on transition arrangements published in August 2016, and our recent [Information Notice](#) on the process for nominating and electing members of the Panel, provide more information. A further Open Water programme update on transition arrangements will be published shortly.

The particular focus of this consultation was on the steps we may need to take to revoke or otherwise ‘switch off’ certain elements of the existing market framework. We proposed to use a statutory transition scheme made in accordance with the provisions of section 91 and Schedule 11 of the WA14 to do this. We received 11 responses to our consultation: 9 from appointed companies, and 2 from associated retailers. The 10 responses that provided detailed comments were all in broadly in agreement with our proposed approach. One company indicated that they had no comments.

The table below summarises our original proposals, the responses from stakeholders, and our plan to take this forward, having considered those responses.

**Table 1: Summary of consultation responses and our planned approach**

	<b>Original proposals</b>	<b>Responses to consultation</b>	<b>Confirmed planned approach</b>
1	To use a statutory transition scheme to help deliver the necessary transition arrangements	Responses agreed with our plan to use the transition scheme to help deliver the necessary transition arrangements	We will use a statutory transition scheme to help deliver the necessary transition arrangements.
2	To use the scheme to revoke all WSLs	Responses agreed with this proposed approach. Some comments suggested that we should make sure that customers are protected if a WSL retailer either does not apply for, or is not granted, a WSSL. Suggestions included having a clear process for those customers to be transferred to another retailer, and by placing an obligation on the retailer to inform the customer.	We plan to use the transition scheme to revoke all WSLs, including Combined Supply Licences (CSLs). We are satisfied that there are processes in place to protect any customers if a licensed retailer is not granted a WSSL, and exits the market.
3	To use the scheme to terminate any existing old	Responses to this proposal were mixed. Some	We understand that Defra intends to include provisions

	section 66D agreements between appointed companies, acting as wholesalers, and licensed retailers	companies suggested that this is unnecessary as existing old section 66D agreements would be terminated anyway. Others welcomed the proposal and confirmed that the approach would be helpful.	relating to existing old section 66D agreements in its 8th Commencement Order, so we do not need to include them in our transition scheme.
4	To use the scheme to confirm that any compensation that would otherwise be payable as a consequence of the effect of the scheme shall be nil	No comments received on this proposal.	We intend to use the transition scheme to confirm that any compensation that would otherwise be payable shall be nil.
5	As part of the wider transition arrangements, to confirm that for a short period (we suggested 20 working days) immediately before market opening, any existing WSL retailers would not be allowed to request to transfer a customer under the existing process. This proposal was intended to avoid any issues arising from customer switches being part-way through at the time that the existing arrangements are replaced by the new ones.	Responses supported this proposal, and four suggested the period should be longer at 30 working days, which is the maximum period that a customer switch can take under the current process.	<p>We have considered this, and agree with the suggestion that the period should be at least 30 working days.</p> <p>We will take this forward with Defra and MOSL as part of the wider transition arrangements.</p> <p>We are also currently considering how best to give effect to this. One option would be through a voluntary agreement between all companies, and this could be a pragmatic solution.</p>

### 1.3 Next steps

As explained above, we have discussed the issues relating to old section 66D agreements with Defra, as there is an interdependency with Defra's 8th Commencement Order for the WA14.

We understand that Defra intends to include provisions relating to old section 66D agreements in its 8th Commencement Order, which means that we do not need to include these provisions in our transition scheme. The [7th Commencement Order](#) provided the powers we need to use the transition scheme to implement our other proposals, and was in effect the section 91 WA14 order required by schedule 11, so we can now prepare the draft scheme for further consultation.

We plan to consult on the draft scheme during February 2017.

## **1.4 Structure of the rest of this document:**

- Chapter 2 – Our planned approach
- Chapter 3 – Next steps



## 2. Our planned approach

In this Chapter we explain how the responses to our proposals have informed our planned approach in relation to the transition scheme and its content.

### 2.1 The transition scheme

#### Legal framework

Under the provisions of section 91 and Schedule 11 of the WA14, we may use a 'qualifying scheme' to establish the necessary transition arrangements for water supply licensing. We refer to this as a 'transition scheme'.

#### Proposed approach

In our consultation, we proposed using a transition scheme made in accordance with the provisions of section 91 and Schedule 11 of the WA14 to help deliver some of the transition arrangements for market opening.

#### Consultation responses

There was unanimous support for the use of the proposed scheme from the 10 companies that provided detailed responses to our consultation.

#### Confirmed approach

We will use a transition scheme to help deliver the transition arrangements for market opening.

Under section 91 of the WA14 Defra may make an order by statutory instrument which makes transitional provisions and in particular those set out in schedule 11. Defra included the necessary schedule 11 provisions in the [7th Commencement Order](#). We anticipate that the scheme would take effect in March 2017, before market opening in April 2017.

## 2.2 Content of the transition scheme

In addition to consulting on our proposed use of a transition scheme to help deliver the necessary transition arrangements for market opening, we also consulted on the proposed content of the scheme, which included using the scheme to:

- revoke current (old) water supply licences (WSLs);
- provide that any compensation that may otherwise be payable would be nil; and
- provide for any necessary transition or termination provisions in respect of old section 66D agreements between the appointed companies and licensed retailers.

The rest of this chapter discusses each of these in turn.

### 2.2.1 Revoking old WSL licences

As explained in our [guidance on applying for a WSSL](#), all retailers who wish to participate in the market after April 2017 must hold a WSSL with a retail authorisation in accordance with the provisions of the WA14. So any holder of a WSL that wishes to continue to participate in the retail market after April 2017 must be granted a WSSL before April 2017. Any holder of a Combined Supply Licence (CSL) that wishes to retain the right to make introductions of water to supply their own customer(s) must [apply for and be granted a new water supply licence with a \(English\) wholesale authorisation or a \(Welsh\) supplementary authorisation prior to April 2017](#).

We proposed to use the transition scheme to revoke all existing water supply licences i.e. WSLs and CSLs and to use the scheme to revoke them immediately prior to market opening (23:59 hrs), to provide a seamless transition to the new WSSLs, which are expected to take effect at 00:01hrs on the date of market opening.

### Consultation responses

All responses that commented on this proposal agreed with our proposed approach. There were some additional comments about handling the transition. These included making sure that retailers would be responsible for informing customers and wholesalers about any changes, and for us to provide more clarity on how customers would be allocated to an alternative retailer in the unlikely event that a WSL does not transition to the new market. It was also suggested that any retailer that is not

granted a WSSL should be prevented from switching any new customers close to market opening, to avoid unnecessary disruption to those customers.

### **Our confirmed approach**

We will use the transition scheme to revoke WSLs and CSLs, as proposed in the consultation. We agree with the comments about the importance of protecting customers, and making sure that WSL retailers are responsible for informing customers and wholesalers of any changes. One of our main priorities through this process is to make sure that customers continue to be protected. By the time we consult on the proposed scheme, we expect to be able to confirm with more certainty whether there may be any customers affected by the revoking of the WSLs and/or CSLs and if necessary will make sure that the appropriate provisions are in place to protect those customers.

### **2.2.2 Section 66D agreements**

As part of the consultation, we asked stakeholders for their views on whether the transition scheme should be used to terminate or facilitate the transition of existing old section 66D agreements between appointed companies acting in their capacity as wholesalers and WSL retailers. As existing old section 66D agreements should be replaced with new wholesale contracts that are compliant with the provisions of the Wholesale-Retail Code (WRC) from April 2017, we asked companies whether they considered it to be necessary or helpful for the proposed transition scheme to make provision in respect of these agreements.

### **Consultation responses**

We had mixed responses from companies to this question. Although many of the responses welcomed this, and suggested it would be helpful to use the transition scheme to deliver a clean break by terminating the agreements, some companies suggested that it would be unnecessary, as the agreements would be terminated on revocation of the WSLs.

### **Our confirmed approach**

We understand that Defra intends to include provisions relating to old section 66D agreements in its 8th Commencement Order, which means that we do not need to include these provisions in our transition scheme.

### **2.2.3 Compensation**

Under paragraph 2 (4)(b) of Schedule 11, and more particularly under paragraph 4 of the [7<sup>th</sup> Commencement Order](#) any qualifying scheme must provide for the payment of compensation by Ofwat in connection with the revocation of rights attached to WSLs or other restrictions imposed on WSLs under that qualifying scheme. Further the qualifying scheme may make provision for the compensation payable to be nil.

We proposed that the transition scheme would include details of how to apply for such compensation, although we noted that we would expect any such compensation payable to be nil. We considered this appropriate because it is possible for an existing WSL retailer to make a successful application for a WSSL if they satisfy the application criteria.

### **Consultation responses**

None of the consultation responses commented on the proposals in relation to compensation.

### **Our confirmed approach**

As stated above, the [7<sup>th</sup> Commencement Order](#) made on 17 October 2016 included the necessary powers to assess the compensation payable for revocation of a WSL at nil. Having considered this issue further, we intend to use the scheme to provide that any compensation that may otherwise have been payable will be nil. We continue to consider this is justified in the circumstances because any current WSL holder may apply for and be granted a WSSL if they satisfy the application criteria. We are not required to include a process in the scheme for claiming compensation, as compensation will be stated to be nil and such a process would be unnecessary.

#### **2.2.4 Other issues raised in consultation responses**

We invited stakeholders to suggest any other issues that may need to be addressed by the proposed transition scheme. There were no suggestions for additional content of the scheme, other than the issues already mentioned above.

## **2.3 Wider transition arrangements**

A couple of responses raised issues relating to the wider transition arrangements, rather than the proposed transition scheme. In particular:

- The date of market opening; and

- Sequencing of activities, including the timing of signing contracts to fit with the assurance process.

### **Planned approach to resolve these issues**

We will continue to work closely with our Open Water programme partners, Defra and MOSL, to consider and respond to these issues as part of our planning and implementation of the wider transition arrangements. More information will be provided in the Open Water programme update that will be published shortly. It would be helpful for companies to continue to bring any further issues or concerns about the transition to the new market arrangements to our attention, so that where necessary, we can agree a sensible way to address them ahead of market opening.

### 3. Next steps

As explained above, we have discussed the issues relating to old section 66D agreements with Defra. We understand that Defra intends to include provisions relating to old section 66D agreements in its 8th Commencement Order, which means that we do not need to include these provisions in our transition scheme.

The WA14 and the 7th Commencement Order provided the powers we need to use the transition scheme to implement our other proposals, and was in effect the section 91 WA14 order required by schedule 11, so we can now prepare the draft scheme for further consultation. We plan to consult on the draft scheme during February 2017. The scheme is anticipated to take effect in March 2017 in time for market opening.

If you have any queries, further comments, or wish to discuss anything contained in this document, please get in touch with Dan Mason on 0121 644 7629, or email us via [RMOtransition@ofwat.gsi.gov.uk](mailto:RMOtransition@ofwat.gsi.gov.uk).

Finally, we will continue to work closely with our Open Water programme partners, Defra and MOSL in relation to the wider transition arrangements, including the proposed freeze on customer switching ahead of market opening. More details will be provided in the Open Water programme update on transition to be published shortly.