

# Consultation on Direction to Supply: Conclusions

## About this document

This document sets out our conclusions on our approach to the Direction to Supply arrangements. These are required by legislation, to ensure that, following the exit of an Undertaker from the business, charity and public sector retail market, eligible customers in an exit area can secure a retail supplier where they have not engaged with the market. This document is accompanied by a [guidance document](#), which sets out the principles for the Direction to Supply arrangements and reflects our conclusions in this document. The Glossary in the Guidance sets out the meanings of some capitalised terms used in this conclusions document.

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 (referred to as business customers in the rest of this document). For those who use the supply or sewerage system of an Undertaker 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 to choose their Retailer 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 (non-household) retail market. This will mean that those Undertakers will no longer be able to provide retail services to eligible non-household customers in their area and so, for example cannot automatically be allocated new or gap site eligible 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 permitted 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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## 1. Executive summary

The Water Act 2014 (WA14) allows the UK Government to make regulations to provide for retail exit – that is, for an appointed company whose area is wholly or mainly in England to apply to withdraw from the non-household retail market in their area of appointment. The Water and Sewerage Undertakers (Exit from the Non-household Retail Market) Regulations 2016 (the “Exit Regulations”) make provision for determination of such applications, for the transfer of eligible customers to one or more Retailers that hold a Water Supply and/or Sewerage Licence (WSSL) and for certain other matters relating to the operation of the non-household retail market following an exit.

In an exit application made under the Exit Regulations, an appointed company could nominate an associated WSSL Retailer (i.e. one which is part of the same overall corporate group), or an unrelated WSSL Retailer to whom its eligible customers should be transferred (the licensee that has acquired transferred customers after an Undertaker has exited the retail market is known as an “Acquiring Licensee”).

In an area where there is no retail exit, new eligible customers who request a supply of water or provision of sewerage services will receive these services directly from the appointed company (as currently). However, where that appointed company decides to exit the business retail market and has its application granted, the appointed company will no longer be able to provide retail services in its area of appointment (we refer to an area of appointment for which an exit application has been granted as a “retail exit area” or “exit area”). It is expected that, in most cases, eligible customers will choose their own Retailer in the competitive market. However, 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 are required.

The Exit Regulations make provision for such arrangements, requiring Ofwat to direct a WSSL Retailer to provide the required services in certain circumstances. A List (or Lists) of eligible licensees is also required from which Ofwat could select a WSSL licensee in each case.

In August 2016, we issued a consultation on our policy proposal for the Direction to Supply arrangements and our draft guidance. Our proposals covered:

- how WSSL licensees can participate in the Direction to Supply arrangements by becoming part of the List;
- the circumstances in which an Acquiring Licensee need not be included in the List;

- how Acquiring Licensees and other WSSL licensees can be removed from the List; and
- our proposed approach to allocating WSSL licensees to customers.

We received 13 responses to our consultation. Responses were broadly supportive of the general approach that we had proposed. Section 2 of this document summarises the issues raised by respondents and explains our conclusions on these and Table 1 below summarises these conclusions. Alongside this document we have published the Guidance which reflects these policy conclusions.

**Table 1: Summary of conclusions**

<b>Issue</b>	<b>Proposed approach</b>	<b>Further information</b>
<b>Facilitation of applications for WSSL to be added to List</b>	WSSLs would submit a simple form to the Market Operator, signalling their intent to opt-in to the List and would also complete the process set out in the Wholesale-Retail Code (WRC). A minor amendment has been made to the form that was consulted on to include a reference to whether the applicant has a contract with a wholesaler.	Section 2.1
<b>Removal / Exclusion from the List</b>	WSSLs can opt-in to the List or leave it at any time. However, if an Acquiring Licensee wishes to leave the List or requests to be excluded, it would need to make the request to Ofwat. Such a request would be assessed taking into account the potential impact on customers and other factors. This was the approach suggested during the consultation.	Section 2.2
<b>Administrative approach</b>	We continue to consider that an administrative approach is the optimal one for the allocation of customers. This was our preferred approach in the consultation document.	Section 2.3
<b>Allocation process</b>	We consider that the most appropriate way to allocate customers is through the process already set out in relation to 'gap sites' in the WRC. This was the approach proposed in our August Consultation.	Section 2.4

## **2. Direction to Supply**

### **2.1 Participation in the Direction to Supply arrangements**

#### **Our proposed approach**

The Exit Regulations require all Acquiring Licensees to join the List for the Direction to Supply arrangements (this in the past has been referred to as the SoFR pool) unless they are a Self-supply Licensee or their removal would leave at least one Acquiring Licensee in the List and Ofwat is satisfied, based on the strategy of an Acquiring Licensee, that it would be appropriate for that licensee not to be included in the List. Therefore, we expect the exit process to be used to identify the Acquiring Licensee(s) to be included in the List.

As with the development of a List of Retailers 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. The Exit Regulations require Ofwat to include in the List any WSSL licensee with a retail authorisation that has applied to be included and has not applied to be removed. Retailers would have an incentive to participate in the List, as it would enable them to acquire customers without marketing effort or expenditure.

In our August consultation we set out our proposals on how we would facilitate applications from WSSL licensees (which are not Acquiring Licensees) for the List. We proposed that the licensee would submit a simple form to the Market Operator, signalling their intent to opt-in to the List (and stating in which Exit Areas). This would 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.

#### **Stakeholder responses**

Respondents were generally supportive of our proposals to facilitate licensees', other than Acquiring Licensees, inclusion in the List. In particular, respondents welcomed our approach to making the process for opting-in to the List straightforward by the submission of a simple eligibility form.

One respondent raised a concern about the ability of an opted-in Retailer to withdraw from the List at any time. It argued that providing the freedom for licensees to add or remove themselves from the List could lead to unintended difficulties with the management of the List and could lead to errors in customer allocations. It was suggested that an opted-in Retailer should not be able to remove themselves from

the List within year, unless they fail to meet the trading conditions for the relevant Exit Area.

One respondent sought clarity on whether an Acquiring Licensee can be allocated customers outside their own Exit Area, without having opted-in.

One respondent suggested that it may be worth conducting a simple check to ensure that the Retailer has a contract with the wholesaler.

## **Our conclusions**

We consider it is important that there should be wide participation in the List, so that it is sustainable. If conditions were introduced which limit the freedom for licensees to add or remove themselves from the List at any time, it could create a barrier to participation in the List. We therefore consider that there should be no restrictions imposed on a Retailer adding themselves or removing themselves from the List at any time. We consider that there is merit in conducting a simple check to ensure that the Retailer has a contract with the wholesaler.

Although we referred to a single List in our August consultation, this List will consist of a List for each Exit Area. When a WSSL Retailer applies to be included in the List, it will indicate which Exit Area(s) it wishes to be included in. An Acquiring Licensee will be added only to the List for the Exit Area for which it is the Acquiring Licensee unless it applies to be included in the List in relation to another Exit Area. Therefore, if an Acquiring Licensee wished to be allocated customers outside their own Exit Area, they would need to apply to be included in the List for those other retail exit areas.

## **2.2 Removal / Exclusion from the List**

### **Our proposed approach**

In our August consultation we proposed that where a Retailer for the purposes of the Direction to Supply allocation process, wishes to be no longer included on the List, the Retailer could “opt out” by notifying the Authority and the Market Operator at the same time.

We noted that there may be instances, where it would be appropriate to remove a Retailer from the List either permanently or temporarily, for example because of insolvency. We proposed that we would deem there to have been notification of an intention to remove in those circumstances. While it should be a simple and straightforward process to remove WSSL licensees (which are not Acquiring

Licensees) from the List(s); for an Acquiring Licensee such requests would need to be considered, as it is important that the List remains sustainable. An Acquiring Licensee strategy may change over time and it may wish to be removed from the List. This could be due to a decision to focus on the high volume customer market or a particular type of business only. We proposed 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. We suggested that 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 a 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.

## **Stakeholder responses**

Respondents considered the criteria outlined by Ofwat for assessing a request by an Acquiring Licensee for removal from the List as appropriate, but also added other factors that should be taken into account.

Two respondents commented that Ofwat must be confident that the List could continue to support customers' needs without an Acquiring Licensee to continue to be mandated to be in the List as a backstop supplier for the relevant area. Another respondent commented that as long as an acquiring company's removal from the List does not have a detrimental impact to the customer and there are alternative suppliers for customers to choose, then there should be consent for such a request. One respondent commented that, if there is evidence that an Acquiring Licensee is likely to go into insolvency or would go into insolvency, it should not be allowed to take on more customers and therefore should be removed from the List.

## **Our conclusions**

It is vital that the List is sustainable, to help mitigate the risk that a customer may not be able to secure a Retailer. We consider that where an Acquiring Licensee wishes the Authority to consider its removal from the List because of a change in their strategy or it seeks to be excluded from the List, the supporting evidence that would need to be submitted by the Acquiring Licensee, including an assessment of the potential impact on customers, would minimise any risk to customers.

There is a requirement generally that an Acquiring Licensee, apart from a Self-supply Licensee and a Acquiring Licensee that is successful in getting Approval to be excluded, is included on the List. Where is a risk of insolvency, we would consider whether that Retailer should be removed from the List.

## **2.3 Direction to Supply allocation approach**

### **Our proposed approach**

In our August 2016 consultation we proposed an administrative approach to allocation rather than a market mechanism. The administrative approach that we put forward for consideration was based on a process already contained in the WRC for allocating customers of gap sites to Retailers.

This process is detailed in the Wholesale-Retail Code, Code Subsidiary Document, 'Gap Site Allocation' CSD 0005. This proposes to allocate customers on a sequential basis from a List of eligible suppliers. We proposed that this approach could apply to all scenarios where Ofwat can issue a Direction to Supply, rather than just gap sites.

### **Stakeholder comments**

Respondents agreed that, given the scale and frequency of Direction to Supply events, the use of an administrative mechanism, rather than market mechanism was the optimal approach.

Respondents agreed that the sequential allocation method, as specified in the WRC in relation to gap sites, could be applied to other scenarios where a Direction to Supply is required. It was considered fair, non-discriminatory and efficient.

### **Our conclusions**

We continue to consider that an administrative approach is the optimal one for the allocation of customers, given the support from respondents. It is a random process,

which 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. 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 also does not incentivise those customers to directly engage with the market.

## **2.4 Maintaining the List of suppliers and the allocation process**

### **Our proposed approach**

We put forward our preferred approach in our August consultation, which comprises the following sequential steps:

1. The Market Operator would maintain a List of eligible licensees on behalf of Ofwat in line with the WRC, Code Subsidiary Document, 'Gap Site Allocation' CSD0005 and the Wholesale-Retail Code, Code Subsidiary Document, 'Trading Party Administration and Notification process' CSD0006.
2. Ofwat's guidance would set out how the allocation would operate (our preferred option, i.e. an administrative approach as set out above.)
3. A customer would request or an appointed company would notify the Market Operator of the need for a Direction to Supply.
4. The Market Operator would follow the allocation process set out in Ofwat's guidance.
5. The Market Operator would notify Ofwat of the proposed allocations using the required process.
6. 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.
7. The Market Operator would issue a notice to the selected Retailer on behalf of Ofwat through the communication channels anticipated in the WRC.
8. The selected Retailer would inform the relevant customer(s) of its appointment in compliance with the Retail Exit Code.

### **Stakeholder comments**

Respondents for the most part agreed with our preferred approach for allocating the customers to Retailers by using a process based on the 'gap site' allocation method which is already included in the WRC. The process is well understood by market participants and is the option which is likely to have the least impact in terms of changes to companies' processes.

One respondent commented that our preferred approach should be streamlined. It was felt unnecessary that there should be a step, where the Market Operator is required to notify Ofwat of a proposed allocation, and Ofwat has to provide authorisation before the Market Operator can proceed and notify the relevant Retailer. It was suggested that Ofwat could exercise oversight through other methods, such as sampling Direction to Supply allocation events, reviewing the List at regular intervals against submissions by licensees and Trading Condition changes, etc. Another respondent queried as to why we should have the right to veto any allocation and also asked under what circumstances we would use this right. It was also felt that a five day period before the allocation could be authorised was a disproportionate.

One respondent did not agree that when making additions to the sub-List (i.e. each such sub-List identifies the List of opted in Retailers for either water or sewerage Services), a new opted in Retailer would be placed in to the existing sub-List at a randomly allotted position, thus affecting the relative position of the existing opted in Retailers.

## **Our conclusions**

We consider that the most appropriate way to allocate customers is through the process already set out in relation to 'gap sites' in the Wholesale Retail Code (WRC). The process takes account of a scenario where there are a number of eligible Retailers in some of the circumstances anticipated by the Direction to Supply arrangements. It is familiar to the sector, as it was consulted on through the Open Water programme. Moreover, the Market Operator is developing a system to allocate gap sites, as specified in the draft WRC, so it would be appropriate to use such a system with appropriate checks and balances rather than develop a new system.

As there is a requirement under the Exit Regulations for Ofwat to direct Retailers, we consider that it is necessary for Ofwat to be involved in the process. In the majority of cases we expect to exercise our powers through directing on the basis of the outcome of the allocation process under the WRC. Our direction is a necessary steps in the exercise of authority given to us under the Exit Regulations. We would only choose not to confirm the outcome of the WRC allocation process in exceptional circumstances and only where such action was proportionate and risk based.

We consider that that the random allocation of new Retailer is the fairest and most non-discriminatory way of maintaining the List.

### 3. Further information:

If you have any questions about this process or this document please email responses to [retailmarketopening@ofwat.gsi.gov.uk](mailto:retailmarketopening@ofwat.gsi.gov.uk), alternatively please feel free to contact us using the details provided below:

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Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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