

# Modifications to the Retail Exit Code – a consultation

## About this document

This document sets out, for consultation, changes we are proposing to make to the Retail Exit Code ('the REC'), issued by Ofwat under Regulation 30 of the [Water and Sewerage Undertakers \(Exit from Non-Household Retail Market\) Regulations 2016](#) (the 'Exit Regulations').

We are proposing to make changes to the REC to remove a regulatory obstacle so as to enable bulk transfers of customers between Water Supply and / or Sewerage Supply licensees (jointly referred to as WSSLs or licensees) – for example, in the case of a merger between two licensees or where one licensee wishes to sell its customer book to another licensee. In particular, we propose amending provisions in the REC that require, in all instances, individual customer consent before a licensee can terminate its supply. The amendment proposes to allow a licensee to include in its scheme of terms and conditions a provision allowing it to terminate its supply in a limited set of circumstances.

We are also using this consultation to invite views on changes we are proposing to make that will allow retailers to adjust their charges in line with changes to wholesale charges of appointed companies. At the moment, a “no worse off” restriction applies to acquiring licensees’ current price term provisions under the REC, but this only applies to 2017-18. For 2018-19 and 2019-20, the REC requires the maximum charges payable by Transferred Customers (as defined in the REC) to be adjusted on 1 April each year by the “Permitted Adjustment” (also as defined in the REC).

We think that the current definition of Permitted Adjustment may be ambiguous, as it refers only to the PR16 determinations which relate only to the retail activities of the relevant company. We are therefore proposing a change to that definition to allow for adjustments in appointed companies’ wholesale charges, as set out in our PR14 Final Determinations, to be passed on by retailers.

We intend to publish a revised Retail Exit Code and a reasons document in January 2018.

## Responding to this consultation

We welcome your responses to this consultation by close of business on **11 December 2017**.

You can email your responses to [retailexitcode@ofwat.gsi.gov.uk](mailto:retailexitcode@ofwat.gsi.gov.uk). You can submit your responses by post to:

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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 1988 and the Environment Information Regulations 2004.

If you would like the information you have provided to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ with which public authorities must comply and 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, in itself, be regarded as binding on Ofwat.

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## 1. Introduction

Mergers and sales of a company's customer book are a normal feature of a well-functioning competitive market. This is possible because under the law of contract a party's rights can be assigned to another party unless the contract provides otherwise. However, a party's obligations under an agreement cannot be transferred without the consent of the other party (in this case the customer).

In commercial transactions involving the transfer of a large volume of customers, the need for consent raises obvious practical difficulties. Particularly in regulated sectors, this difficulty is often addressed via statutory transfer schemes. Where there is no provision made for statutory transfer schemes, commercial practices have developed whereby consent is deemed to have been given if the customer is fully informed of the proposed transfer and is given the opportunity to object.

In the context of the business retail market, statutory transfer schemes only apply to transfers between appointed companies, and between appointed companies and licensees. There is no provision for a statutory scheme between licensees except in the context of special administration.

The transfer of customers between licensees is currently a live issue in the market as there is an assumption that such a transfer is or should be possible in order for the competitive market to operate effectively. We agree with this, and consider this to be in line with our objectives for a dynamic market where entry, exit and expansion is prevalent. We therefore consider that we should facilitate such transfers by removing any unnecessary restrictions that are in place which prevent a bulk transfer of customers between licensees.

Another feature of a well-functioning market is that customers are sufficiently protected. The Exit Regulations, and the REC issued by Ofwat, require acquiring licensees to publish and keep under review a scheme of terms and conditions that sets out the terms and conditions that will apply in all cases where Retail Exit has occurred and affected customers have not otherwise negotiated a contract.

Currently, a "no worse off" restriction applies to acquiring licensees' current price term provisions under the REC, but this only applies until March 2018. For 2018-19 and 2019-20, the REC requires the maximum charges payable by transferred customers to be adjusted on 1 April each year by the "Permitted Adjustment" (as defined in the REC).

However, the definition of the “Permitted Adjustment” only allows licensees to make the adjustments that the exited companies would have been allowed to make under the PR16 final determinations, which relate only to the retail activities of those companies and which only form a small part of the bills paid by end-user customers.

The price controls for wholesale activities that apply to the same period (2017-20), and which form the largest part of the bills paid by end-user customers, were set in our PR14 final determinations, and as such we think that amendments to the REC need to be made to allow licensees to adjust their charges in line with adjustments in wholesale charges.

This document is structured as follows:

- Section 2 sets out the relevant legal framework within which we are proposing to make changes to the REC;
- Section 3 sets out our proposals for changes to the REC; and
- Section 4 sets out the next steps.

## 2. Legal framework

### 2.1 The duty to supply

Chapter 4 of the Water Act 2014 (the Act) gives the Secretary of State the power to make regulations to provide for retail exit – that is, for an appointed water or sewerage company to transfer all of its business customers to one or more holders of a WSSL (the acquiring licensee).

Among other things, the Exit Regulations require:

- any WSSL holder who acquired customers via a retail exit to make and keep under review a scheme setting out the terms and conditions that will apply in all cases where retail exit has occurred and affected customers have not otherwise negotiated a contract (this is sometimes referred to as a deemed contract)(regulation 29);
- Ofwat to issue a code setting out the basis for such schemes of terms and conditions (regulation 30);
- an acquiring licensee to continue to supply until the supply or service is discontinued in accordance with the terms and conditions set out in a licensee’s scheme of terms and conditions (regulation 26).

This means that in a retail exit area all customers will have a clear contractual basis for their supply, either under a deemed contract established under regulation 29, or an individually negotiated contract.

Ofwat issued the [Retail Exit Code](#) (REC) on 17 March 2017 under regulation 30.

The REC makes provision about:

- the principles to be applied by licensees in developing schemes of terms and conditions; and
- the obligations placed on a licensee to inform customers in a retail exit area of its applicable scheme of terms and conditions.

The REC also provides that a supply or service may only be discontinued .... “with the consent of the customer”.

## 2.2 Pass through of adjustments in wholesale charges

Licensees providing, or proposing to provide, business retail services in a retail exit area (an area where retail exit has taken place) are required to make and keep under review a scheme setting out the terms and conditions that will apply in cases where a contract has not been negotiated with a customer. Ofwat is required to issue a code (the REC) setting out the basis for the schemes to be produced.

The current version of the REC specifies price and non-price requirements for terms and conditions offered to transferred customers as well as certain other eligible customers in the area where the appointed company has exited. This second group of customers comprises

- i. new customers;
- ii. customers which request us to direct another WSSL retailer to take over supply; and
- iii. (iii) customers receiving interim supply.

For transferred customers, the price requirements aim to ensure that the acquiring licensee does not charge customers more than they would have paid had the exiting water company remained in the market. Thus, the initial charge must be the same as the charge that the appointed water company charged on the date that it exited.

However, this charge can be adjusted annually in the same way as the appointed company would have been allowed to adjust its charges (“The Permitted Adjustment”). These adjustments that the appointed company would have been allowed to make are set out in the determinations of retail business controls made on 16 December 2016 (“PR16”).

The protection for the remaining eligible customers differ depending on whether the company is a Small and Medium Enterprises (SMEs) or larger companies, where SMEs are defined as companies with fewer than 250 employees. The price terms for SMEs are based on PR16, in a similar way to transferred customers. Eligible large customers’ prices are required to be reasonable and non-discriminatory.



### **3. Summary of our proposals for change**

This section sets out the changes we are proposing to make to the REC. We are proposing changes to address two separate issues. These are:

- to remove a regulatory obstacle to the bulk transfers of customers between licensees. In particular, we propose amending the existing provisions in the REC that require, in all instances, individual customer consent before a licensee can terminate its supply. The amendment proposes to allow a licensee to include in its scheme of terms and conditions a provision allowing it to terminate its supply in a limited set of circumstances; and
- to allow retailers the ability to adjust their charges in line with changes to appointed companies' wholesale charges.

The drafting changes to the REC are set out in full in Appendix 1, and this section should be read alongside the proposed drafting changes.

#### **3.1 Consent before discontinuing a supply**

Our objectives for the business retail market include providing the framework to allow for market entry, exit and expansion. We consider that these are particular hallmarks of an effective, well-functioning market that is delivering benefits for customers. We therefore consider that we should ensure that the market framework removes any unnecessary restrictions that are in place which prevents or restricts the ability of licensees to enter or exit the market.

Having reviewed the REC we consider that the requirement it imposes for the individual customer to consent before an acquiring licensee can be relieved of its duty under regulation 26 of the Exit Regulations to supply or serve acts as a barrier to a bulk transfer of customers. We also think that it goes further than is required by regulation 26. We therefore consider that including a limited set of circumstances that can be included in a scheme of terms and conditions where a licensee is relieved of its duty without individual customer consent is permissible.

We propose to implement this through modifications to sections 3.2.3, 4.2.3 and 5.2.3. The purpose of these modifications will be to remove the requirement for consent of transferred customers in all instances before the supply duty is relieved. Instead, the REC will provide that the licensee may be relieved of its duty either by consent or in circumstances where a licensee has secured a commitment from another licensee to supply customers on equivalent terms.

For the reasons set out below, we consider that this proposed change will still mean that customers are protected.

### **3.1.1 Customer protection**

A number of the provisions in the Exit Regulations and also in the REC apply not only to the acquiring licensee but also to any other licensee in the retail exit area. For example, the duty to supply applies not only to the acquiring licensee but also to any other licensee operating in the retail exit area. Similarly, all licensees operating in a retail exit area must have a scheme of terms and conditions.

For this reason we consider that customers will be protected even if we amend the REC to provide that a licensee may terminate its duty to supply in certain specified circumstances. The new licensee will also have a duty to supply and must also have a scheme of terms and conditions in place.

To protect customers' interests, we are proposing a further change to the REC requiring the licensee to give at least two months' notice that it intends to transfer its customers to another licensee (see new section 3.2 in appendix 1).

### **3.1.2 Customer consent or deemed consent**

Importantly, our proposal aims to remove an obstacle to the bulk transfer of customers by removing the prohibition on terminating a duty to supply unless there is customer consent. However, as a matter of contractual and commercial law, customers' consent or deemed consent will still be required before a company can transfer its obligations to another company.

As companies will take the commercial risk on any transfer, they should in all instances ensure that:

- their schemes of terms and conditions comply with the REC and with normal contractual provisions on the assignment of rights and obligations; and
- they take steps to ensure they have the deemed or actual consent of customers before effecting a transfer to another licensee.

## **3.2 Pass through of adjustments in wholesale charges**

Unless the definition of "Permitted Adjustment" and other sections of the REC are amended, the REC could be interpreted as requiring licensees to absorb any

increases in wholesale charges and to allow them to keep any reductions in wholesale charges.

We do not believe that this was the policy intent behind the Exit Regulations or the REC, which was to ensure that customers are at least no worse off than they would have been had they remained with the relevant undertaker. There is also a risk that not amending the definition could lead to an anti-competitive framework, as there would be an impact on the margin available to licensees.

We are therefore proposing to amend the REC to provide for licensees to set their charges for 2018-19 on a different basis and in line with adjustments to wholesale charges of appointed companies.

We are also proposing other consequential changes to relevant sections of the REC. Taken together, these changes are intended to ensure that:

- the limit on charges should be adjusted in line with (i) changes in wholesale charges and (ii) any change that the relevant undertaker would have been entitled or required to make to comply with the price controls for business retail activities set at PR16;
- restrictions should apply to the charges paid by individual Transferred Customers through the creation of “default tariffs” based on the charges set for those customers by the exiting relevant undertaker;
- no restrictions should apply to the charges payable by a Transferred Customer where the Transferred Customer freely chooses to pay different charges to those that they would otherwise be liable for (such customers are excluded from the price controls for business retail activities that Ofwat set at PR16); and
- the restrictions should protect Transferred Customers whose charges were set in or under individual agreements (also referred to as special agreements) with the relevant undertaker rather than in statutory charges schemes (even though the existing definition of “Permitted Adjustment” specifically refers to a “Charges Scheme”).

Our proposed revised wording for the Permitted Adjustment definition, as well as these other sections of the REC, is included in Appendix 1. We are inviting views on this wording as part of this consultation.

## **4. Next steps**

We are consulting on the basis of the proposed modifications to the REC set out in Appendix 1, with the deadline for responses of close of business on 11 December 2017.

We intend to formalise the modifications and publish a revised REC, along with our reasons, in January 2018.

## Appendix 1 Proposed modifications to the Retail Exit Code

### Proposed draft wording to replace or add to relevant sections of the Code (changes highlighted)

#### 1.1 Defined terms

“Permitted Adjustment” – for each Transferred Customer who has not freely chosen to pay different charges to those that they would otherwise be liable for, the Permitted Adjustment is the sum of:

- (1) the change in the Wholesale Charges payable by the Acquiring Licensee; plus
- (2) any change in charges that the relevant undertaker for the Exit Area in which the Transferred Customer’s Eligible Premises are located would have entitled or required to make pursuant to the Authority’s determination of Price Controls for Business Retail Activities (made under the relevant undertaker’s Appointment) that was notified to the relevant undertaker on 15 December 2016 (save that, for the purposes of calculating the Permitted Adjustment, references to “wholesale revenue” in that determination shall be read as references to the Wholesale Charges payable by the Acquiring Licensee).

~~the adjustment that the relevant undertaker for the retail exit area in which the Transferred Customer’s Eligible Premises are located would have been entitled or required to make to the part of the Charges Scheme applicable to the Transferred Customer and/or Eligible Exit Area Customer pursuant to the notice given by the Authority to the relevant undertaker on 16 December 2016 of a determination of price controls under that undertaker’s Appointment save that, instead of “wholesale revenue”, the Licensee shall include the relevant Wholesale Charges for the class of customer which would include the Transferred Customer and/or Eligible Exit Area Customer. This adjustment would include the possibility of making adjustments to tariffs to rebalance charges between customers and to make adjustments to meet control limits, in each year to which the determination of price controls applies, as would apply had the undertaker not exited.~~

#### 3.1 Price requirements

- 3.1.1 Subject to section 3.1.2, ~~in-making~~ the price terms ~~to be~~ included within a Scheme of Terms and Conditions for Transferred Customers, ~~the Acquiring~~

**Licensee** must ensure that the charges payable by the Transferred Customer in the period from 1 April 2017 to 31 March 2020 do not exceed:

- (a) **initially**, the charges that would have been payable on the Exit Date by that Transferred Customer had they been able to remain with the relevant undertaker; **and**
- (b) **thereafter**, those charges as adjusted on 1 April in each subsequent year by the Permitted Adjustment<sup>1</sup>.

3.1.2 ~~The Acquiring Licensee shall adjust the maximum charges payable by Transferred Customers on 1 April each year by the Permitted Adjustment. The price terms may allow higher charges to be paid by a Transferred Customer where the Transferred Customer freely chooses to pay different charges to those that they would otherwise be liable for.~~

### **New Section 3.2.3**

3.2.3 A supply to be made or the services to be provided pursuant to a Scheme of Terms and Conditions may be discontinued only if

(a) the Acquiring Licensee would be entitled to make a request pursuant to section 61(1ZB) of the 1991 Act; or

(b) the Transferred Customer has consented to or has requested the discontinuance;  
**or**

~~(c) the Acquiring Licensee sells or otherwise transfers ownership of all or part of its business to an Eligible Licensee who offers a supply to the Transferred Customer on an equivalent Scheme of Terms and Conditions.~~

### **New Section 4.2.3**

4.2.3 A supply to be made or the services to be provided pursuant to a Scheme of Terms and Conditions may be discontinued only if

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<sup>1</sup> To be clear, the Permitted Adjustments are cumulative. In other words, in year 3 the maximum charge should be the charge that would have been paid on the Exit Date if a customer of the relevant Undertaker plus the Permitted Adjustment on first subsequent 1 April plus the Permitted Adjustment on the second subsequent 1 April.

(a) the Eligible Licensee would be entitled to make a request pursuant to section 61(1ZB) of the 1991 Act; or

(b) the Eligible Exit Area Customer has consented to or has requested the discontinuance; or

(c) the Eligible Licensee sells or otherwise transfers ownership of all or part of its business to another Eligible Licensee who offers a supply to the Eligible Exit Area Customer on an equivalent Scheme of Terms and Conditions.

### **New Section 5.2.3**

5.2.3 A supply to be made or the services to be provided pursuant to a Scheme of Terms and Conditions may be discontinued only if

(a) the Eligible Licensee would be entitled to make a request pursuant to section 61(1ZB) of the 1991 Act; or

(b) the Eligible Exit Area Customer has consented to or has requested the discontinuance; or

(c) the Eligible Licensee sells or otherwise transfers ownership of all or part of its business to another Eligible Licensee who offers a supply to the Eligible Exit Area Customer on an equivalent Scheme of Terms and Conditions.

## **Section 6**

### **Insert new section 6.2 as follows:**

6.2.1 As soon as possible and not later than two months of the date before which the Licensee discontinues supply pursuant to sections 3.2.3 (c), 4.2.3 (c) or 5.2.3(c) to the Transferred Customer or Eligible Exit Area Customer under the applicable Scheme of Terms and Conditions, the Licensee shall write to its Eligible Exit Area Customers providing the following information:

(a) the name and contact details of the new Licensee to which it is selling or otherwise transferring ownership to of all or part of its business

(b) the date on which supply will be discontinued and supply from the new Licensee will commence, if the Eligible Exit Area Customer does not object to the transfer;

(c) a copy of the applicable Scheme of Terms and Conditions and confirmation that the new Licensee will supply on an equivalent Scheme of Terms and Conditions;

(d) that the Eligible Exit Area Customer has the right to switch to another provider of water and/or sewerage services at any time; and

(e) that alternative terms and conditions from the applicable Scheme of Terms and Conditions may be available from the new Licensee and how information about such alternative terms and conditions may be obtained.

6.2.2 If the Eligible Exit Area Customer requests a copy of alternative terms and conditions that the new Licensee has available, the new Licensee shall provide these within 10 business days after receiving the request.



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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