

July 2018

Trust in water

**Decision under section 13 of the Water Industry Act
1991 on proposed modification to condition B of
new appointees' conditions of appointment**

About this document

On 28 March 2018, Ofwat began a consultation on a proposal to modify condition B of the conditions of appointment of all but one new appointee.

The consultation ended on 30 April 2018. During the consultation period, we received responses from four new appointees which we considered in making our decision. On 24 July 2018, we modified condition B of the appointment conditions of Albion Water Ltd, Icosa Water Services Ltd, Independent Water Networks Ltd, Leep Water Networks Ltd, SSE Water Ltd and Veolia Water Projects Limited.

This notice gives our reasons for making these modifications.

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1. Background

All new appointees (with the exception of Albion Eco) have a licence condition that requires that they charge no more than the 'Relevant Charge' of the incumbent (i.e. the previous undertaker). The Relevant Charge is defined by reference to the incumbent's charges scheme. This cap on their charges is considered a more proportionate way of regulating new appointees than subjecting them to a full price review.

However, since the business retail market opened in England in 2017, most incumbents have exited that market. The incumbents that have exited the business retail market, no longer have business customers and they therefore no longer publish charges for business customers in their charges schemes. This means there is no longer a published comparator to act as a cap on the charges to business customers of new appointees. There was therefore a need to find an alternative way of regulating new appointees' charges to business customers in retail exit areas.

2. Our consultation

We proposed a modification that would make amendments to paragraph 1A of Condition B of new appointees' conditions of appointment to reflect that the retail charges for business customers can no longer be pegged to the incumbent's charge, where retail exit has occurred.

We considered various options and agreed with new appointees that the most appropriate solution would be to base prices for business customers on the default tariffs of the relevant acquiring licensee (i.e. the retailer to whom the relevant incumbent's business customers were transferred).

The approach to default tariffs is set out in the [Retail Exit Code](#) issued by Ofwat. It sets out that default tariffs for small and medium-sized enterprises (SMEs) - defined as those with less than 250 employees - should be based on Ofwat's final determination of business retail price controls (PR16). The same approach is taken for larger customers that were transferred to an acquiring licensee in April 2018.

The Retail Exit Code takes a different approach to setting the default tariffs for new larger business customers of the acquiring licensee, specifying that the price charged to these customers should be reasonable and non-discriminatory, rather than directly linking it to PR16.

In our consultation, we considered that, in areas where the incumbent has exited the business retail market, new appointees should peg prices:

- 1) for SMEs and for large customers that were already customers of the new appointee prior to April 2018 to the prices that would have applied to these customers had they been supplied by the acquiring licensee; and
- 2) for large businesses who become customers of the new appointee after April 2018, prices that are reasonable and non-discriminatory.

While Ofwat's [Charges Scheme Rules](#) require that new appointees publish their charges schemes by 22 February in every year, there is no prescribed date by which acquiring licensees must publish their tariffs. This lack of alignment around timing means that a new appointee may need to finalise its charges scheme before the acquiring licensee publishes its tariffs for the forthcoming charging year.

We therefore proposed that new appointees use the most recently published tariff when they publish their charges on 22 February and may (but will not be obliged to)

adjust their charges schemes if the acquiring licensee subsequently publishes revised default business tariffs.

If an acquiring licensee sells its business, we proposed that the default tariff would be the tariff for the customers transferred to the new licensee.

3. Responses received to the consultation

We received four responses to our consultation. We considered these responses before making the decision to modify condition B of new appointees' conditions of appointment. The points raised in the responses are set out below.

Stakeholders' views on the issue

Timing issues

Three respondents agreed with the proposal, but raised some concerns, in particular with regard to the practical timing issues raised above. They suggested that we should require acquiring licensees to publish their tariffs by a certain date each year.

One respondent said that if a new appointee does review its charges part-way through a year and the acquiring retailer's charges have decreased, the new appointee should not have to reconcile its charges and refund any monies to the customer. Similarly, if the retailer has increased its charges, the new appointee should not expect to recover any undercharged amount from customers.

New appointees' costs

One respondent also raised a concern that new appointees are expected to match the potentially lower prices achieved by retailers through large economies of scale.

Application of changes to all new appointees

One respondent, Severn Trent Connect, did not explicitly support or reject the proposals, but asked whether the changes would apply to future new appointees as it currently held a sewerage only appointment and was in the process of applying for a water only appointment. It also pointed out that it has exited the sewerage services retail business market and would be applying to exit the water retail business market if it was granted a new appointment for water.

Ofwat's response

Timing issues

The Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations 2016 provide that a licensee must revise its scheme of terms and conditions from time to time and publish its scheme as soon as possible after each

revision. Its scheme of terms and conditions must include its default tariff. We therefore consider that moving to a specific date by when licensees must publish their tariffs, will require amendments to those Regulations. We consider that the proposal contained in our consultation offers a more pragmatic solution to the timing issue and serves to protect customers in retail exit areas without a need for amending the Regulations.

All new appointees must have a charges scheme in place by 22 February of each year and it is not the practice of any company (new appointees or large incumbents) to publish mid-year charges schemes. We therefore think the risks around the alignment of timing are not significant. In any event, charges schemes are not backward looking so the requirement will be to charge an equivalent charge from the date that the charges scheme is published. It will not involve giving customers a refund. Similarly, a customer's obligation to pay a charge as set out in a charges scheme cannot be retrospective, so any increase in charges will be effective from the date of the revised charges scheme.

We are currently reviewing the future price protection arrangements beyond March 2020 in the Retail Exit Code (REC). The price protections in the REC apply to business customers in England. This could potentially result in changes to the way default tariffs are set. However, we will reach any conclusions of that review well in advance of any changes coming into place, so that appointees are able to anticipate any changes to incumbents' tariffs.

New appointees' costs

Our current system of regulation of new appointees relies on a relative price control, rather than a control based on appointees' specific costs. This is considered more proportionate than subjecting new appointees to a full price control.

Application of changes to all new appointees

We confirm that when an appointment is granted it will be given the most up-to-date licence conditions applicable for a new appointee. This will include this condition B change and depending on timing, the licence simplification changes.

We note that Severn Trent Connect has exited the retail business market, and we agree that the licence changes are not required for a new appointee that has exited the retail business market. We therefore have not made these changes to the conditions of Severn Trent Connect.

4. Conclusion

Having assessed the need for a modification to condition B of new appointees' conditions of appointment, and having taken account of the responses we received to our consultation, we decided to amend condition B of most new appointees' conditions of appointment.

These amendments to the conditions of appointment will apply to the following companies:

[Albion Water Ltd](#)

[Icosa Water Services Limited](#)

[Independent Water Networks Ltd](#)

[Leep Water Networks Ltd](#)

[Veolia Water Projects Limited](#)

[SSE](#)

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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July 2018

ISBN 978-1-911588-72-6

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