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Trust in water

Future protections for business retail customers: Decision on Retail Exit Code – non-price protections

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1. Introduction

The Retail Exit Code (**REC**) was put in place as a transitional arrangement to provide protection to business customers until competition in the retail market becomes fully functional. It is designed to provide default protection to customers on deemed contracts (that is where the customer has not actively negotiated and agreed a contract with their retailer) in areas where the incumbent has exited the market.

On 11 December 2018 we issued a consultation document [Retail Exit Code – Non-price protections](#). This included a proposal to amend the REC to strengthen protection for customers on deemed contracts against non-voluntary changes to their **non-price terms**.

As we consider that non-voluntary changes can mean that customers are worse off than they were pre-market opening, we proposed a modification of the REC to introduce an explicit '**no worse-off**' principle with respect to the non-price terms.

In our consultation document we explained that, in our view, this was in line with the original intent and spirit of the REC and the [Exit Regulations](#).

Our aim in proposing a modification is not to move away from the initial principles underpinning the REC. It is to ensure that those principles are fully captured in its provisions so it is clear to retailers that they must ensure that any non-voluntary changes to their non-price terms do not lead to customers who have not engaged in the market being worse off.

In our consultation document we also noted that while our primary objective in considering a modification to the REC is to strengthen customer protections, we do not want to stifle innovation or prevent retailers from making efficiency enhancing changes that may benefit customers. For this reason, we explained that when interpreting the 'no worse off' principle retailers should be able to alter the non-price terms for customers on deemed contracts so long as they are transparent about any proposed changes; are able to clearly articulate what the impact on customers will be and are able to demonstrate to customers why, and how, they will be at least 'no worse off' relative to pre-market opening as a result of those changes.

In our document we made it clear that while this was our preferred approach it was just one of four options that we sought views on. These options were:

- **Option 1:** Do nothing;

- **Option 2:** Require retailers to be open and transparent about any proposed change in non-price terms;
- **Option 3:** Ban specific changes to specific non-price terms (for example, a move to advance billing) for customers on deemed contracts;
- **Option 4:** Introduce an explicit 'no worse off' principle into the REC.

In this document we summarise the responses we have received from stakeholders during this consultation process; we comment on a number of key issues or points of clarification raised by those respondents and, having considered the views expressed by respondents, we set out our decision in respect of the proposed modifications to the REC.

This document should be read alongside our [consultation document](#).

We have also published separately our decision document following our consultation on the [price protections](#) contained in the REC.

2. Responses to our consultation

2.1 Introduction

We received ten responses¹ to our consultation. This included eight from retailers as well as two from customer representative organisations – the Consumer Council for Water (**CCWater**) and the Association of Convenience Stores (**ASC**). Copies of the responses are published separately on our website.

In the following section we provide an overview of the responses received, grouped under a number of broad headings. Where appropriate, we also address a number of the issues or points of clarification raised by respondents in their submissions. It is not intended to provide a fully comprehensive answer to every point of detail raised but rather to address a number of key themes and issues.

2.2 Consultation responses

There was widespread support for our proposal to strengthen customer protections². The majority of respondents also supported our preferred option (option 4) and agreed that this should provide the appropriate balance between customer protection and allowing retailers to innovate.

Affinity for Business, for example, told us that it “supports our proposal to modify the REC” and that it “strikes a balance between customer’ protection whilst allowing a retailer to make efficiency enhancing changes”. Similarly, Yorkshire Water told us that it “agrees with the content of the proposal document and supports option 4 to insert a general principle” and considers that this “should provide the appropriate balance of customer protection without restricting retailers from introducing innovative changes that will benefit the market”.

From a customer perspective too, ACS told us that it “welcomes the consistency [our proposal] would bring among suppliers and the further protection it would provide customers”.

¹ Affinity for Business, Association of Convenience Stores, Business Stream, Castle Water, Clear Business Water, Consumer Council for Water, Water2Businessve, Waterscan, Wave, Yorkshire Water.

² No respondent supported the ‘do-nothing’ option.

Similarly, in its response, CCWater stressed the importance of ensuring that all business customers who do not actively engage in the market must be 'no worse off' as a result of retail exit activity. It agrees that "the REC does not currently refer expressly to ensuring that customers are 'no worse-off', and that non-price protection requirements in the REC must be strengthened. The principle of 'no worse off' should be made clear and explicit so that it cannot be open to interpretation by retailers and should act as a fundamental protection against customer detriment. Detriment in the market could erode customer confidence and reduce interest in engaging. This is not in the best interests of customers or retailers". It also agreed that "option 4 could achieve a good balance between ensuring customer protection, whilst allowing for innovation that could be to the benefit of customers in the market".

While supporting our proposal to modify the REC, a number of retailers told us that, in their view, the 'no worse off' principle was already included in the REC. This was the way that they had interpreted it and had been conducting their retail activities.

Business Stream, for example, told us that "this is the principle that the company has applied to date and believes that most other retailers have also followed".

Water2business noted that "the no worse off principle is already embedded within the REC but the fact that some retailers have chosen to act against this core principle shows that embedding of the principle is not as strong as Ofwat would have expected". Wave noted too that "the Retail Exit Regulations were clear in their intentions that customers who had transferred through the Retail Exit process should generally be no worse off than if the transfer had not occurred." While in principle, it considered that Ofwat should take action against those breaching the existing requirements rather than imposing an additional regulatory burden on all retailers, it had no objections to the introduction of a 'no worse off' principle". In its view "this confirms what the Retail Exit Regulations and Explanatory Memorandum already say".

In contrast to the views expressed by the majority of respondents, a minority either felt that our preferred option did not go far enough or went too far.

Waterscan told us that it was concerned that affected customers would not be sufficiently engaged and would find it difficult to understand information from retailers on what a change might mean for them. Its preference, in the early stages of the market, would be for a ban on specific non-price changes (for example, advance billing, alteration to payment terms). This, it argued "would make the contractual relationship clear to customers but would not hinder any retailer innovation. It would also help to maintain trust in the market".

Water2business also thought that our preferred approach did not go far enough to mitigate the risk of customers being made worse off and suggested instead that we adopt a blended approach combining option 2 (increased transparency), option 3 (outright ban) and option 4 (no worse off principle). This would include clear requirements and examples for what retailers would need to do to comply with the REC so that there would be no need for retailers to interpret the principle. In its view, this would assist in making this 'no worse off' principle an intrinsic element across the market and would also make it easier for Ofwat to monitor compliance.

Clear Business Water advocated combining the ideas of options 2 and 4 into one solution to protect customers and promote effective competition. Under this approach, retailers would be required to write to their customers to inform them of any changes to their non-price terms that could result in them being worse off and inform them of their ability to change provider should they be unhappy with the change (in line with option 2). The notification should be sent at least 30 days before the change is due to take effect to give customers sufficient time to review the change and decide whether to remain with the retailer or engage in the market and switch provider. In Clear Business Water's view, this would "help to promote customer choice; promote engagement in and awareness of the market; be simpler to regulate as the subjective decision of 'no worse off' is made by the customer on a case-by-case basis; and be more proportionate than the current proposal, as customers will continue to be protected without the need to establish specific prohibitions".

Similarly, while agreeing with our policy objectives (that is, customer protection, promoting competition, simplicity and proportionality), Castle Water argued that the best way to achieve these is through retailers being transparent about their terms and conditions of supply (that is, a version of option 2), and more effective promotion of the market. In its view this would enable customers to engage with the market by making informed decisions about their existing and preferred terms of supply; overall value for money taking into account broader customer service factors; and, ultimately, whether to stay with their existing supplier or switch to a supplier that better suits their needs. It told us that "this is the most effective way to ensure a vibrant, well-functioning competitive market and safeguard customers' interests now and in the longer term. To the extent that some customers may remain reluctant to engage with the market, a proportionate remedy would be to manifest the above principles in an enhanced form in the REC."

2.3 Key issues raised

While the majority of respondents were generally supportive of our proposed approach, a number of issues or points of clarification were raised. These are summarised below under some broad headings. We have also provided our view of these issues.

2.3.1 The case for change:

As indicated above, there was widespread support for our proposal to strengthen the REC (even amongst those respondents who already considered that a 'no worse off' principle was already in the REC). Castle Water did, however, challenge the justification for our consultation and suggested that concerns about changes in non-price terms, such as those relating to advance billing, have been over-stated. In its view, many of the complaints that CCWater and Ofwat have received about advance billing are due to misunderstandings by customers about how they had been billed previously or data errors. In its view, therefore, our proposed approach is poorly evidenced and disproportionate to the actual level of customer detriment experienced.

Our view:

We welcome the responses that we have had from stakeholders to our consultation and the support that we have received for our proposed modification. While we recognise and acknowledge that many retailers have already been adopting this approach in their dealings with customers on deemed contracts, it is also evident that this principle is not being applied consistently across the market.

Because the REC does not currently refer expressly to ensuring that customers are 'no worse off', (even though this is what the Exit Regulations intended)³, it has permitted some retailers to interpret the code in ways which can give rise to customer detriment. To rectify this, therefore, we consider that a modification of the REC is necessary and proportionate. Our aim in proposing this modification is not to move away from the initial principles underpinning the REC. It is to ensure that those principles are fully captured in its provisions and to make sure retailers are clear

³ See pages 6 to 8 of our consultation document [Retail Exit Code – Non-price protections](#).

about the need to ensure that any non-voluntary changes to their non-price terms do not lead to customers on deemed contracts being made worse off.

Notwithstanding the suggestion from some respondents about the nature and scale of detriment that customers may be experiencing as a result of non-voluntary changes, it is clear from CCWater's and our own complaints data that customers are concerned about these changes. It is also clear that there is a lack of consistency in approach across the market and that this lack of consistency is causing difficulties.

In its response, for example, CCWater confirmed that it had received "over 100 complaints since September 2017 specifically about non-voluntary changes to NHH customer billing arrangements". In its view, therefore, "doing nothing is not appropriate, nor is it in the best interests of customers or the market".

Water2business also cited examples of potential customer harm arising from changes to customers' non-price terms and expressed concern about the impact that this is having on customers' ability to switch supplier. For this reason it "does not consider the "do nothing" approach to be appropriate – given the actual and potential harm that it is observing".

We noted in our consultation document that complaints about advance billing was one of the triggers for our review but we stressed that this was just an example of the type of change that could give rise to customer detriment. The principle we consulted on was wider than this.

Moreover, in our consultation document we also considered a number of options to address our concerns. This included an option to require retailers to be more transparent about any changes in non-price terms (that is, option 2). There was limited support for this option from our consultation responses.

CCWater told us, for example, that in its view, "this would not prevent some customers from being 'worse off'. In addition, we would already expect retailers to clearly communicate with their NHH customers about non-price terms. At this stage of the market option 2 does not go far enough. NHH customers should not be expected to negotiate a different deal or switch to another retailer if they are not happy with a proposed change after being informed about it in advance. This is particularly key given the low level of market awareness, particularly amongst SMEs".

Similarly, the ACS noted that while it recognises that suppliers may take voluntary action to be transparent about any proposed change in their non-price terms, in its view "this may not be robust".

We recognise that a minority of respondents considered that our preferred option does not go far enough and would prefer an outright ban on changes to specific non-price terms (that is, option 3). However, this view was not shared by the majority of other respondents. CCWater told us, for example, that “prohibiting specific banned changes to non-price terms for customers on deemed contracts might be the simplest for retailers to understand, but it would be impractical to develop an exhaustive list of all possible specific changes that would be banned. Therefore, we do not believe this option is appropriate”.

Similarly, Castle Water suggested that a blanket ban on retailers’ billing customers for some of their charges in advance rather than in arrears would “impose a significant barrier to entry for non-vertically integrated suppliers, thereby perpetuating a vertically integrated structure which is against the grain of the market opening policy and thus the interests of customers”.

Wave told us that, in its view, it is important not to prevent changes that may benefit customers and noted that “customer pre-payment or direct debit payment can be a valuable option bringing benefits to both customers and retailers and therefore this choice should not be taken away when the customer is aware and in agreement”.

Having considered the feedback from respondents and the views expressed on the options set out in our consultation document, we still consider that the introduction of an explicit ‘no worse off’ principle into the REC (option 4) enhances protection for customers on deemed contracts but in a way which gives retailers flexibility in the way they operate their businesses. Retailers are able to innovate and make efficiency enhancing changes to their terms and conditions so long as they do so in a way which does not adversely impact their customers – and that they are transparent with their customers about the change.

2.3.2 The commercial imperative to change non-price terms:

A number of respondents (including those that support our proposals) suggested that the reason that some retailers may feel compelled to introduce changes such as advance billing is because of the working capital costs they face under current market arrangements and the level of margin they can achieve.

Clear Business Water told us, for example, that “if default retail margins were increased through PR19 and the REC price control, and commercial credit terms were made available to retailers from wholesalers, such changes to customers’ non-

price terms would not be necessary and retailers would not be under so much pressure to try to match their supplier credit terms with their customer credit terms.”

Clear Business Water supported our proposal to introduce a ‘no worse off’ principle, but pointed to Ofwat’s duty to protect customers where appropriate by promoting effective competition and argued that in order for competition to exist, retail businesses need to be viable. In its view “in the absence of increased retail margins or changes to credit terms between wholesalers and retailers, a prohibition on retailers’ ability to bring their payment terms with customers in line with their wholesalers (as such a change might result in the customer “being considered worse off”) means that retailers will remain unviable. It will also increase the risk of financial failure or prevent new retailers from entering the market – which in turn could harm customers.”

Business Stream made a similar point. It told us that “whilst not condoning the imposition of non-voluntary changes ... retailers may feel compelled to introduce changes such as advance payments because of the working capital costs they face under current market arrangements”. In its view “unless retailers have the means to provide a ‘no worse off’ service, it would not be reasonable to require it”. It therefore stressed the importance of ensuring that “the review of both the price and non-price protections are joined-up and that the costs of market participation are recognised”.

Castle Water put forward a similar argument and suggested that in our consultation document we were focusing on the wrong issue. In its view “rather than imposing unjustified regulatory burdens on responsible suppliers in an attempt to address the symptoms of the consumer issues in this market, [Ofwat] should instead be seeking to address their root cause”. It argued that due to working capital arrangements requiring retailers to pay in advance (or provide security) “the independent retailer is only viable if payment terms can be financed, which is not possible if all customers are billed fully in arrears, given the significant time lag between a customer receiving a bill and paying it.”

Our view:

We recognise the links between the price and non-price protections contained in the REC and have been working closely with colleagues to ensure a joined-up approach. However, as we explained in our consultation document, in our view (and in the view of the majority of respondents) the spirit of the REC has always been clear. Our aim in proposing a modification is simply to make the actual wording more consistent with that spirit.

Furthermore, we have made it clear that it is not our intention to prevent companies from making changes which may help to improve their operating efficiency, nor are we opposed to advance billing per se. However, if retailers are proposing to make these changes, they need to do so in a way which takes account of the impact on their customers and leaves them at least 'no worse off'. And similarly, when considering whether to retain such changes where they have already been made. In our view, this approach gives retailers flexibility in the way they operate their businesses and manage their costs – but it also ensures that customers who have not engaged in the market are protected.

We note that a number of respondents have pointed to the regulated credit terms included in the market codes as a key reason why some retailers may feel compelled to change their billing arrangements. We do not consider that introducing terms which render non-engaged customers worse off is the way to address this.

One of the key findings from the [review of credit arrangements in the business retail market](#) that we commissioned was that the fundamentals of the credit framework were not, in and of themselves, a barrier to competition or caused significant problems for market participants. Moreover, retailers and wholesalers have the ability to agree bespoke credit agreements between themselves (that is, they are not bound by the regulated options prescribed in the market codes) and we introduced a [code modification](#) in December 2018 to allow greater flexibility in how payment terms are agreed. If retailers consider that there are problems with the existing codes, then they have the option to raise a code modification themselves or if they have concerns about wholesaler behaviour (that is, their willingness to discuss bespoke terms), they can raise these with Ofwat. We also note that the credit committee is taking forward a number of recommendations from the credit review on areas where existing arrangements could be improved or clarified.

2.3.3 Implementing the 'no worse off' principle:

While the majority of respondents supported our proposals or told us that this was the way they were already interpreting the REC, a number claimed that the principle would be difficult to implement or they appeared to have misunderstood what we were actually proposing.

Clear Business Water told us, for example that whether or not a customer is 'no worse off' is subjective and while a change to a retailer's billing method from monthly in arrears to quarterly in advance may be considered a change that would make a customer worse off, some customers may wish to be billed in this way as it allows them to budget and reduces administration charges. It also cited circumstances

where a retailer may change its billing method but provide a discount to customers for this so on balance customers may be at least 'no worse off'. In Clear Business Water's view "automatically prohibiting this kind of change removes customer choice and will be difficult to monitor" and "customers should have the option to review any changes and decide whether or not they will be to their benefit".

Water2business noted that at present 'no worse off' doesn't actually provide any formal guidelines or criteria that a retailer or a wholesaler should consider before making any changes to the way in which they provide a service to the customer. It considers that the requirements need to be explicit, with examples provided where retailers may be able to interpret the change, and that an explicit requirement also needs to be identified in the mechanism for the transparency of the proposed change (option 2) to ensure that these changes can be monitored and understood by the regulator as well.

Castle Water also expressed concerns about our proposals and the impact that it would have on independent retailers. It also questioned the level of detail at which Ofwat is proposing to require retailers to analyse and compare their terms of supply with the "status quo ante". In Castle Water's view our proposals would be detrimental to the development of a well-functioning market; would stifle innovation and embed the status quo; would be highly complex and impracticable for retailers to implement and "would place a significant burden on retailers in circumstances where it is not clear that there is a widespread problem that needs to be addressed".

Castle Water also told us "of greater impact, the REC does not apply to wholesale charges. These represent around 90% of the prospective bill. Changes to these charges are outside a retailer's control. ... In these circumstances, under Ofwat's proposal the retailer would be unable to pass through the increased wholesale charges, but would be bound to pay the increased charges to the wholesaler" ... "With 90% of water charges determined by wholesale charges, a retailer cannot control whether a customer is "no worse off". "

Our view:

As we explained in our consultation document, our concern is not about advance billing *per se* as many types of services are billed in this way and many customers, including unmetered customers, may have already been billed in advance prior to market exit and may prefer this arrangement. Similarly, we noted that we are not concerned about situations where customers have made an active and informed choice and have voluntarily entered into contracts where some form of advance billing is part of the terms, or have actively agreed to a change in their terms. We are concerned, however, about customers who have not actively chosen this

arrangement and have had a **non-voluntary** change in their **non-price** terms imposed upon them.

Our proposed modification of the REC is designed to protect these customers. It does not impact on a retailer's ability to pass on any increase in wholesale charges⁴; it does not ban any specific changes to non-price terms, nor does it prevent retailers from changing their terms if customers agree (for example one retailer told us that it has offered customers incentives to change their billing or payment arrangements, but in all cases customers are made aware of the options and ultimately it is the customers' choice).

In our consultation document we acknowledged, however, that a principle-based approach may not be as simple in terms of ease of understanding or enforcement as an outright ban on changes in non-price terms.

Castle Water told us, for example, that they have hundreds of thousands of customers on deemed contracts and therefore it is not realistic to require it “to identify the basis on which every one of these customers was previously supplied, compare this to the terms that the retailer intends to offer and determine (with even reasonable accuracy) whether they would put the customer in a worse position. Many terms will not be comparable and whether their effect is net positive or negative will depend on the customer's particular characteristics of demand and use. In addition, record keeping by previous incumbents is often defective and their historic invoicing practices unclear”.

We recognise that the situation is complex. However, as these are 'default' terms and conditions which have not been actively negotiated and agreed by the customer, the onus must be on the retailer to clearly communicate any proposed change to their customers; to explain why they are introducing the changes; what the impact on customers will be and why, as a result of these changes, customers will, on balance, be 'no worse off'.

We also recognise that it may not be possible to assess the impact of a proposed change on each individual customer. Nevertheless, we expect retailers to be able to demonstrate with a reasonable level of accuracy that their full range of customer groups are 'no worse off' as a result of that change. As we indicated in our

⁴ The wholesale price changes would happen in the counterfactual as well. The no worse off assessment is a comparison to that counterfactual not to wholesale charges as set at market exit.

consultation document, we would be very concerned if we found that this approach was being used by retailers to introduce changes that resulted in large numbers of customers, or particular groups of customers, who have not actively chosen a change in terms being worse off than they would have been on their previous terms.

It is not our intention to be prescriptive about what changes retailers can and cannot make as, in our view, it is the retailer's responsibility to understand and engage with their customers. We also consider that our approach strikes a balance between ensuring that customers who have not engaged in the market are protected but in a way which allows retailers flexibility to improve their service, offering or operations.

As explained above, we would not expect retailers to produce bespoke calculations for every single customer, but we would expect them to be able to estimate what the net cost or benefit would be for particular types of customers. This could include different categories of customers (for example, water, wastewater customers); customers in different consumption bands or tariff bands or, depending on the proposed change, customers on different billing methods etc. The relevant categories are likely to vary from retailer to retailer and may also vary depending on the change in terms that is being considered. (We have provided some more detail on assessing the impact of a change in terms on customers in Appendix 1.)

Similarly, if for example a retailer is proposing to change the terms for customers on deemed contracts and move them onto some form of advance billing, or are requiring customers to pay by direct debit but are also offering customers an incentive to do so (for example, a discount or cashback), we would expect them to be able to demonstrate why, on balance, customers are likely to be 'no worse off'. In our view, if they are unable to assess the impact of a change on customers who have not actively agreed a change in terms, then they should not be making that change.

We have set out a number of scenarios in the following text box to illustrate these points.

Examples of proposed change in billing arrangement.

Scenario 1: Customers are informed of a proposed change in billing arrangement and actively agree to the change or actively opt in⁵. If they do not agree or actively opt in, the default position remains the same and they continue to be served on their existing terms and conditions. The retailer does not impose a non-voluntary change in terms on these customers.

Scenario 2: Customers are informed of a proposed change in billing arrangement and are offered an incentive (e.g. a discount or a cash-back) to encourage them to actively agree or actively opt in. If they do not actively agree or actively opt in, the default position remains the same and they continue to be served on their existing terms and conditions. The retailer does not impose a non-voluntary change in terms on these customers.

Scenario 3: Customers are informed of a proposed change in billing arrangement and are offered an incentive (e.g. a discount or a cash-back) to encourage them to actively agree or actively opt in. If they do not actively agree or actively opt-in, the retailer may impose a change in terms **but only** if the retailer is able to demonstrate that, as a result of these changes, their customers are 'no worse off' on balance.

To be able to do this, the retailer would need to assess the impact of the proposed changes in billing arrangements on a range of typical customers to make sure that no particular category of customer is rendered worse off as a result of the change. If they are not confident that they can demonstrate this with a reasonable degree of accuracy, they either should not change the terms or they should adjust the overall package of measures to ensure that, on balance, these customers are no worse off.

It may be necessary for retailers to gather evidence from their customers to support their assessment and understand the nature and scale of the potential impact on customers. This could include, for example, trials with representative samples of customers, customer surveys or the development of numerical models to enable the retailer to analyse the potential impact across a range of typical customer groups.

CCWater suggested that any proposed changes to deemed contracts should first be discussed with Ofwat and CCWater to confirm that they are unlikely to cause

⁵ For the avoidance of doubt, in our view, a lack of response from a customer by a certain date or the failure of a customer to uncheck a box on a web-form does not constitute active agreement.

detriment to customers or groups of customers and be kept under review on an ongoing basis.

While we understand why CCWater may feel that this is appropriate, in our view, the onus must be firmly on the retailer to own the relationship with its customers, to engage with those customers and be able to communicate with them about what it is proposing to do and why it is in their interests that these changes are being made. It is not our role to 'approve' changes to retailers' terms and conditions.

We consider that it is essential that retailers have customers at their heart. This involves them understanding the different customers they serve, engaging directly and regularly with them, and ensuring that their decision-making is well-informed by customer priorities, interests and changing expectations.

Indeed, in our view, it is an integral part of a responsible retailer's job to be treating their customers fairly and to be having proper regard to their interests. They ought to understand what 'no worse off' means or, if they are uncertain, they should be engaging with their customers to check. It should not be necessary for them to have to seek approval from us.

2.3.4 Retrospective application

In our consultation document we recognised that some retailers may have already made changes to their terms and conditions for customers on deemed contracts compared to those in place immediately before market opening and that these changes could mean that they would not be compliant with a modified REC from April 2020 onwards. We stressed, however, that it was not our intention to use any new rules to penalise, or take enforcement action against, behaviour which may have been legitimate in the past (that is, to seek to apply the modified rules with respect to activities prior to April 2020).

While accepting that our proposals are forward looking, a number of respondents⁶, expressed concern that some retailers may have breached the existing REC and Exit Regulations and urged us to consider whether enforcement action might be appropriate.

⁶ CCWater, Water2business, Wave.

Our view:

In our consultation document we noted that although the original intent of the REC and the Exit Regulations was to ensure that customers were no worse off as a result of market exit, the current REC did not expressly state this.

Moreover, while the Exit Regulations⁷ contain specific provisions in relation to billing, it is not clear that these cover the changes to non-price terms we have observed. As a result, some retailers have interpreted the provisions as referring to the method of billing (that is, paper or electronic), rather than whether customers are billed in arrears or advance. It was for this reason that we considered that a modification to the REC to remove any ambiguity was more appropriate than enforcement action against the existing code.

As we have highlighted previously, our aim in proposing a modification is not to move away from the initial principles underpinning the REC. We are simply seeking to clarify the wording of the REC to ensure that it does what it was always intended to do. This will also help to remove any ambiguity that may exist and help to ensure that all retailers are interpreting and applying the REC in the same way.

2.3.5 Ensuring future compliance with a modified REC

While we are not proposing to take action against retailers for past changes to their non-price terms, in our consultation document we stressed that in the event of a change the REC to include a 'no worse off' principle, we would expect all retailers to comply with the new rules **going forwards**. We also proposed a transition period⁸ to enable retailers to take steps to ensure they are in compliance with the modified REC.

A number of respondents expressed support for this approach. Business Stream told us that it supported the proposal to require retailers who previously moved customers onto prepayment without their consent, to rectify the position before 2020. In its view "it is critical that equivalence is restored between retailers" as at present

⁷ Regulation 29(7) stipulates that "an acquiring licensee's scheme under this regulation must provide for each transferred customer to be billed by the same method and pay by the same method as immediately before the exit date."

⁸ CCWater questioned the need for a transition period and had concerns that retailers might have an incentive to make changes in deemed contracts before the revised Code is implemented.

“the regulations do not appear to be being applied consistently and, as a result, the playing field is skewed”.

Similarly, Clear Business Water told us that it would not support a situation where the changes proposed in our consultation did not apply to customers on deemed contracts whose non-price terms have already been changed. In its view, the protections contained in the REC should be offered to all customers on deemed contracts equally and warned that, otherwise, other retailers would have an incentive to change their non-price terms in advance of the proposed protections being introduced.

In its response, however, Castle Water told us that “to the extent that Ofwat does introduce any changes, it is critical that these do not have retrospective effect”. It stressed that this should relate not only to action to penalise behaviour which may have been legitimate in the past but also any requirement for retailers to amend the terms to which existing customers are subject if they cannot demonstrate that those customers are not worse off than they were prior to market exit.

Our view:

We recognise that some retailers may have already made changes to their terms and conditions for customers on deemed contracts. We also recognise that retailers may be reluctant to reverse or amend changes which they have already introduced. However, in our view, it is essential that **all** customers on deemed contracts are protected adequately. This also limits the incentive that other retailers may have to introduce changes in non-price terms before we issue a modified REC, if they subsequently have to reverse them.

Where retailers have made changes which may potentially have rendered customers worse off, the onus is on those retailers to review and amend those changes or to put in place other measures to be able to demonstrate that, on balance, their customers are no worse off relative to pre-market opening. (If they are uncertain about the possible impact, they may, for example, want to engage with a representative cross-section of their customers or test how the changes have affected them). We recognise that this may take time and it was for this reason that we proposed the introduction of a transition period to enable retailers to consider what if any changes might be needed to ensure that they are in compliance with a modified REC.

2.3.6 Identifying a breach of the modified REC

We note from the responses to our consultation document that some respondents⁹ would like Ofwat to be actively involved in either approving or monitoring retailers' activities to ensure that they are adhering to the modified REC.

As explained above, we do not consider that it is our role to approve changes to retailers' non-price terms. However, we will continue to monitor developments in the market and if we become aware of potential problems with a retailer's behaviour (for example, through our own complaints and enquiries function, complaints escalated from CCWater or feedback from business representative groups) we will take action using the full range of enforcement tools available to us¹⁰.

2.3.7 Other issues

In addition to the issues highlighted above, some respondents also sought clarification on the treatment of gap sites and situations where there has been a change of tenancies.

A gap site is a premises which is receiving water or sewerage services from a wholesaler but whose supply point(s) is not registered on the Central Market Operating System (**CMOS**)¹¹. This means that although the premises is connected to the water and sewerage network the site has never been billed by a licensed provider. Once identified, the owner of the gap site is notified and informed that they must choose a retailer. If they do not choose their own retailer, they are allocated a retailer by the Market Operator (**MOSL**). In these circumstances, as the customer will not have negotiated or agreed a contract with their retail provider, they will be served on the default schemes of terms and conditions of that retailer.

Similarly, in the case of new tenancies at premises where the customer has not entered into an agreed contract with the retailer, we would expect the retailer to apply its standard default terms and condition.

⁹ For example, CCWater and ACS.

¹⁰ See [Ofwat's approach to enforcement](#).

¹¹ See MOSL [information](#) and Ofwat [Gap site template letter](#).

However, where a customer on a deemed contract moves premises within the same area, the REC contains provisions to ensure that customer is continued to be supplied on the same terms and conditions¹².

¹² Sections 3.2.5, 4.2.5 and 5.2.5 of the REC effective 25 January 2018 states that “Where a Transferred Customer relocates within the same Area the Acquiring Licensee should continue to offer the same Scheme of Terms and Conditions”

3. Decision and next steps

Following careful consideration of the responses received and the views expressed by stakeholders, we have decided to proceed to modify the REC to include an explicit 'no worse off' principle with respect to **non-price terms and conditions**. This is in line with the original intent and spirit of the REC and will strengthen protection for customers on deemed contracts against retailers making **non-voluntary** changes to their non-price terms which could lead to them being worse off than pre-market opening.

While this modification will strengthen customer protections, it is not intended to stifle innovation or prevent retailers from making efficiency enhancing changes that may benefit customers. However, if retailers are proposing to make changes, they need to do so in a way which is open and transparent; takes account of the impact on their customers and are able to demonstrate that these changes leave them at least 'no worse off'. This gives retailers flexibility in the way they operate their businesses and manage their costs – but it also ensures that customers who have not engaged in the market are protected.

The modifications which are set out in the revised [Retail Exit Code](#) will apply from 1 April 2020.

Appendix 1: Assessing the impact of a change in billing arrangements

In our consultation document we used the example of a change to customers' billing arrangements to illustrate our concerns that customers could be rendered 'worse off' by a non-voluntary change in their non-price terms. This was prompted by complaints from customers had previously been billed in arrears being moved onto terms under which they were being billed, wholly or partially, in advance.

The nature of the complaints received indicates that, for many customers, this change was unexpected and unwelcome. In some instances, customers had either not been aware that their terms were being changed, or when they did become aware, felt that they were not given sufficient information about its potential impact. Many also felt that they had not been given any choice and would have preferred to retain their existing billing arrangements. In many instances, customers were frustrated that they were being asked to pay in advance for water that they had not yet consumed and felt that this was unfair.

As we have explained previously, we consider that it is essential that retailers own the relationship with their customers. This requires them to engage with them and ensure that they are responsive to their needs. It also requires them to be open and transparent about any proposed changes to customers' non-price terms, and set out clearly the options available to customers if they have concerns about those changes or there is a risk that those changes could leave them worse off.

We have also explained that our concern is not about advance billing **per se** as many types of services are billed in this way and many customers, including unmetered customers¹³, may have already been billed in advance prior to market exit and may prefer this arrangement. We are also not concerned about situations where customers have made an active and informed choice over the relevant parts of their contracts and, therefore, have **voluntarily** entered into contracts where some form of advance billing is part of the terms.

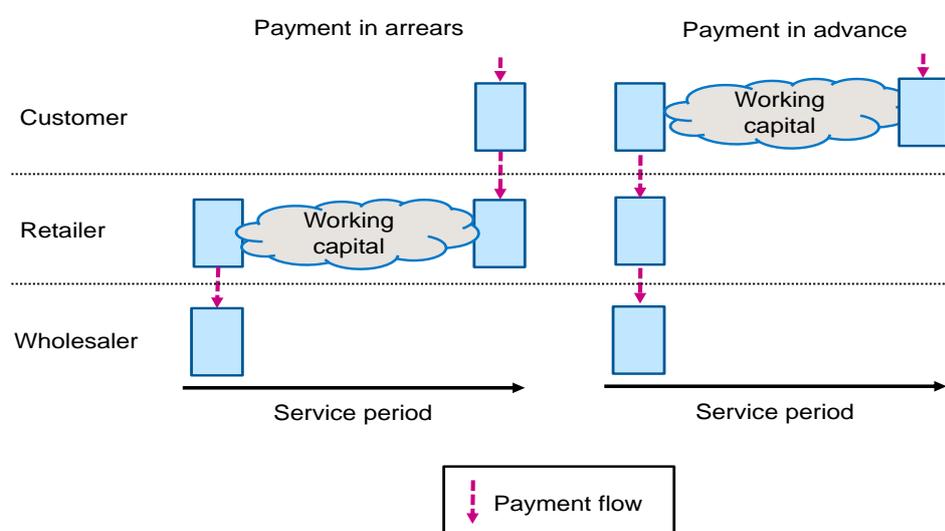
We are concerned, however, about customers who have not actively chosen this arrangement and have had a non-voluntary change in their non-price terms imposed

¹³ It is standard industry practice, for example, for unmetered customers to be billed in advance since their bills are based on the rateable value of their property. These customers may therefore be in the same situation following their transfer to a new retailer.

upon them. In addition to the anxiety, stress and disruption that this can cause to customers, it can also have a direct financial impact.

In the case of advance billing, for example, by requiring customers who had previously been billed in arrears to now pay all or part of their bill in advance, retailers are effectively transferring some of their working capital costs to these customers. In our consultation document we used the following figure to illustrate the situation.

Figure 1 **Stylised illustration of billing cycles**



Source: Ofwat

Although the nominal bill remains the same, these customers now have to ensure that they have sufficient funds in place to enable them to pay their bill at an earlier date than they had done previously. This will impose a direct cost on those customers if they have to use credit to pay the advance bill, or, alternatively, if they pay the bill out of cash flow, they will incur an opportunity cost¹⁴. This will, therefore, be equivalent to the customer's cost of capital.

In the following table we estimate the direct cost for customers from a move from billing in arrears to advance billing under a number of different illustrative scenarios. These take account of how frequently customers are billed, so consider the impact of

¹⁴ For example, the interest they could have earned if they had put the money in the bank for that period instead or the rate of return that could have been earned by investing the money.

a change on customers who had previously been billed quarterly, bi-annually or annually in arrears and are now billed in the same frequency but in advance instead.

Table 1: Estimates of cost to customers from a move to advance billing from billing in arrears.

Billing frequency	Previous cost – billed in arrears	New cost – billed in advance	Change
Quarterly	£606	£619	£13
Bi-annually	£599	£626	£26
Annually	£587	£640	£53

Source: Ofwat estimates.

In these calculations we have assumed a nominal bill of £587 per annum. This is for illustration, but is based on our estimate of the average default tariff for both water and wastewater services across the sector¹⁵.

To calculate the cost to a customer we compare the profile of payments over the course of a year under the different billing arrangements and use an illustrative, weighted average cost of capital of 9.5% to discount those payments to take account of the interest/opportunity cost that the customer will incur because they are required to pay the bill earlier than they had previously done.¹⁶

¹⁵ The average nominal bill is calculated using data on default tariffs of lower usage customers (customers using less than 5Ml per annum). Our choice of lower usage customers reflects the fact that these customers have low switching rates and are typically less engaged with the retail market compared to larger usage customers. Lower use customers are more likely to be on a default tariff and therefore more likely to be affected by an involuntary switch in their billing cycles when compared to larger customers.

¹⁶ This was the cost of capital for small businesses estimated by PwC (2017), p80, <https://www.ofwat.gov.uk/wp-content/uploads/2017/07/PwC-Balance-of-incentives-June2017.pdf>. We recognise, however, that there is a degree of uncertainty around estimating customers' cost of capital and therefore, when undertaking an assessment of the impact of a change in terms on different

As shown in the table, customers incur an additional cost as a result of the change in billing arrangements under all scenarios. This ranges from £13 to £53 depending on the billing frequency.

These estimates are intended to demonstrate the potential impact on customers of a change in terms. Clearly, in practice, the actual impact on customers will depend on factors such as the size of their bill (which in turn will be impacted by the services they receive, their consumption levels, tariffs etc.) and, as highlighted above, factors such as previous and new billing frequency.

In addition, however, it may be appropriate to take account of other factors such as how swiftly customers are required to pay their bills¹⁷ or whether, because of their past payment behaviour, they are required to provide a security deposit.

Similarly, the additional costs that customers are likely to face as a result of a move to advance billing may also be mitigated by the provision of a discount or cashback. In some instances, too, retailers may offer alternative payment arrangements to help customers manage/mitigate the additional costs they are likely to face. This could include, for example, the option to pay by monthly direct debit or the options for the customer to submit his/her own meter reads and be billed accordingly. Nevertheless, it will still be important for the retailer to consider what impact these options might have on their customers (e.g. whether they impose additional administrative costs on customers) and, crucially, also ensure that customers who do not actively agree or opt-in to these options are not made worse off.

Furthermore, if retailers are offering these incentives and alternatives, it may also be necessary to assess the extent to which these constitute a 'one off' benefit only or whether they are sufficient to offset the ongoing costs that customers will experience as a result of the change in the retailer's billing arrangements.

As we have sought to stress, the actual impact on customers will depend on the specific circumstances of the change being proposed by the retailer and the profile of that retailer's customer base and their particular business model.

customer groups, we would expect retailers to use reasonable assumptions (for example, around cost of capital) for that class of customer rather than gathering information from each individual customer.

¹⁷ In our example, in profiling the payments over the course of a year, we have assumed that customers pay their bills within the same month. In practice, however, the cost impact on customers of a move to advance billing could be slightly lower if customers pay several weeks after receipt of the bill.

As we have also explained, while we do not expect retailers to be able to identify the exact impact on each individual customer, we would expect them to consider and be able to assess the impact on the full range of its different 'types' of customers. As illustrated above, this could include customers in different consumption or different tariffs bands or with different bill size. Depending on the proposed change, it could also necessitate a distinction between customers' previous billing arrangements.

Appendix 2: Revised Retail Exit Code.

The revised Retail Exit Code is available [here](#).

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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