

**Department for Environment, Food and Rural Affairs**

## **Retail Exit fact sheet**

**December 2014**

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## Background

1. The Water Act 2014 received Royal Assent on 14 May 2014. It introduces a number of reforms that will enable the water sector to deliver increased resilience, increased customer choice and support economic growth. A key plank of these reforms is the extension of competition in the retail market for non-household water and sewerage services in England.
2. The Water Act 2014 also enables the Secretary of State to introduce regulations that will allow water and sewerage undertakers to cease to offer retail services to non-household customers with the consent of the Secretary of State—this is known as “retail exit”. Following Royal Assent, the Government has undertaken an extensive programme of work to develop our policy on retail exit. A key aspect of this work has entailed engaging with stakeholders to ensure that the approach we take to implementing this policy reflects the views of all those affected. The Government is committed to ensuring that undertakers that wish to exit the market are able to do so when the retail market opens in April 2017, subject to meeting clearly specified criteria.
3. The Government published a consultation on 10 December 2014 which sets out the policy decisions arising from the retail exit reform and seeks comments on the Government’s proposed approach to implementation.<sup>1</sup> This fact sheet aims to provide further background on the retail competition regime that was introduced in the Water Act 2014 and how it relates to the policy on exits.

## What is retail competition?

4. “Retail” services incorporate all customer-facing activities such as selling, billing, and dealing with enquiries, these are distinct from the “wholesale” activities. In the context of the water industry, wholesale would include all those activities involved in sourcing, transporting and treating water and waste water.
5. The Water Act 2014 introduces retail competition for non-household water and sewerage services in England. This will allow non-household customers to switch from their local undertaker to a licensee for the provision of retail services. This will not mean that the water that comes out of customers’ taps will be any different, or that it will come through different pipes. Rather, it means that new companies (“licensees”) will be able to enter the market to provide all the customer-facing services that an undertaker typically provides. This includes billing customers for the provision of their water supply and the removal of their wastewater and sewage, handling their payments, reading meters and taking calls from customers about the network or other related issues. Licensees entering the market to provide retail services will have to pay the undertaker an agreed price for the water and for their use of the network.

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<sup>1</sup> <https://consult.defra.gov.uk/water/retail-exits-reform>.

6. Currently, a small number of non-household customers are already able to switch their water supplier but everyone else has to stay with their regional undertaker. This is because retail competition has been limited to non-household customers that consume over 5 megalitres of water per year in England. The Water Act 2014 extends retail competition by enabling all non-household customers, regardless of size, to switch their water supplier from April 2017. When the new retail market opens, these customers will also be able to switch their sewerage provider for the first time. The Water Act 2014 includes reforms which will make it more attractive for new suppliers to enter the market by creating a transparent system of charges for the use of the public water supply system. It will ensure that all parties operate on a level playing field, governed by transparent rules and codes. This will mean that new businesses that want to enter the market as licensees will not have to negotiate with the undertaker on a case-by-case basis.

7. The Government has expanded retail competition in response to clear demand from business customers. Research carried out in 2012 found that over two thirds of small and medium-sized businesses support competition in the water industry.<sup>2</sup> Our reforms will mean that all non-household customers will be free to negotiate for the package that best suits their needs. Benefits may come from:

- more efficient customer service;
- better-tailored packages, water efficiency advice; or
- a better deal on price.

8. In Scotland, where all non-household customers have been able to switch their water and sewerage service supplier since 2008, more than 45,000 customers (around 50%) have renegotiated the terms of their supplies. The public sector in Scotland is forecast to save over £36 million over four years from discounts to prices and new water efficiency measures.

9. Large multi-site businesses, such as retail chains, hospitals and supermarkets, will be able to make savings by choosing to deal with one single supplier across England and Scotland for all their water and sewerage needs. One business customer who receives over 4,000 paper bills a year for their different sites could save £80,000-£200,000 per year in administration costs alone.<sup>3</sup> Large water users might also look for a water supplier that provides them with better data on their water usage, smart metering, online support and advice on water efficiency to help them reduce waste. This offers obvious environmental benefits as water companies seek to attract new customers through new water efficiency services and advice. In Scotland, Business Stream estimates their water efficiency services have saved customers over £13 million and saved 7.4 billion litres of water.

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<sup>2</sup> "Understanding the Needs of Small and Medium Enterprise Customers", Consumer Council for Water and Ofwat, 2012.

<sup>3</sup> "Water retail services competition in England and Wales: Still Hobson's choice", Policy Exchange, 2011.

## What is retail exit?

10. Since 1991, all water industry legislation has been premised on the idea of vertically integrated undertakers that are required to provide bundled wholesale and retail services to all premises in their areas of appointment (water company regions). The Water Act 2014 contains powers to make regulations that will allow undertakers to apply to the Secretary of State to exit the non-household part of the retail market. Under these regulations, from April 2017, undertakers that choose to exit will be able to transfer their non-household customers to one or more licensees for the provision of retail services. This will require the removal from the exiting undertakers of the legal powers and duties relating to the provision of these services to non-household customers. Once these powers and duties have been removed, the undertaker will no longer be able to provide retail services to non-household customers in their area of appointment. The undertaker will still be responsible for the provision of wholesale services to both household and non-household customers and for the provision of retail services to household customers.

11. The purpose of increasing retail competition is to give non-household customers choice over their water and sewerage supplier. This will expose water and sewerage undertakers to the pressures of the marketplace. The policy driver for enabling retail exits is to ensure a well functioning competitive market. It is therefore important that undertakers are able to make informed choices about their retail strategies—including the choice about whether they wish to compete in this market. The Government is not seeking to require companies to exit, nor are we seeking to shape the market in any particular way. Rather, we are putting in place a framework that will allow the competitive market to evolve.

12. The Government is committed to creating a simple, clear applications process that provides maximum certainty for all parties about whether an exit will be allowed. We are also committed to ensuring that the customers of an exiting undertaker have access to the same safeguards as they would have had if they had remained with the undertaker. This “principle of equivalence” between those customers transferred to a licensee following an exit and those customers whose undertaker has chosen not to exit the market underpins the Government’s proposed approach to exits.

13. One of the key tools for securing the principle of equivalence will be the deemed contract. In contrast with other regulated utilities, the vast majority of water and sewerage customers do not operate under a contract with their undertaker. This role is filled by the Water Industry Act 1991 and associated secondary legislation, which sets out the essential terms under which undertakers have a duty to supply both wholesale and retail services and customers must pay for these services. Customers that opt to switch will negotiate a contract with their new licensee but, unless we provide for it, there would be no formal contract, and therefore no clear legal rights, in place for transferred customers immediately following an exit. Our consultation therefore proposes that a deemed contract should apply in all instances where a non-household customer is served by a licensee but has not negotiated a contract with that licensee.

14. Under our proposals, the deemed contract will secure a transparent set of fair terms and conditions for all transferred customers. The deemed contract will remain in place until such point as the customer decides to switch to a new licensee or renegotiate terms with their current licensee.

15. Allowing retail exits will enable a greater diversity of licensees to enter the retail market. For example, some licensees will seek to specialise in serving specific classes customers while others will wish to maximise economies of scale by serving a larger customer base. It follows that the Secretary of State will need to be assured that an acquiring licensee has sufficient capacity and capability to serve the customers of the exiting undertaker before granting an exit application. We will look to Ofwat's licensing regime to provide this assurance.

16. Exit will require the removal of certain powers and duties from the undertaker and some of these roles and responsibilities will need to be adopted by the acquiring licensee. Examples of such roles and responsibilities include engagement with regimes designed to ensure that all customers are always able to secure a retail service. These are known as the "supplier of first resort" regime (covering new non-household customers emerging in an area of appointment where the undertaker has exited the non-household market); and the "supplier of last resort" regime (covering customers in the event that their licensee becomes insolvent).

## **Retail exit in a competitive market: a customer's perspective**

17. The expansion of retail competition will mean that, from April 2017, all non-household customers will be able to switch to a licensee for the provision of retail services. This will apply equally to customers who have been transferred to an acquiring licensee as a result of an exit as to those customers whose undertaker has chosen not to exit the retail market. This will mean that *all customers* will have the option of switching their supplier at or after market opening in April 2017.

18. The Government wants customers to engage effectively with the market so that they can negotiate a better deal with their licensee. Enabling customers to negotiate a service package that best suits their needs is one of the key benefits of expanding retail competition. Customers that think they may wish to switch at market opening will be free to contact prospective licensees in the months running up to April 2017—and, indeed, are encouraged to do so.

- If a customer decides before market opening that they want to switch to a particular supplier, and their undertaker opts to exit at market opening, the Government will ensure that they experience a smooth, seamless transition to the supplier of their choice when the retail market opens in April 2017.

- If a transferred customer decides that they want to switch their supplier after market opening, they will be able to identify a new licensee in the normal way.

19. Effective customer communication will be a key tool for ensuring that all transferred customers have a positive experience of the process. The Government will therefore place a requirement on undertakers and licensees to communicate with customers at specified points in the application process—both before and after the transfer. This will enable all transferred customers to understand what is happening and to raise awareness of the choices available to them. It will also ensure that transferred customers are aware of the terms and conditions that will apply to them following an exit.

20. Information about the process for enabling exits and the options available for customers both before and after a transfer will need to be provided in a co-ordinated way by all interested parties including Government, Ofwat, Open Water and CCWater.

## **Retail exit in a competitive market: a commercial perspective**

21. All undertakers will need to develop a retail strategy in preparation for market opening. Doing this will require them to take decisions about whether or not their group business plans to compete in the national market for non-household retail services, either at market opening or at a later date. An undertaker cannot compete in the national market under its own licence of appointment; to do this it must establish a separate legal entity with a retail licence (or an “associate licensee”). The other key players in the new competitive market will be licensees set up by new businesses entering the market to provide retail services.

22. An undertaker will therefore be able to choose whether or not to exit. If it does wish to exit it will have a further choice about whether it proposes to transfer its non-household customers to its own associate licensee or to a licensee set up by a new business. This transfer will take the form of a commercial agreement between the undertaker and licensee. The Government has no preference regarding which of these strategies companies may choose to adopt:

- some undertakers may wish to stop providing non-household retail services altogether and will therefore exit by transferring their customers to an unrelated licensee;
- some undertakers may wish to exit by transferring their in-area customers to an associate licensee (a separate legal entity that is part of their wider group business);
- some undertakers may decide not to exit but may choose to outsource their in-area non-household retail business to a licensee under contract; and

- some undertakers may decide neither to exit nor to compete in the national market for non-household retail customers, but instead to focus on retaining their existing customers in-area.

Whether or not they choose to exit, all undertakers will need to prepare both the retail and the wholesale part of their business for market opening.

23. Prospective licensees will also need to start considering their retail strategy in advance of market opening—i.e. whether they are planning to win customers one at a time and/or to acquire a ready-made customer base through a customer transfer. Undertakers that decide to exit will need to negotiate a commercial agreement about a potential transfer in a way that meets the needs of both parties. Such agreements will need to comply with all relevant legislation. Negotiations will need to be completed prior to an application for exit because the Secretary of State will only be able to give consent for a particular exit to one or more specified licensees. Our consultation seeks to provide clarity about the exit applications process to support these negotiations.

24. Undertakers will not be able to exit the retail market before market opening in April 2017. However, they will need clarity about the Secretary of State's decision substantially in advance of market opening. Undertakers and licensees may wish to come to a contractual arrangement to ensure a smooth transition through the exit process and to limit the duplication of activity.

25. The Government proposes to put in place a light-touch applications process which secures that:

- the exit is undertaken voluntarily;
- customers are transferred to a retailer that has received a licence from Ofwat;
- both the divesting undertaker and the acquiring licensee communicate clearly and effectively with the affected customers at the appropriate stages in the process.

## Next steps

- We would welcome any responses from interested parties to our consultation on the proposed content of the draft regulations: <https://consult.defra.gov.uk/water/retail-exits-reform>. The deadline for responding is 18 February 2015.
- We plan to publish the summary of responses to this consultation in May 2015
- We will consult on the draft regulations in summer 2015.
- We will seek the views of all interested Parliamentarians on the draft regulations.
- We plan to lay the revised regulations in early summer 2016. These regulations will be debated by Parliament.
- We will open the applications process immediately following the completion of the parliamentary process.

# Glossary

**Acquiring licensee** – A licensee that has acquired transferred customers after an undertaker has exited the retail market.

**Associate licensee** – A separate legal entity that has been established by an undertaker so that it can participate in the retail market. This term is used in the consultation document to distinguish these licensees from the licensees set up by new businesses entering the market and from the in-area non-household retail arms of undertakers.

**Codes** – The mechanism by which Ofwat will regulate the various agreements that undertakers make with other parties in the new competitive markets.

**Deemed contract** – A contract that is deemed to apply between any non-household customer and the licensee that serves them where the customer has not negotiated a separate contract with that licensee.

**Default tariff** – Price protection that all undertakers will be required to offer their non-household customers from April 2015.

**Exit regulations** – Any regulations made by the Secretary of State under the powers in Chapter 4 of Part 1 of the Water Act 2014.

**Exited area** – The area of appointment of an undertaker that has exited the retail market.

**Exited/exiting undertaker** – An undertaker that has voluntarily exited the non-household retail market.

**Guaranteed Service Standards (GSS)** – Statutory standards of performance that undertakers must meet when providing services for customers. In the retail context, this includes response times for written complaints, meeting appointments etc.

**In-area customers** – Non-household customers with premises in the undertaker's area of appointment.

**Licensee** – An entity that is licensed to provide retail services to the end customer in the competitive market. This includes an associate licensee set up by an undertaker as well as a licensee that is set up by new businesses entering the market. This document also uses the term “retailer” to refer to these entities.

**Outsourcing** – Where an undertaker outsources the provision of retail services to another body, while still retaining ultimate responsibility for providing these services.

**Retail** – Customer-facing services, for example billing, meter reading and call centre services. The full list of retail services for the purposes of the competitive market is outlined in the Ofwat price review methodology.



**Retailer** – An entity that is licensed to provide retail services to the end customer in the competitive market. The consultation document also uses the term “licensees” to refer to these entities. The term “retailer” can also be used to mean the retail arm of an undertaker that has not exited the market but is not used in this sense in this document.

**Retail exit** – Where an undertaker exits the competitive part of the retail market with the consent of the Secretary of State. This reform will mean that those undertakers choosing to exit the non-household retail market will be able to transfer their non-household customers to a licensee and that various legal duties relating to the provision of retail services to such customers will be modified or removed.

**Self-supply licensee** – A customer with a water supply or sewerage licence that provides retail services to its own premises and those of its associates (for example, subsidiaries or partners).

**Sewerage licence** – A sewerage licence, introduced by the Water Act 2014, will allow entry into the market for wastewater and sludge services for the purpose of providing retail and/or upstream services. A licensee may hold one or more of three “authorisations” within a sewerage licence.

**Supplier of First Resort** – A licensee who is assigned any non-household customer that arises in an exited area and has not chosen an alternative licensee themselves.

**Supplier of Last Resort** – A licensee or undertaker who is assigned the non-household customer(s) of a licensee that has left the market, where those customers have not chosen an alternative licensee themselves.

**Switch** – Where a non-household customer chooses to switch from either their undertaker or an acquiring licensee to another licensee for the provision of certain retail services. From April 2017, the expansion of retail competition will mean that all non-household customers will be able to switch their retail service provider—whether or not their undertaker has chosen to exit the retail market.

**Transfer** – Where an undertaker that has chosen to exit the market transfers their non-household customers to an acquiring licensee. This can also include the transfer of asset, e.g. a call centre lease and staff.

**Transferred customer** – A customer that has been transferred to an acquiring licensee in an undertaker’s area of appointment after the undertaker has exited the retail market.

**Undertaker** – A company that has statutory powers and duties to supply water and/or sewerage services to premises within an appointed geographical area under the Water Industry Act 1991. It is also responsible for maintaining and operating the public water supply and/or sewerage networks.

**Water Act 2014** – A piece of primary legislation that amended the Water Industry Act 1991 to expand retail competition. It also contains a broad enabling power to make regulations that will allow undertakers to apply to the Secretary of State to exit the non-household retail market.

**Water supply licence** – A water supply licence allows entry into the competitive water supply market for the purpose of providing retail and/or upstream services. A licensee may hold one or more of four “authorisations” within a water supply licence.

**Water supply licensee** – The holder of a water supply licence.

**Wholesale** – The inputting of water to, or the removal of sewage from, the network either by an undertaker, a neighbouring undertaker or by a licensee with a wholesale or disposal authorisation. This does not include distribution services.

**Water Industry Act 1991** – This is the main piece of primary legislation that concerns the regulation of the water industry, including water and sewerage services.

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