



Department
for Environment
Food & Rural Affairs

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Consultation on the government's proposed policy approach to the retail exits regulations Summary of responses

July 2015



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A. Introduction

The Water Act 2014 (“WA14”) received Royal Assent on 14 May 2014. It introduced reforms that will extend competition in the retail market for non-household water and sewerage services in England. This includes powers that enable the Secretary of State to allow water and sewerage undertakers to cease to offer retail services to non-household customers – this is known as ‘retail exit’.

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 undertaker of the legal powers and duties relating to the provision of these services. Undertakers who wish to exit will be able to do so when the retail market opens in April 2017, subject to meeting clearly specified criteria.

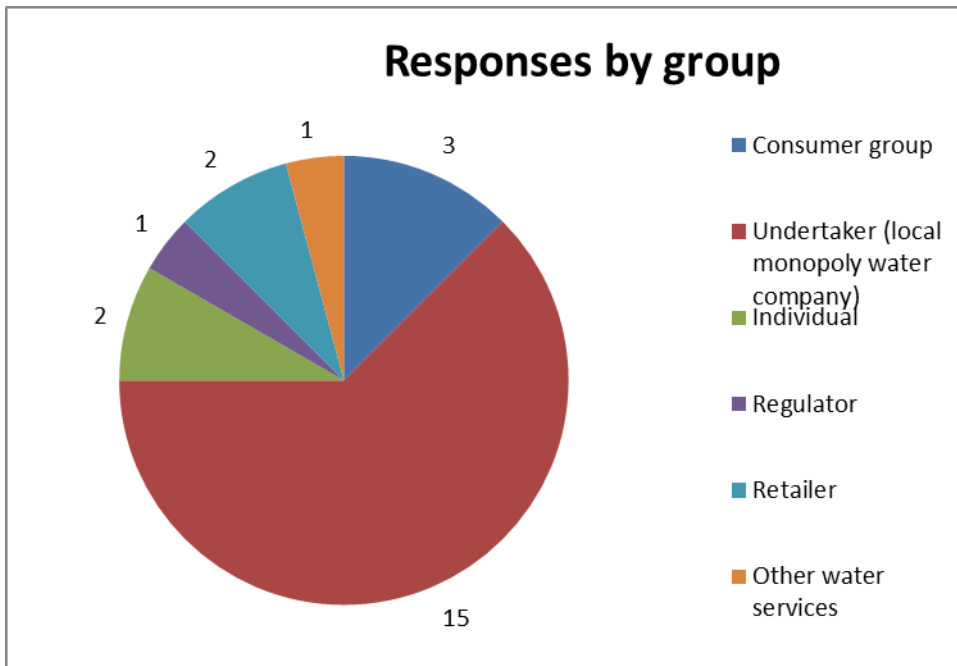
The policy driver for enabling retail exits is to ensure a well-functioning competitive market. Retail competition will give all non-household customers choice over their water and sewerage supplier. This will require that undertakers are able to make informed choices about their retail strategies – including the choice about whether they wish to compete in this market.

The government is not seeking to require undertakers to exit, nor are we seeking to shape the market in any particular way. The objective is to put in place a framework that will allow the competitive market to evolve. Following Royal Assent, Defra undertook preparatory work to plan for the implementation phase of WA14 in the months and years ahead.

A consultation on retail exits was launched on 10 December 2014, and ran until 18 February 2015. The aim of the consultation was to gather views on the transition to retail competition in the non-household market which is planned to take effect in April 2017. The consultation set out policy proposals that the government is considering as the opening of retail market approaches. These proposals cover issues related to the option of retail exits by local monopoly water and sewerage companies (“undertakers”).

Responses to the consultation were received by a range of groups (see Figure 1).

Figure 1: Number of responses to the consultation by group



The consultation document set out ten assumptions about how the retail exit would work. These assumptions were arrived at based on detailed engagement with stakeholders. The aim of this was to help respondents to understand the government's intention in respect of retail exit. The consultation document also asked 23 specific questions about the proposed approach to prompt respondents and elicit their views.

Key themes emerging from the consultation were:

- Principle of equivalence
- Deemed contracts
- Guaranteed Service Standards (GSS)
- Licensing regime
- Supplier of First Resort
- Supplier of Last Resort
- Requirements of undertakers and licensees

Summary

In summary, there was general support for the government's proposed approach. There was particular support for a robust framework for consumer protection, and also for the commitment to clarity around the role of market participants over the long term.

B. Answer to consultation questions

1. Do you agree that we should seek to secure equivalence between customers that have been transferred following an exit and customers who are still served by an undertaker that has not chosen to exit the market—and, if so, why?

There was a strong level of support amongst respondents for the overarching ‘principle of equivalence’ set out in the consultation document. The principle of equivalence aims to ensure that, following an exit, the customers that have been transferred will have an equivalent level of protection as if they had remained with the undertaker.

The most common reason given in the support of this principle was because customers transferred following an exit would have had no choice in the matter, since it is a water company’s choice to exit the market. It was therefore seen as important that they were not disadvantaged by the process.

A water company said ‘there is no reason why a customer being transferred should lose any element of their customer protections based solely on their retailer’s decision to exit. The principle of equivalence should be central to Defra’s approach to retail exit’.

A number of respondents also mentioned the role of this principle in providing customers and their representatives with confidence about the operation of the new retail market and reassurance that it will be a positive change.

2. Are there circumstances in which you think this might prove difficult to achieve? If so, how could we best approach this?

There were a range of responses to this question. Some respondents said that they could see no circumstances where this principle couldn’t be achieved. However, others said that they thought that equivalence would be difficult to achieve in practice. For example, some respondents questioned the extent to which direct equivalence would be possible in a national market; noting that customers do not currently receive uniform services or prices across England.

The majority of respondents, however, focused only on particular areas where it might prove difficult to achieve.

The circumstance which received most mention was where agreements on non-standard terms were in place between undertakers and customers, either on a contractual or informal basis. This was an issue of particular concern to consumer groups who said that a lack of knowledge of these arrangements may cause complications for the new licensee and a change of service levels and conditions for the customer. They stressed that it is important that acquiring licensees honour these agreements and exiting undertakers should ensure they have correct records of these agreements and provide these to the

acquiring licensee. This topic was also mentioned by Ofwat who said that customers who had previously formally agreed a contract with the undertaker should receive a consistent service after their transfer.

The related issue of 'special agreements' was also mentioned. Special agreements are where customers pay lower than standard charges in return for a benefit provided to an undertaker. An undertaker recommended that undertakers and licensees should proactively engage with all affected customers to agree whether equivalent special agreements would be provided in future.

Ofwat noted that equivalence should be achievable for the majority of customers through the introduction of the deemed contract.

3. Do you agree that there should be a deemed contract in all instances where a non-household customer is served by a licensee but has not negotiated a contract with that licensee—and, if so, why?

All respondents agreed there should be a deemed contract put in place for all customers that are transferred following a retail exit. The main reasons given for this were:

- The protection it would provide for customers and retailers.
- Its ability to ensure equivalence between customers in an exit area and those who continue to be served by an undertaker.
- The clarity and confidence it would provide customers ahead of market opening.

Groups representing consumers noted that the baseline level of service represented by deemed contracts would be unlikely to offer the optimal terms and conditions for individual customers and recommended that the focus should be on encouraging and empowering customers to engage in the market by negotiating their own terms and conditions with a retailer.

While respondents expressed clear support for deemed contracts, some conditions were attached to this. Those mentioned most frequently were:

- Deemed contracts should not prevent or dis-incentivise customers proactively engaging in the new retail market in any way.
- The power of a licensee to chase for outstanding debt should not be reduced by a deemed contract being in place.
- Early clarity is needed about the content of the deemed contracts ahead of market opening to allow business decisions to be made.

In addition, some respondents stressed that deemed contracts have a wider role to play in the retail market beyond instances of retail exit, for example where a customer has moved into a previously vacant property. Indeed, one respondent suggested that it could be

beneficial for all customers, whether in an exit area or not, to be placed onto a deemed contract at market opening. However, others felt that the use of deemed contracts should be limited as far as possible to encourage customers to actively participate in the competitive market.

4. What terms do you think should feature in the deemed contract?

There was consensus amongst respondents that the deemed contract should include both price and non-price terms. There was also broad consensus that the price terms in the deemed contract should reflect the price charged by the exiting undertaker. Respondents were keen to ensure that transferred customers would continue to receive the same price terms as if their undertaker had not exited the market. However, there was some confusion about how this could best be achieved.

There was a range of views about the non-price terms which should feature within the deemed contract. Many respondents felt that these should represent a baseline level of service, building on the Guaranteed Service Standards (GSS). The priority for these respondents was to encourage customers to participate in the competitive market. An undertaker said: 'The contract should be basic allowing new contract offerings from retailers to enter the market that bring advantages for customers that help move the market forwards. Overly elaborate deemed contract may encourage customer inactivity and contribute to a market failing'.

Others felt that some undertakers already offer better non-price terms than those required by the GSS. Some respondents argued therefore that the deemed contract should include exactly the same non-price terms as the customer was receiving from the undertaker at the time of exit. A consumer group said: 'customers do not want to see any deterioration in the service they receive, so we believe acquiring licencees should honour the service standards provided by the undertaker to the individual customer.' Consumer groups also mentioned that the deemed contract should not require customers to pay any termination penalty or give notice. Customers should be able to switch without restriction.

5. From Market Opening to 2020 do you agree that the deemed contract should include price terms which are identical to those that the customer was receiving from its water undertaker at the time of the retail exit?

Responses to this question were broadly in two categories. The first, which received the most support, was that the price terms in deemed contracts should apply the default tariffs that Ofwat has set under PR14. Reasons given for this were that providing customers with a set price could discourage participation in the market. It could also mean that customers lose out on reductions in prices which may be required under price controls.

The second category was those favouring the deemed contract including price terms which are identical to those the customer was receiving from its undertaker at point of exit. The reasons for this were that it would be less burdensome than requiring licensees to set

default tariffs based on the same methodology as the undertaker. It was also the option favoured by consumer groups that pointed out that it will afford customers price stability and protect them from price rises after exit. It was suggested, however, by some supporting this option that customers could be provided with a fixed price but for a shorter period of time than was proposed.

It was noted by some respondents that the prices which customers receive would need to be able to change year-on-year to reflect the changes in wholesale charges which vary on an annual basis, partly due to inflation.

6. If we work on the assumption that the transferred customers of an exited undertaker should have a deemed contract that includes a clear set of price terms, what factors do you think should be taken into account when establishing those terms post 2020?

A considerable number of respondents were clear in their support for keeping price protection for non-household customers under review as the market develops. Respondents mentioned the need for Ofwat to review the market and consider what the most suitable price terms are post 2020, based on how far it is delivering reasonable prices. Ofwat also welcomed this proposal and highlighted their commitment to monitoring the new market both before and after 2020 in order to ensure customers are protected.

7. How could we make our approach to setting non-price terms more effective?

All respondents recognised the need for non-price protection for customers transferred following an exit. There was also agreement around the proposal that pre-existing contractual arrangements regarding non-price terms should be transferred following an exit. However, there were different perspectives to how non-price term protection should be secured where no pre-existing contract exists prior to an exit.

The first, favoured mostly by water companies, was support for the approach set out in the consultation document. This is that the revised GSS should form the baseline standards of service. It was stressed by a number of respondents that the standards in the deemed contract should be basic and not exceed or differ greatly from the existing statutory obligations.

Other respondents pointed out that standards vary across the sector at present, with some undertakers exceeding the statutory levels. Another perspective, therefore, was that customers should continue to receive the exact same non-price terms that they received prior to an exit. This would mean that some customers would need to be transferred on terms higher than the baseline standards. This perspective was favoured by some consumer groups and also some water companies, who felt that customers should experience the same (or better) level of service following an exit.

Other points raised included the possible need for additional levels of protection for certain groups of customers, especially small and medium sized enterprises. Several respondents also mentioned the relevance of non-price protection for all customers who participate in the new market, beyond just those transferred following a retail exit.

8. What do you think the revised Guaranteed Service Standards (GSS) should include?

A common point of view in answers to this question was that the revised GSS should be a simple and basic set of standards which can protect customers. A water company said that they 'should be a set of simple measures and performance requirements that cover all customer types within the broad non-household population. They should be able to be delivered by all licenced retailers irrespective of size, customer segment or the water regions covered'. A number of respondents also indicated that the current GSS are fit for purpose and the new standards should not change or vary greatly from these.

Other respondents provided more detailed responses, listing specific areas which the new GSS should/ could cover. These included minimum standards for:

- Meter reading;
- Billing;
- Payment;
- Debt management;
- Termination of agreements;
- Switching process;
- Keeping appointments;
- New connections, reconnections and information about charges for connections;
- Water quality and other wholesale standards;
- Supply interruptions; and
- Response times to complaints and enquiries.

The importance of getting these standards right so that they can protect customers whilst not distorting the new market was also raised.

9. Are there any other non-price terms that do not form part of the GSS that you would expect to see included in the deemed contract?

Some respondents did not identify any other non-price terms and it was suggested that these should not go beyond GSS or minimum standards.

Other respondents identified specific terms in their answers. Two terms received particular mention. The first was the way in which payment was made. Respondents from both water companies and consumer groups said that customers should be able to pay on the same terms as they had paid their undertaker (e.g. monthly, quarterly) in order to ensure a smooth transfer. The second was around switching. Respondents said that deemed contracts should provide information about switching and also allow customers to switch freely.

Other terms mentioned, which aren't already listed in response to question 8, included:

- Confidentiality of information;
- Limitations around liability;
- Clarity of responsibility (between customer, retailer and wholesaler);
- Arrangements for access to customer sites for wholesalers;
- Contact points for the retailer and wholesaler for raising public health issues;
- Consequences of non-payment; and
- Niche services where they are essential to a customer's ongoing service.

Several respondents also encouraged Defra and Ofwat to study the default terms which apply in the Scottish water market and other utilities sectors in developing the deemed contract. It was also thought that some areas set out in the Open Water codes regarding retail/ wholesale relationships may be applicable to the deemed contract.

10. Do you agree that there should be different requirements for licensees that are looking to take on large-scale customer transfers compared with licensees that wish to specialise in providing services to a niche class of customers?

Broadly equal numbers of respondents agreed and disagreed with the question and strong viewpoints were expressed from both perspectives. There was, however, consensus across the range of viewpoints that there should be minimum requirements in place for all licensees in order to ensure that all customers are protected. This would include the niche classes of customers who may be served by a smaller licensee.

Respondents who agreed with the question mainly considered that different requirements were needed in order to ensure that the licensing regime did not disadvantage small

businesses who may wish to enter the market. A water company answered ‘Yes. It would be an unreasonable barrier to entry to require all potential licensees to retain equivalent capacities, as this would discourage entry by any niche player.’ A prospective new entrant also argued that additional conditions should be put in place for associated licensees in order to ensure that their relationship with the undertaker did not give them an advantageous position in the market.

Other respondents felt strongly that a differentiated system could undermine the level playing field. Several respondents suggested instead that licences should be flexible to accommodate differences in size. This would be important to allow companies to grow their businesses in the future and make changes in their business strategy. There was also a concern that having different requirements for licensees of different sizes could result in some customers being disadvantaged.

11. What differences do you think it would be reasonable to see in the licensing regime in terms of capacities and/or capabilities between acquiring licensees and smaller entrants?

One view was that the same licence conditions should apply as at present, where ‘licence conditions which are unnecessary for some suppliers can be dis-applied until and if such time requires.’ It was also noted that the application process for acquiring a licence could be different for those with a track record and new entrants. In this vein, some were of the view that ‘it would be appropriate for there to be more onerous requirements for a licensee wishing to take on a large-scale customer transfer, as compared with a new entrant with only a handful of customers.’ Others expressed support for a consistent and universal process being applied in respect of licensing.

There was strong support for the categories that form part of the current water supply licensing (WSL) arrangements: financial position, managerial competency, and technical competency. In this context, one respondent stated ‘given that this presupposes a level of specialism then there will have to be certain specific requirements for a niche retailer, however these should be as limited as possible to avoid the perception of an overtly tiered market.’ Ofwat stated that they were reviewing the WSL areas mentioned above and expected to be able to consult on the new licensing arrangements shortly.

12. Do you agree that a transferred customer should remain on the deemed contract until they choose to switch to a negotiated contract or another licensee – even if they are transferred on more than one occasion? What do you think are the main advantages and disadvantages of this approach?

There was strong support for transferred customers remaining on the deemed contract until they choose to switch to a negotiated contract or another licensee, the main perceived advantage being it would ensure consumer protection. One respondent caveated this by adding that price and non-price terms related to providing equivalence should be time limited. A further point was that deemed contracts could have a negative

impact on customer switching and competition, so should not in the long term hold on to historic pricing levels or structures where this leads to below market rates. Other respondents also stated that deemed contract provisions should be transitional and that further consideration should be given to how this might be achieved.

An additional point made was that the benefit of a deemed contract is a transparent price and level of service for customers. This also provides retailers with the legal protections they need, i.e. the right to recover charges, when it is not possible to negotiate contracts with all customers. A strong theme was that customers should only see their prices and terms and conditions change if they actively choose to do so, and that this seems fundamental to competition.

13. Do you agree that customers should retain the right to return to their acquiring licensee on the deemed contract terms and conditions for two years following a transfer?

There was a mixture of views on this point. Some respondents felt that customers should retain the right to return to their acquiring licensee on the deemed contract terms and conditions, although not all agreed to the two year limit, with one respondent stating that one year would be sufficient. However, others were concerned that this would not encourage active engagement in the market.

Some respondents felt that the approach proposed could be administratively complex, requiring retailers to keep track of all customers who had switched away from them, along with the date and terms of which they were served at the point of switching. Others raised questions about what would happen if a business had changed ownership in the two year period, where would the customer 'return' to? One respondent noted that many switching customers will sign deals of at least two years duration and considered that the provision would therefore be of limited value.

Ofwat also disagreed with this policy proposal, since they were concerned that the proposed solution would weaken customers' incentives to engage with the market and that a policy of returning customers to an acquiring licensee might risk perpetuating an incumbency advantage.

14. How far you agree that this protection should be time-limited? What do you think is a reasonable time-frame?

There was some diversity of opinion on this question. One respondent stated this was a difficult question to answer prior to market opening because it will depend entirely on the success of market opening. Others stated that the rights of the customer that has been transferred to a new licensee should match those of the incumbent's customers. A further view was that a short e.g. six month window for customers could be provided to enable switch back (subject to any contractual conditions the customer agreed to in the switch). Ofwat's view was that time-limitation is likely to create a difficulty in monitoring and enforcement terms.

15. Do you agree that we should introduce a "supplier of first resort" (SoFR) panel across England that will be available to take on new customers following an exit?

There was general support for introducing a 'supplier of first resort' (SoFR) regime to ensure that a customer is not left without a retailer where the undertaker has exited the retail market. Ofwat recognise the need for a SoFR arrangement across England that will be available to take on new customers following an exit. They consider that customers should be encouraged to engage with the market to find their own retailer as far as possible and that the SoFR approach should be limited to those situations where it was absolutely necessary.

One retailer objected to having a single pool across the country, because this would force members to have wholesale contracts in place with every undertaker in the country, and to be prepared to serve customers in any region even if their retail strategy is to focus on a narrow geographical area. Other respondents suggested that the SoFR pool should be extended across the whole country to also apply in areas where an undertaker had not exited. This was to provide retailers with an equal opportunity to win business through the SoFR pool in all areas.

16. Can you think of any ways in which we could refine our approach to new connections and new owners/occupiers in exit areas to make it more effective?

Several different issues were raised in responses to this question. One of these was regarding the basis of membership of the SoFR pool. One view was that membership should be made on an 'opt-in' basis. This was recommended because of the opinion that suppliers are likely to want to join the pool in order to receive new customers and it is expected that there will be sufficient interest amongst companies in joining the pool on a voluntary basis. An alternative view, which supported the approach set out in the consultation, was that there should be an 'opt-out' approach where all licensees would automatically be part of the pool unless Ofwat approved an application not to participate in it. A third view was that acquirer of the retail base upon exit should hold the obligation to always provide a service in the exit area.

Another issue mentioned was regarding the participation of niche retailers in the SoFR regime. Several respondents questioned the approach of allowing niche acquiring licensees to be able to 'opt-out' of the pool. The reasons given for this that a niche retailer may be the best option for a particular customer.

17. Do you agree that we should require at least one acquiring licensee in every transfer to opt into the supplier of last resort (SoLR) regime?

There was general support for this requirement, which was seen as reasonable. There was a suggestion that it could be relaxed where there are alternative suppliers who are

willing and have the capability to become the supplier of last resort (SoLR) for a given area. In addition, if other retailers subsequently opt to become a SoLR, then the obligation for the acquiring retailer to remain a SoLR could be removed. Another view was that participation in the regime should be entirely voluntary, including for acquiring licensees. One retailer had the same objection as mentioned in question 15, i.e. having a single panel nationally.

18. Can you think of any ways in which we could refine our approach to the supplier of last resort (SoLR) regime to make it more effective?

A variety of points were raised in response to this question. One issue mentioned was the need for the size of the retailer in the SoLR regime to be taken into account when being assigned new customers. This was because of the concern that the exit of a large licensee could lead to a smaller retailer being swamped. One consumer group also echoed the point about the participation of niche licensees in the SoLR regime, made under question 16. Other respondents requested further clarity on aspects of the regime in their responses. This included clarity on any contingent liabilities associated with customers on deemed contracts, the basis which new terms and conditions could be applied, and the mechanism for allocating customers.

19. Are there other issues that we should consider in our suggested approach to the applications criteria and process?

Water companies generally support a light touch and universal application and approvals process. Companies also support a clear, predictable and timely exit process being put in place well before market opening in April 2017. They see the proposed approach as pragmatic and appropriate. Ofwat also support the light touch approach set out in the consultation. They state that the approach provides greater certainty for companies and investors and reduces political risk in the process.

20. Do you agree that we should require both undertakers and licensees to communicate with transferred customers?

Water companies agree with this requirement with some suggesting that this should be a minimum requirement and parties should be free to communicate more extensively with customers as they choose. One water company stated that 'it should be recognised that in some circumstances i.e. retail exit to an associate retailer, the exiting retailer and acquiring licensee will effectively be the same. This creates alignment and consistency for customers and therefore may require a different level of communication than if customers were being transferred to a new entity'.

Another water company did not see a requirement for communications to be prescribed in detail by the government or the regulator. An alternative suggestion was that further consideration should be given to the option of this communication being undertaken jointly by the undertaker and the incoming licensee (i.e. one communication) – in particular if it is an exit to an associated licensee.

21. Are there any additional issues that we should consider in our approach to customer communications?

One water company thought it may be beneficial for the acquiring licensee to be allowed to communicate with the customer before the transfer of the registration takes place. This would allow a relationship to commence prior to transfer after any initial contact outlining exit from the undertaker. A second water company mentioned the importance of timing of these communications.

Another water company stated that they 'would expect that, ahead of retail exit, the transferring customers would be provided with the deemed contract along with confirmation that this is the basis on which they will receive retail services from their retailer post retail exit.'

One suggestion was to direct customers to a government-backed website that has a recognisable domain name to increase customer confidence and give clear unbiased advice to customers informing them of their options and licenced provider.

22. Do you have any other comments about our overall policy approach to retail exit?

Water companies reiterated their support for a clear and predictable application and approvals process so all parties have appropriate expectations of the outcome of the process. One water company stated 'we encourage its universal application and that the consent of the Secretary of State is not unduly influenced by other retail exits or movements in the market as a whole across England.'

A further point raised was that companies will need to incur costs to be ready for market opening in April 2017. It will be more efficient therefore if exiting undertakers can have early confidence that they will be allowed to exit the market to enable them to avoid abortive market preparation costs.

23. Is there anything else you would like to add to your response?

One water company emphasised the need to ensure retail exits can be enacted efficiently by the Market Operator by requiring suitable capacity designed in from the outset. This would help to manage multiple bulk transfers of registrations in the central supply registration system in a compressed period. In order for this to appear seamless to the customers, there must be a smooth and prompt transfer process on behalf of the undertaker and acquiring licensee, whilst maintaining ongoing business as usual activities not related to bulk transfers for the rest of the market in England.

One water company mentioned that they remain wary of the potential for customers to become 'stranded' as a result of the exit process and hence it is important that ongoing liabilities are clarified to ensure that a customer is never without a relevant retailer, or one to fall back on should there be a default.

A retailer had concerns around the retail margin, and the potential implications for the viability of acquiring retailers. They suggest that Defra consider how this potential risk should be considered during the exit process.

C. Government response

1. Summary

The government welcomes the thoughtful, detailed feedback it has received in response to this consultation and notes the broad-based support for the proposed approach. We recognise the clear support for a robust framework for consumer protection, based on a principle of equivalence, and also the desire for clarity around the role of market participants over the long term.

2. Securing equivalent rights for transferred customers following an exit

The government welcomes the strong support amongst respondents for the overarching 'principle of equivalence' set out in the consultation document; and for achieving this through the introduction of a deemed contract.

3. Putting a deemed contract in place

The government welcomes the support for the proposal to put in place a deemed contract to secure clarity about the rights and responsibilities of both customers and their retailers following an exit. The government recognises that a careful balance will need to be struck in setting terms and conditions that provide an appropriate degree of protection for both parties whilst also encouraging and empowering customers to engage in the market. The government agrees that deemed contracts should not act as a disincentive to customers proactively engaging in the new retail market.

The government's expectation is that all licensees wishing to operate in exit areas will publish deemed contract schemes on their websites. Ofwat will regulate the content of these schemes in order to ensure that they provide effective protection for transferred customers and licensees. Recognising that clarity is needed about the content of the deemed contracts ahead of market opening, Ofwat will be taking forward the necessary work with companies and other stakeholders over the summer and plans to consult on deemed contracts, including any associated draft code provisions or licence conditions following publication of Defra's consultation on exit regulations.

Customers will stay on the deemed contract until such time as they choose to switch. This will remain the case where a retailer chooses to leave the market or to transfer all or part of their customer base to another retailer.

Details of how we propose to secure equivalent rights for a transferred customer that does choose to switch are set out under section 8 below.

4. Non-price terms in the deemed contract

There was a range of views about the non-price terms which the deemed contract should contain. These were divided between those that felt that the terms should represent a uniform acceptable baseline level of service and those that felt that each customer's individual arrangements should be replicated.

The government wishes to ensure that transferred customers are able to access an equivalent level of service at an equivalent price without creating unduly complex or burdensome arrangements. Where there are special agreements, or other formal agreements regarding non-standard terms in place between a customer and their undertaker, the draft exit regulations require that these are secured through a transfer scheme. However, our view is that it would not be practical or proportionate to seek to secure more informal arrangements in this manner.

The government agrees with consumer representatives that the deemed contract should not require customers to pay any termination penalty and that such customers should be able to switch without restriction.

5. Price terms in the deemed contract

There were two schools of thought amongst respondents to the consultation on how price terms should be set. Some took the view that an acquiring retailer should be required to apply the default tariffs that Ofwat has set under PR14. Others considered that the deemed contract should require the retailer to charge the same retail price as the customer was receiving from its undertaker at point of exit.

The government has addressed the question of price terms in the new retail market through the draft Charging Guidance to Ofwat published on 9th July 2015:

- As the new retail market develops, the government is clear that Ofwat must continue to keep the market under review and where necessary take action to ensure that the retail charges received by non-household customers remain both fair and affordable.
- The expectation is that at market opening the deemed contract would include price terms which are equivalent to those that the customer would have been receiving from the undertaker had they not chosen to exit.
- The government expects Ofwat to set out rules governing how price terms will continue to be secured through the deemed contract post 2020 to ensure equivalent levels of protection for the customers of undertakers and the customers of acquiring licensees.

The views expressed by respondents to this consultation have been shared with Ofwat to support the work currently underway on the process for establishing deemed contracts.

Ofwat will be addressing the detail of how price terms are secured as part of this work on deemed contracts, which it expects to be able to consult on in the autumn.

6. Guaranteed Service Standards (GSS)

At present, the GSS arrangements only apply to appointed water and sewerage companies and not to water supply licensees. The WA14 includes powers for Ministers to apply GSS to both water supply and sewerage licensees as well as appointees, based on recommendations from Ofwat. Ofwat has begun a review of the existing GSS arrangements, with a view to consulting on proposals during Summer 2015, and is expected to make recommendations to Defra by the end of October 2015. Ofwat's review will focus in particular on the possible application of GSS to all retailers in order to provide protection for non-household customers. Ofwat and the Open Water programme have already undertaken preparatory work to ensure that the market codes contain provisions to support the practical application of GSS arrangements.

One particular proposal was made by respondents from both water companies and consumer representative organisations in relation to GSS. This was that customers should be able to pay in the same way and on the same terms as they had paid their undertaker (e.g. monthly, quarterly) in order to ensure a smooth transfer. Given the consensus in this area the government's proposal is to secure this directly through the exit regulations.

7. Requirements for acquiring licensees

There was a mix of views on this point, with respondents equally concerned to minimise potential burdens for entrants and to ensure that acquiring licensees have the capacity and capabilities required to serve customers effectively.

In developing their proposals for the new Water Supply and Sewerage Licence, Ofwat has given careful consideration to this balance of risks. Their proposal is to provide enhanced guidance in relation to the 'certificate of adequacy'. This is the document that retailers will be required to provide confirming that they have all of the resources needed to meet their licence and statutory obligations.

Ofwat proposes to issue guidance covering circumstances where a material change in customer numbers could occur. This will be in addition to the annual requirement for licensees to provide confirmation of resource adequacy for the following year. Any licensee preparing to acquire a portfolio of customers as the result of an exit would need to update their certificate of adequacy. The exits application process will require applicants to confirm that the acquiring retailer has a certificate of adequacy that covers the proposed transfer.

8. Allowing customers to return to their acquiring licensee for two years

In our previous policy consultation, we proposed that for a two year period following a transfer customers would have the right to switch away from the acquiring licensee and then return to them on the deemed contract. The aim was to encourage customers to participate in the new market, knowing that they had the option of returning to the deemed contract terms and conditions.

However, stakeholders were concerned that this could create undue complexity in the market, particularly over time as acquiring licensees merged or exited. Ofwat was also concerned that this could weaken customers' incentives to engage with the market and that a policy of returning customers to an acquiring licensee might risk perpetuating an incumbency advantage.

We have reviewed the policy in response to this feedback and are proposing an alternative approach. Instead of granting a time limited right to return to a particular licensee, we propose that all transferred customers that subsequently opt to switch from the deemed contract terms and conditions should retain a right to apply to Ofwat to be allocated to an alternative licensee. Ofwat will be able to direct a licensee from the 'Supplier of First Resort' pool to supply the customer on that licensee's published deemed contract. This right will not be time-limited.

In our view, this will retain the principle of equivalence between transferred customers and the customers of undertakers that had not chosen to exit without creating undue complexity, disincentives to engaging in the market or perpetuating an advantage for any party. In practice, we consider that applications to Ofwat for this purpose would be relatively rare, because we expect the market to evolve to meet the needs of customers and to offer a better deal than that available on the deemed contract.

9. Supplier of first resort and supplier of last resort regimes

There was general support for introducing a SoFR regime to cover exit areas. Some stakeholders questioned the principle of having a single pool across the country. However, the government's view is that the exit regulations should not reinforce a regional advantage for any party. The government considers that, in the vast majority of cases, newly arising customers in an exit area will opt to engage with the market in order to choose their own supplier. These measures are, therefore, designed as a back-stop form of protection to ensure that no new customer can be left without a supplier in an area where the undertaker has exited the retail market.

There was general support for the requirement that at least one acquiring retailer in each exit area must join the supplier of last resort (SoLR) panel and similar points were raised in response to SoFR.

There was a certain amount of confusion about the opt-in arrangements for SoLR as compared to the opt-out arrangements for SoFR. The SoLR is a regime that will apply

across the whole of England and Wales (not just exit areas) and requires the undertaker to be the ultimate supplier of last resort in all areas where an exit has not taken place. However, Ofwat will also have the option to allocate customers to one or more alternative licensees in the SoLR regime, rather than simply allowing them to default to the undertaker. However, because there is no undertaker to fall back on in an exit area, Ofwat will have to find alternative licensees.

It is the government's view that any licensees that acquire a substantial customer base as the result of an exit should join both panels. The policy objective is to ensure that, with the removal of the undertaker as the de-facto supplier of first and last resort within an area of appointment, fundamental safeguards designed to secure that all customers receive both retail and wholesale services are retained. Ofwat will have discretion about how they implement these requirements to ensure that they do not pose undue burdens on niche licensees.

10. Applications criteria and process

Respondents were supportive of a light touch and universal application and approvals process and supported the creation of a clear, predictable and timely exit process well before market opening in April 2017.

11. Communications requirements on undertakers and licensees

Most respondents recognised the importance of good customer communication from both exiting undertakers and acquiring retailers. Some respondents made the point that both parties should be free to communicate more extensively with customers if they choose and the government agrees with this point. Others suggested that communication could come jointly from the undertaker and the acquiring licensee and the government sees no problem with this so long as the requirement for the undertaker to communicate prior to exit and the retailer to communicate following the exit is observed.

One suggestion was that customers should be signposted to an impartial source of advice which would explain how to engage with the market and set out the options around switching. This suggestion has been shared with the Open Water programme.

D. 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 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.

Exit 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 the ultimate statutory 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. This 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).

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.

Wholesale – The inputting of water to, or the removal of sewage from, the network. 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.