EXPLANATORY MEMORANDUM TO

THE WATER AND SEWERAGE UNDERTAKERS (EXIT FROM NON-HOUSEHOLD RETAIL MARKET) REGULATIONS 2016

2016 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations make provision for water and sewerage undertakers ("undertakers") whose areas are wholly or mainly in England to apply to the Secretary of State for permission to exit the non-household retail market in their area of appointment. Subject to the approval of the Secretary of State, the undertaker would exit the retail market by transferring its non-household retail business to one or more water supply and/or sewerage licensees ("licensees") and would thereafter be prohibited from providing retail services to any new non-household customers that arise in its area of appointment ("the exit area").

2.2 The Regulations also introduce provisions that set out how the non-household retail market should operate in an exit area. These in particular ensure that customers in exit areas are never left without a licensee and provide customer protections that are broadly equivalent to those they would have been provided if the undertaker had not exited the retail market.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 This entire instrument applies only to England and Wales.

3.3 The instrument applies only to England and Wales because it applies only to relevant undertakers whose area is wholly or mainly in England (which will include undertakers mainly in England but also partly in Wales) - see regulation 4(1). The instrument does not have minor or consequential effects outside England and Wales.

3.4 In the view of the Department, for the purposes of House of Commons Standing Order 83P the subject-matter of this entire instrument would be within the devolved legislative competence of the Northern Ireland Assembly if equivalent provision in relation to Northern Ireland were included in an Act of the Northern Ireland Assembly as a transferred matter and the Scottish Parliament if equivalent provision in relation to Scotland were included in an Act of the Scottish Parliament and the National Assembly for Wales if equivalent provision in relation to Wales were included in an Act of the National Assembly for Wales.

3.5 The Department has reached this view because it considers that the primary purpose of the instrument relates to the regulation of water companies, which is within the devolved legislative competence of each of the three devolved legislatures: the primary purpose of the subject matter of the instrument is not within Schedule 5 to the Scotland Act 1998 and is not otherwise outside the legislative competence of the Scottish Parliament (see section 29 of that Act); the primary purpose of the subject matter of the instrument is not within Schedules 2 or 3 to the Northern Ireland Act 1998 and is not otherwise outside the legislative competence of the Northern Ireland Assembly (see section 6 of that Act); the primary purpose of the subject matter of the instrument is within paragraph 19 of Schedule 7 to the Government of Wales Act 2006 and is not within one of the exceptions listed therein, nor is it otherwise outside the legislative competence of the National Assembly for Wales (see section 108 of that Act).

4. Legislative Context

4.1 Chapter 4 of Part 1 of the Water Act 2014 includes powers that enable the Secretary of State to make regulations to allow an undertaker to apply to exit the non-household retail market for that area. The Regulations can include provisions about determining an exit application, for transferring the relevant non-household business to an eligible licensee or licensees and about the operation of a retail exit area after the exit has taken place. The Regulations can also include provisions for protecting the household and non-household customers affected by the exit.

4.2 Chapter 1 of Part 1 of the Water Act 2014 amends the Water Industry Act 1991 by expanding and revising the current water supply licensing regime and adding a sewerage licensing regime. It also increases choice in the retail market by removing the threshold principle which sets the water usage limit for when non-household customers in England can switch to a water supply licensee (currently 5 megalitres).

5. Extent and Territorial Application

5.1 The extent of this instrument is England and Wales.

5.2 The territorial application of this instrument is as detailed in paragraph 3.2. However, the Regulations only apply to undertakers that are wholly or mainly in England. The Regulations therefore do not apply to areas in England and Wales served by undertakers that are mainly in Wales[1].

6. European Convention on Human Rights

6.1 The Parliamentary Under Secretary of State for Environment and Rural Affairs has made the following statement regarding Human Rights:

"In my view the provisions of The Water and Sewerage Undertakers (Exit from Non-Household Retail Market) Regulations 2016 are compatible with the Convention rights."

[1] Welsh Water and Dee Valley Water are both undertakers that are mainly in Wales but serve some premises in England. Severn Trent Water serves premises in Wales but it will be able to apply for an exit because its area of appointment is mainly in England.

7. Policy background

What is being done and why

7.1 The Water Act 2014 enabled reform of the water sector, including by extending the scope for competition in the market for non-household retail services. These reforms will allow all business, charity and public sector customers to choose their water and sewerage supplier for the first time. During the passage of the Water Bill, the Government responded to cross-party support in both Houses of Parliament by introducing amendments designed to enable undertakers to voluntarily exit the retail market. The Government is committed to ensuring that undertakers who wish to exit the market can do so when the retail market opens in April 2017.

7.2 The policy driver for enabling retail exits is to ensure a well-functioning competitive market. Retail competition will give some 1.2 million 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 the reformed market. Allowing exits will also enable licensees to increase their market share through acquisition of an exiting undertaker's business rather than pursuing individual customers contract by contract. The Government is not seeking to require undertakers to exit, nor is it 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.

7.3 In enabling exits, the Government wants to ensure that the customers of an exiting undertaker have access to the same standards of protection that they would have had if they had remained with the undertaker. For example, all customers must be assured of receiving both retail and wholesale services. 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 retail market underpins the Government's policy approach to exits.

7.4 The Regulations require responsibility for the handling of any outstanding complaints from customers on the exit date to be transferred from the undertaker to the acquiring licensee. The details around potential liabilities arising from customer complaints will be addressed as part of the commercial agreement between the exiting undertaker and the acquiring licensee and may be covered in the transfer scheme if there is one (see 10.2).

7.5 The Regulations also enable exited undertakers to have their areas of appointment changed to include additional areas (in cases where for example, an undertaker agrees with another undertaker to change its border or where Ofwat allows it to become the undertaker for a previously unserved site in another undertaker's area of appointment). This means that unexited undertakers will be able to serve non-household customers in the unserved parts of an exit area and an exited undertaker will not have to submit a further exit application to the Secretary of State to serve its new areas.

8. Consultation outcome

8.1 Late introduction of the exit provisions during the passage of the Water Bill meant that there were limited opportunities for policy consultation and parliamentary scrutiny. The Government recognised in parliamentary debates that the detailed policy on how to implement the exit provisions would need to be developed in consultation

with all interested parties. Immediately following Royal Assent the Government began a process of detailed engagement with the water industry, consumer groups and Ofwat to inform the development of the policy on exits and build consensus around the policy approach. This involved:

i. engagement through the Water UK council and its public affairs network;

ii. engagement with business customers through the Consumer Council for Water, Citizens Advice, the Federation of Small Businesses and the Major Energy Users Council;

iii. publication of a discussion document setting out the high-level principles underpinning our approach to exits policy, supported by a workshop involving a wide cross section of stakeholders in July 2014;

iv. creation of a stakeholder contact group, consisting of undertakers, licensees, customer bodies and Water UK; and

v. regular stakeholder workshops and widespread bi-lateral engagement with undertaker, licensees, customer groups and Ofwat.

8.2 Following this extensive dialogue with stakeholders, Defra formally consulted on its detailed policy objectives between December 2014 and February 2015.[2] Respondents to the consultation were supportive of the proposed approach. In particular there was strong endorsement for a robust framework for consumer protection, and also for clarity around the role of undertakers and licensees over the long term.

8.3 Following this first phase of consultation, Defra continued to work closely with stakeholders to translate the policy into draft Regulations. Defra then carried out a second consultation, on the draft Regulations themselves, between July and October 2015. The significant majority of responses received to the consultation expressed support for the approach taken forward in the draft Regulations. Respondents were once again supportive of the approach taken and some provided some helpful suggestions to improve the drafting.

8.4 At the conclusion of the Water Bill process, Ministers committed to sharing a copy of the indicative Regulations with the EFRA Select Committee to provide an opportunity for its members to comment on our intentions. A copy of the draft Regulations was sent to the Committee in August 2015 and a further communication was sent in March 2016 confirming our final approach. To date, the Committee has not indicated that it would like to provide any comment on the draft Regulations.

9. Guidance

9.1 Defra has produced an application form with embedded guidance on how to reply to individual questions to simplify the application process for undertakers. An initial draft application form was published alongside the consultation on the draft Regulations and this was updated in light of some comments made in that consultation and will be re-published alongside the summary of responses.

10. Impact

10.1 There is no direct impact on charities or voluntary bodies. The Regulations will have a direct impact on undertakers (businesses) that want to exit the market and, if the Secretary of State approves the exit, on non-household customers that are

[2] https://consult.defra.gov.uk/water/retail-exits-reform

subsequently transferred to a licensee. These non-household customers might include charities, voluntary bodies and other businesses.

10.2 The direct impact on the public sector is limited to Defra incurring some additional costs through handling exit applications. These will not be significant and will be met within existing budgets. Ofwat will also incur additional costs in approving statutory transfer schemes[3] if undertakers have to use one or more schemes to transfer special customer agreements to licensees or they decide to transfer their retail businesses using these schemes. It should be noted that transfer schemes can only be used to transfer property, rights or liabilities in respect of the non-household retail element of the undertakers' business – as this is the only part of their undertaking from which the Regulations permit them to exit. The remainder of their undertaking (ie. their wholesale business and their retail business for household customers) is unaffected.

10.3 Indirectly, the Regulations will impact those public sector organisations whose water and sewerage undertaker decides to exit the market and subsequently transferred to a licensee. The Regulations are designed to minimise disruption to transferred customers and help ensure that they are made no worse off as the result of the exit (e.g. the licensee must allow transferred customers to be billed and make payments by the same methods as they were able to do before the exit).

10.4 The Regulations, along with wider retail reforms, are estimated to deliver benefits of £211 million NPV over 30 years. This was based on an assumption that 50% of undertakers (approximately 10 companies) would exit at market opening in April 2017. The benefits are mostly driven by the proportion of undertakers that choose to exit meaning that the NPV could be higher if more undertakers choose to exit next year.

10.5 An Impact Assessment on reform in the retail market was produced in advance of the Water Bill entering Parliament in June 2013 and updated[4] and re-published in light of the decision to provide for retail exits. A copy is available on legislation.gov.uk here alongside the 2014 Act.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses where these are undertakers who want to exit.

11.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to make exits voluntary and allow any undertakers (including those with fewer than 50 employees) to decide themselves whether or not to apply to the Secretary of State to exit the retail market.

12. Monitoring & review

12.1 The Secretary of State must review the Regulations within five years of the Regulations coming into force and publish a report setting out the extent to which the Regulations have met their intended objectives and whether those objectives are still

[3] Transfer schemes are compulsory for special customer agreements but voluntary for other parts of the non-household retail business.

[4] The impact assessment published alongside the Water Bill included an option for undertakers to voluntarily transfer their non-household and household retail businesses to licensees. The updated impact assessment amended this option to only allow for a voluntary exit of the non-household market.

appropriate for legislation and, if so, the extent to which they could be achieved with less regulation. Subsequent reports must be published at intervals not exceeding five years.

13. Contact

13.1 David Jones at the Department for Environment, Food and Rural Affairs Telephone: 020 802 63003 or email: david.jones@defra.gsi.gov.uk can answer any queries regarding the instrument.