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Retail Licensing
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Dear Sir

Consultation on licensing and policy issues in relation to the opening of the non-household retail market

Sutton and East Surrey Water welcomes the opportunity to comment on issues related to non-household retail competition. In responding to the issues on retail licensing we have also drawn on our related company, Sutton and East Surrey Water Services Ltd's, recent experience of applying for a retail licence. Our response to each question is attached at Appendix 1.

We generally support your proposed approach to the issues covered. As you will see our comments focus on keeping arrangements as simple as possible and reducing the burden on parties that will operate in the new competitive market. For example, we highlight where it may be better to include information about operating in the market in only the code rather than duplicating it in licences.

We still have material concerns about the proposed approach to registering sites that are under construction. This is briefly covered in the "developer services" section of your consultation. We agree with the information in the consultation which makes it clear that developers can choose who provides them with contestable connection services. We are however concerned with the proposed process for registering sites that is included in the Market Architecture Plan version 3 (MAP3). In our view the proposed process would result in registration of sites which ultimately would not be part of the competitive market. We ask that consideration be given to the appropriate point in the process when registration should take place to avoid unnecessary processes that will make operating the market more costly.

Please let us know if you would like further explanation of the points we raise. In the first instance please get in touch with Joanna Campbell, Economic Regulation Manager (JoannaC@waterplc.com, 01737 785 692).

Yours faithfully

A handwritten signature in black ink, appearing to read 'J Downer', written over a light blue circular stamp.

Jeremy Downer
Retail Services Director



Appendix 1: Response to questions asked

Q1 Do you agree with the proposal to have separate licences covering water and wastewater retail? If not, please explain how you envisage that a single licence for water and wastewater would differ?

We think the proposed modular structure is the most appropriate form of licence if it can be demonstrated that the licensing requirements for retail water and retail wastewater services are different. You note that there would be additional technical competency questions for wastewater and you would consult with the Environment Agency and Natural Resources Wales. So it is possible that an applicant would not wish to demonstrate competency in this area and therefore be able to apply only for a water retail licence.

It would be helpful to understand what technical expertise a wastewater retailer would have to have and how these would differ from a water retailer. If there is limited difference then it may be more sensible for the retail licence to automatically allow the licensee to carry out both functions, even if they subsequently choose only to provide retail services for one. If this is the case the modular structure may not be needed.

Q2 Do you agree with the proposed amendments to standard conditions for the new water supply and sewerage service licence (WSSL)?

Q3 Do you think any of the proposed amendments listed in Table 3 are non-routine and require additional discussion? If so, why?

We agree that the proposed amendments are routine but our answers to questions 1, 4, 5 and 6 suggested some changes to the proposed drafting which should be taken into account. There are also a number of references in the text to further developments required. These points may, depending on the final drafting, require further discussion.

Q4 Do you agree with the proposed approach to maintaining customer protection in the future WSSL?

In a competitive market for retail services customers' ability to switch will be the key driver of retail licensees ensuring that they have adequate resources available to maintain service quality. If a licensee does not demonstrate that it has adequate resources it is likely to lose customers. In addition, being party to and complying with the industry codes should provide the customer protections that the licence requirement is aiming to achieve.

Given the above we question whether updating the certificate of adequacy is necessary and therefore whether this section of the proposed licence is needed. If this licence requirement is to remain it would be useful to understand what form of assessment Ofwat will carry out each year (or more frequently as needed) and what action it could take following the assessment.

Q5 Do you agree with the proposed approach to Market Arrangements Code enablement?

Q6 Do you have any specific comments on the legal drafting?

We agree that a licence condition on retailers and wholesalers to be a party to and comply with the Market Arrangements Code (MAC) is sensible. We also agree that the MAC should include a process for its modification.

We think the content of this condition can be significantly reduced. It need only include a high level statement for each of the areas covered in paragraph 1.1 of the draft text in appendix A4.

The other information should be contained in the MAC and does not need to be duplicated in the licence.

Our reasons for suggesting that these requirements be included only in the code are:

- Having one document which gives parties all the information they need to participate in the market makes it easier to participate effectively which may reduce costs and limit the potential for unintentional non-compliance.
- It prevents a future situation where modification of one document, without the modification of the other, introduces inconsistencies.
- As all modifications to the code require Ofwat approval there would be no potential for modifications to the MAC to introduce arrangements which Ofwat considered were not in the consumer interest.

Our view is that the current draft MAC (Appendix 4, section 7) does not fulfil all the requirements of the draft licence condition and therefore further revisions will be necessary to achieve Ofwat's requirements. For example, the draft MAC does not make it clear that all change proposals will be brought to the attention of all market participants or whether market participants will have the opportunity to evaluate the modification prior to the submission of the Final Report to Ofwat.

Q7 Do you agree with the proposed approach to include requirements on arm's length transactions and non-discrimination?

Q8 Do you have any other comments on our proposed conditions in this area?

Equivalence of treatment is essential to the functioning of a competitive non-household retail market. We fully support the removal of the in-area trading ban for retail licensees as this will allow all retailers to compete on equal terms.

We agree that transactions between related retail licensees and undertakers should be at arm's length. We also agree that any requirements on non-discrimination in charging should apply equally to retail licensees and undertakers who choose not to exit the market. Retail licensees will be required to comply with competition law so we do not see the need to include such requirements in the licence. If Ofwat consider that this additional safe guard is required it should make sure that the legal drafting is fit for purpose. For example, paragraph 1.8(b) of the draft stapling licence condition (appendix B3 of the consultation) could be interpreted as introducing requirements that go further than what would be required under competition law. We do not think this is the intended purpose but it shows that care is needed when introducing licence requirements in this area.

Q9 Do you have any other observations about our proposals on changes to the standard conditions for the new Water Supply Licence?

Q10 Are there any areas not covered in the proposals in which you consider changes are required?

Our comments and suggestions are covered in response to questions 1 to 8.

Q11 Do you agree with our proposals for the conditions within Table 4? Please respond separately on each of the three Appointment conditions (Q, G and I) discussed.

We agree with the intent of the changes proposed to conditions Q, G and I.

Retail licensees should have the same obligations as undertakers to inform their customers of CC Water's role and contact information. Undertakers may not have a direct relationship with some customers and therefore customers should be able to get this information from their

retailer. For the reasons outlined in response to questions 5 and 6 our preference is for all such operational requirements to be in the code rather than in licences and therefore support your view that the code should include this.

Q12 Do you agree with our proposals for the conditions within Section 5.1.2 on equivalence? Please respond separately on each of the eight conditions discussed.

Taking each proposed change in turn:

- *F6*: It is not clear that any changes are needed. The condition is there to protect customers of the regulated monopoly business. These protections will be equally necessary if the licensee exited the non-household retail market.
- *F6 A2A*: In our opinion a certificate of adequacy is only necessary for the sections of the business that are not subject to competition. Therefore we do not think a certificate of adequacy is needed for non-household retail section of the appointment. See our response to question 4.
- *R1-3*: We support removal of access codes where this is now covered by market codes.
- *R5.1*: We agree that the in-area trading ban should be removed. We also think that reference to arm's length transactions can also be removed because this will be covered by condition F, paragraph 6.
- *R5.3*: We support removal of this subparagraph.
- *R7-9*: We support removal of content that will now be in the market codes.
- *S*: We support removal of content that will now be in the market codes.
- *N*: We think it is appropriate that the licence fee should be separately identifiable for the competitive and non-competitive sections of the market. All else held equal, an appointee that exits the non-household retail market should see a reduction in the licence fee it pays.

Q13 Do you agree with the draft condition set out in Appendix A to enable the Market Arrangements Code? Are there any reasons why this condition should differ between the Appointment and the standard conditions of the WSSL?

Please see our response to questions 5 and 6. We don't see any reason why the condition should differ between the appointment and the retail licence.

Q14 What are your views on the proposed 'stapling' condition set out in Appendix B requiring the company to adhere to the Wholesale Retail Code in its interactions with its own retail business? Does the proposed condition work alongside Schedule 8 of the Market Arrangements Code?

Q15 Do you consider that the proposals will achieve the objective of equivalence, with the same obligations and opportunities for all retailers? If not, what additional suggestions do you have?

We understand that the intent of this condition is to bind all non-household retailers into the provisions of the code whether they hold a retail licence or are part of a non-exited incumbent. We support the proposed intent. Our interpretation of the proposed condition suggests it goes beyond this intent. In particular, paragraph 1.8(b) could be interpreted as introducing requirements that go further. We suggest that the legal drafting be reviewed as part of the proposed working groups in August.

Q16 Do you have any other observations about our proposals on changes to the conditions for the Instruments of Appointment?

Q17 Are there any areas not covered in the proposals in which you consider that changes are required?

Q18 Are there any areas in your Appointment in which you think differences from the examples used will require detailed consideration in future work?

We have no further comments.

Q19 Do you agree that we should retain the three basic elements of financial stability, managerial competency and technical competency in assessing future licence applications?

We agree that these three areas cover the information that should be required when applying for a WSSL licence. Equally important is for Ofwat to adhere to the timescales associated with a licence application to demonstrate legitimacy of the process to any new entrant.

Q20 Do you agree that gaining a retail future WSSL licence should be conditional on successfully completing market accession testing? Are there any aspects of the licensing process that could be further simplified to avoid duplication/overlap across the two processes?

We agree that both processes are essential and that duplication should be avoided to limit barriers that onerous processes could introduce. Keeping timescales as short as possible is important as a new entrant may be ready (with a customer) to start trading.

Q21 Do you have any comments on the proposal that licence applications for the future market should include the provision of a completed certificate of adequacy?

It seems sensible to include this as part of the licence application process. We have queried in response to earlier questions whether an annual update of this certificate is needed and what process Ofwat goes through to assess its content on an annual basis.

Q22 Do you have any comments about the coverage of wastewater in the licence application process and the role played by the Environment Agency?

It would be helpful to understand what technical expertise a wastewater retailer would have to have and how these would differ from a water retailer. If there is limited difference then it may be more sensible for the retail licence to automatically allow the licensee to carry out both functions, even if they subsequently choose only to provide retail services for one.

Q23 Do you consider that the role of any sponsor should be maintained, limited or removed entirely? What are your reasons for this view?

We have no comments at this time.

Q24 Do you have any comments about the proposals to include coverage of customer facing systems in the managerial competency tests?

It is reasonable to assess whether a retailer has in place systems for interacting with its customers before granting it a licence. Developments of both market accession and licence application processes should be developed in tandem to avoid any duplication in what is required.

Q25 Do you agree that the scale considerations are better dealt with via the certificate of adequacy rather than additional testing in the licence application process?

We agree that assessing the potential implications of a change in scale should not be part of the application process. We have, in response to question 4, questioned the role of on-going updates to the certificate of adequacy for retailers. In our view the competitive market, ie the

potential to lose customers, will drive the behaviours needed from retailers. A retailer would not wish to increase its scale if it ran the risk of lowering its service standards and losing customers. Additionally, we note that it would require a significant increase in scale to have any real impact on retail capability.

It is also unclear what Ofwat would do with the information provided to it in a certificate of adequacy. If Ofwat finds that the retailer will not be able to maintain service standards if it gained more customers will Ofwat prevent the retailer from supplying these additional customers?

Q26 Do you agree with our proposed transition approach for current retail only WSL?

For those parties that already have retail licences the process should be as simple as possible to avoid imposing additional burden and cost on parties. We would appreciate clarity on what steps current retail licence holders will be required to take and the proposed timelines.

Q27 Do you agree with our proposed approach to transition current combined supply WSL?

We support removal of the customer transfer protocol and do not see any reason why these processes could not be dealt with under the new market arrangements as suggested in the consultation. Where common carriage arrangements exist they could be addressed through bilateral contracts.

Q28 Do you agree with our proposed approach for creating self-supply licences?

We have no comments at this time.

Q29 Do you agree that there should be a new condition in current licences and Instruments of Appointment to underpin the required preparations?

Q30 If you agree that there should be a condition, should it cover both a general obligation and a specific link to a formal transition plan?

Q31 Are there any additional provisions that you think it would be helpful to include in a licence condition on company readiness or any other comments/concerns you would make?

We do not think a licence condition is the most appropriate tool for making sure that participants in the market are ready for market opening. By the time the licence condition becomes effective participants will already have had to make progress so that the market is ready for April 2017. It is therefore clear that participants will need to carry on preparing with or without a licence requirement to do so. The level of engagement in the process so far has been high and we are fully participating in making sure we are ready for April 2017.

Instead of a licence obligation we suggest that a more pragmatic approach would be to gain assurance from market participants that they have the resources and systems in place to implement the changes needed for market opening. In order to provide this assurance we will need to fully understand Ofwat and Market Operator Services Limited's (MOSL) requirements. As identified in the baseline review of Open Water (published 30 June) there is information we need and don't currently have to make sure our own processes are adequate. Focusing on providing companies with the information they need to make sure they are ready is more important than focusing energy on drafting a licence condition. We support the conclusions of the baseline review and look forward to working with Ofwat and MOSL on building programme management and assurance processes that fit with requirements.

Q32 Do you consider that implementing an auction style allocation process similar to the one that Ofgem has adopted ahead of a backstop allocation process would be the best approach to protecting customers in the event of the failure of a retailer?

We support the auction process in principle but we need to understand the detailed arrangements. The success of the regime will be dependent on getting these details right. We do not, for example, support arrangements that would allow for any bidder in the auction to “cherry pick” the customers that it had a preference to supply. Allowing for cherry picking makes it more likely that less desirable customers have to be allocated based on back-stop powers. This may reduce the willingness of parties to volunteer to be the supplier of last resort (SOLR). Or if there is a requirement to be the SOLR it could increase the cost of operating the market as the retailer acts to protect itself from the additional risk it may have to take on from gaining customers through back-stop SOLR arrangements.

Q33 Do you have any suggestions about the best approach to ensuring that the new market arrangements are proportionate for a) smaller wholesale companies and b) small retailers.

Q34 Do you have any suggestions about the best approach for companies operating wholly or mainly in Wales?

We have no comments at this time.

Q35 Do you have any comments about the circumstances in which a retail supplier should be able to opt out of Supplier of First Resort (‘SoFR’) arrangements?

We have no comments at this time.

Q36 Do you agree with our proposed approach for the developer services market and the related process proposed within MAP3?

Q37 Do you agree with our assessment of the interactions between the various parties?

We do not agree with the process outlined in MAP3 and think it would create processes that could be avoided.

The consultation focuses on the market for connections. We agree with how this market is described, eg that some sections are contestable and so the developer should be able to choose whether the undertaker or another party carries out the work.

We also agree with your statement that “non-household premises will need to be registered with the Market Operator at the appropriate point in the process”. We are though concerned that the MAP3 proposals include registering connections for Building Water and domestic only premises. This does not seem to align with the text of the consultation because this is not an appropriate point in the process.

It is unclear why connections for domestic premises need to be registered with the Market Operator. Ultimately the end customers at these premises will not be able to choose their retailer. Therefore registering them will create unnecessary processes.

We also consider that registering premises that only require Building Water may be unnecessary. The supply of Building Water will be finite as ultimately the premises could be domestic or if non-household it will be up to the occupant(s) to choose its retailer. We encourage Ofwat to discuss these proposals with developers to understand their desire to have choice in who supplies them with Building Water. We suggest as an alternative approach that Building Water supplies are not subject to competition. The code should outline the timescales

required for registration prior to connections being made so that adequate time is available for Eligible Premises to choose a retailer.

Q38 Do you agree with principle that Special Agreements should be contestable and the current thinking on the details of the approach outlined in section 9.2.5?

We agree that customers that currently receive a special agreement should, assuming no changes in circumstance, continue to receive this in the competitive market as a reduction in the wholesale charge. Therefore we agree that the wholesale charges under special agreements should be made public.

The proposal with regards to retail agreements is unclear. Agreements for retail charges should be a matter for a customer and its retailer.

Q39 Do you agree with the principle that there should be early publication of wholesale charges and the current thinking on the details of the approach outlined in section 9.3?

We would like to understand both the magnitude of the issue this is trying to address and whether the proposed approach would achieve the desired outcome before concluding it is beneficial.

Our interpretation of the proposal means that the charges published in July would be indicative. Publishing early may not therefore create the certainty that retailers may want as alongside the unknown impact of RPI there are other factors that influence each year's charges, eg forecast customer numbers and usage. Any indication of these factors produced in July would, by their nature, not be as accurate as the figures used to set final charges published by February the following year. The additional process requirements on wholesalers, in terms of generating and assuring indicative charges, can only be warranted if there are benefits to retailers and ultimately customers. We have not seen the evidence that these benefits exists.

We have also seen, particularly in recent years, that RPI can vary considerably even over a few months so there could still be material differences between interim and final charges just due to the change in RPI.¹

Q40 Do you agree that wholesalers should only levy charges that are in their wholesale charges schemes or published as special agreements? If not, please provide arguments as appropriate to support your position.

We agree that wholesale charges, including special agreements, should be published in full. There is however an issue of timing that needs to be considered. Situations are likely to arise where within a charging year a wholesaler and retailer want to agree terms of use that are not in line with the published charges. We would not want to see this prevented because no process had been put in place to allow for such situations. In our view preventing this would stifle choice and innovation in the market.

We would appreciate clarity that the market operator will allow for updates to charges within year. We would support all retailers being informed of any changes to charges during the year in the interests of transparency.

Q41 Do you agree with our proposed approach to implement these licence changes? If not, how should we go about making these changes?

We have no comments on the proposed approach.

¹ For example the Office of Budget Responsibility's latest forecast for RPI for Q3 2015 is 0.9 compared to its forecast of December 2014 of 2.1.