

# Licensing and policy issues in relation to the opening of the non-household retail market – a consultation

## Southern Water's Response

20 July 2015



## **Southern Water's response to Ofwat's consultation on licensing and policy issues in relation to the opening of the non-household retail market**

### **Overview**

We welcome this consultation, which is an important document covering both the proposed licence amendments and policy issues required to enable an effective and efficient non-household retail market within a suitable framework of new obligations and codes.

We accept that retail licence changes and amendments to incumbents' conditions of appointment are required to reflect the new scale and scope of the market and enforce the associated statutory and non-statutory codes being implemented.

We have provided our response to the specific consultation questions, but we would like to highlight three key issues:

- There is clearly still a huge amount of work required to deliver the market, including publication of a number of policy guidance documents, such as credit security, eligibility guidance and charging rules. We believe the focus should be on ensuring the market is in place for 2017. Therefore, any changes should only be implemented where it is essential for the market, such as ensuring the MAC is enabled, WSSLs are fit-for-purpose and amendments to the instruments of appointment reflect requirements of the new market arrangements, with minimum impact where possible.
- Section 9, which covers charging under special agreements, raises a number of issues and questions worthy of further debate. This includes issues concerning informal arrangements for non-price services and legacy non-chargeable premises.
- This publication is more than a consultation document, providing a framework of how the various provisions in the Water Act 2014 and proposed statutory and non-statutory codes will be knitted together and the programme of work required to deliver this framework. We believe it is important to continue to provide visibility of the timescales and interdependencies of the wider regulatory activities to ensure transparency of the overall market reform programme.

**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.**

The paper does not explain the rationale for separate licences . We understand it is the same as Scotland, but we do not see the benefit of two separate retail licences and do not consider water and wastewater to be separate retail activities. To simplify the process we feel that it would be preferable to have a single licence for both water and wastewater retail services.

**Q2 Do you agree with the proposed amendments to standard conditions for the new supply licence?**

Yes, we agree with the proposed amendments as they are required to accommodate changes in scope, new market arrangements and changes in terminology.

**Q3 Do you think any of the proposed amendments listed in Table 2 are non-routine and require additional discussion?**

We believe that the proposed amendment to Condition 8 on arm's length transactions is significant and we would like to further understand the meaning of arm's length transactions in this context. It would not be in the interest of customers to prevent the benefits of scope and scale from being realised and such provision may have an impact on retail exit decisions. Therefore this proposal would benefit from further discussion following publication of Defra's draft retail exit regulations.

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

With the wider market scope and the impact of retail exit, we believe the additional provisions for customer protection following a prospective material change in customer base would be beneficial. However, the condition as currently drafted, does not align with the requirement described in the consultation paper to provide a new certificate upon any material change to customer numbers, only to report and notify the Authority if it believes that it does not have adequate resources.

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

We agree that new licence and appointment conditions would be a suitable approach to enablement of the Market Arrangements Code (MAC).

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

We suggest that the obligation in 1.1.2 to 'take all steps within its power' should be amended to 'take all reasonable steps'

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

We agree with the proposed approach.

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

No.

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

No.

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

No.

**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.**

The definition of “business customer”, “domestic customer” and “domestic premises” within the condition needs to be aligned to the eligibility criteria for the market.

The requirements of Condition G relate to domestic customers only and should, therefore, unaltered. However, we agree that it would be more pragmatic to include provisions for the retailer to inform customers about CCWater in the WRC.

Condition I relates to domestic customers, and, as previously noted, the definitions need to be aligned to the eligibility criteria for the market.

**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.**

<b>Condition</b>	<b>Nature of proposed change</b>	<b>Southern Water’s comment</b>
F6 (arm’s length transactions)	Amend wording (detail to be published following publication of Defra’s exit regulations)	Awaiting publication of Defra’s exit regulations.
F6 A2A (Certificate of Adequacy)	Amend wording to require separate certificates and align requirements on NHH certificate with those for WSSL licensees.	We do not see the benefit of producing separate certificates for NHH retail as the scope and scale of the appointee service provision is not changing.
R1-3 (Access code for WSL)	Amend wording to remove access codes for retail only WSL or delete	We agree with this proposed change.

	condition if obligation on access code for combined supply sits within transition scheme.	
R5.1	Amend wording to remove the in-area trading ban and maintain requirement for arm's length transactions.	We agree with this proposed change.
R5.3 (relationship with licensees)	Strong minded to remove this obligation to inform Ofwat where circumstances change. Ofwat intends to rely on its ex-post powers in assessing whether there is evidence of any anti-competitive behaviour.	We agree with this proposed change.
R7.9 (information sharing with WSL)	Amend or delete depending on form of transition schemes for combined supplies.	Awaiting details of transition scheme.
S (Customer Transfer Protocol)	Amend or delete depending on form of transition scheme for combined supplies.	We agree with this proposed change.
N (Licence fees)	Views requested on the need for a separate licence fee for non-exited non-household retailers.	We do not believe that a separate licence fee is an essential requirement.

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

We agree that there should be an equivalent condition which requires the use of the MAC, following the amendment suggested in question 6.

**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 Markets Arrangements Code?**

We agree that there should be a condition for companies to adhere to the operational and market terms when interacting with its own retail business to ensure a level playing field. However, the drafting of the condition essentially mandates legal separation by requiring companies to behave as if they were separate, contrary to the intention of Parliament.

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

We believe adherence to the MAC and WRC, along with ex-post powers, should achieve a level playing field.

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

The draft condition requiring arm's length transactions may require further consideration, as this may impact financing arrangements of integrated incumbents.

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

No comment.

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

Without knowing which licence has been used it is not possible to identify whether there are relevant difference which need to be taken into account. Therefore, this will require further consideration, which we will feedback on in due course.

**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 basic elements should be retained.

**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 licence process that could be further simplified to avoid duplication/overlap across the two processes?**

It is apparent that both the licence assessment and market accession testing are required before a new entrant can participate in the market. We do not see any reason to link the two assessment processes as dependencies.

**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?**

We agree with the proposal.

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

No comment.

**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 strong view, but any such requirement for a sponsor should be proportionate and not act as a barrier to entry. It is not clear that the process adds significant value.

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

This proposal appears reasonable but should be proportionate and not act as a barrier to entry.

**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 the certificate of adequacy is the appropriate method to address scale considerations.

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

We agree with the proposed approach.

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

Yes. However, we are concerned that the customer transfer protocol process would not be fit for purpose should the new market arrangements not be in place at market opening.

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

Yes, we agree with the proposed approach. The key issue will be the calculation of fees for self-supply, which will be the key determinant of whether it is economic to self supply.

**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 the 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 are unable to reach a view based on the information provided. The consultation provides very little information on the new licence provisions to underpin company readiness and we suggest further work on this topic, including engagement with companies, is required to fully understand the specific obligations.

**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?**

Whilst we support the proposed approach in principle, we do not see this mechanism as a critical deliverable given the tremendous programme of work required to deliver the market for 1<sup>st</sup> April 2017 and the current “amber” status of the programme.

**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.**

No comment.

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

No comment.

**Q35 Do you have any comments about the circumstances in which a retail supplier should be able to opt out of SoFR arrangements?**

No comment.

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

Yes, the developer services processes in the WRC should focus on ensuring newly connected non-household premises enter the retail market.

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

Figure 6 lacks clarity on which activities would be dealt with by the incumbent retail business and the incumbent wholesale business. As described in the WRC, developers are able to directly contact the incumbent for pre-application enquiries and, considering the provision for retail exit, this must be the wholesale business, which is not apparent on the diagram.

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

We agree with the principle that special agreement customers should be able to access the market. However, there may be instances of pre-privatisation legacy agreements for non-chargeable tariffs, such as where access rights have been historically agreed. We do not believe these non-chargeable sites should contain a retail tariff element, which could result in negative wholesale charges. These customers do not receive any retail services and therefore should not incur any retail charges.

**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 this section?**

Whilst we understand the request for early sight of wholesale charges and agree that it should not take long to adjust the forecast RPI, we do not believe it is practical to publish indicative wholesale access prices by July as it would not allow sufficient time to develop the

charges scheme. For example, companies seeking to re-structure or rebalance their tariffs, or to introduce a new tariff, would have insufficient time to undertake the impact assessment, customer and stakeholder consultation, and to gain Board approval. We believe October would be a more reasonable publication date for indicative charges.

**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 all charged services should be contained within the wholesale charges scheme or published as special agreements. For the sake of clarity and consistency, we believe there should be a standard list of non-primary charges that companies are required to include in their wholesale charges scheme if they wish to levy these charges.

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

We do not have a preference whether the changes are made under the section 13 or section 55 process. The important thing is that whichever the legal route, stakeholders are engaged in the process and have sufficient opportunity to make representations on the proposed changes