

# **Application of the new non-household retail market framework to new appointees, small companies and companies based wholly or mainly in Wales**

## About this document and responding to this consultation

These document shares slides covering issues that were discussed at a workshop held on Friday 11 March, attended by

- new appointees;
- Cholderton & District Water;
- Dŵr Cymru;
- Dee Valley Water;
- Market Operator Services Ltd (MOSL);
- Defra; and
- Consumer Council for Water

We are now inviting views from stakeholders on the issues raised. We request views by close of business on **Friday 18 March 2016** to Dan Mason, Principal - [Daniel.mason@Ofwat.gsi.gov.uk](mailto:Daniel.mason@Ofwat.gsi.gov.uk)

We will publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory 'Code of Practice' which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## Questions discussed

### **New appointees setting non-household charges in a retail exit scenario**

1. Do you agree with the options we have considered?
2. How else could charging for non-household customers be set and why is this approach more suitable?
3. Are there any other issues that we need to take into account? What is your preferred option?

### **Small companies setting wholesale charges**

1. Do you agree with the options we have considered?
2. How else could wholesale charges for small companies be set and why is this approach more suitable?
3. Are there any other issues that we need to take into account? What is your preferred option?

### **Licensing and interactions with market systems**

1. Do you agree with the options we have considered?
2. How else could small and Welsh companies interact with the market systems and why is this approach more suitable?
3. Who should be responsible for managing decisions on derogations? What is your preferred option?

### **Company eligibility**

1. Do you have any views or comments on this issue?
2. Do you think there are there any outstanding issues that need to be resolved?

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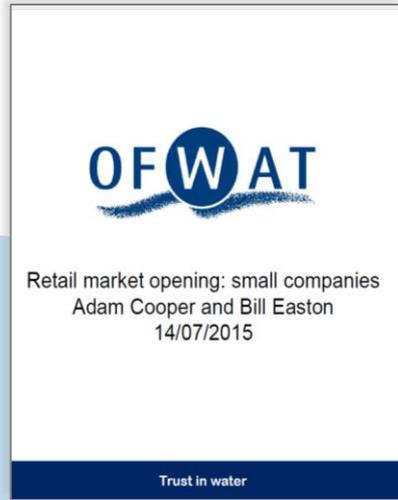
Workshop on the application of the new non-household retail market framework to new appointees, small companies and companies based wholly or mainly in Wales

11 March 2016

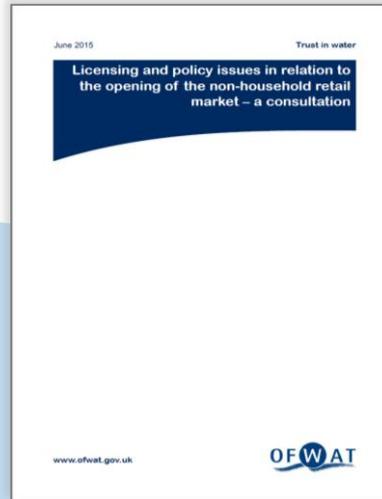
Dan Mason and Andrew Beaver

# Welcome, introductions and context

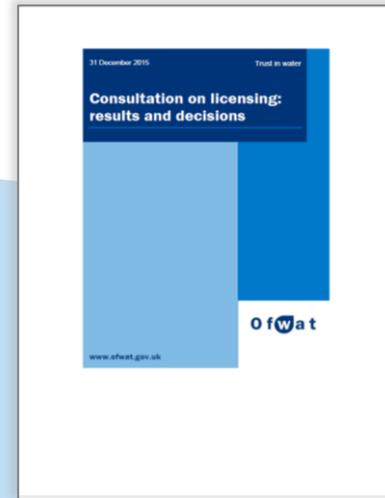
## Issues relating to small companies and Wales have been discussed and highlighted previously with stakeholders



Small company workshop discussed the proposed market arrangements to small companies, focussing on proportionality



Licensing consultation invited views on how small and Welsh companies should interact with new market



Licensing results document provided an update on our thinking and signalled further engagement

### Key issues identified for market opening

NHH charges in an exit scenario

Small companies setting wholesale charges

Licensing and interaction with market systems

Company eligibility

The purpose of today's meeting is to discuss a number of key issues relating to the application of the new non-household retail market framework to small companies and companies based wholly or mainly in Wales

# Objectives and our approach



Building on previous engagement, our objectives are to:

Explore approaches to a number of key issues relating to retail market opening to assist where possible with companies' market readiness

Provide clarity on issues around the definition of “wholly or mainly” and its impact on market preparation

Establish a way forward to ensuring that the interaction with new market arrangements are proportionate

We are aware that there are some other issues that remain outstanding regarding the ongoing regulatory arrangements for small companies that are not related to Retail Market Opening

Limit today's discussion to key issues relating to market opening only – we are looking for constructive engagement aimed at reaching workable solutions

In designing regulatory arrangements for the new non-household retail market we act in accordance with our statutory duties and guidance received from UK and Welsh Governments

## **Ofwat's statutory duties:**

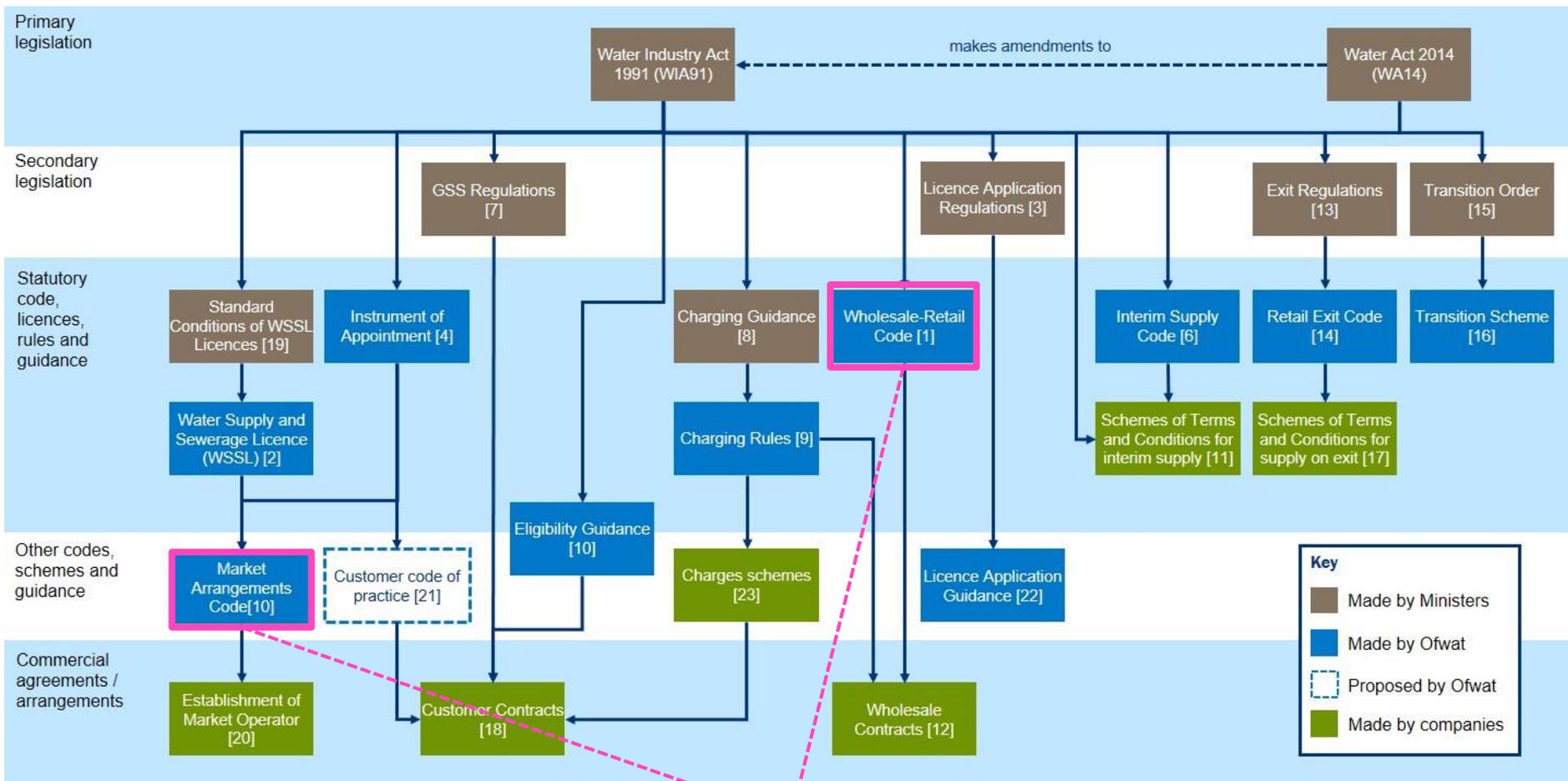
- Protect the interests of consumers, wherever appropriate by promoting effective competition
- Secure that efficient companies can finance and are able to carry out their functions
- Further the resilience objective
- Promote sustainable development.
- Efficiency and economy
- Non-discrimination and better regulation

## **Ofwat's policy objectives are that the new market arrangements must:**

- Promote effective competition
- Ensure that eligible non-household customers continue to remain protected
- Ensure that wholesale companies remain financeable and able to fulfil their obligations
- Be efficient and proportionate, including for small companies

In developing our thinking we have assessed a suite of potential options against a consistent set of criteria reflecting the above

# Objectives and our approach - legal architecture for the new market



We believe that these items, managed by the Interim Code Panel, will drive the majority of burden for small companies

We have identified four main areas where there are issues outstanding for small companies and Wales

## 1. The “no worse off” principle

We have broken down the issues around the no worse off principle into two main areas for RMO

a. Charging for NHH customers in a retail exit scenario

b. Small companies setting wholesale charges

## 2. Interaction with market systems

The extent to which small and Welsh companies are required to interact with market systems given their lower volume of eligible customers

## 3. Licensing

The extent to which broader licence changes are relevant

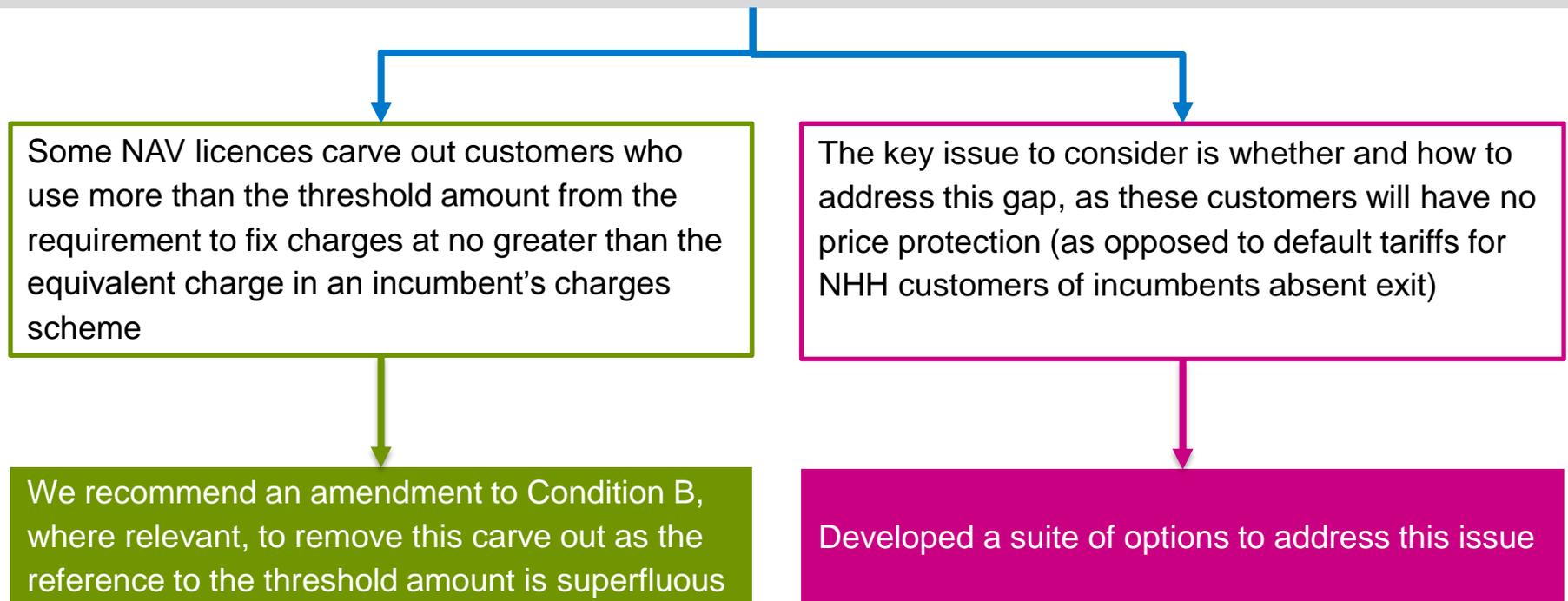
## 4. Eligibility

Issues around the definition of “wholly or mainly”

## Issue 1 – setting non-household charges in a retail exit scenario

**Underlying the no worse off principle** is the inclusion of condition B1A.3, which requires the NAVs' charges to not exceed the "Relevant Charges" of an Incumbent

The **potential for retail exit creates a gap for NHH customers** insofar as there will be no "Relevant Charges" to peg to



We assume that where the incumbent does not exit, the no worse off principle will continue to apply – subject to minor licence amendments needed for consistency with new licences (per PR14) and to reflect other areas of the WIA91 that are no longer necessary once the WA14 is commenced

# Charging for non-household customers where exit occurs

OPTIONS

## 1. Do nothing.

Essentially, this will leave eligible NHH customers without any price protection (vs others who have e.g. default tariffs) and so will rely on them either engaging with the market to switch supplier to get a better deal or remain with the NAV on terms that are offered

## 2. Require the NAV to peg the relevant charge to the domestic tariff of the incumbent and offer equivalent levels of service to that of domestic customers.

3a. **Require the NAV to set prices that are 'not unduly onerous'** – that is, revenues should not significantly exceed costs

3b. **Require the NAV to comply with the tariff** (in terms of both price and service) that would have applied to them had the incumbent not exited

4. **Ofwat to give notice to the NAVs** that we intend to bring Condition B fully into effect so NAVs become subject to their own price control

Option	Promote effective competition	Protect eligible non-household customers	Maintain wholesalers' financeability	Market arrangements are efficient and proportionate
1. Do nothing – no price protection for customers	Low	Low	Med	Med
2. Link to domestic tariffs	Med	Med	Med	Med
3a. Make prices 'not unduly onerous'	Med	Med	High	High
3b. Comply with relevant tariff absent exit (price and service)	Med	High	High	High
4. Bring Condition B fully into effect	Low	High	High	Low

## Group discussion

- 1) Do you agree with the options we have considered?
- 2) How else could charging for non-household customers be set and why is this approach more suitable?
- 3) Are there any other issues that we need to take into account? What is your preferred option?

## Issue 2 – small companies setting wholesale charges

# Small companies setting wholesale charges

## Neither the NAVs or Cholderton have separate wholesale price controls

If a customer wants to switch, NAVs and Cholderton will be required to offer a wholesale charge

## We are currently developing rules for wholesale charges

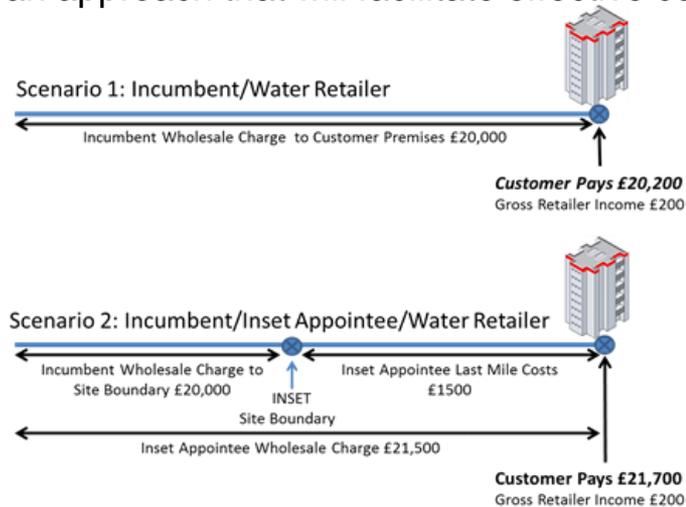
Question on how these rules apply, if at all, to NAVs and Cholderton in the absence of wholesale controls

## Slightly different issues face the NAVs vs Cholderton

NAVs normally rely on a wholesale service (bulk supply) to the site boundary that is priced the same as wholesaler's tariffs to retailers. The 'last mile' costs of wholesalers is therefore already included before the NAV adds it's own last mile costs

Current assumption is that Ofwat's charging project is not intending to look at bulk supplies this year

We therefore need to establish an approach that will facilitate effective competition whilst maintaining customer protection



# Small companies setting wholesale charges

OPTIONS

## 1. Do nothing.

This option assumes a NAV or CHL have been asked for a wholesale price and they offer one on the basis of no information or guidance from Ofwat.

## 2. Ofwat produces some limited information

about what we would take into account in determining a dispute. Company to then calculate their wholesale prices on that basis.

## 3. Issue charging rules/guidance for small companies so that they are able to calculate their own wholesale charges

## 4. Formal regulatory intervention to limit wholesale charges, for example amendments to Condition B to link the no worse off principle also to the wholesale charge of the incumbent

## 5. Remove the no worse off principle and bring condition B fully into effect, setting a wholesale and retail price control for NAVs [and Cholderton who already have Condition B activated]

Companies required to comply with competition law at all times

Option	Promote effective competition	Protect eligible non-household customers	Maintain wholesalers' financeability	Market arrangements are efficient and proportionate
1. Do nothing	Low	Low	Med	Med
2. Ofwat produce limited information	Med	Med	Med	Med
3. Issue charging rules for small companies to calculate wholesale charges	High	High	High	High
4. Licence change to constrain wholesale charges	Med	Med	Med	Low
5. Remove the no worse off principle and give wholesale price control to small companies	Med	High	High	Low

## Group discussion

- 1) Do you agree with the options we have considered?
- 2) How else could wholesale charges for small companies be set and why is this approach more suitable?
- 3) Are there any other issues that we need to take into account? What is your preferred option?

## Issue 3 – licensing and interaction with the market systems

Small companies have questioned the requirement to fully comply with market systems

Also an issue for Welsh companies with small a number of eligible NHH customers



## Companies already (or will need to) comply with regulatory/legislative tools, including:

- Instrument of Appointment – including further changes (e.g. stapling condition, Customer Protection Code of Practice)
- Potentially WSSL
- Wholesale-Retail Code / Market Arrangements Code
- CTP / Access Codes (excl. NAVs and CHL)
- Water resource plans
- Competition Act 1998
- EU legislation – Water Framework Directive etc.
- Compliance code

## Companies have raised a number of concerns:

- Resources required to interact with the market
- How to demonstrate compliance with limited resource
- Requirement to operate separate wholesale/retail businesses depending on decisions on whether to retail exit
- The extent to which Welsh companies need to undertake market entry activities for England where customers are evenly distributed
- Additional regulatory burden from further licence changes
- Some concerns from large companies that small companies should not receive unduly different treatment

**We have looked at other sectors and there is precedent for derogations based on proportionality**

Sector	Code	Scope for derogations?
Scotland	Operational Code	No
UK Gas	Uniform Network Code	No
Northern Ireland Gas	Supply Meter Point Agreement	Yes – on application
UK Electricity	Distribution Code	Yes (some scope for modifications to SLCs)
Northern Ireland Electricity	Market Registration Code	Yes – but for limited timescales only

In the domestic electricity market, Ofgem handle derogation requests to standard licence conditions by application

## **Market Arrangements Code, signed by all wholesalers, retailers and the market operator**

- Market Operator membership, duties and board/constitution
- Panel set up and membership, and change process
- Market Operator budget and cost sharing

## **Wholesale-Retail Code, statutory code given effect by the wholesale contract**

- Part 1 – Objectives, Definitions, Principles
- Part 2 – Business terms
- Part 3 – Operational terms
- Part 4 – Market terms
- Part 5 – Code Subsidiary Documents (CSDs)
- Part 6 – Operational forms

## **Wholesale Contract, signed by wholesaler and retailer**

- Glue that binds things together
- Made under S66D/S117E of 1991 Act
- Short and simple bilateral contract: incorporates terms and conditions set out in the Wholesale-Retail Code

## Burden on companies

OPTIONS

**Do nothing -  
comply with  
current codes**



**Total exemption  
from codes**

WHO

**Derogation decisions made by...**  
Market Operator  
Ofwat

**Companies are free to propose any derogations based on evidence**

Option	Promote effective competition	Protect eligible non-household customers	Maintain wholesalers' financeability	Market arrangements are efficient and proportionate
1. Do nothing	High ▲	High ▲	High ▲	Med ■
2. Minimum derogations from codes – most elements apply	Med ■	Med ■	High ▲	Med ■
3. Maximum derogations from codes – only some elements apply	Low ▼	Low ▼	High ▲	High ▲
4. Total exemption from codes	Low ▼	Low ▼	High ▲	Med ■

### Group discussion

1. Do you agree with the options we have considered?
2. How else could small and Welsh companies interact with the market systems and why is this approach more suitable?
3. Who should be responsible for managing any decisions on derogations? What is your preferred option?

## Issue 4 – company eligibility



Two main issues relating to eligibility concern NAVs and Welsh companies – both are about how the definition of “wholly or mainly” is decided (rather than relating to the eligibility guidance Ofwat publishes e.g. in relation to defining ‘principal use’ of a premise).

- 1) Issues around how companies determine the eligibility of customers – for example where there is significant switching on market opening
- 2) Potential for NAVs to ‘flip’ between being English and Welsh depending on the number of sites they are granted

Important issue as it could affect companies’ preparations for market opening and have a consequential impact on customers – not an issue for the eligibility guidance

Recent code changes made reflecting Wales – we understand SLA’s are in place to address issues around meter reads where customers are in the market for only one service



“Wholly or mainly” is **defined by the geographic size of appointed areas** – currently, all NAVs are wholly or mainly English

This will remain an issue until Silk recommendations, if accepted, on aligning company boundaries with national borders are implemented – we understand that the Wales Bill will go through its first reading after the Welsh election this year

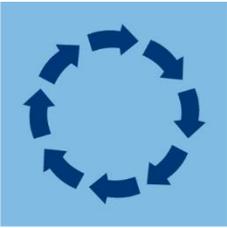
## **A pragmatic approach for market opening is needed**

Also a need for Welsh companies to complete market entry activities (even for a small number of eligible customers)

Companies should therefore prepare on the basis of current customer base and company geographic area – up to NAVs to keep their status under review at any point in time if they get further Welsh sites

### Plenary

1. Do you have any views or comments?
2. Do you think there are any outstanding issues that need to be resolved?



In addition to the comments raised today, we are **inviting further views**

Please provide these to Ofwat (Dan Mason) by no later than close of play **Friday 18 March 2016**

We will consider all the points raised in finalising our proposals

We will issue a decision note on the policy issues discussed today by the **end of April** and then **work towards implementation**

**Interim Code Panel meeting in May** for the ICP to decide on any required code changes reflecting the discussion on the interaction with market systems – **you are represented on the ICP and are able to feed views into that process**

**On licensing** we plan to publish our consultation in April, so we expect to engage with you **towards the end of April or early May**

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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