South East Water's response to Ofwat's consultation on further changes to all instruments of appointment

31 May 2016

1 INTRODUCTION

This is South East Water's response to Ofwat's consultation "Retail market opening – further changes to all instruments of appointments".

2 GENERAL COMMENTS ON THE APPROACH

We generally agree with the approach and principles proposed in the consultation. We have made specific comments on wording below. We also note that some of the changes mentioned in the consultation require further elaboration and changes to conditions or market documents. We would expect to be able to comment on these changes when they have been formulated in more detail.

3 ANSWERS TO SPECIFIC CONSULTATION QUESTIONS:

Below are responses to the specific questions in the consultation.

Q1. Do you agree with the proposed new conditions summarised in Table 1.1? In your response, please provide comments on each of the proposed new conditions separately.

We agree with the principle of having a new MAC condition, stapling condition and CPCop condition.

However, we have a number of observations on the wording of the proposed stapling conditions and also on the factors and issues that should be taken into account in the drafting.

The new condition relating to the MAC will require all undertakers including those remaining integrated to be a party to the MAC. Schedule 8 of the MAC refers to the arrangements that undertakers who remain integrated must have in place as required by the stapling condition.

It follows that the stapling condition needs to provide that when the Appointee carries out non-household retail activities it should have in place arrangements in writing. We suggest that it also states that these arrangements should replicate the provisions of the WRC to the extent applicable between the Appointee's wholesale business and the Appointee's non-household retail business in order to ensure that there is a level playing field between its non-household retail business and third party licensees.

Our main comment is that the current wording creates some ambiguity and that a simplified condition would achieve the intended purpose whilst eliminating the ambiguities. In our view, paragraph 1 is unnecessary and the current paragraph 2 should be amended to have a content similar to the previous paragraph. At the very least, sub-paragraph 1(a) should be deleted.

We provide below further comments on the current wording of paragraph 1 of the draft stapling condition:

- We believe the intended meaning of paragraph 1 is: "[…] as if the Appointee's Wholesale Business and its Retail Businesses were carried out by separate legal

entities and there was an agreement under s66D and/or s117E of the Act (regardless of whether any such agreement exists or not) between these entities", and that the wording of paragraph 1 could be simplified.

- However, we believe that the condition would be clearer and more readable if there was no reference to a "deemed" wholesale agreement (for example by deleting sub-paragraph 1(a)). The provisions relating to the interpretation of "Contract" in Schedule 8 provide that where the undertaker remains integrated, "Contract" in the WRC should be understood as the arrangements prepared under the stapling condition (i.e. something that is not a wholesale-retail agreement). Paragraph 2 of the stapling condition as currently drafted, requires the arrangements to be "consistent with the terms of paragraph 1". That cross-reference creates some ambiguity. To be consistent with the terms of paragraph 1 should the arrangements be a deemed wholesale-retail agreement? It seems that on the one hand schedule 8 clearly states that the written arrangements and the wholesale-retail contract are different things but that the stapling condition suggest they should be the same. We believe that there is no need for any reference to a deemed wholesale-retail agreement in paragraph 1 (or anywhere in the entire stapling condition) and of a cross-reference from paragraph 2 to paragraph 1. A simplified condition as suggested at the beginning of this section would have the intended effect as the specific requirements relating to the contents of the arrangements are fully covered in paragraph 4.

In respect of the issue of derogation from the WRC, we agree that in certain cases it will not be possible to apply the provisions of the WRC (which have been designed to apply between separate legal entities) within an integrated undertaker without some modifications or exceptions. It is also necessary to take account of the fact that integrated undertakers who provide non-household retail activities will do so under their statutory duties to end-users. There will therefore need to be some differences.

Although further provisions may be included in Schedule 8 of the MAC, we believe that the differences highlighted above should also be recognised in the wording of paragraph 4 of the stapling condition. If reliance was placed only on the provisions of Schedule 8, then it would be possible that if Schedule 8 does not cover all necessary exceptions undertakers would be required to apply codes provisions under the stapling condition that they cannot in practice apply or that contradict they statutory duties. This is an unreasonable transfer of risks to undertakers who are not fully in control of the provisions of schedule 8.

A better approach would be to set clearly that the obligation of undertakers should be to apply the codes to the extent it is reasonably possible but, as an additional compliance obligation, state that the objective of these arrangements is to ensure there is level playing field between the non-household retail business of the Appointee and any third party licensee. The arrangement that undertakers would put in place would be sufficiently flexible but would also have to be designed to achieve this purpose.

The obligation of undertakers under paragraph 4 could be to "apply to the written arrangements put in place pursuant to paragraph [•] of this Condition any code or codes issued by the Authority from time to time pursuant to s66DA and/or s117F of the Act, so far

as is reasonably possible in order to ensure that there is a level playing field between the non-household retail business of the Appointee and any third party licensee, provided that [….]".

Q2. Do you agree with the proposed changes to existing conditions as summarised in Table 1.2? In your response, please provide comments on each of the proposed changes separately.

We agree with the principle of the proposed changes to the IoA.

In respect of the proposal to have a separate certificates of adequacy for the non-household retail business of undertakers, there seems to be some ambiguity in the proposal considering that the change is presented as a new requirement to have a separate certificate for the non-household retail business whilst the proposed drafting creates a requirement to provide an additional certificate for the retail business as a whole (i.e. both household and non-household).

Q3. Do you consider that derogations may be required for small companies and/or companies whose supply systems are wholly or mainly in Wales, due to their limited number of eligible customers? Please state what any such derogations should cover.

We consider that certain derogations may be necessary to ensure proportionate regulation.

Q4. Do you agree with our proposal to use a combination of 'sunset' and/or 'sunrise' clauses for the changes so that we can implement these changes ahead of the Secretary of State's decisions on retail exit?

We agree with the principle of including conditions in the licence that would determine whether and when certain provisions of the licence would cease or start to apply.

Q5. Do you agree with our proposal to use section 55 of the WA14 to make these changes?

We agree with the principle of using section 55 for implementing proportionate changes to the IoA which fall within the scope of that section. It is important however that sufficient consultation takes place including on the specific wording of the changes. In a number of cases the consultation provides indication of policies and future changes and further consultation may be needed on the specific changes proposed when these have been defined.

Q6. Do you have any comments on the proposed drafting set out in the Appendices?

In respect of the CTP condition, an alternative for the first sentence of the additional wording may be: "This condition shall not apply in respect of customer transfers governed by the Wholesale Retail Code." A definition of Wholesale Retail Code should also be included in the CTP Condition or in Condition A. It would not be necessary to specify a date as transfers would not be governed by the WRC until it comes into effect.

In respect of paragraphs 1 to 4 of Condition R, a similar approach as above may be: “Paragraphs 1 to 4 of this Condition shall not apply in respect of the relationship between the Appointee and any water supply licensee and/or sewerage licensee governed by the Wholesale Retail Code.”