United Utilities response to the Ofwat consultation:
Retail market opening – further changes to all instruments of appointment

Introduction
United Utilities welcomes the opportunity to comment on the Ofwat consultation: "Retail market opening – further changes to all instruments of appointment."

We support the central focus of these proposals, being those changes necessary for the introduction of the non-household market. Our response seeks to aid the clarity of these proposals and recommends some changes to them in a small number of areas.

Changes to Condition Q
As set out below, the proposed change to condition Q raises a number of issues. The proposals require that wholesalers pay drought payments to retailers and that retailers then pass these payments onto customers in turn. This proposed change increases the risk to customers of not receiving payments relating to drought orders either on time (if a retailer delays payment) or at all (if, for example, a retailer became insolvent).

These payments represent a particular type of payment where the wholesaler is not paying money to a retailer because it is intended for the retailer but, rather, is making a payment to the retailer which is expressly intended for receipt by the customer. The retailer is merely intended to act as a transmission mechanism for this payment. We strongly recommend that such payments should be subject to some ringfence protection in order to minimise the risk of customer detriment. These payments should be treated as "client money" and segregated as such, rather than be absorbed by the retailer. Furthermore, retailers should be obliged to pass on customers' compensation payments swiftly to the customers they are intended for. Where client money is not successfully delivered to these customers within a specific timescale the client money should be returned to the wholesaler. To ensure that this approach works there should be an obligation on the retailer to account for the client money and that these accounts should be independently assured.

It is also important as a matter of good regulatory principle that, in relation to such payments, the actions of retailers do not serve to increase the burden on wholesalers, given that wholesale allowances do not take into account any such additional support or payments. Should a retailer become insolvent and fail to pass on drought payments to the customer the wholesaler should not be expected to pay compensation twice.

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Consultation questions

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 see no reason to object to the changes proposed within table 1.1 of the consultation. However the proposals do raise issues connected with two elements of the market structure being:

- how changes are made to the Customer Protection Code of Practice (CPCoP); and,
- membership of the Market Operator.

There are limited details as to how the CPCoP will be amended or be kept in line with other market codes. It is also unclear how if a change is made to the CPCoP requiring a particular action by the retailer how any consequential amendment would be made to the Wholesale Retail Code (WRC). The absence of an appeal process leaves retailers vulnerable to changes to the CPCoP that may have a significant impact to their operations. We therefore believe that Ofwat should reconsider the process for changes being made to the CPCoP and how corresponding changes are made to the WRC such that any changes are subject to proportionate review and appeal procedures. Having changes to the CPCoP be accessed by the same panel as changes to the WRC would mitigate the chance of a decoupling of requirements.

Whilst the proposed additional licence condition that gives effect to the Market Arrangements Code (MAC) is necessary, this highlights an issue as to the long term approach to representation on the market operator. Associated retailers have reduced rights compared to other retailers and are not to be represented on the MOSL board. Therefore associated retailers may not have rights to fully influence this as they do not have full voting rights independent of the incumbent company.

Given the push for separation as a means of ensuring a level playing field, the requirement for representation of the associated retailers' views to be made on their behalf by the associated incumbent should not be entrenched by market rules.

In the case of United Utilities in particular, the separation of our non-household retail activities into Water Plus means that there is an even greater separation than may be required to meet the requirements of a level playing field. The new JV retailer has been set up with the express intention of acting independently of the incumbents, with separate management and a separate legal entity with a separate board. In such circumstances, it would seem inequitable for such a separate retailer to have curtailed rights compared to other independent retailers, particularly post "retail exit."

Recent proposals have looked to develop an "observer member" status for retailers associated to incumbent companies. This proposal seeks to ensure that associated licensees at least have equivalent access to *information* as other participants in the market. This is one of the most fundamental building blocks of the level playing field. It also, however, would only address one facet of the broader issue. For example, the MAC as it currently stands limits the ability of associated retailers to fully engage with the MO. We suggest that following retail exit, those associated retailers who are legally separate and not subject to direct control of the incumbent company need to be considered as equivalent to any other independent retailer.

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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.

The consultation introduces the concept of incorporating a level playing field requirement into Condition F6 (Transfer pricing).

Given that the guidance so far given on "level playing field" means that it is not capable of clear definition ex-ante we would caution against including this within companies' Instruments of appointment. Condition F6 goes beyond the interaction between wholesale and retail elements of an incumbent company and covers, under the Regulatory Accounting Guidelines, all interactions between the appointed company and any associated entity, in addition to interactions within price controls. We believe that the further addition of a LPF requirement could lead to confusion and unnecessary additional regulatory burden, with no benefit to the market as any issue will be caught by the proposed stapling agreement.

The new proposals also require that wholesalers pay drought payments to retailers and that retailers then pass these payments onto customers in turn. This proposed change increases the risk to customers of not receiving payments relating to drought orders either on time (if a retailer delays payment) or at all (if, for example, a retailer became insolvent).

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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 have no comment on arrangements for operations wholly or mainly in Wales.

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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 support the use of "sunset" and "sunrise" clauses as a sensible approach to making alterations to company's licences in an efficient and timely manner.

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

Given the issues raised as a consequence of the consultation (and as commented upon in this response) we consider that a small number of changes are required to the proposed changes before it would be appropriate to apply a s55 approach to implementing the changes. If there is consensus on how to resolve these issues then a s55 approach may be appropriate. However, in the absence of this, we believe Ofwat should either undertake a further consultation, having taken account of responses received, or adopt a s13 approach on this occasion.

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

We have two recommended changes to drafting.

Firstly, we believe that greater clarity would be prudent to more explicitly reference the Customer Protection code of practice. On page 51 rather than:

"The appointee must comply with the Customer Protection Code of Practice"

We suggest

*"The appointee must comply with the **Ofwat non-household** Customer Protection Code of Practice".*

Secondly, as drafted, it is also unclear whether the proposed new condition F6A2A refers to all retail services or just non-household retail services. We believe that the intention is that it should only relate to non-household retail services; otherwise this could lead to a new requirement for an additional certificate of adequacy relating to household retail services. Accordingly, referring to page 71 of the consultation, rather than:

"The Appointee shall, at the same time as it complies with sub-paragraph 9.3 (submission of Accounting Statements) submit to the Water Services Regulation Authority separate Certificates in respect of each of its retail business and its wholesale business in the following terms:"

We suggest

*"The Appointee shall, at the same time as it complies with sub-paragraph 9.3 (submission of Accounting Statements) submit to the Water Services Regulation Authority separate Certificates in respect of each of its **non-household retail** business and its wholesale business in the following terms:"*