

# The proportionate application of the market architecture to Welsh and small companies

## Overview

From April 2017, 1.2 million eligible business, charity and public sector customers (business customers) mainly in England will be able to shop around for their water and wastewater retailer. For business customers of companies whose areas are wholly or mainly in Wales, only those customers using more than 50 million litres of water each year are able to choose their water retailer, and this will continue.

Retail services include things like customer service and billing. In shopping around customers will be able to benefit from lower prices, consolidated water bills, higher standards and more tailored services, for example in relation to water saving advice.

All companies, irrelevant of scale and size, are expected to be ready for market opening in April 2017. But smaller water companies and those whose area is wholly or mainly in Wales ('small companies and Welsh companies') will have fewer eligible customers in the new business retail water market. So we have considered how the new retail market arrangements apply to these companies to make sure they are applied proportionally in line with the principles of better regulation.

## Engagement process

We summarise the engagement we have carried out with small companies and Welsh companies in developing how the new market framework will apply to them in the diagram below.

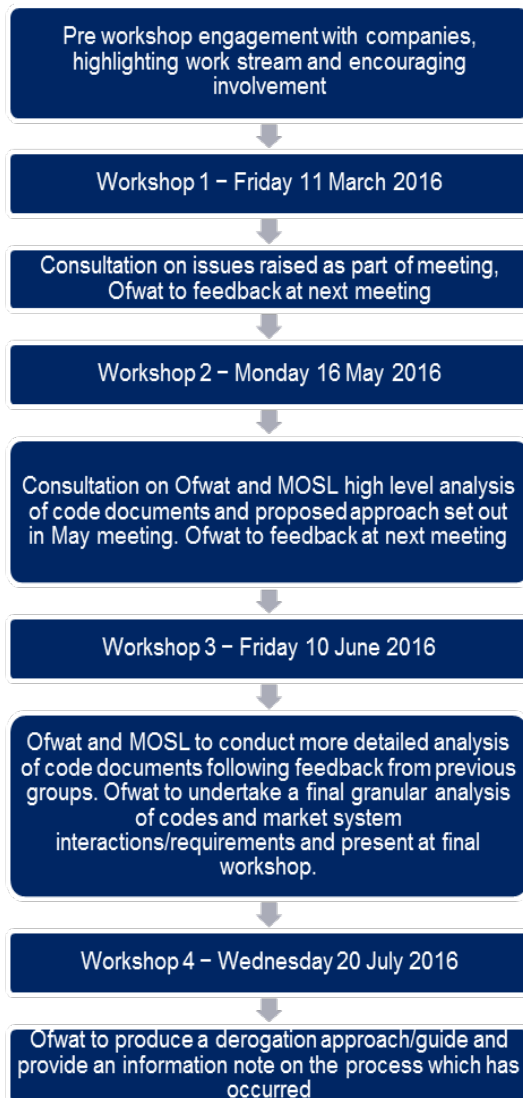
A key part of our engagement was holding four workshops to identify and discuss the issues small companies

and Welsh companies face in relation to the opening of the business retail market in April 2017.

Ofwat, [Defra](#), the [Welsh Government](#) and [Market Operator Services Limited \(MOSL\)](#) attended these workshops. This ensured that issues captured were considered from both a regulatory and an IT systems perspective.

Ofwat and MOSL also provided updates on the progress of the development of the market architecture and IT systems.

## Summary of engagement



## Workshops

The objectives of the workshops were to:

- provide an overview of the market architecture;

- explore approaches to key issues (for example retail exit, wholesale charges, licensing and interaction with the market operator and eligibility);
- provide clarity on the definition of ‘wholly or mainly’ within the context of the Welsh/English border and its impact on market preparation;
- consider the definition of a small company and whether this should be defined using a threshold based on factors such as numbers of eligible customers and revenue;
- consider whether there was scope for derogations. This included discussing if there could be a set of pre-defined derogations (and who could these be applied to), or alternatively if an optional/structured derogations process should be considered and what potential process and principles would this include; and
- discuss concerns around interacting with the central IT systems/market operator and to provide information on this to small and Welsh companies.

In the ‘[Water strategy for Wales](#)’ the Welsh Government state:

**“We will work with Ofwat, the Consumer Council for Water and the water companies to ensure strong communications and information are made available to business customers about eligibility for retail competition to avoid any confusion, particularly for those customers in cross-border areas, and to ensure they are not disadvantaged.”**

So we also used the workshops to clarify the term ‘wholly or mainly’ in Wales. We stated that this was set out in the legislation and is based on the geographic size of each company’s appointed area. So, for example, if the area an appointed water company serves is in Wales, the company would be considered Welsh.

We discussed the potential of derogations and agreed to carry out an analysis of the market codes to inform the discussions around derogations.

### Review of codes

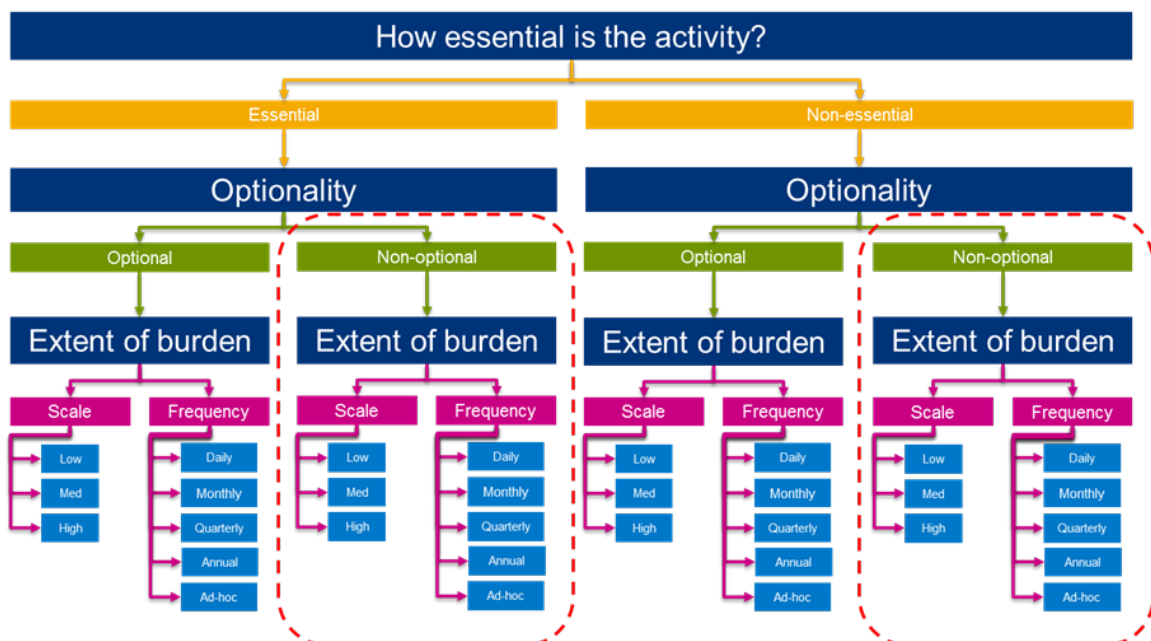
We carried out a detailed review of the suite of market codes and provided some illustrative examples of areas where derogations could apply.

As part of the review, we considered the market operator’s IT system to ensure that a reasonable judgement could be made on the potential impact of a derogation taking place.

**The diagram below illustrates the principles and approach to making code derogations that we agreed with small and Welsh companies.**

From this process we derived a number of illustrative examples that could be presented to small companies and Welsh companies to aid discussions on developing a derogations approach.

We agreed to consider the feedback from the workshops on the type of approach and potential threshold alongside other examples of derogations processes from other sectors and legal advice, to inform the approach in its final derogations guidance.



## Proposed exemption

We updated the companies on the proposed exemption, within our section 55 consultation, which would mean that small companies and Welsh companies would not be required to have a separate certificate of adequacy. Within the proposals to modify Instruments of Appointment under section s55: a consultation we stated:

**‘We propose to provide an exemption to companies with limited numbers of eligible customers on the grounds of proportionality. We are considering a threshold of 5,000 eligible customers, with the intention that this threshold would align with the threshold for possible code derogations, once that framework has been finalised and agreed. This would exempt new appointees, appointees wholly or mainly in Wales, and Cholderton and District Water Company Limited. We would do this by not modifying F6 in their IoAs, so that the existing condition would remain unchanged.’**

We informed the workshop that all companies, including new appointments and small companies, will need to be able to offer a wholesale price once the market opens and that this is an essential requirement. And we presented companies with information on how they could approach this to aid them in developing their own methodology.

We reminded companies that our accounting separation requirements already take a proportionate approach with regard to small companies within the ‘[Regulatory Accounting Guidelines \(RAG\) 3.08 – Guideline for the format and disclosures for the annual performance report](#)’.

As part of section 5 we set out that small companies are not required to publish accounts that comply with the RAGs as this would represent a significant data burden. If a company meets the Ofwat financial reporting definition of small (annual turnover of less than £6.5 million), it only needs to produce a small company return. This contains a simple P&L that splits operating costs between retail and wholesale but no requirement to comply fully with, for example, RAG 2.05.

The ‘[RAG 2.05 – Guideline for classification of costs across the price controls](#)’ also contains an outline of how companies should allocate of operating costs between retail and wholesale. We also highlighted in a [previous consultation on the RAG](#) how companies should act to facilitate market reform.

The participants at the workshop agreed that companies could outsource and utilise agency agreements to carry out activities such as interacting with the market operator, but that responsibility for meeting the obligations of the licence remain with the retailer/licensee. It is therefore their responsibility to ensure any agency or

third party is compliant with the company's obligations.

The key issues which were identified at the workshop for companies interacting with the market were the frequency of use of the market system, unintentional non-compliance, automation of processes within the central market operating system (CMOS) and the costs to companies of interacting with the market. Ofwat and MOSL provided feedback on IT systems information to companies. This is set out in the table below.

### **Systems information**

The following information was presented and discussed at the workshops.

- Details about the high and low volume interfaces in the central market systems, including how the high volume interface allows bulk uploads but requires a higher degree of company assurance.
- The security and access requirements for the market systems, including the need for a security certificate(s) and a registered IP address.
- How system notifications work in the system and why email notifications were being restricted for security, system and data privacy reasons;
- Identification of the processes in the market codes that are the responsibility of the market

operator such as producing systems reports;

- The development of the reporting tool within the MOSL CMOS system and highlighting the reporting areas of the codes.
- MOSLs ongoing efforts to support companies via its support and programme managers and reemphasising that companies should work with MOSL to ensure they are ready for shadow/live operations.
- The system performance framework and how this will affect companies/MOSL.
- The market codes and their reference to continuity management plans and how these affect various sizes of companies.
- MOSL will continue to support companies via their support desk and programme leads.
- MOSL is engaging with companies about training and how they can assist them going forward.

### **Conclusions**

The feedback that we received from companies on the workshops was positive. Companies felt that Ofwat had identified the correct issues when discussing licensing and wholesale charges. We agreed to continue to keep companies up to date with the development of the market architecture arrangements.

## Next steps

We are currently [consulting on our draft derogations guidance](#), which sets out proposed approach to derogations. A derogation is a direction from us which relieves a licensee or appointee from compliance with certain of its obligations in the [Wholesale-Retail Code \(WRC\)](#). The WRC is a statutory code which sets out the business terms, market terms and operational terms that will apply to all two-way arrangements between a wholesaler and a licensed retailer.

## More information

[Consultation on derogations guidance](#), Ofwat, August 2016

[Water strategy for Wales](#), Welsh Government

[Proposals to modify Instruments of Appointment under section 55: a consultation](#), Ofwat, July 2016

[Regulatory Accounting Guidelines 3.08 – Guideline for the format and disclosures for the annual performance report](#), Ofwat, October 2015

[RAG 2.05 – Guideline for classification of costs across the price controls](#), Ofwat, October 2015

[Consultation on changes to the regulatory accounting guidelines \(RAGs\) – impact assessment](#), February 2013, Ofwat

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 leading economic regulator, trusted and respected, challenging ourselves and others to build trust and confidence in water.

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