

By email to: retailmarketopening@ofwat.gsi.gov.uk

MAC and WRC Consultation
Retail Market Opening Programme
Ofwat
21 Bloomsbury Street
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Dear Retail Market Opening Team

We welcome this opportunity to respond to this consultation, which is an important milestone towards opening the retail non-household water market in April 2017.

We have chosen to provide one response to the consultations focused on the Market Arrangements Code (MAC) and the Wholesale Retail Code (WRC), as the comments we are making are relevant to both.

We believe that the WRC and MAC are both fit for purpose for market opening. We would like to recognise that there are opportunities to improve the efficiency of the market in the future.

Our response sets out key points that we believe will improve the market.

- Conduct a review of the codes which concludes 18 months after market opening;
- Introduce a requirement for periodic strategic code reviews; and
- Simplify the codes.

We look forward to working in collaboration Ofwat and the wider industry to the opening of the market and beyond.

Kind regards



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Response to the consultation on the Wholesale Retail Code and the Market Arrangements Code

Summary

This paper sets out MOSL's response to Ofwat's consultations focused on the Wholesale Retail Code (WRC) and the Market Arrangements Code (MAC) (hereafter referred to as codes).

We believe that the current codes are fit for purpose for market opening. However, we also recognise that there is scope to improve the competitiveness of the market. As such, we set out key points that we believe will improve the market; conduct a review of the codes which concludes 18 months after market opening; simplify the codes; and introduce a requirement for periodic strategic code reviews.

The codes should develop in line with the governments overall vision for market reform

We have recognised the government's long term vision that open, competitive markets are the cornerstone of a dynamic economy. Improved competition drives efficiency and innovation which, in turn, creates improved services at a better value for customers.¹ The regulatory regime should evolve to inform, enable, and incentivise beneficial behaviour whilst minimising the requirement for intervention.²

Regulation is one of the key areas that impacts innovation.³ The government has formally committed to reducing regulatory impact to businesses by £10 billion between 2015 and 2020.⁴

The codes are currently fit for purpose for market opening

Administration of the WRC and MAC was inherited by MOSL from Open Water Markets Limited in July 2015. All market participants have been able to propose changes to the codes and the Interim Codes Panel (ICP) has been responsible for reviewing proposals and recommending code changes to Ofwat.

The key driver of code changes in the WRC has been the design, build and test of the Central Market Operating System (CMOS). The MAC changes have been driven by the development and implementation of MOSL's enduring processes.

We believe that the codes and associate documents are fit for purpose for market opening.

We note that there is a log of potential changes which are intended to be considered for implementation after go live, but may be brought forward for consideration before go live.

¹ Chancellor of the Exchequer - A better deal: boosting competition to bring down bills for families and firms https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/480797/a_better_deal_for_families_and_firms_print.pdf

² Catherine Ross Speech - Towards legitimacy through efficiency <http://www.ofwat.gov.uk/wp-content/uploads/2016/10/Towards-PR19-legitimacy-through-efficiency-v2.pdf>

³ Department for Business, Energy and Industrial Strategy – Innovation Plan <https://beisgovuk.citizenspace.com/innovation/national-innovation-plan/>

⁴ National Audit Office – Departmental Overview 2015-16. DEFRA. <https://www.nao.org.uk/wp-content/uploads/2016/10/Departmental-overview-2015-16-Department-Environment-Food-and-Rural-Affairs.pdf>

We recognise that the codes are not prescriptive about how they should be implemented. MOSL is currently working in collaboration with Ofwat and Defra, as part of the Transition Group, to address how the codes will come into effect.

Key points about the codes that MOSL believes will improve the market

The role of market operator encompasses an obligation to at all times act in the best interests of the market as a whole.

An efficient market allows market participants to gain competitive advantages through innovation and minimises the costs of operating and transacting. It allows for symmetry of information between buys and sellers and reduces barriers to exit and entry.

We believe that this can be pursued in the following ways, each of which is explained in more detail below.

- Conduct a review of the codes which concludes 18 months after market opening;
- Introduce a requirement for periodic strategic code reviews; and
- Simplify the codes.

Conduct a review of the codes which concludes 18 months after market opening

The gas and electricity markets' strategic reviews of codes provide a useful precedent for code governance. These have been driven by concerns regarding the effectiveness of code governance and in response to significant changes to the market.^{5 6}

We believe a widely consultative review of the codes should be undertaken to consider how efficiency could be improved and if technology could be employed to modernise the market.

This review should conclude after the market has been operational for 18 months. After this period the market will have matured and there will be a clearer picture about policy and market developments.

Our data analytics, code expertise and the pro-market principles, as set out in our business plan, make us well suited to facilitate a review of the codes.

Introduce an obligation for periodic strategic code reviews

The Competition and Markets Authority (CMA) has recommended a periodic review process of the energy industry codes. This will ensure the codes are able to handle market developments and facilitate the gradual streamlining of energy codes.⁷

We believe this type of model should be adopted at the outset in the non-household retail water market, with a particular focus on improving the competitiveness of the market. This process would be highly consultative, involving Ofwat, market participants and wider stakeholders in the industry.

⁵ Review of industry code governance – Ofgem 2007

<https://www.ofgem.gov.uk/sites/default/files/docs/2007/11/open-letter-announcing-governance-review.pdf>

⁶ Further review of industry codes – Ofgem 2015

<https://www.ofgem.gov.uk/sites/default/files/docs/2015/05/cgr-open-letter.pdf>

⁷ CMA Energy Market Investigation.

<https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

The WRC and MAC currently do not prescribe an obligation to review the codes. We believe the market operator's code governance and modification expertise makes it best suited to undertake this.

We believe the market operator should have an obligation to undertake annual reviews of the codes and to present the findings of these reviews to Ofwat and the wider industry for consideration. The outcomes of such reviews should inform the development of the market operator's business plan for the coming year.

Simplify the codes

MOSL believes the codes currently serve two primary functions. They define the rights and obligations of market participants and provide essential certainty. Secondly, they provide information in an accessible manner about how the market works.

However, there is a risk that the codes may be overly complex and prescriptive and may not fully embrace the potential of new technology. In the longer term this may constrain innovation and impact the realisation of benefits by consumers.⁸

The CMA identified the complexity of energy codes and governance increases the risk of inefficiencies and disincentivises engagement with code governance. They concluded that significant compliance cost created by this complexity is a barrier to enter the market.^{9 10}

Prescriptive rules set with imperfect foresight may increase the risk of undesirable behaviour, as companies focus on compliance. Ofgem have proposed to use a balance of principled and prescriptive rule to realise market benefits in licensing conditions. This places a greater onus on suppliers to understand and deliver what is right and fair for customers.¹¹ The CMA supported the use of output-based conditions, rather than prescriptive rules, as a means to incentivise industry toward desired behaviour.¹²

We believe any strategic review of the codes should actively consider the potential scope for simplifying the complexity and prescriptive nature of the codes.

Enquiries

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⁸ Ofwat – Agreement for water and sewerage companies to adopt infrastructure. http://www.ofwat.gov.uk/wp-content/uploads/2016/09/pap_con20160929adoptionagreementsdiscuss.pdf

⁹ CMA - Energy Market Investigation. <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

¹⁰ Ofgem – Code Governance Review. Role of code administrators and small participant / consumer initiatives https://www.ofgem.gov.uk/sites/default/files/docs/2008/12/code_admin_condoc_191208.pdf

¹¹ Ofgem – The future of retail market regulation. https://www.ofgem.gov.uk/sites/default/files/docs/the_future_of_retail_market_regulation.pdf

¹² CMA - Energy Market Investigation. <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>