

United Utilities' response to the Ofwat consultations:

Wholesale Retail Code and Market Arrangements Code

Introduction

United Utilities welcomes the opportunity to comment on the Ofwat consultations: Wholesale Retail Code (WRC) and Market Arrangements Code (MAC). We recognise the immense quantity and quality of work that has been applied to generating the market codes from all stakeholders. We understand the importance of the market codes and would highlight that despite the focus that has been applied to the generation of the market codes we anticipate a significant number of future queries around the interpretation of the codes. Therefore we would urge that processes for providing clarity on points of contention be appropriately resourced ahead of market opening, and that clarifications should be widely shared on a timely basis.

Code changes necessary for the market to function at market opening

We have identified no specific changes, beyond those currently being progressed through the ICP, that are necessary for the market to function at market opening.

Code changes which would improve the functioning of the market and which could be considered after market opening

Although not essential at this time, there are two changes we believe would serve to improve the functioning of the market. These changes could be made following market opening and therefore form part of the agenda for the enduring codes panel to consider once established.

- We believe that the elements of the codes relating to the mandatory allocation of developer services activities to retailers are not fit for purpose. These provisions are currently suspended for 18 months and prior to the conclusion of this suspension significant work will be required to amend the codes. We support the removal of these provisions as they are unnecessary given the operation of the existing self-lay market.
- In order to be able to demonstrate our adherence to the confidentiality requirements associated with the CMOS system we require that the market operator be able to provide details of those staff from United Utilities which have a login to the CMOS system. We believe this would only require minor changes to the CMOS system and codes. Without this it would be extremely difficult for companies to demonstrate they are only giving access to CMOS to those for whom it is necessary and removing those who no longer require access.

The need for alignment between CMOS and the market codes

Whilst we have not identified any specific code changes that are required ahead to market opening there is one area of work where we feel further work is necessary and potentially essential to the successful opening of the retail market. Throughout the development of the Central Market Operating System (CMOS) the system and codes have not been aligned. Failure to align CMOS with the codes could lead to market participants not being able to meet the requirements of the codes.

The industry needs clarity well ahead of market opening as to what will be functioning within CMOS and be assured that the codes and CMOS will be aligned for April 2017. Where the changes to the Code are driven by CMOS releases, misalignment poses a significant problem as the specification describes how the functionality will work in a few months' time when the CMOS releases catch up with the Codes, both in the process we have to follow and data we have to use.

United Utilities Water's response to the Ofwat consultations: Wholesale Retail Code and Market Arrangements Code

The extension of unsecured credit

We are aware that further changes to the credit and payment sections of the market codes are planned by Ofwat ahead of market opening. The intent of these changes is to deliver on the following element of the Ofwat decision document: Credit terms between wholesalers and retailers in the new retail market, appendix two p41.

"The unsecured credit limit assigned to a user can be based on the credit strength of a parent guarantor."

The proposal as we currently understand it is that if:

- a retailer's parent company holds an investment grade credit rating; and
- the parent company provides the retailer with a guarantee for a portion of the credit requirements

then the retailer would be entitled to 40% unsecured credit based on the credit strength of the parent guarantor.

This proposal was not explicitly discussed during the working groups and workshops on credit and payment terms.

Credit provided by a parent company offering a guarantee is substantially different from unsecured credit. Should a retailer cease to trade a parent company guarantee can be exercised to recover the money owed. Without the guarantee there is no mechanism for recovering this money. The two options are not equivalent and the additional unsecured credit extends the exposure of wholesalers to credit risk.

This effectively means that for retailers for whom this option applies less than 40% of their debts are covered by a credit mechanism and therefore wholesalers are at risk for over 60% of the debt.

It is important to ensure that wholesalers are not exposed to an unnecessary credit risk without being appropriately compensated. To achieve this we consider that it is very important that a suitable wholesale credit risk sharing mechanism should be introduced as the most effective mechanism for the allocation of risk should the retailer default. This should be applied from April 2020 and taken into account in the PR19 charge setting process. Given the proposed expansion of credit risk for wholesalers an acceptance now of the need for a wholesale credit risk sharing mechanism would help to allay the concerns of all wholesalers.

The failure of a retailer is a potentially high impact event, but is also a repeated feature of newly opened markets including energy and telecommunications. In these markets mechanisms have subsequently been put in place to ensure that there is an appropriate sharing of credit risk. It is important that appropriate schemes are put in place as soon as practicable in the water market in order to ensure that the market is capable of withstanding such shocks.