Chris Bollington
Ofwat
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Dear Chris

We welcome the opportunity to comment on Ofwat's proposed changes to the setting of licence fees. In addition to the three questions asked, we also have some comments on the proposed level of costs, and the way in which these will be allocated between WSSLs and undertakers.

Proposed changes to the license fee calculation

1. Flat fee element calculation

We agree that it makes sense to align CC Water's calculation for fixed costs with Ofwat's. We believe that doing so will make the charges simpler and more transparent.

2. Market Shares and transferred businesses

We agree with the proposal that following an acquisition, the market share figure for the acquirer should include the other company for the full year, regardless of when they were bought.

3. Fees for self-supply licensees

We also agree with the introduction of licence fees for self-supply licences from 19-20, which will make charges fairer and more transparent. While we fully agree with the principle of reducing barriers to entry, it is also important that all companies pay their fair share, and self-supply licensees depend on an effective licensing regime in order to do business. Self-supply companies represent a significant proportion of new entrants over the past year, and the consultation notes that new entry is one of the factors that have helped to increase overall costs. We suggest that the most straightforward approach would simply be to calculate Ofwat charges in the same way as for WSSL holders.

2018-19 Costs and Allocations

Cost allocations

The methodology for calculating license fees was originally set at a time when almost all undertakers had indicated their intention to exit either at market opening or shortly afterwards, meaning that over 98% of the market would be served under WSSLs. On this basis, the difference between market share based on all customers (as used for MOSL's charges) and that based on WSSL licences was relatively trivial. Subsequently, however, two of the largest companies, comprising around 25% of the total market, postponed their date of exit and currently still serve their non-household customers under their Instrument of Appointment. As a result we understand that they have not paid any Ofwat and CC Water fees in relation to the costs of retail regulation and complaints handling over the past year and will not do so in 2018-19 either.

We do not see how this can be equitable. Ofwat's initial consultation on setting license fees in October 2016 listed 8 areas of regulatory cost that would result from the non-household market. All companies that operate in the market will contribute to these costs, regardless of whether they do so under a WSSL or an appointment. Similarly, CC Water will incur the same costs in dealing with complaints about retailers regardless of their licensing arrangements. This point is reflected in MOSL's allocation of retailer costs, which are divided on an equal basis among all companies, and we would urge Ofwat to adopt a similar approach.

For the upcoming year, we calculate that the 3 companies affected would be due to pay approximately £285,000 under a market-share based allocation of retail-related costs, without which this amount would have to funded by their competitors. In a market with extremely low margins, these are substantial sums and sufficient to create a genuine competitive advantage for these companies as well as a barrier to entry for new retailers. Given that the companies in question have already benefitted from this situation over the past year, it is particularly important that the situation is not repeated for 2018-19, particularly given the increase in overall costs.

Total costs

We note that the proposed license fees for next year represent a significant increase on this year. We understand the reasons behind this, and indeed it is consistent with a range of other areas where market costs are proving to be higher than initially expected. It does however create further pressure on retailers' margins, and makes it even more important that these costs are allocated proportionately between all benefitting parties (as described above) and that a key regulatory priority for the coming year must be to find ways of helping to reduce the costs of retail market participation.

We hope this response is useful. If you have any questions about anything included here please do not hesitate to get in touch with me.

Yours sincerely

Rosalind Carey

Rosalind Carey

Director of Regulation and Strategy

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