wave
A joint venture between
business anglianwater NWG Business

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Review of the Retail Exit Code
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Dear Paul,

Retail Exit Code

We welcome the opportunity to input to Ofwat's early thinking on proposals for price protection beyond March 2020. Our views incorporate those of both Anglian Water Business (National) Limited and NWG Business Limited, together as the joint venture called Wave.

In summary, our view is that the best outcome for customers is to use PR16 as the basis for modified price protection to apply to both SMEs and non-SMEs. Specifically, we would like to see an extension of the use of a gross retail margin cap to the 0-5Ml per year customers. The gross retail margin cap approach is having a positive effect on larger customers and extending it to the smaller customers, would in our view, help to promote greater competition whilst maintaining price protection. Furthermore, this approach is simple and proportionate.

We have explained our views more fully in our responses to the questions raised as follows:

Q1 Do you consider that future price protections in the REC should be aligned with PR19? If so, how do you consider this would be best achieved in the context of the options for future protections in the REC (see section 3.4)? Please explain your view.

As a principle, the price protections need to be the same for exited and non-exited retailers. This ensures a level playing field for both customers and retailers.

We consider that the current approach to price protection for customers using up to 5Ml per year is inhibiting competition for these customers. This is confirmed by Ofwat's own observations that SMEs are less active in the market. We think that this is best addressed by extending the use of a gross retail margin cap to the smaller customers and this approach should be aligned to both exited and non-exited retailers.

We suggest that it would be helpful for PR19 and price protection setting in the REC to align on this occasion, so that any changes to wholesale charges can be managed in conjunction with changes to retail charges.

Q2 What is your view on our proposed assessment framework? Please explain why you take this view.

We are supportive of the proposed assessment framework. We agree with the four key objectives (consumer protection, promoting competition, simplicity and proportionality) and agree that it is useful to assess each option against these. We thought it might be useful to share our assessment of the options with you as follows. This applies to both SMEs and non-SMEs.

	Customer protection	Promoting competition	Simplicity	Proportionality
Removal of price protection	no	yes	yes	yes
Reasonable & non-discriminatory prices	no	yes	no	yes
Cost based control:				
PR16 control	yes	no	yes	yes
PR16 based control	yes	yes	yes	yes
New price control	yes	yes	no	no

This analysis indicates to us that the option which best meets the objectives is a cost based control using PR16 as the basis but with some modifications. See below for further explanation of the modifications we recommend.

Q3 Do you agree that we should adopt a PR16-based control for SMEs who are transferred customers, that is, using the existing price levels as the starting point for the level of price protection, with any necessary adjustments? Please explain your view and provide supporting evidence.

We agree with Ofwat's observation that, despite best efforts, there is less activity within the SME segment. We believe that this is because the current default tariffs and associated margins in some locations are so small that it is simply not worth the effort in providing a quote. We do not consider that this position is sustainable for customers, it does not contribute to building trust and confidence for customers and does not sufficiently meet the objective of promoting competition. Therefore, we have disregarded applying the PR16 control without modification. Conversely, removing all price protection or simply applying reasonable and discriminatory pricing to SMEs from March 2020 probably goes too far and too quickly in removing price protection, given the evidence to date.

We think there are merits in developing a new cost based price control but we agree that this does not meet the proportionality or simplicity objectives.

Therefore, we agree that price protection based on the PR16 approach is the most appropriate. We believe that the price protections currently in place for the more than 5Ml per year customers are working effectively by achieving the right balance of customer protection and competition whilst being simple and proportionate. This is reflected in the high levels of customer activity within this segment. This has been achieved by applying a consistent gross retail margin cap approach across the industry.

Therefore, we would like to see an extension of the gross retail margin cap approach to the less than 5Ml per year customers which we consider achieves the best balance of objectives. This could be done in the same way as was done at PR16 for the larger customers. It has the advantages of providing a level playing field for all retailers and has proved effective to date. Furthermore, it can be applied independently of any changes in wholesale charges so that timescales for further reviews would not necessarily have to align with price setting processes for wholesalers.

There will now be plenty of evidence to support making modifications to the PR16 costs, where insufficient information was available at PR16. Specific aspects where costs are materially different from PR14/PR16 include MOSL costs, meter reading costs, credit terms, system costs, costs of transacting with wholesalers, new IT, inflationary pressures and customer acquisition costs. These can all be evidenced.

We agree that addressing this simultaneously with potential reductions in wholesale charges at PR19 would help to ensure that customers do not see material price increases. We would not like to see a scenario where prices to non-household customers went down due to a reduction in wholesale charges only then to increase again at a future date due to higher retail costs. There is therefore an advantage is aligning PR19 and Retail Exit price protection, but this need not be the case for future price reviews.

Q4 Do you agree that we should adopt a PR16-based control for non-transferred SMEs who are otherwise eligible exit area customers, that is, using the existing Retail Exit Code: Price protections beyond March 2020 price levels as the starting point for the level of price protection, with any necessary adjustments? Please explain your view and provide supporting evidence.

We think that applying the same price protections to both transferred SMEs and non-transferred SMEs best meets the overall objectives. In particular, it is simple and proportionate whilst protecting customers. We see no reason for treating transferred and non-transferred SMEs differently.

Q5 How do you suggest we should roll forward the PR16 controls for SMEs? Please explain your view and provide supporting evidence.

See our response to question 3.

The definition of an SME as being a business with less than 250 employees is difficult to capture from the available market information and therefore setting different levels of price protection on this basis is not feasible. As a retailer we consider customers using over 5Ml per year to be Industrial & Commercial and customers using less than 5Ml per year to be SMEs. This evaluation is on a site specific basis and therefore a multi-site customer could be treated as a number of SME sites.

There is a key difference here between water and energy in respect of tariffs and charging. In energy, a multi-site customer would buy their energy based on their overall national consumption across all its sites, enabling it to access large user tariffs. The appropriate tariff achieved from this large scale would apply to each site. This is not the case in water because the consumption of all sites cannot be aggregated in the same way either nationally or within an individual wholesale region. Each site pays a charge based on its individual size. This means that achievable cost savings in water are much smaller and limited much more to solutions such as consolidated billing.

We would therefore expect to offer whatever price protection is afforded to SME customers to all customers using less than 5Ml per year to aid simplicity of our business and avoid the risk of misclassifying customers based on poor data. We would however expect to remain active in encouraging multi-site customers to tender their national portfolio to benefit from the achievable cost savings and efficiency that our consolidated billing solution can offer.

Q6 Do you believe that we should make different adjustments for different usage bands? Please explain your view and provide supporting evidence.

We consider that in principle there are benefits in having different adjustments for different usage bands. However, this is not feasible until wholesale charges are aligned in the same way. Therefore, until this time, we would like to see a single gross margin cap applied to three customer segments, namely 0-5Ml per year, 5-50Ml per year and above 50Ml per year.

The issue of the overwhelming extent and variety of wholesale charges across wholesalers should be highlighted. This complex arrangement is extremely difficult, time consuming and costly for retailers to manage, particularly new entrants and those operating on a national basis. We would like to see movement in wholesale tariff structures towards greater harmonisation across the industry.

Q7 If currently non-exited companies exit the retail market after March 2020, what form of control should apply to their transferred customers? Please explain your view.

The form of price protection for all customers should be consistent across non-exited and exited retailers, irrespective of the time of retail exit. This is important to ensure a level playing field for both customers and retailers.

Q8 What approach to price protection do you suggest we adopt for transferred customers who are not SMEs? Please explain your view and provide supporting evidence.
See our response to question 5.

We consider that the current price protection for transferred customers who are not SMEs is appropriate for consumption over 5 Ml. As explained above, this achieves the right balance of customer protection and competition whilst being simple and proportionate and is reflected in the high levels of customer activity within this segment.

Q9 What approach to price protection do you suggest we adopt for eligible exit area customers who are not SMEs? Please explain your view and provide supporting evidence.

We see no reason for treating transferred and non-transferred non-SMEs differently and suggest that most retailers probably would not differentiate between transferred and non-transferred customers within their pricing models. Therefore, whatever approach is applied to transferred non-SMEs will probably also be used to meet the requirement that prices are reasonable and non-discriminatory.

For customers who have switched retailer and are neither a transferred customer or a non-transferred customer, it is not clear what, if any, price protection applies to them. Is it the case that they have proved to be active in the market by switching and therefore no price protection is required? Or should a maximum price be set at the wholesale rate plus the relevant gross margin for that customer? Clarity on this point would be helpful in the forthcoming further consultation in the summer.

We trust that this is helpful. Please let us know if you would like further details or would like to discuss our response more fully.

Yours sincerely

Wendy Monk
Head of Policy and Compliance