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To: covidbusinessretailmarket@ofwat.gov.uk

Sent by email only

29 October 2021

Dear Ofwat,

Re: Business Retail Market: Proposals to deal with un-invoiced Wholesaler charges in the event of an unplanned Retailer exit

Thank you for the opportunity to respond to your proposals on how the RFI (as set out in our 2019 price review determinations) and the Reconciliation Rule Book5, should be amended to achieve your policy decision.

We have serious concerns about the proposals, which we think are based on a misunderstanding of how the market operates and which are therefore not consistent with the relevant statutory duties. We have explained our views in our response to the questions in the consultation document.

We would be happy to discuss further bilaterally, and/or to participate in any further analysis of the issues and proposed solutions. As we set out in our response to question 3, we are of the view that a study of Aquaflo's exit from the market could provide a test case of how the current mechanisms work and inform how the policy aim could be delivered.

Yours Sincerely,



Alex Plant
Director of Strategy & Regulation



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Appendix

Q1. Does our proposed approach deliver the following policy aim in a way that is consistent with our statutory duties?

“in the event of a Retailer’s unplanned exit from the business retail market, a Wholesaler should be able to recover relevant un-invoiced revenues for services that the Wholesaler has provided to that Retailer - but were not due for invoicing or had not been invoiced - at the point of Retailer failure.”

We do not consider that the proposed approach delivers on the policy aim in a way that is consistent with the statutory duty.

We understand the proposition to treat invoiced and uninvoiced revenue on an equivalent basis so that in the event of a Retailer’s unplanned exit from the market the wholesaler is indifferent to the timing of invoicing retailers for revenue, however we are concerned that the proposed mechanism misconstrues two important aspects of the market:

1. The invoicing timetable in the non-household market is set out in the market rules. Under the common market terms, it is not therefore at the discretion of wholesalers as to when and how much they invoice retailers; and
2. The revenue that wholesalers report in relation to non-household customers may not automatically be based on the value of settlement, given the time lag in data being reflected in market settlement, as explained below. The wholesaler may decide to defer or accrue revenue compared to market settlement where it believes that the data in the market being used to calculate invoiced amounts is not timely and is not reflective of recent usage.

We are of the view that greater consideration as to the normal operation of the market is required in designing the approach to achieve the proposed aim.

Outstanding settlement

The invoicing timetable in the non-household market is set out in the market rules and it is not therefore at the discretion for wholesalers as to when they invoice retailers. The current invoicing process is dictated by the Market Settlement calculation and reporting for each billing period (calendar month). This process is run on 5 separate occasions (P1, R1, R2, R3, RF) for each month over a 16-month period before a final invoice is issued. Further Settlements can be requested by a Wholesaler or Retailer up to 28 months after the RF report is published subject to charge corrections meeting specific minimum value rules. In addition, Wholesalers and Retailers can request a Settlement Correction, but again this is conditional on meeting specific charge error minimum value rules and can also incur delays on invoicing and/or issuing refunds.

The current wording of the proposed change to the RFI formula references amounts “in relation to **the period** following the end of the period that was covered by the last invoice issued to the Licensee by the Appointee for those activities”. However, this reference to a singular period does not reflect the actual operation of the market, whereby not just one period is left to be invoiced at the point of an unplanned exit, but also the final reconciliation (RF or post-RF corrective) for all periods for the previous 16 months.

The proposal seems to assume that the wholesaler reports revenue directly from the settlement report, on the assumption that it has been updated on a real time basis. The

market is designed to pick up new information as it becomes available over time and include it in settlement at set points in time; so it is inherent that not everything that will drive the final reconciliation for an invoice period (the “RF”) is known at the time of the first post period end invoice (the “R1”).

Many of the “normal” market transactions that determine the value of settlement (e.g. meter read, YVE change, tariff change, occupancy status) are in the control of the retailer and can be backdated and affect multiple periods (and more than one reporting year). As a consequence, the wholesaler may choose to reflect these timing differences in their revenue calculation at an earlier opportunity whilst waiting for the settlement report(s) subsequently to catch up. This therefore may leave settlement values invoiced to a retailer and the value of revenue reported by the wholesaler at different amounts.

For example, the market rules require the retailer to submit a meter read once every 6 months. Whilst larger users are typically read more often, those smaller users that make up the bulk of the market are not read frequently (this issue has also been compounded across the market with the high number of long unread meters). This could leave settlement based on out of date information at the point of unplanned exit. However, it could be the case that the meter read when input to the market was immediately used by the wholesaler in updating its view of usage for a site which would create a significant gap before the market incorporated that meter read itself into the settlement calculation.

Therefore, at any point in time if a retailer fails, up to 16 invoice periods (months) will still be open and expected to go through the settlement process up to RF (and even “closed” periods will be subject to the post-RF corrective process). This could cover up to 3 financial years (for the open periods alone) depending on the point in the financial year when the retailer fails; and for each of these financial years the wholesaler may have reported revenue that reflected either an accrued or a deferred position compared to market settlement.

ARt adjustment

Given the above points, whereby the revenue reported by the wholesaler may not automatically match the value of settlement to date (given the data lag noted), we are also concerned that the proposed mechanistic adjustment through the UIRt to the ARt may not be appropriate for all wholesalers as it risks a double count of the uninvoiced adjustment. The wholesaler revenue covered by the revenue control and so reflected in performance against the control in table 2M of the APR for the charging year t-2 may already account for any adjustment to settlement proposed in the UIRt formula.

Q2. Do you agree that it is appropriate to apply company specific Totex cost sharing rates to amounts relating to un-invoiced revenue to be recovered via the RFI mechanism in the event of a Retailer failure?

In our response to Q1 above we are concerned as to the appropriateness of a mechanistic adjustment through the UIRt to the ARt based on the value of settlement rather than the value of non-household revenue reported.

In relation to the application of the totex cost sharing rates, we note that the invoicing timetable in the non-household market is set out in the market rules and it is not therefore at the discretion for wholesalers as to when they invoice retailers. The exposure of the wholesaler to “uninvoiced” revenue is therefore a function of that invoicing timetable. As a consequence, it is not necessarily appropriate that company specific Totex cost sharing rates are applied as the basis for an adjustment relating to un-invoiced revenue.

We agree that before it looks to the RFI to correct for revenue under recovery, a wholesaler should access and so fully exhaust securities and credit protection in place for the retailer in question. In order to do so it would need to establish the final net adjustment to revenue due from (or to) that retailer for the sum of all open periods up to RF (and any post-RF corrective periods). This emphasises the issue that operation of the market makes it equally likely that for a particular period a refund may be due to the retailer. Therefore, we assume that part of the mitigation process for the wholesaler will be to offset these uninvoiced refunds against uninvoiced charges.

Once this process is complete, the wholesaler would look to the securities and credit protection in place. The availability and amount of these protections is a function of the market Settlement calculation and reporting of provisional (P1) charges whereby the value of the credit security to be provided by a Retailer at any time is calculated on the basis of the value of the reported P1 charges calculated over 50 days. Therefore, this has the potential to create the situation whereby the value of the total charges owed (invoiced and un-invoiced) is greater than the value of the credit security available for a Wholesaler to draw upon. Thus, it is unlikely that in all situations a Wholesaler that would be able to fully offset the uninvoiced amounts through credit protection etc.

Therefore, any limitation to the amount of revenue recovered through the RFI should be based on those amounts that the wholesaler can recover through fully exhausting the securities and credit protections that it has in place rather than other cost sharing ratios. This would then ensure the integrity of the revenue control is maintained.

Q3. Do you have views that alternative approaches may be more effective or straightforward to implement?

We feel that it may be more appropriate for OFWAT/MOSL to carry out some analysis of the market data to better understand the level (and so risk) of un-invoiced revenues at any point in time. As outlined above, the level of uninvoiced revenue is a function of the extent to which actual data subsequently input to the market data system (CMOS) can change the value of settlement for open periods (and post-RF corrective periods). This therefore highlights the need for accuracy of initial estimates in settlement and speed with which actual data is input to replace estimates for any given period. The analysis should specifically assess the Settlement process and whether additional performance incentives could be introduced to improve Settlement accuracy, the submission of data to the market, and the timely collection of charges.

We consider it would be beneficial to consider the learning from the exit from the market of AquafLOW: For example, how were final charges calculated and how did they compare with

Settlement reports prior to Aquaflo becoming a Defaulting Trading Party. It would also be useful to understand how any Wholesaler un-invoiced revenue and/or Retailer refunds were dealt with in this instance. We hope this is a practical suggestion that could help to enable a more appropriate set of proposals to be considered.

Q4. Do you agree with the proposed change to the WRC? Please explain your answer.

For the reasons stated above we would not agree with the proposed changes to the WRC at this stage.

Q5. Do you agree with proposed amendments to the legal drafting? Please explain your answer.

For the reasons stated above we would not agree with the proposed amendments to the legal drafting at this stage.

Q6. Do you agree that the proposed change to the WRC furthers the objectives and principles set out in WRC Schedule 1, as described in section 4 above?

For the reasons stated above we would not agree that the proposed changes to the WRC furthers the objectives and principles of the WRC at this stage.