



Allocation process for gap sites and providers of last resort — proposed Commission change to the Market Code July 2008

This document presents a proposed Commission change to the Market Code, designed to simplify market processes during the first year of market operation. When a gap site is identified, or when supply points become available under the provider of last resort process, the Commission proposes that all such supply points should be allocated to Business Stream in the period to 1 April 2009. After this period, supply points will be allocated among all licensed providers.

The Commission welcomes comments on its proposal. Comments should be sent to the address below by **16 July 2008**.

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1. Background

On 1 April 2008, the Scottish market for water and sewerage services to non-household customers opened up to competition. Non-household customers can choose their supplier from several competing providers, operating under licences issued by the Commission. Before 1 April 2008, all non-household customers were served by Business Stream, a subsidiary established by Scottish Water under the Water Services etc. (Scotland) Act 2005 (the 2005 Act).

The market framework allows customers to switch between licensed providers in a process co-ordinated by the Central Market Agency (CMA), an independent body that also calculates the wholesale charges payable to Scottish Water by each licensed provider.

In certain circumstances, a customer's supply points might not currently be allocated to any licensed provider. This may occur:

- When Scottish Water identifies a site that has not previously been registered in the market but should be (a "gap site"), for example, a non-household site that had previously been billed as a household; or
- When a licensed provider withdraws from the market with supply points registered to it. This triggers the Provider of Last Resort (POLR) process. Supply points so reallocated are known as "POLR supply points".

In these circumstances, if the affected customer does not choose a licensed provider, the Market Code requires the CMA to allocate the supply points among all of the other licensed providers.

2. Policy developments

On 1 June 2008, the Commission refined the process for allocating gap sites identified by Scottish Water.¹ Under this process, Scottish Water will invite the customer to choose a licensed provider and, if the customer fails to make a choice, the CMA will allocate the gap site to a licensed provider on a rotational basis.

Scottish Water is currently installing meters at unmeasured non-household premises under the Scottish Government's full business metering programme. Scottish Water is due to complete this programme by the end of March 2009.

¹ See the eighteenth licensing consultation, which is available on the Commission's website, www.watercommission.co.uk.

In the process of installing meters, Scottish Water has identified many more gap sites than had originally been anticipated. Scottish Water is currently identifying around 40 gap sites each week, a rate that it expects to continue until meter installations under the full business metering programme are finished.

The Commission has received representations in relation to the challenge that this unexpectedly high flow of gap sites presents to new entrants that are commencing operations at a small scale. This is not an issue for Business Stream, which began with 100 per cent market share and can easily take on responsibility for new customers at this rate.

3. Proposed action

The Water Services (Codes and Services Directions) 2007 (the Codes and Services Directions) allow the Commission to require the amendment of any core industry document if the Commission considers such an amendment:

- Is necessary in the interests of securing the orderly participation of licensed providers in the provision of licensed services; and
- Is consistent with the principles the Commission has established in respect of those core industry documents.²

A key objective for the market is to ensure licensed providers may compete on a level playing field, given the natural advantages that would otherwise accrue to Business Stream as the original supplier to all non-household customers. The practice of allocating gap sites and POLR supply points amongst all licensed providers — rather than, for instance, allocating all such supply points to the original incumbent provider — is integral to this objective. The Commission considers that such an allocation mechanism is essential in the long term.

However, the Commission recognises that the orderly participation of licensed providers in the provision of licensed services may require moderation of this approach in the early stages of market operation. Therefore the Commission proposes to suspend the allocation mechanism for gap sites identified by Scottish Water, and for POLR supply points, until the market has been open for one year.

The Commission considers this change will promote the following principles, as set out in the Codes and Services Directions:

- **Proportionality.** The objective of a level playing field remains; in the short term the allocation of gap sites identified by Scottish Water and POLR supply points to all licensed providers may place a disproportionate burden on new entrants.

² The principles are set out in the Schedule to the Codes and Services Directions, which are available on the Commission's website, www.watercommission.co.uk.

- **Transparency.** The change in the rules is concise and accessible to market participants. The rules will be simpler in the short term than otherwise and there will be no change to the longer-term situation.
- **Barriers to entry.** To the extent that the existing circumstances could be said to erect a barrier to the entry of new providers, the proposed change will reduce such barriers. From 1 April 2009, the full business metering programme will have been completed and the inflow of gap sites should not be as great as it is at present, so the reinstated allocation process will not present a barrier to entry after that point.
- **Non-discrimination.** The proposed change will promote non-discrimination by removing a source of potential disadvantage to new entrants which are in a substantially different position, as regards the scale of their operations, when compared to Business Stream.
- **Core functions.** The proposed change will not affect the ability of Scottish Water to exercise its core functions.

All licensed providers holding general licences will still bear a universal service obligation to non-household customers in Scotland. That is, any customer may insist on purchasing — from any licensed provider — the default services that the Commission has set out at the default tariff.³

Furthermore, the existing arrangements in relation to a gap site identified by a licensed provider will remain. That is, the relevant supply points will be allocated to the licensed provider that identified the gap site.

4. Consultation process

The Commission's proposed change to the Market Code is attached at Annex A. The Commission welcomes representations from interested parties on its proposal. Such representations should reach this office by 16 July 2008, using the contact details supplied on the front cover of this consultation document.

³ This obligation is contained in standard licence condition B1 (Duty to provide default services) of water and sewerage services licences granted by the Commission. It would not apply to holders of a specialist licence or a self-supply licence. The standard licence conditions and the default directions are available on the Commission's website, www.watercommission.co.uk.