



SHEPHERD+ WEDDERBURN

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**THE TEMPLATE WHOLESAL SERVICES
AGREEMENT**

**JAMES SAUNDERS: PARTNER, SHEPHERD
AND WEDDERBURN**

A. INTRODUCTION

In its first consultation document issued in April 2005, the Water Industry Commission for Scotland (the “Commission”) confirmed that the terms and conditions of the relationship between Scottish Water and its retail subsidiary (now called Business Stream) should be set out in a written agreement. The Commission expected this “wholesale services agreement” (WSA) to include details of information exchanges between the parties (including those relating to complaints or emergencies); billing and payment terms; and procedures for resolving disputes between the parties.

This agreement was to be scrutinised by the Commission before it granted an interim licence to Business Stream for the period up to market opening in 2008.

After 2008, there would be a need for a standard bi-lateral WSA to regulate the relationship between Scottish Water and all of the licensed retailers operating in Scotland (including Business Stream).

B. ORIGINS OF THE WHOLESALE SERVICES AGREEMENT

Section 16

The WSA was underpinned by Section 16 of the 2005 Water Services Act. This Section allowed a licensed retailer to request Scottish Water to supply to the retailers’ customers’ premises through the public water supply and placed a duty upon Scottish Water to comply with this request, subject to agreeing terms and conditions with the retailer (i.e. through a WSA) and subject to it being consistent with the exercise of Scottish Water’s core functions.

2007 Directions

In its 2007 Directions to Scottish Water, the Commission set out a number of principles applying to core industry documents such as the WSA. One of these principles was that the rules and/or arrangements established by or under each core industry document should not be detrimental to the exercise of Scottish Water’s core functions. This principle was particularly important in determining the payment arrangements under the WSA. By authorising Scottish Water to collect wholesale charges in advance (i.e. prepayments) from all retailers, including Business Stream, protection was provided to Scottish Water’s core business.

Retail/Wholesale Split

In establishing a retail market, one of the Commission’s main principles was that there should be clarity about who has responsibility for specific market functions. The Commission’s starting point was to define all customer facing activities as retail.

The Commission’s view was that retail activities would include all matters relating to:

- the billing process;
- collection of charges;
- debt follow-up and debt management;
- meter reading and customer meter operations;
- call and correspondence handling;
- responses to customer enquiries, complaints or requests for information;
- key account management;
- liaising with the wholesaler to deal with customer issues; and
- marketing.

The expectation was that new entrants could improve the level of service offered to customers through assuming responsibility for all customer facing activities. For example, they could offer customers multiple payment alternatives (in terms of method or frequency of payment), could combine the bills of various locations into one single bill (for multi-site customers) or could offer advice as to how to reduce consumption.

C. THE COMMISSION'S ROLE IN DEVELOPING/APPLYING THE TEMPLATE WSA

The process of drafting the WSA began in 2006 with the Commission working with Scottish Water to produce a template or model WSA. The template WSA sets out the Commission's starting point in considering what terms would be reasonable for such an agreement and so provides a clear basis for negotiations between Scottish Water and retailers.

The standard licence conditions, codes and services directions require retailers and Scottish Water to obtain the Commission's consent for the WSA they enter into allowing the Commission to monitor the development of the market. In reviewing a WSA agreed between Scottish Water and a retailer, the Commission will regard the template WSA as the backstop of minimum terms and conditions.

A WSA cannot be amended without the Commission's consent.

D. LINK WITH THE WHOLESALE CHARGES SCHEME

The template WSA specifies the charges that retailers must pay Scottish Water by reference to the wholesale charges scheme and prescribes the timing and method of payments of charges and any interest.

The wholesale charges scheme controls the charges that Scottish Water can levy on retailers for its wholesale services. It is prepared by Scottish Water and forms part of the wider charges scheme that is required to be prepared by Section 29A of the Water Industry (Scotland) Act 2002. The scheme must be made with reference to the Commission's 5 yearly price control of Scottish Water, is updated annually and must be approved by the Commission. Section 29 of the 2002 Act prevents Scottish Water from levying charges that are not in accordance with its charges scheme (or specifically approved by the Commission under Section 29E). The wholesale charges scheme contains a series of charges that apply to the various wholesale services Scottish Water provides. A description of the methodology by which those charges are to be applied in any particular case has also been provided by Scottish Water.

E. LINK BETWEEN WSA AND SECTION 29E POLICY

Section 29E of the Water Industry (Scotland) Act 2002 essentially allows Scottish Water to depart from the wholesale charges scheme (charging either more or less) where the customer has done or agreed to do something that reduces or increases the costs incurred by Scottish Water or where it is otherwise justified to depart from the charges scheme. To date there have not been any Section 29E determinations but this mechanism could provide an incentive for innovation and efficiency within the Scottish Water and waste water industry. Provisions in relation to Section 29E are contained within the template WSA, as described below.

F. WHAT DOES A WSA COVER?

Essentially, the WSA sets out the basis on which Scottish Water will provide wholesale services to the retailers.

As mentioned earlier, each WSA is a matter for negotiation between Scottish Water and the licensed retailer. However, under the template WSA, Scottish Water is required to provide the following services to a licensed retailer:

- Water services – the supply of water through the public water system where the supply is metered; the supply of water through the public water system to the supply point where the supply is unmeasurable; and the supply of water through the public water supply system where supply is measurable but is not metered.
- Sewerage services – the provision of all foul sewerage services; all surface water drainage services (including roads drainage) and trade effluent services.

In supplying water under a WSA, Scottish Water is required to comply with the duties imposed by statute in relation to the quality of water under the various statutes. This provides a contractual overlay to the existing statutory obligation placed upon Scottish Water.

Scottish Water Metering Services

Under the template WSA, Scottish Water is required to provide, maintain, repair, routinely test for accuracy and either routinely or where faulty, replace meters. In addition, when a retailer requires, Scottish Water must:

- install and meter for any supply point where that supply is not measured by meter;
- remove a meter installed for any supply point; or
- replace a meter or meters installed for any supply point which is not appropriately calibrated or undertake a meter accuracy test.

Provision is made for meters to be fit for purpose and compliance with relevant industry standards. Retailers are allowed to provide meter reading and other customer meter operations.

Under Scottish property law, where an object is attached to a property, then normally it becomes part of that property. However, Scottish Water have a statutory exception to this in relation to meters whereby a meter installed by Scottish Water remains its property and it can remove the meter from the property. This has meant that meter ownership has continued with Scottish Water and explains why they continue to provide these meter “upkeep” services.

Application for departure from the wholesale charges scheme

As referred to above, if the retailer believes that, as a consequence of action taken by one of its customers, a departure from the wholesale charges scheme is justified, it may write to Scottish Water requesting that Scottish Water apply to the Commission for consent to depart from that wholesale charges scheme. There are detailed provisions in the template WSA that regulate that application to the Commission and ensure that there is monitoring by the Commission of that process.

Liability

Under the template WSA, the parties’ liability is based along similar lines in other utility industries, namely:

- there is no liability for consequential or indirect loss;
- there is no liability for loss or damage except where there is negligence or wilful misconduct; and
- there is no limit on liability for death or personal injury.

There was comment during the consultation process regarding the exclusion from liability for failure to deliver services under the WSA in a range of circumstances. However, under the current contracts with retailers and customers, delivery of services to non-household customers are subject to the exclusions set out in the WSA. As replication of these provisions in the retailer-customer contract does not cause any detrimental damage in the level of service delivered to the customers, the Commission considered the potential risk to licensed retailers to be low.

However, there were introduced a number of service standards into the WSA which were based upon Scottish Water's existing guarantee service standards.

Service Standards

Service standards are specified, however, like the remainder of the template WSA, are subject to negotiation. Service standards cover:

- complaints from customers – if a retailer passes to Scottish Water a complaint by a customer regarding provision of the services by Scottish Water, Scottish Water must respond within a specific timeframe. If it fails to make this response, then it pays a set amount;
- keeping appointments with customers – if Scottish Water arranges through the retailer an appointment to meet with a customer, it will offer a morning or afternoon appointment or a 2 hour time band. Again, there is a payment if this is not made;
- planned interruptions to water supply – Scottish Water is required to give the retailer notice of any planned interruption to water supplies to customers, which is linked to the operational code. If there is no notice given or Scottish Water fails to restore the service by a specified time, then a payment is required to be made;
- unplanned interruptions to water supply – if the water supply is disrupted because of a fault or breakdown in plant, equipment or pipes which form part of the “public water supply system”, Scottish Water will restore the supply within 12 hours from the time that Scottish Water finds out about the interruption unless a burst affects a strategic main, in which case the supplies are restored within 48 hours. Again, a payment is due for failure;
- water getting into gas system – Scottish Water will return any telephone call from the retailer to its emergency helpline regarding water entering the gas system within 2 hours of the initial contact, given the potential health and safety issues;
- flooding from sewers – if waste water from Scottish Water's sewers flooded the inside of a customer's premises occupied by a customer, then Scottish Water is required to refund the retailer's annual waste water charges up to a maximum of £1,000 per flooding incident;
- meter installation applications – if the retailer requires Scottish Water to fit a meter, it is required to carry out a survey to establish if a meter can be fitted and the costs involved within 8 business days of receiving a request;
- water pressure – Scottish Water is required to supply water at a minimum pressure of 1 bar. If there is low pressure discovered and confirmed, then payment must be made to the retailer in specified circumstances; and
- response in emergencies – during an emergency (which is referred to in the operational code), Scottish Water must take specified steps such as announcing information and providing alternate drinking water supplies. If Scottish Water fails to meet these standards, then compensation up to a maximum of £5,000 per end customer is payable as well as compensation in respect of waste water or water charges.



Payment

Consistent with the no detriment to Scottish Water's core functions principle, the template WSA contains a requirement for prepayment unless otherwise agreed (see Additional Payment Methods below). The prepayment provisions provide that the monthly charge for the wholesale services is paid by the retailer by the 10th business day prior to the start of the month. This charge is called a provisional monthly charge. Following a settlement report which is produced by the Central Market Agency under the Market Code after carrying out what is called a "settlement run"; there is reconciliation between the provisional monthly charge and the Central Market Agency's calculation of the reconciled charges for that month. If the provisional amount is less than the reconciled charges, payment is made by the retailer together with interest and if the provisional amount is greater than the reconciled amount, payment is made by Scottish Water, again together with interest. Interest is calculated at the base lending rate.

G. DEVELOPMENTS TO THE WSA SINCE MARKET OPENING

One of the principal aims of the introduction of retailers to the Scottish market was to provide new and improved services. There are now a number of examples where retailers are tailoring their services (and their WSAs with Scottish Water) to meet specific needs of their customers. Effectively they are designing their services around the interests of their customers and not the wholesaler. Examples of these include:

- arranging for leaks to be repaired and meters to be replaced at night in order to minimise the impact on the customer's business;
- providing regular management information that identifies uses, trends and any anomalies. By proactively providing this information, customers are able to catch and quickly correct any unexpected increases in consumption, such as leaks, and avoid running up large bills;
- identifying additional ways to reduce bills and lower consumption through services such as metering unmetered properties, fixing leaks and dripping taps, and installing rainwater harvesting; and
- working with developers on a water efficient commercial and residential development whereby the buildings will be fitted with a range of water saving devices including integrated grey water recycling systems.

Contestable Services

Since market opening, the template WSA now makes provision for a retailer to provide water metering services, water connection services and/or trade effluent sampling and analytical services. The provision of these services points to the use of accredited operators and should, in the future, lessen the requirement to regulate these services directly but, rather, should, through the accreditation process, ensure that sufficient protections for the retailer and the wholesaler are built into that process.

Additional Payment Methods

However, the principal changes to the template WSA have been in the means available for retailers to pay the wholesale charges. This now ranges from prepayment, which was established in the initial market, to the use of an escrow account and the use of an alternative to prepayments such as a guarantee.

The Commission determined that those retailers that do not have a demonstrable business track record must provide a clear and on-going financial commitment to the competitive market. Where a retailer prepays its wholesale charges, this commitment will be in the form of an escrow account to be used for the payment of monies owed to Scottish Water by the retailer.

The escrow account will only be accessible by Scottish Water and the retailer must provide an initial balance and then ensure that the balance of the account remains at that amount or an amount equal to the retailer's monthly wholesale charges (whichever is the greater). The escrow account will be interest bearing with the retailer entitled to any and all interest therein.

The introduction of guarantees was the Commission's response to the changes that took place within the credit market since market opening. A lack of available credit was impacting on the competitive market. To address this issue, the Commission put forward an alternative measure of financial liability which was the provision of a guarantee to Scottish Water from a company with a defined investment grade credit rating for all sums owed by the retailer under the market framework agreement arrangements. A guarantee would allow a parent company to guarantee the sums owed to Scottish Water by its subsidiary. The Commission viewed that this use of a guarantee would not place Scottish Water in a financially less secure or riskier position.

H. LESSONS LEARNED

The following key points were learned in developing the template WSA:

- the introduction of the prepayment regime for wholesale charges protected Scottish Water's core business and allocated the customer facing activity and associated risk with the retailer themselves;
- the removal of credit risk from the wholesaler was useful in allowing it to view its own commercial obligations to the retailers such as payment, service standards, outages and dispute resolution as a part of a wider balance. Requiring new entrants to demonstrate an ability to comply with the prepayment obligation (with escrow or guarantee support as necessary) has reduced the on-going cost of licensing new entrants accepted;
- introduction of further contestable services – since market opening has widened the scope of the role of the retailer which has been welcomed not only by the retailer but by the wholesaler as a means of focussing its own service provision;
- a vehicle for engagement – the WSA has provided a standard for the industry which has been followed and departed from as retailers have required the relevant flexibility. In addition, it is provided that a means whereby enhancements to the provision of services by retailers can be focussed and discussed and then reflected in a document which records the increase in the scope of the retailer's activities; and
- to date there has been no recourse to the Commission's determination powers in relation to disputes under the WSA – perhaps an indication that the template mechanism is working well.



James Saunders
Partner, Shepherd and Wedderburn LLP
E: James.Saunders@shepwedd.co.uk
DL: 0131 473 5288