

Date: 25 May 2018

Dear stakeholder:

Review of the water and sewerage non-household retail market

Non-household customers have benefitted from lower prices and better and more tailored services following the Scottish Parliament's decision to allow non-household customers to choose who provides their water and sewerage services.

The retail non-household market has now been operating for over ten years. Most non-household customers have switched or renegotiated the terms of their supply - receiving either better prices and/ or more tailored levels of service. Licensed providers provide tailored water efficiency advice and use technology to improve levels of service to customers. There has been a marked reduction in non-household customers' use of water.

However, the Commission is not complacent. The Commission keeps the regulatory framework under review. It wants to be sure that the market arrangements serve the interests of customers.

The Commission notes that there are 26 retailers competing in Scotland. Some of these retailers are associated with regional English water and sewerage companies, others have come from other industries, including energy and telecoms. Over the last ten years, we have experienced changes of ownership, consolidation and failures amongst licensed providers.

We consider it is now appropriate to launch a comprehensive review of the market framework. The Commission wants to ensure that the market framework in Scotland will continue to work well for customers, licensed providers and Scottish Water.

The Commission is publishing this letter to set out its views of the issues that it should, as a minimum, consider during its review. The Commission would welcome stakeholder's initial views on these issues and suggestions of any other issues that the Commission should consider during its review.

Please provide any comments or suggestions by 15 June 2018 to competitionteam@watercommission.co.uk in order that we can plan our proposed review. We will confirm the timeline and opportunities for input to our review by the end of September 2018. Given the likely extensive nature of this Review, the Commission

envisages applying a modified version of its licence application policy (in relation both to pending and new applications) until the Review is complete.

The Commission plans to consider the following questions, as a minimum, during its Review. It will take into account the views of stakeholders on these and any other questions that they believe the Commission should consider during its Review. The Commission will publish its timeline for, and the opportunities for stakeholders to contribute to, the Review by the end of September 2018.

Making the market work better

1. Should the Commission revise its approach to assessing applications for licences?
 - a. Should the existing process be amended to improve the Commission's ability to assess a licence applicant's ability to perform the activities for which it is being licensed?
 - b. Should we consider an applicant's plans for serving customers?
 - c. Does the Commission collect unnecessary information? Is there any additional information that the Commission should collect?
2. Licensed providers and their Ultimate Controllers are required to provide the Commission with an annual declaration that they complied, and expect to continue to comply, with UK and EU competition and State aid law. Are these annual declarations sufficient? Should we require additional information? Should we require evidence to be provided to support the declaration? For example, can we be fully confident that any support to a licensee from a related undertaking is provided on an arm's length, commercial basis?
3. Are all licensed providers contributing fairly towards the costs associated with managing the competitive framework?
 - a. Is the current methodology for calculating the fixed and variable elements of the licence fees proportionate and fair to all market participants?
 - b. Are licensed providers who are not actively trading in the market contributing towards the costs of operating and maintaining the central market systems? What further controls could be put on access to, and use of, the market data set?
 - c. Are licensed providers paying a licence fee commensurate with the value of the market data set? If not, what should we do to remedy this?

- d. Should the Commission be recovering from individual retailers directly attributable costs that have been incurred when deemed unreasonable that all retailers contribute towards those costs?
4. The Commission has responded to consolidation, changes of ownership and retailer failure over the past ten years. What changes are appropriate in the light of this experience – bearing in mind the Commission’s duty to promote the interest of customers and orderly participation in the non-household retail market. For example, should the Commission review the arrangements for handling changes in ownership?
 - a. Are there governance issues and risks associated with having two or more licensed providers who are controlled by the same Ultimate Controller(s)? Should we require the cancellation of one licence in such circumstances?
 - b. Should licensed providers be allowed to transfer their customers to another licensed provider without customers’ explicit consent?
 - c. Licence conditions¹ require licensed providers to notify the Commission of any change of control or any material change in circumstances of the licensed provider as soon as practicable. Should the Commission also reassess licensed providers’ adequacy to perform the activities they have been licensed for in the event of a change of ownership or any other material change in circumstances?
 5. If a licensed provider goes out of business the continuity of the services is guaranteed through the Provider of Last Resort (PoLR) mechanism. How can the PoLR mechanism be further improved to secure a smooth reallocation of customers? What arrangements should be in place for participation in the Provider of Last Resort mechanism?
 6. Since 2012 new connections² to the network have been made contestable. Are market arrangements for new connections fit-for-purpose and how could they be improved? How can the Commission best achieve its desire to see significant innovation in how asset capacity is used as effectively as possible?
 7. The Gap Site Scheme incentivises retailers to seek out and register non-household customers at sites which should be part of the market. Does the Gap Site Scheme

¹ The Commission revised licensed providers’ Standard Licence Conditions in November 2016. Details of the changes can be found here:
<https://www.watercommission.co.uk/UserFiles/documents/Application%20Policy%20Decision%20Issued.pdf>

² In the Final Determination for 2010-15 the Commission determined that three activities, metering, trade effluent and connection activities, should open up to competition through the retail market. Details of the arrangements can be found here:
<https://www.watercommission.co.uk/UserFiles/Documents/New%20Retail%20Areas%20response.pdf>

provide proportionate and effective incentives to register new customers in the market?

8. Are gross retail margins appropriate for each service? How should we make any appropriate transition given that licensed providers may have specific contracts with customers for specific services and prices? How should we ensure there is no detriment to the core business of Scottish Water?
9. Market data has now reached a higher level of quality than at market opening. How can we ensure market data continues to improve?

Improving customer experience

10. How can the Commission support retailers in providing excellent service to customers?
 - a. How can the market arrangements (including the expectations on licensed providers) ensure that customers are put at the heart and contribute to high standards of conduct? How can the Commission ensure those high standards are met?
 - b. What information about a retailer's performance could be made available to customers on an ongoing and consistent basis to promote greater transparency?
 - c. Should we consider an accreditation scheme to provide customers with greater transparency of the levels of services that are being offered by retailers? If so, how should this work? Where would we make the information available? Should it be compulsory?
 - d. What role should the Market Audit play? Could it, for example, confirm that retailers are committed to appropriate behaviour towards their customers?; have upheld their service commitments?; have provided contract terms that are written concisely and are easy to understand?; and that are fair?

Protecting customers

11. The Commission extended the pre-payment required from licensed providers to ensure that the market arrangements protected the core business of Scottish Water from any detriment. This change was in line with the statutory duties of the Commission. Should the Commission take any steps to ensure that customers cannot suffer any loss if they pre-pay a licensed provider? How could we achieve this goal if a licensed provider were to enter administration?

12. How can the Commission ensure that the use of third parties through the sub-contracting or outsourcing of retail activities by licensed providers is consistent with its statutory duty to promote the interests of customers? How can we ensure that licensed providers carry out, and take full responsibility for, the activities they are being licensed for? Should the Commission collect and monitor information on the use of third parties by licensed providers?
13. Self -supply licences concentrate bad debt risk for Scottish Water. It is not clear that this is allowed for in wholesale charges. As such, the Commission intends to review whether self-supply arrangements are consistent with the Commission's statutory duty to do no detriment to the core business of Scottish Water. What is the impact of self-supply on Scottish Water's overall bad debt risk and the cost of managing individual Wholesale Services Agreements?
14. Self-supply licences may also allow 'cherry-picking of customers. Do the 'self-supply' arrangements make it more difficult for 'full service' retailers to operate effectively in the market? Are there any reputational issues for the market that need to be considered? Are potential 'self-supply' applicants sufficiently aware of their obligations and the potential risks and costs if they fail to meet their licence obligations?
15. In the light of this analysis, we intend to review: should the Commission continue to issue self-supply licences? If so, are there any further conditions that should attach to them (to ensure that there can be no detriment to the core business of Scottish Water)?

Next steps

The Commission welcomes the views of market participants, customers and other stakeholders on these questions. It will take into account the views of stakeholders on these and any other questions that they believe the Commission should consider during its Review. The Commission will publish separate consultations on the details of the proposed changes in due course.

Yours sincerely,



Alan D A Sutherland

Chief Executive