Application of the new non-household retail market framework to new appointees, small companies and companies based wholly or mainly in Wales - an Ofwat consultation
1  Introduction

The Consumer Council for Water (CCWater) is the statutory consumer organisation representing the interests of customers of water and sewerage companies in England and Wales. CCWater has four regional committees in England and a committee for Wales.

On 11 March 2016, Ofwat held a workshop attended by CCWater, New Appointment and Variation (NAV) appointees, small companies, and companies based wholly or mainly in Wales. The workshop explored the specific impact that non-household (NHH) retail market reform would have on these companies.

We welcome the opportunity to respond to Ofwat’s consultation on the issues raised at this 11 March meeting.

2  General Comments

2.1  Changes to charging arrangements should not cause a price shock for customers.

If an incumbent water company exits the NHH retail market, then any new system of calculating a NAV appointee’s charges should result in charges that are as close as possible to the departing incumbents’ charges.

2.2  New market arrangements should ensure that charges are reasonable and customers are protected.

This is especially true for customers less able or willing to switch because they are time and/or resource poor or find it difficult to access relevant information.

2.3  New market arrangements could disrupt the financial viability of NAV appointees which in turn could affect customers’ service.

Features of NHH retail competition could put some NAV appointees at a financial disadvantage that may lead to them exiting the market. This could create uncertainty for customers, including domestic customers who are not yet in a position to switch supplier. CCWater feels that this could have a negative impact on customer perceptions of current and future competition.

3  Response to Ofwat’s Questions

3.1  New appointees setting non-household charges in a retail exit scenario

Condition B1A.3 of the water companies’ Licence of Appointment requires that the NAV appointee’s charges for NHH customers should not exceed the ‘relevant charges’ of an incumbent. However, if the incumbent in the area of a NAV appointee’s site exits the market, there will be no ‘relevant charges’ for a NAV appointee to match or better.
Of the four options presented in Ofwat’s consultation, CCWater prefers option 3b to *Require the NAV to comply with the tariff that would have applied had the incumbent not exited*. We believe this offers the most continuity with existing charges set under the five yearly price controls.

We assume that a supplier of first resort would take over the exiting incumbent’s NHH retail function and adhere to price and service terms, at least for a limited period. A NAV appointee in that area would then have to peg its price and service levels to those offered by the supplier of first resort under the ‘no worse off’ principle.

We expect companies to inform NHH customers about retail exit and provide assurances that price and service will be protected under the new arrangements and that customers have the option of switching retailer.

In the longer term Ofwat may want to explore Option 4 where *Ofwat gives notices to the NAVs and brings Condition B fully into effect so that NAVs become subject to their own price control*. However, we recognise that this option may be disproportionate due to the relatively small size of NAV appointees, the geographically disparate nature of their customer base and their administration costs.

In general, we feel that the other options offer less protection to customers.

### 3.2 Small companies setting wholesale charges

If a NHH customer wants to switch, NAV appointees and small companies will be required to offer a wholesale price.

It is clear from the issues that were discussed at Ofwat’s workshop on 11 March that some NAV appointees have concerns about the viability of their business once the NHH market opens. In particular, they are concerned that a number of factors interact to cause margin squeeze:

- Loss of income if NHH customers switch; and
- additional costs arising from installing the systems and processes required to facilitate competition.

Generally, NAV appointees will have to set wholesale charges at the level of the incumbents’ wholesale charges to which they will add their own costs. This will have an impact on the retail charges that they can set.

Due to the ‘no worse off’ rule, however, NAV appointees will have limited scope to recover any additional costs through their charges. This problem is exacerbated because their margins are related to the charges for bulk supplies, which are calculated according to a methodology that bears no relation to the wholesale/retail pricing structure.
Allowing NAV appointees to set their own wholesale charges may be a sensible option if the ‘no worse off’ principle was retained to protect customers. However, we would only support this if the mechanism for setting charges reduced the potential margin squeeze and the risk of NAV appointees leaving the market, with potential disruption to customers. We consider that guidance from Ofwat, and possibly intervention, may be necessary as experience shows us that smaller companies can struggle to set charges without assistance.

We, therefore, urge Ofwat to further consider how to address NAV concerns about the bulk supply pricing methodology with a view to ensuring that it reflects the wholesale/retail pricing arrangements and reduces the level of margin squeeze that they may experience.

3.3 Licensing and interactions with market systems

Small companies have questioned the requirement to fully comply with market systems as they feel that this may be disproportionately burdensome.

As long as there is no detriment to customers, we would support a flexible approach. Forcing these companies to adopt an unduly complex system in time for market opening could compel them to exit the market, leading to potential disruption for customers.

We expect that Ofwat and MOSL may need to work closely with NAV appointees, small companies and companies wholly or mainly in Wales to help get their processes ready.

3.4 Company eligibility

The legislation provides a fixed definition of ‘wholly or mainly’ in relation to the eligibility of NAV appointees and companies in Wales.

We think that Ofwat’s approach to eligibility seems sound and is in line with the legislation.

4 Enquiries

If you have any questions about CCWater’s response to this consultation, please contact:

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