

INVITATION FOR EXPRESSION OF INTEREST

Establishing a market health check for the non-household retail market

13 December 2021

Executive summary

WICS is seeking to introduce an innovative market-wide process, the Market Health Check (MHC) in the non-household water and sewerage market. This process seeks to improve customer outcomes and promote compliance and the overall effectiveness of the retail market.

This presentation pack provides information on the context and rationale for the MHC and describes some key operational principles underpinning the process. It also sets out some key selection criteria for a Market Health Checker (MHCer).

The MHC will be carried out by an independent individual who is publicly appointed by WICS. We are therefore inviting interested parties to submit an expression of interest in undertaking the role of MHCer by 31 January 2022 to competitionteam@wics.scot

CONTENTS

SECTION 1

Background to the retail non-household market 04

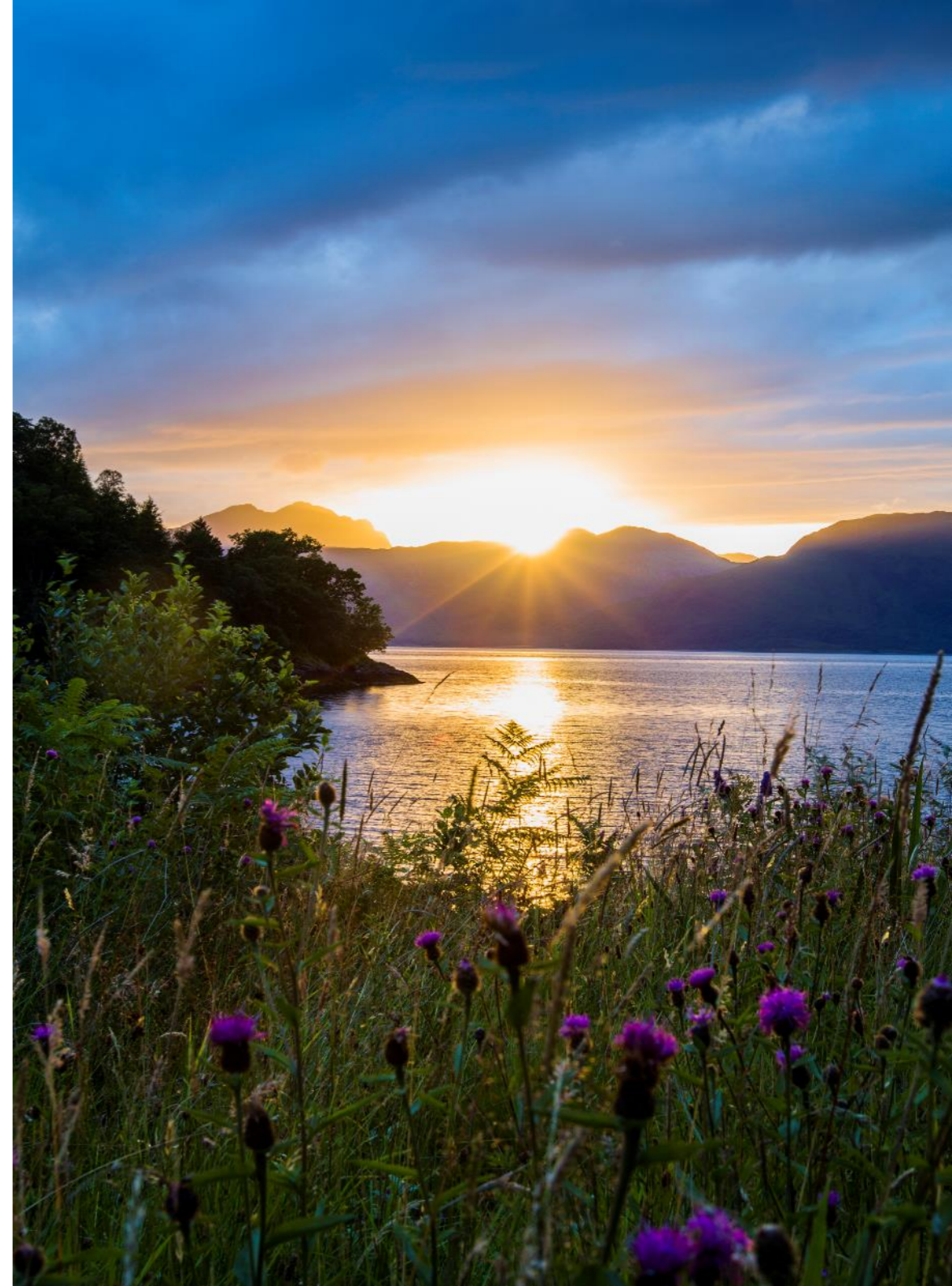
SECTION 2

Context for the market health check 12

SECTION 3

Criteria for selection 23

APPENDICES 26



BACKGROUND TO THE RETAIL NON-HOUSEHOLD MARKET

Section 1

The Water Industry Commission for Scotland (WICS) was formed on 1 July 2005 under the Water Services etc. (Scotland) Act 2005...

- WICS is a non-departmental public body with statutory responsibilities.
- WICS is accountable, through the Scottish Ministers to the Scottish Parliament and, ultimately, to customers in Scotland. In summary, its statutory duties are to:
 - Promote the interests of Scottish Water’s customers and, in so doing, to have regard to the interests of future customers;
 - Ensure that customer charges reflect the lowest reasonable overall cost for Scottish Water to deliver the Scottish Ministers’ Objectives;
 - Comment on Scottish Water’s reporting of its performance, challenging Scottish Water to become more efficient and sustainable;
 - Allow for the participation of retail water and sewerage providers that wish to supply non-household customers in Scotland; and
 - Support the Scottish Government’s vision of ensuring that Scotland is a Hydro Nation, and to meet our obligations under the Water Resource Act 2013.

Since 1 April 2008, all non-household and public sector customers have been able to choose their licensed provider (LP)...

- The 2005 Act gave WICS the power to licence new entrants to the retail non-household market. The licensing powers of WICS are limited by an obligation to encourage an orderly participation in the market in a manner that is not detrimental to the exercise of Scottish Water's core functions (a similar no detriment duty was not introduced in England).
- WICS also monitors retailers' compliance with their licence conditions and has powers under the 2005 Act to investigate and take, when appropriate, enforcement action.
- Whilst WICS does not have an active remit to promote competition nor does it have any concurrent competition powers, it ensures that the market arrangements support a level playing field and are compliant with competition law requirements.



As 'administrator' of the licensing framework WICS ensures that the market operates in an orderly fashion.

Governance of the non-household retail market...

Stakeholder	Key Role
Scottish Government	Sets the Principles of Charging (PoC) that underpin the charging arrangements for water and wastewater services provided by Scottish Water to LPs. The PoC require that charges for similar services are averaged across all of Scotland.
Scottish Water	The wholesaler of water and wastewater services to LPs. It continues to operate the network of pipes, resources and treatment assets. It publishes annual wholesale charges and offers a regulated access to new entrants through a standard Wholesale Services Agreement.
Water Industry Commission for Scotland (WICS)	The economic regulator for the water and wastewater industry. WICS manages the regulatory framework by encouraging the Scottish water industry to provide a high-quality service and value for money. As such, WICS: <ul style="list-style-type: none"> • Grants and revokes licences; • Monitors compliance with licence conditions and market codes; • Ensures a fair and well-functioning market i.e. customers can switch and LPs can compete on a level playing field; and • Works with the industry to improve the market framework and can veto proposed changes that go against the market principles.
Central Market Agency (CMA)	Jointly owned by all market participants it manages the market settlement, customer registration and switching for the retail market. It administrates operational changes to the market codes through the Technical Panel.
Licensed Providers (LPs)	LPs purchase wholesale water and sewerage services from Scottish Water at a regulated price and then sell these services, along with other value added services to customers. LPs are required to comply with their licence conditions, a Market Code and an Operational Code .
Citizens Advice Scotland (CAS)	Advocacy body for consumers with a range of statutory powers and duties relating to water, energy and postal services.
Scottish Public Services Ombudsman (SPSO)	The SPSO handles final stage customer complaints on matters relating to the service provided by Scottish Water and LPs.

A number of key principles underpin the retail non-household market in Scotland

- **All customers in Scotland are appropriately protected.** There is a universal service obligation that requires LPs to offer all customers, regardless of their location or cost to serve, default services at a maximum default tariff. Default tariffs, which are set annually by WICS, act as a safety net to ensure that all customers, regardless of their location, can receive an appropriate minimum level of service.
- **Non-household customers should not be worse off as a result of the introduction of the retail market.** Wholesale charges continue to be set on a geographically harmonised basis, in line with Scottish ministerial policy. This allows all customers to experience the benefits of competition.
- **No detriment is made to the core business of Scottish Water as a result of the retail market.** This principle allows retailers to focus on doing what is right for their customers, which aligns the interests of retailers and of their customers. The no detriment provision also ensures that household customers are not worse off. In line with WICS's no detriment duty, Scottish Water collects wholesale charges in advance from all retailers. This prevents arrears building up should a retailer run into financial difficulties and limits Scottish Water's credit risk exposure. It has not acted as a barrier to entry.

A number of key principles underpin the retail non-household market in Scotland (cont.)

- **Customers are protected in the event that their LP becomes insolvent.** In addition, a Provider of Last Resort mechanism was put in place to support continued supply and customer protection in the event of an LP's failure.
- **Supporting a level playing field in the market.** A regulated access to the market through:
 - A standardised wholesale services template which is available to all new entrants and is used to agree the credit term arrangements with Scottish Water.
 - An Operational Code that sets out the obligations of Scottish Water and LPs in relation to the provision of water and sewerage activities.
 - Clear governance rules as set out in the Market Code for wholesale settlement procedures and payment, switches and customer registration.
 - WICS also introduced additional licence requirements on the incumbent Business Stream to further support a level playing field in the market. As part of these requirements, a Governance Code requires Business Stream to operate on a financially stand-alone basis and to enter transactions with Scottish Water only on a normal commercial basis.
- **Allowing new entrants to earn a fair return.** WICS sets appropriate retail gross margins by taking into account the return (on debt and equity) that should be available to an appropriately capitalised stand-alone LP on a portfolio of customers, the working capital needs and the wholesale payment terms.

There are currently nineteen general LPs offering different levels of service, payment terms and prices to c.160,000 non-household customers in Scotland.

Name	Date licence granted
Business Stream	January 2008
Anglian Water Business	April 2008
Water2Business	October 2009
Veolia Water Projects	September 2012
Water Plus	April 2012**
Clear Business Water	April 2009**
Commercial Water Solutions	October 2013
Castle Water	July 2013**
Blue Business Water	September 2014
Everflow	October 2015
Brightwater Services	February 2016
Pure CGV	February 2016
Sutton and East Surrey Water Services	February 2016
The Water Retail Company	March 2017
Advanced Demand Side Management	October 2017
Lettermay Ltd t/a Pinnacle Business Water	May 2018
Waterscan	October 2018
Smarta Water	November 2018
Pennon Water Services	April 2014**

*LPs with registered Supply Points.

**LPs that have undergone a licence transfer. The date of grant outlined above represents the earliest general licence held by one of the LPs prior to a transfer.

Since April 2008, the retail non-household market has delivered several benefits...

- Lower prices and more tailored services - consolidated and electronic billing has resulted in savings and reduced administration costs for non-household customers.
- There have been significant environmental benefits due to the reduced level of water consumption since market opening - water consumption has decreased by 20% since market opening, reducing the operational carbon footprint of the industry.
- Some licensed providers have developed additional services to meet the expectations of their customers by offering different methods of payment, automatic meter readers and advice on how to improve water efficiency or reduce wastewater discharges. Customers have been prepared to pay for these value-adding services, foregoing price reductions that may otherwise be available.
- Most importantly, the opening of the market required WICS to work closely with Scottish Water to develop cost reflective wholesale and retail tariffs. This laid the foundations for more collaborative and effective joint work between the Commission and Scottish Water. It also allowed Scottish Water to improve its understanding of costs.
- In 2018, WICS launched a multi-annual root and branch review of the retail market to ensure that the market continues to work well for customers, LPs and Scottish Water.
- However, the retail non-household market has now been operating for over 13 years. WICS understands that markets evolve and that, to be properly effective, the regulation of those markets must evolve with them.

CONTEXT FOR THE MARKET HEALTH CHECK

Section 2



In 2017 WICS adopted the principles of Ethical Business Practice and Regulation¹ (EBP & EBR) in its approach to regulation...

- The new approach is quite different from the traditional approach to regulation, which tends to be adversarial. The approach recognises that the regulatory framework will be most effective at improving the behaviour of individuals through an open and collaborative culture.
- This approach draws on evidence from behavioural responses to regulatory action – in particular health and safety regulation and the aviation industry have shown how impactful the presence or absence of trust can be. One of the key conclusions is that a collaborative relationship among stakeholders – backed by strong incentives to ‘do the right thing’ – will maximise benefits for customers and promote compliance.
- EBP also requires companies to demonstrate how they are acting in the best interests of their customers and to show they are committed to open and candid behaviour across their organisation and with their customers, in order to build and maintain trust.

Implications for WICS

- Under this new approach the regulator does not play as prescriptive and interventionist a role as it used to. However, it still holds its regulatory powers and may decide to exercise them where it is not satisfied that an LP is engaging with the principles of EBP.
- WICS is, therefore, seeking to establish a supportive and open culture amongst market participants by proposing not to sanction market participants who proactively report cases of non-compliance, shortfalls in customer service and wider operational issues. WICS would, however, expect LPs to put forward remedial steps to address such issues.
- It is important to note that such an approach is not ‘light touch’ regulation – the expectation is that formal regulatory interventions are minimised, and the onus is firmly placed on LPs to establish trust with all stakeholders, including their customers. When the regulator has to intervene sanctions are significant.

There are three key implications for LPs

1. The EBR framework places the onus on market participants to demonstrate that they are abiding by the spirit and letter of their licence, and are treating customers fairly. This approach encourages LPs to take ownership for addressing issues pro-actively and treats mistakes and errors as learning opportunities for improvement. In the event that LPs are not engaging with EBR, however, WICS will take necessary and appropriate steps to sanction such behaviours.
2. Market participants should recognise their collective interest in ensuring that the market works and that it continues to deliver benefits to customers. The expectation is, therefore, that LPs take individual and collective responsibility to promote the reputation of the market and work constructively together and with other stakeholders to improve, wherever possible, the functioning of the market.
3. Market participants are expected to evidence high standards of conduct and demonstrate good behaviour towards their customers, which involves for example:
 - Treating customers fairly and responsibly;
 - Upholding their service commitments;
 - Offering contract terms that are fair to customers and easy to understand; and
 - Communicating with their customers in a clear and transparent way at all times.



To this end, WICS is proposing to offer LPs access to periodic MHCs that could be used to improve their business and demonstrate their full commitment to EBP.

WICS has already consulted on the concept of an MHC...

- In 2020, WICS completed a root and branch review of the non-household market framework. As part of this, WICS consulted on the introduction of a market-wide process that would encourage market participants to demonstrate high standards of conduct. More details on the review are set out in the Appendix.
- When considering how to develop an MHC, WICS is asking itself the following questions:
 - How can it encourage LPs on an ongoing basis to take greater ownership of performance and be open about issues and risks? How can it encourage LPs to act in an open and transparent manner with their customers, treat them fairly at all times and uphold their service commitments?
 - How can WICS improve customer outcomes whilst reducing the need for enforcement actions? How can we provide customers with access to clear and transparent information about LPs' service commitments?
 - How can new applicants demonstrate robustly that they have the appropriate operational and financial capability to meet their licensing obligations?
 - How can WICS encourage LPs to demonstrate that they have and retain the appropriate financial strength to operate on a sustainable basis and honour their commitments towards Scottish Water and its customers?

Key operating principles underpinning the MHC

- 1. Eligibility** - The MHC should be accessible on a voluntary basis to all active LPs. New entrants will be required to undertake an MHC within 12 months of being granted a licence to demonstrate they have the appropriate operational and financial capability.
- 2. Objective** - The MHC should allow LPs to demonstrate that they operate in line with the letter and spirit of the licence and demonstrate that they are treating customers fairly and upholding their service commitments. The MHC also aims to provide LPs with a way to improve their business and, ultimately, customer outcomes. As such, the final certification from the MHCer should also provide customers with information about LPs' service commitments and may also be used by LPs for marketing purposes.
- 3. Scope** - The scope of the MHC should be proportionate to the market share held by an LP and may be tailored to the level of assurance that an LP is seeking to obtain from an MHCer.
- 4. Governance** - The MHCer should be independent from any LP and have a duty of care towards WICS, Scottish Water and all LPs. Whilst WICS will appoint an individual to carry out the MHC, LPs will be contracting directly with the individual appointed by WICS. Opting in LPs are expected to meet the costs incurred by the MHCer.
- 5. Outcome** - At the end of the MHC, LPs will receive a final accreditation from the MHCer. The list of LPs who received such accreditation will then be published online.
- 6. No duplication** - It is important that the MHC does not duplicate the audit carried out by the CMA.

The role of the MHCer

- The interim outcome of the MHC would also include a requirement for each participant to remedy any weakness identified by the MHCer within reasonable timescales, taking into account the materiality and significance of each issue. This would not be published nor shared with WICS or Scottish Water.
- The MHCer would then follow up with LPs to ensure appropriate steps have been taken to address any identified issues. The MHCer would not report to WICS unless:
 - an LP had failed to address any identified issues within reasonable timescales agreed with the MHCer; or
 - there has been a material breach of licence or gross negligence/misconduct.
- At the end of the process, the MHCer would:
 - provide WICS with a written assurance statement confirming that the LP has abided by the spirit and letter of their licence; and
 - issue a certificate of completion for all participants who successfully completed the process.
- The MHCer may also suggest some market-wide recommendations that WICS will review at the end of the process.

It is important to highlight some fundamental differences between a traditional audit and the MHC...

	Traditional regulatory audit	Market Health Check
Objective	Aims to sanction non-compliance and is imposed as a regulatory requirement.	Voluntary process – aims to identify issues and support remedial actions. Provide LPs with a form of accreditation that can be used for marketing purposes.
Role of auditor/MHCer	Duty of care towards the regulator.	Duty of care towards the retailers, wholesaler and WICS.
Approach	Focus on compliance with the letter of the licence and on retailers' systems and processes.	Focus is not only on compliance with the letter and spirit of the licence but also on the customer service. More of a strategic focus.
Implementation	Scope is set out by the regulator. The auditor contracts directly with the regulator after formal tender process.	Scope and methodology is developed by the MHCer (in collaboration with WICS, Scottish Water and LPs). Given the innovative nature, WICS would follow a 'pilot approach'. The MHCer would be publicly appointed by WICS but contract directly with LPs.

In light of the innovative nature of the MHC, WICS will ‘pilot’ this approach and implement it through the following key steps:

1. Public invitation to express interest in the MHCer role. Interested parties are expected to submit an expression of interest letter setting out their experience and expertise.
2. WICS shortlists interested individuals and undertakes interviews. Through the interview process, WICS will seek ideas from interested parties around the key design issues set out in the following slide.
3. Following the interview process, WICS will appoint an MHCer. WICS expects the MHC to be a multi-annual process. Once the first MHC is complete, WICS will consider (in consultation with Scottish Water and other LPs) whether to re-appoint the same individual.
4. The MHCer sets out its approach and a budget for carrying out the MHC in consultation with WICS, Scottish Water and LPs.
5. The MHCer enters bilateral contracts with the LPs that wish to opt in to the MHC.
6. Once the MHC is complete, the MHCer will issue a final letter to WICS confirming the name of the LPs that have completed the process.
7. WICS publishes online information on LPs that complete the MHC.

Throughout the selection process, WICS will seek ideas from interested parties on some key design questions:

Scope

- a) How should the MHCer go about assessing whether LPs are abiding by the letter and the spirit of their licence? What should be the areas of focus of the MHC? What evidence from LPs may be required? Which areas of customer service should a MHCer focus on?
- b) How should the MHCer go about assessing new entrants' operational and financial capability?
- c) What additional areas could be useful to LPs in helping them improve their business? Given the different value propositions that LPs offer, could the MHC provide different tiers of assurance?

Methodology

- a) How should the MHCer ensure that it can discharge its duty of care towards WICS, LPs and Scottish Water whilst ensuring that the process is as robust as possible?
- b) How might the MHC take into account the size and market share of LPs?
- c) Could there be a basic MHC process for a minimum assurance level and for an enhanced level(s)? How could the scope of the MHC tailor for those different levels?

Implementation

- a) What are the key milestones and timescales of the MHC?
- b) What are the likely costs involved with carrying out a robust MHC?
- c) How should the MHC be priced?

Indicative timescales for implementation

Date	Milestone
13 December 2021	Invitation to express interest
31 January 2022	Deadline for responses
February – March 2022	Interviews with interested parties
March 2022	Formal appointment of a Market Health Checker
March – April 2022	Discussion between MHCer and LPs and Scottish Water
May 2022	Market Health Check starts
November 2022	Follow up actions by the Market Health Checker
May 2023	Second Market Health Check
October 2023	Interim review and follow up actions

CRITERIA FOR SELECTION

Section 3



Criteria for appointment

- Candidates with the appropriate expertise and experience to undertake the role effectively should demonstrate a:
 - Proven ability to analyse complex strategic, financial and customer service issues;
 - Successful track record of observing and commenting and/or participating in a regulatory framework; and
 - Willingness to gain a deep understanding of the regulatory framework of the Scottish water retail market.
- In addition, it would be desirable that candidates have:
 - An established and well-recognised reputation for delivering positive and impactful change.
 - A proven ability to investigate regulatory and customer service issues with a forensic attention to detail.
- Throughout the interview process, WICS will evaluate candidates based on the quality of their contribution.
- Candidates should be independent from LPs and not have any involvement with the provision of services to LPs.

Deadline for submission

- Candidates who are interested in the role are invited to send a letter of expression of interest and their (and any supporting expert team's) CV(s) to competitionteam@wics.scot by 31 January 2022.
- Based on the criteria set out in this slide pack, WICS will then shortlist interested parties and arrange interviews in February 2022.
- If you have any further questions on the appointment process you can get in touch by sending us your questions to competitionteam@wics.scot by 5 January 2022.

APPENDICES



Appendix 1: Operational Code

- The Operational Code sets accountabilities for situations where a customer needs to approach its LP for a service that is Scottish Water's operational responsibility. It makes provision for a range of operational matters: it is designed to facilitate the performance of the obligations of Scottish Water and licensed retailers in relation to the provision of water and sewerage services. It covers, in detail, matters related to:
 - i. new connections;
 - ii. water quality sampling;
 - iii. metering;
 - iv. enquiries, complaints and contacts;
 - v. long and short term planning: e.g. investment plans.
 - vi. unplanned changes to services;
 - vii. trade effluent control;
 - viii. communications about the network: e.g., leaks, unplanned disconnections etc; and
 - ix. provisions designed to prioritise and safeguard supplies to sensitive customers, such as hospitals.

Appendix 2: Market Code

- The Market Code sets out the governance rules for the market, and the procedures for settlement, payment and registration. It positions the CMA as the settlement and registration hub for the market.
- The Market Code sets out the roles and responsibilities of each of the parties to the market and covers the following:
 - Commencement, objectives and principles
 - CMA duties
 - LP's duties
 - Scottish Water (Wholesaler) duties
 - Market design
 - Performance standards, monitoring and issues resolution
 - Cost recovery
 - Governance
 - Disputes procedure
 - General terms
- In addition to the core document there are 24 supporting schedules including 18 Code Subsidiary Documents (CSDs). The Market Code and associated CSDs are updated on a regular basis to reflect the continuing evolution of the market.

Appendix 3: Additional Market Documents

- Disconnections document which describes the circumstances in which water supply or supplies and trade effluent service may be disconnected).
- Standard Licence Conditions which sets out the standard conditions for a water and sewerage licence.
- Wholesale Services Agreement which outlines the wholesale services agreement between Scottish Water and retailers.

Appendix 4: List of consultations and decision documents published by WICS as part of its market review

- [November 2020: Letter extending the existing COVID-19 support measures and opening the consultation on new measures](#)
- [February 2021: First submission from industry Working Group on support measures in response to Covid-19](#)
- [March 2021: WICS response to initial proposal from industry Working Group for new measures in response to Covid-19](#)
- [March 2021: Second submission from industry Working Group with updated proposals on Covid-19 support measures](#)
- [April 2021: WICS consultation on measures in support of the retail market in light of the current pandemic](#)
- [April 2021: Update on consultation on measures in support of the retail market in light of the current](#)
- [May 2021: Responses to consultation on proposed measures in support of retail market](#)
- [May 2021: WICS decision on measures in support of retail market in light of the pandemic and consultation on SLCs & directions](#)
- [May 2021: WICS decision on directions to support implementation of measures](#)
- [July 2021: WICS decision on proposed SLC revisions to support implantation of measures](#)
- [Scottish Water financial resilience assessment framework](#)

Appendix 5: What WICS has publicly said about the MHC

- In its July 2019 consultation, as part of the market review, WICS consulted on initial proposals to implement annual MHCs carried out by a reporter to actively monitor market participants and help them target improvements in their systems and processes.
- WICS published an initial decision in September 2019 confirming its intention to undertake an MHC as opposed to a more traditional market audit.
- In its policy decision in April 2020, WICS confirmed its decision that the MHC should be undertaken on the basis of a number of principles including:
 - The MHC should be accessible on a voluntary basis for existing licensees who want to use this process to target improvements in their business.
 - New entrants would be required to undertake an MHC within 12 months after the granting of the licence to demonstrate they have the appropriate operational and financial capability to meet their licensing obligations.
 - WICS would appoint a named individual with an established reputation and strategic and executive experience.
 - LPs would be contracting directly with the appointed individual. At completion of an MHC, participants would receive some form of accreditation from the MHCer which could then be published on Scotland on Tap and WICS’s website.

Appendix 5: What WICS has publicly said about the MHC: (cont)

- In November 2020, WICS launched a consultation on steps to transition the market back to normal operations which included questions surrounding future proofing the market and the role that MHCs might play in ensuring the financial strength of LPs.
- In its March 2021 paper, WICS confirmed that the MHC could also be used to audit the operation of the new wholesale deferral scheme and could provide additional information on the financial strength of LPs.
- WICS proposed in April 2021, and confirmed in its May 2021 decision paper, that only LPs committing to financial resilience measures would have access to MHCs. Those LPs not committing to the new licence conditions would not be entitled to take part in the MHC and would be kitemarked as a ‘high risk provider’ with this status being published on the Scotland on Tap and its own website.

THANK YOU

T: 01786 430200

E: competitionteam@wics.scot

W: wics.scot

WICS Economic
regulation for
Scotland's water

