

Measures in support of the retail market in light of the current pandemic

21 May 2021

The ongoing coronavirus (COVID-19) outbreak is presenting unprecedented challenges to businesses and the wider economy in Scotland. Mindful of its statutory duties to promote the interests of customers, the Commission has consulted on measures to support non-household customers affected by the pandemic and transition the market back to its normal operations.

This document summarises responses received to the Commission's consultation and sets out the Commission's decision. This document is also consulting on revisions to the standard licence conditions and on the directions previously issued in support of the measures in response to the current pandemic. Comments should be sent to competitionteam@watercommission.co.uk on the proposed revisions to the directions no later than 28 May 2021 and on the proposed revisions to the standard licence conditions no later than 23 June 2021.

This document has been sent to:

- All Licensed Providers;
- Scottish Water;
- The Central Market Agency Limited;
- The Scottish Government; and
- Citizens Advice Scotland.

This document is also available on the Commission's website: www.watercommission.co.uk

1. Background

1.1 Measures in response to the pandemic

In May 2020 the Commission implemented [steps](#) to support customers affected by the pandemic and to support licensed providers during these challenging times. Since March 2020, Scottish Water has also supported licensed providers by [suspending](#) the two-month wholesale prepayment requirement on licensed providers.

As we now consider how to phase out the current support measures, we are mindful of our statutory duties to ensure an orderly functioning of the market and that there is no detriment to the wholesale business of Scottish Water.

The Commission is also mindful that, in the absence of evidence of licensed provider's financial resilience, the measures taken in response to the current pandemic have increased the risk exposure to Scottish Water, and ultimately, household and non-household customers. The pandemic has, therefore, brought into focus the need to ensure that licensed providers are appropriately financially resilient and can manage market systematic risk for which they are remunerated through the allowed gross retail margin.

To this end, in November 2020 the Commission published a [consultation letter](#) on steps to transition the market back to its normal operations and improve the financial resilience of market participants. The Commission also invited licensed providers to work collaboratively on developing a set of proposals to address the issues identified.

1.2 More recent steps

In December 2020, licensed providers established a Working Group, chaired by Citizens Advice Scotland that worked on proposals for the introduction of a new deferral scheme in support of businesses affected by the pandemic along with other measures to ensure that licensed providers are, and remain, financially resilient.

In line with the principles of Ethical Business Practice, the Commission encourages licensed providers to continue to work collaboratively with the Commission and other stakeholders to improve the market framework. The Commission has, therefore, been pleased to see licensed providers taking ownership for the market framework and working together constructively on a solution consistent with the Scottish Government's Principles of Charging for the water industry. The Commission would like to thank Citizens Advice Scotland for its continuing efforts in chairing the Working Group.

In April 2021, the Commission published a further [consultation](#) setting out a timeline to transition the market back to its normal operations. The Commission's proposals have been developed to ensure that:

- Customers are, as far as possible, supported throughout this pandemic and can access the appropriate support.
- Measures are consistent with the Principles of Charging set out by Scottish Ministers.
- Measures are consistent with the Commission's duties to make no detriment to the core business of Scottish Water.
- The Commission can continue to facilitate an orderly participation of LPs in the retail market and use the lessons learnt from this pandemic to improve the market framework.

As part of the consultation, the Commission invited stakeholders to provide their comments on its proposals to introduce new voluntary licence conditions that would require licensed providers to:

- Support affected customers by the pandemic through a new deferral scheme; and
- Demonstrate their financial resilience to Scottish Water and the Commission.

In April 2021, the Commission organised an industry-wide [roundtable](#) to update stakeholders on its proposals and provided participants with an opportunity to discuss these proposals in more detail. As part of its proposals, the Commission consulted on additional measures that would allow licensed providers who commit to these additional licence requirements to:

- Benefit from more gradual unwinding of the relaxation of wholesale prepayments;
- Have the flexibility to agree with Scottish Water tailored credit term arrangements with a level between 1.5 to 3 months of wholesale prepayments depending on Scottish Water’s creditworthiness assessment of the licensed provider;
- Benefit from the relaxation of regulatory provisions on customer prepayments that licensed providers can collect from their customers (in light of the restrictions that the Commission is looking to introduce as part of the [market review changes](#)); and
- Access an independent Market Health Check which could be used by licensed providers to improve their business and obtain a formal accreditation.

The Commission also consulted on measures that would require licensed providers who do not make commitments on customer support and financial resilience measures to:

- Start prepaying wholesaler charges earlier;
- Have no flexibility to agree with Scottish Water tailored credit term arrangements and be required to prepay Scottish Water 3.5 months of wholesale charges;
- Be banned from collecting any prepayments from their customers (in light of the restrictions that the Commission is looking to introduce as part of the [market review changes](#)); and
- Have no access to the Market Health Check. The Commission would kitemark the licensed provider as a ‘high risk provider’ on its website and Scotland on Tap.

The next section summarises the comments received and sets out the Commission’s final decision.

2. Representations received

The Commission has received nine responses to the consultation including responses from licensed providers, the Working Group, Citizens Advice Scotland and Scottish Water. The Commission would like to thank stakeholders for responding to the consultation and for those licensed providers that proposed draft licence conditions to support these additional requirements.

The majority of the responses are supportive of the introduction of additional support measures for customers affected by Covid and additional measures in support of licensed providers' financial resilience. For transparency, all stakeholders' formal responses have been published on our website alongside this consultation document. The table below summarises the key issues highlighted by stakeholders and set out the Commission's response.

Issue	Issues and proposals	The Commission's response
New deferral scheme in support of customers	<ul style="list-style-type: none"> - Licensed Providers' (LPs) support targets those customers mostly affected by the pandemic - customers who can pay continue to do so and are not encouraged to build up debt. - LPs make all eligible customers aware of the availability of COVID support and use proactive and tailored communications to contact those customers most affected by COVID. - The Commission could set out a list of criteria for the access to the scheme. - As part of the market health check process, an audit could be undertaken to ensure that small and medium-sized customers in need are receiving the appropriate support. 	<ul style="list-style-type: none"> - Whilst the Commission agrees that the support should be appropriately targeted, it is important that all affected customers who are in need are made aware of the support and can take advantage of a deferral through their LP. - The Commission does not plan to set out additional eligibility criteria (other than the ones set out as part of the operating principles of the scheme contained in Appendix 2 of this document). LPs are, however, expected to be able to evidence that they have taken appropriate steps to provide the support available - this includes for example communicating with affected customers proactively and providing details of the support on their website. - The Commission agrees that the Market Health Check process could be used to verify whether LPs have taken appropriate steps to support their customers.
	<ul style="list-style-type: none"> - Given the technical constraints of the central settlement system, in some cases, it may not be practical for LPs to provide at retail the exact same support received at wholesale. The relief should however apply to the same SPIDS and cover the same time period. 	<ul style="list-style-type: none"> - The Commission is not aware of any constraint in the wholesale settlement system that would limit the ability of LPs to match the tailored support offered at retail. Although there may be a timing mismatch between wholesale and retail deferrals, LPs are expected to offer at retail (at least) an equivalent support to their customers to the one received at wholesale through the deferral scheme. The Commission agrees that retail support should apply to the same Supply Points receiving a wholesale deferral and over the same time period.
	<ul style="list-style-type: none"> - Proposes that the period for the support provided to customers who have not paid nor engaged with their LP, should be increased from 3 to a maximum of 6 months. 	<ul style="list-style-type: none"> - The Commission agrees that the deferral should cover as a maximum a period of 6 months for customers who have not paid and have been contacted by their LP but failed to respond or have not asked for any additional support.
	<ul style="list-style-type: none"> - The proposal that allows customers who are in need of support but cannot access it from their existing LP to switch freely to another LP (despite having entered a valid contract or having historic debt with their current LP) without incurring any penalty or fee could be open to abuse. This proposal would not be consistent with the market codes and would allow customers to avoid paying any outstanding debt. It also has the potential to overwrite existing contractual terms between LPs and customers. - The respondent also challenged the proposal that allows customers to switch away without any penalty or additional fee. 	<ul style="list-style-type: none"> - It is important that customers receive the appropriate support throughout this pandemic. Given the exceptional nature of the pandemic, the Commission confirms its intention to require LPs not to block a transfer request on the basis that there is a valid existing contract in place or to apply a penalty or additional fee if the LP has refused to provide any Covid support. Such a practice would be inconsistent with ethical business practice. - The Commission recognises the unintended consequences associated with allowing any customer in debt to switch freely to a new LP. It proposes, therefore, to allow customers in debt who are not receiving Covid support to switch to a new LP provided only if the incoming LP agrees to take responsibility for the historic debt.
	<ul style="list-style-type: none"> - Does not believe that the requirement on a LP who has not signed up to the additional licence condition on customer support to explain to their customer base why they are 'not providing support' is in customers' interest. 	<ul style="list-style-type: none"> - The Commission is surprised to read this comment and disagrees that such a requirement would not be in the interest of customers. Ethical business practice requires LPs to evidence how they are operating in the interest of customers. LPs who are not opting in the additional licence condition on customer measures are, therefore, still expected to explain why they are not offering the additional support that has been made available through the new wholesale deferral scheme.
Existing deferral scheme	<ul style="list-style-type: none"> - Sought clarity from the Commission on the unwinding of the existing wholesale deferral scheme. 	<ul style="list-style-type: none"> - The current wholesale deferral scheme will begin to unwind from July 2021 and will continue over the following 12 months period in accordance with the schedule published by Scottish Water on 27 April 2021 for the repayment of deferred amounts.

Issue	Issues and proposals	The Commission's response
Financial resilience	<ul style="list-style-type: none"> - Proposals could be onerous for smaller licensed providers and new entrants. 	<ul style="list-style-type: none"> - It is important that <u>all</u> LPs can operate on a financially sustainable basis regardless of their size and undertake the functions for which they have been licensed. The Commission believes that the arrangements are fair and proportionate and that the prepayment requirement already accounts for the size of the customer based served by a licensed provider.
	<ul style="list-style-type: none"> - The measures appear to be introduced a year earlier than the Working Group had originally proposed and what was originally proposed in the WICS April consultation document. 	<ul style="list-style-type: none"> - The Commission has reflected further on the implementation timetable in light of the comments received and has decided to provide LPs who commit to the additional financial resilience requirements an additional year before the revised (negotiated) prepayment of wholesale charges cap would be applied. - LPs who do not sign up to the additional licence requirement would still be expected to pre-pay Scottish Water 3.5 months of wholesale charges in April 2022 as set out in the WICS "Roundtable discussion with licensed providers and updates to the consultation".
	<ul style="list-style-type: none"> - Any change of Scottish Water's financial resilience and creditworthiness framework could be subject to agreement with a representative body from LPs. 	<ul style="list-style-type: none"> - The Commission disagrees with such a proposal as this would undermine its ability to carry out its primary duties to promote the interest of customers and protect the core business of Scottish Water. The Commission will continue to monitor the arrangements and consult with stakeholders on any material change to the framework.
	<ul style="list-style-type: none"> - All consequences of failure to sign up to the licence condition again need to be transparent. 	<ul style="list-style-type: none"> - The Commission has already set out a timeline for the reinstatement of wholesale prepayments and a ban on customer prepayments that LPs would be allowed to collect. Section 3 sets out in detail the steps.
	<ul style="list-style-type: none"> - Welcomes the opportunity for licensed providers to negotiate tailored payment terms with Scottish Water but believe this must be managed with appropriate transparency. 	<ul style="list-style-type: none"> - The Commission understands that Scottish Water has shared its draft assessment of LPs' creditworthiness and will publish its Financial Resilience Policy Document setting out its approach to assessing LPs' creditworthiness on its website for transparency. - The Commission will also approve revised Wholesale Services Agreement for market participants with more than 30% of market share and will ensure that they are published.
	<ul style="list-style-type: none"> - One respondent explained that whilst it expects to make commitments to the financial resilience requirements, it still believes that the increased prepayment is unnecessary given that once the market will have transitioned back to normality, Scottish Water would not be exposed to any bad debt risk. 	<ul style="list-style-type: none"> - The Commission disagrees with such statement. The pandemic has shown the importance of ensuring that market participants are sufficiently financially resilient to withstand external systematic shocks. In the absence of any evidence of licensed providers' financial strength, future shocks that impact the entire market could expose Scottish Water to bad debt risk (if a similar relaxation of wholesale prepayments or a mechanism to defer charges is introduced to support LPs). It is therefore important that these lessons learnt during this pandemic are used to improve the operation of the market.
Other remarks	<ul style="list-style-type: none"> - One respondent argued that evidence from the published accounts of LPs operating in both the Scottish and English markets suggest that some LPs are loss-making, most likely as a result of the arrangements put in place in the English market. Consequently, there is a high likelihood that there are subsidies between the Scottish and English markets and that the only way in which LPs could provide the assurances proposed in relation to cross-subsidies, is if changes are made to the English market to enable LPs to recover their efficient costs and earn a reasonable margin. 	<ul style="list-style-type: none"> - The Commission is solely responsible for managing the retail market in Scotland and is committed to ensuring that LPs participating in the Scottish market are operating on a financially sustainable stand-alone basis. In line with its primary duties, the Commission will take the necessary steps to ensure that Scottish customers are not adversely impacted by LPs operating in both the English and Scottish market. To this end, the Commission is consulting on changes to Standard Licence Condition A9 to strengthen the existing reporting requirements.
	<ul style="list-style-type: none"> - Clarity on how the Commission will ensure that LPs who access a relaxation of the pre-payment restriction (Commission policy decision – April 2020) will not miss-use the pre-payment option. 	<ul style="list-style-type: none"> - The prepayment cap was introduced to mitigate the risk that prepaying customers would lose their monies in the event of a LP's financial failure. The financial resilience framework is an important step for ensuring that LPs are and can demonstrate that they are financially resilient. The measures on financial resilience do not remove but can mitigate the risk of a LPs' financial failure.
	<ul style="list-style-type: none"> - Invites the establishment of a senior stakeholder group to strengthen the strategic overview of the market and ownership of policy and decision-making within the market that will improve outcomes for all. 	<ul style="list-style-type: none"> - The Commission welcomes the establishment of a senior stakeholder group for the retail market. It is important that such a group has a consumer voice and retains an appropriately strategic focus. The Commission would be happy to engage with such a group periodically to discuss strategic issues and evidence-based proposals that could improve the operations of the market and customers outcomes.
	<ul style="list-style-type: none"> - LPs are being asked to bear the risk that customers may not be able to repay deferred charges. In light of this, the Commission is asked to consider the issue of increased bad debt risk and consider whether an adjustment to default charges is appropriate. 	<ul style="list-style-type: none"> - The ability to defer charges for customers who are not able to pay, is an important tool for managing the risk of non-payment and, as such, it does not increase the level of bad debt risk. - It is important to recognise that LPs are remunerated for managing the bad debt risk. The allowance for bad debt risk is consistent with the long-term average bad debt cost allowed for in the gross retail margin. The Commission will, of course, continue to keep under review the impact that the pandemic has on the market. At this stage, however, the Commission does not plan to take any further step.
	<ul style="list-style-type: none"> - The inability to disconnect for non-payment increases the risk to LPs of managing bad debt risk and makes the market less attractive. The Commission could consider adjusting the gross margin to account for that increased risk. - Another respondent suggested that the legislative requirements should be amended to allow to reinstate temporary disconnections for non-payment. 	<ul style="list-style-type: none"> - The Commission understands that Scottish Water is undertaking a further review of legislation and of its disconnection practices. The Commission will continue to work with Scottish Water and other stakeholders on this issue.

3. Implementation of the measures

Voluntary licence requirements

After having closely considered comments received throughout this consultation and in light of the ongoing engagement with stakeholders, the Commission is setting out its decision to introduce additional voluntary licence conditions on:

- Measures in support of customers affected by the pandemic through the introduction of a new deferral scheme; and
- A requirement on licensed providers to demonstrate their financial resilience to Scottish Water and the Commission.

Such approach is also consistent with encouraging licensed providers to take ownership for improving the market framework. The Commission is also inviting stakeholders to provide comments on the draft licence conditions respectively “Standard Licence Condition B5 Wholesale relief scheme” and “Standard Licence Condition B4 Financial Resilience” contained in track change in Appendix 1 of this document.

Deferral scheme

In support of the introduction of a new deferral scheme the Commission has set out the final operational principles in Appendix 2 of this document. Section 2 of this document clarifies questions raised by stakeholders during the consultation process on the operations of the deferral scheme.

Appendix 3 to this consultation sets out the proposed direction that would allow all Wholesale Services Agreements in place between Scottish Water and licensed providers to be modified in line with this decision document.

The deferral scheme will be open to any licensed provider who provides to the Commission and Scottish Water confirmation of their commitment to sign up to both the additional licence requirements. Licensed providers who wish to make such commitment are invited to send a written letter confirming their commitment to competitionteam@watercommission.co.uk as soon as practical. Subject to considering comments received on the new licence requirements, the Commission intends to invite licensed providers who have provided commitments to give formal consent to bringing them into effect in their licences.

Financial resilience

The Commission has reviewed market evidence from other re-financing arrangements in response to the pandemic from licensed providers and has observed that 4 months of wholesale prepayments is a sufficient level of liquidity for any licensed provider who has committed to demonstrate its financial resilience. This is based on the level of cash (or cash equivalents) made available to the business to manage the risks associated with the current pandemic.

Given the exceptional nature of the Covid-19 pandemic, the Commission believes that 3 months of wholesale prepayments is a reasonable level of liquidity that should be required by any retailer who has committed to evidence their financial resilience. In the absence of such commitment, the Commission has concluded that licensed providers should be required to prepay 3.5 months of wholesale charges.

The Commission also believes that 1.5 months of wholesale prepayment is the lowest level of prepayment that would be consistent with its duty to ensure no detriment to Scottish Water.

Commitments to the additional licence requirements

The table below summarises the measures that the Commission will implement depending on whether licensed providers opt in the voluntary licence conditions on customer support and financial resilience measures.

Having reviewed the responses to the consultation, the Commission is extending the timescales for the implementation of the revised credit term arrangements for licensed providers who commit to the financial resilience licence requirement to May 2023. In the absence of any commitments on financial resilience, the 3.5-month prepayment of wholesale charges requirement will be introduced in April 2022.

Measures	Option 1 LP signs up to the customer support and financial resilience licence condition	Option 2 LPs signs to the financial resilience licence condition but not the customer support licence condition	Option 3 LPs does not sign up to the additional licence conditions
Wholesale prepayments	<ul style="list-style-type: none"> - 1-month prepayment in July 2021 - 2-month prepayment in December 2021 - Between 1.5 and 3-months prepayment in May 2023 based on Scottish Waters' assessment of a LP's creditworthiness 	<ul style="list-style-type: none"> - 1-month prepayment in July 2021 - 2-month prepayment in October 2021 - Between 1.5 and 3-months prepayment in May 2023 based on Scottish Waters' assessment of a LP's creditworthiness 	<ul style="list-style-type: none"> - 1-month prepayment in July 2021 - 2-month prepayment in September 2021 - 3-month prepayment in January 2022 - 3.5-month prepayment in April 2022.
Wholesale payment terms	Flexibility to negotiate tailored agreement with Scottish Water	Flexibility to negotiate tailored agreement with Scottish Water	Fixed 3.5 months prepayment of wholesale charges
Customer prepayments	No cap – full flexibility to offer tailored arrangements	No cap – full flexibility to offer tailored arrangements	Ban on customer prepayments
Market Health Check (MHC)	Access to MHC	Access to MHC	No access to MHC. LP is kitemarked as 'high risk provider' on WICS website.

If the Commission receives no formal response confirming a licensed provider's commitments by 16 July 2021, the Commission will deem the licensed providers as not opting in to the additional licence conditions on customer support measures and financial resilience. The steps set out in the table above under Option 3 would therefore apply.

The Commission will issue a Direction that will allow Scottish Water to cater for the necessary modifications to the Wholesale Services Agreements in line with the decision set out in this decision document. The Commission will continue to work alongside Scottish Water, the Central Market Agency and market participants on the implementation of the measures.

In light of the issues discussed throughout the market review on customer protection [measures](#) and to support the implementation of the further measures on customer prepayments set out in this document, the Commission is proposing to amend "Standard Licence Condition (SLC) B2 Further obligations on charges and related matters" as set out in track changes in Appendix 1 of this document.

The revised SLC B2 (which was the subject of a previous consultation as part of the market review) would apply to all general licensed providers. Any licensed provider signing up to the measures on financial resilience would thereafter receive a written confirmation from the Commission confirming its decision to relax the restrictions on licensed providers ability to collect customer prepayments.

Measures in support of a level playing field

The Commission is committed to ensure that the financial resilience measures support a level playing field in the market. To this end, the Commission will require licensed providers with more than 30% of market share (based on its wholesale charges) to:

- Seek the Commission’s approval for any amendment to the Wholesale Services Agreement as part of the renegotiation of its wholesale credit terms with Scottish Water;
- Explain to the Commission as part of this application how the arrangements are consistent with a level playing field in the market; and
- Publish the final Wholesale Services Agreement for transparency.

The Commission will also review Business Stream’s [Governance Code](#) and consider whether changes should be made in light of these additional measures.

Increased transparency of Licensed Providers’ activities across the English and Scottish market

The Commission has also been pleased to receive from the Working Group drafting proposals to strengthen the requirements set out in “Standard Licence Condition (SLC) A9 Constraints on certain arrangements” on licensed providers operating in the English and Scottish market to ensure there is no detriment on Scottish customers.

The Commission agrees with the proposal to:

- Require an assurance from licensed providers’ Board confirming that Scottish customers are not unduly disadvantaged by the activities undertaken in the English retail market and
- Undertake an audit of such assurance through the use of the Market Health Check. Appendix 1 of this document sets out in track changes the amendments to “Standard Licence Condition (SLC) A9 Constraints on certain arrangements”.

The revised SLC A9 set out in Appendix 1 of this document contains in track change the amendments in support of these measures. The Commission is inviting stakeholders to provide final comments on this drafting. The revised SLC A9 would apply to all licensed providers.

Granting of new water and sewerage licences

As discussed earlier, the Commission proposes to introduce the new “Standard Licence Condition (SLC) B4, Financial resilience” for any new entrant to the market. The Commission, therefore, plans to reopen the application process for general water and sewerage licences only once it has concluded its consultation on SLC B4. Given the implementation timescales, the Commission anticipates reconsidering any general licence application only from the beginning of September 2021.

4. Timescales for implementation and next steps

The table below sets out final timescales for the implementation of the measures set out in this document.

Date	Milestone
21 May 2021	The Commission’s publishes its response to the consultation and launches a statutory consultation on new Standard Licence Conditions and revisions to the existing ones and on the directions required to implement the new deferral scheme.
28 May 2021	Consultation closes on Directions to implement new deferral scheme and new scheme opens.
June-July 2021	LPs notify the Commission and Scottish Water whether they are intending to sign up to the additional licence requirements to access the deferral scheme.
23 June 2021	Consultation closes on revised Standard Licence Conditions.
June 2021	Scope for Market Health Check.
16 July 2021	Formal confirmation about LPs’ commitment to the additional licence requirements.
July 2021	Procurement for appointment of the Market Health Checker.
July 2021	New licence conditions come into force.

Date	Milestone
December 2021	First Market Health Check.
April 2022	Interim review of progress on financial resilience arrangements.
November 2022	Second Market Health Check
April 2023	All deferred wholesale charges are repaid

Comments should be sent to competitionteam@watercommission.co.uk on the proposed revisions to the directions no later than 28 May 2021 and on the proposed revisions to the standard licence conditions no later than 23 June 2021.

The Commission will continue to work alongside Scottish Water and the Central Market Agency on the implementation of the measures set out in this document.