

Market Review: Summary of Responses and Initial Decision of the Commission on Changes to the Market Framework

September 2019

In September 2018 the Commission published a notice setting out its intention to carry out a comprehensive review of the non-household retail market and providing an indicative timeline and scope for the review.

In July 2019 the Commission launched a consultation on Changes to the Market Framework. This document summarises stakeholders' responses to that consultation and the Commission's conclusions in relation to the consultation.

Having regard to the responses to the consultation and in view of the Commission's function and duties, the Commission has set out in this document an initial decision on changes to the market framework to ensure the market continues to function well for customers, Scottish Water and market participants.

The Commission's initial decision will be subject to a final decision at the end of the market review.

This document has been sent to:

- All Licensed Providers participating in the Scottish water market;
- 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. Introduction

The Commission has reviewed the market framework and has consulted with stakeholders on its proposed changes. We thank all stakeholders for their comments.

We received ten responses to the consultation on [Market Review: Changes to the Market Framework](#). These comprised responses from Scottish Water, Citizens Advice Scotland, seven licensed providers and one licence applicant.

Having considered all the consultation responses and in view of its functions and duties, the Commission has set out its initial decisions on changes to the retail market framework below.

2. Timeline

All participants welcomed the publication of the revised timeline and scope of the review.

Review	Indicative area of scope	Timeline
Improving market arrangements	<ul style="list-style-type: none">- Market Health Checks- Mergers and acquisitions- Licence application process- Level playing field- Licence fees- Gap site scheme	<ul style="list-style-type: none">- Commission published an initial decision in September 2019.
Improving customer service	<ul style="list-style-type: none">- Accreditation scheme / Retail Code of Practice	<ul style="list-style-type: none">- Commission consults in September 2019 and publishes an initial decision in October 2019.
Licensing regime	<ul style="list-style-type: none">- Self-supply licence arrangements- Specialist licence arrangements	<ul style="list-style-type: none">- Commission consults in September 2019 and publishes an initial decision in October 2019.
Final review	<ul style="list-style-type: none">- Final market review bringing together all provisional decisions	<ul style="list-style-type: none">- Commission consults on final review in November 2019.
Legal documents	<ul style="list-style-type: none">- Revised licence conditions, directions and documents in line with the final decision.	<ul style="list-style-type: none">- Go live timeline confirmed by the Commission.
Market Health Checks	<ul style="list-style-type: none">- Scope and approach of Market Health Checks.	<ul style="list-style-type: none">- Consultation in December 2019
Implementation of final decisions	<ul style="list-style-type: none">- Final changes to market codes.- Implementation of certification process.	<ul style="list-style-type: none">- Final changes completed by March 2020

3. Measures to retain trust in the market

3.1 Comments received on measures to retain trust in the market

The Commission has received the following comments from stakeholders:

- Most respondents support the Commission's proposals to place greater focus on incentivising the right behaviors by market participants.
- Several respondents have asked for more details on the scope and approach of the Market Health Check.
- Other respondents are concerned about the increased regulatory burden and have suggested that the Commission implements an industry Code of Practice instead of undertaking annual Market Health Checks.
- One respondent stressed the importance of ensuring that the Reporter undertaking the Market Health Checks acts independently of market participants and retains confidentiality of the information provided. Another respondent asked whether the Commission would carry out Market Health Checks in addition to annual market audits.

3.2 Commission's view on measures to retain trust in the market

The Commission¹ has adopted the principles of Ethical Based Regulation (EBR)² and has committed to act in a transparent way with all stakeholders. The Commission wants to ensure that market participants contribute to an effective market and treat consumers fairly and honestly. Given its statutory duty to promote the interest of customers as a whole and an orderly functioning of the market, the Commission considers that it is appropriate to monitor the behaviour of market participants through annual Market Health Checks.

The Commission believes that an EBR approach will facilitate ethical and fair behaviour in the market and establish a supportive and open culture amongst market participants. This is aimed at reducing the use of traditional enforcement measures. The Commission does not intend to undertake a Market Audit and proposes to use the Market Health Check instead of implementing a traditional auditing approach.

The Commission expects licensed providers to act in an open and transparent manner with the Commission and their customers. This requires licensed providers to take responsibility for high standards of conduct towards their customers. The Commission also expects licensed providers not only to comply with their licence conditions but also to be committed to appropriate behaviours and put customers at the heart of the business, above and beyond minimum compliance.

In line with EBR the Commission has sought to consult at an early stage on the use of Market Health Checks. The Commission plans to engage with market participants further through workshops and will bring forward a more detailed proposal on the scope and approach for the Market Health Check. The Commission will also set out the costs associated with the Market Health Checks and how it can recover such costs from market participants.

¹ 'Innovation and Collaboration: future proofing the water industry for consumers, Methodology for the Strategic Review of Charges 2021-2026', April 2017 and 'Strategic Review of Charges 2021-27: methodology refinements and clarifications', November 2018, can be found at: https://www.watercommission.co.uk/view_Approach_2021_27.aspx

² Hodges, C. (2016), 'Ethical Business Regulation: Understanding the Evidence', February.

The Commission notes stakeholders' suggestion of introducing an industry code of practice and will consult on this as part of the next consultation on improving customer service. The Commission, however, does not believe that this measure would be sufficient on its own and that the use of Market Health Checks can promote trust in the market whilst reducing the use of enforcement measures.

4. Licence application and assurance process

4.1 Comments received on licence application process

The Commission has received the following comments from stakeholders:

- Most respondents welcome the Commission's proposal to strengthen the licence application and compliance assurance process.
- Most respondents are not supportive of reducing the information requirements at the application stage and suggest that the Commission should use the business plan to assess an applicants' viability and fitness to carry out the licensing functions.
- Respondents have asked for more details on the ongoing certification requirement and whether this requirement would apply to all licensed providers.

4.2 Commission's view on licence application process

The Commission believes that the information provided at the application stage is not in itself sufficient to make a proper and robust assessment of the applicants' operational and financial fitness and ability to undertake all the licensing activities.

The Commission, instead, is placing greater focus on the knowledge and expertise of the applicant both at the time of application and following licence grant. The Commission would also like to clarify that the ongoing certification will apply to all licensed providers.

4.3 Initial decision on the licence application process

When assessing a licence application for the competitive market in Scotland under the Water Services etc. Scotland Act 2005 (the Act), the Commission must be satisfied that any applicant has the ability to perform adequately the activities authorised by the licence³. To ensure in can make a proper and robust assessment, the Commission has made an initial decision to:

- Amend the CMA Assurance Process to ensure that licence applicants can evidence that they have a good understanding of all relevant regulations and market code obligations. This certification will form part of the Assurance Process and will be funded on a cost-reflective basis by the applicant. This certification will have to be completed successfully by the applicant prior to any licence being granted.
- Introduce a new licence condition requiring licensees to participate in a Market Health Check within 12 months of commencing trading. This licence condition will confirm that, pending the completion of the initial Market Health Check, the Commission may impose transitional requirements on the licensed provider's trading activity. This could occur in cases, for

³ Section 7(1) of the Act.

example, where retailers failed to address the issues identified at the Market Health Checks within the agreed timescales. The Commission will exercise its judgement in a proportionate manner and on a case-by-case basis.

- Require all licensed providers to demonstrate on an ongoing basis that they have the relevant regulatory and technical knowledge required to carry out the licensing functions and have at least one member of staff certified.
- Require all applicants to provide a written statement of compliance with all relevant regulations and licence conditions, signed by the ultimate controller's board of the licence applicant and by a named managing director of the licensed provider.

The Commission plans to set out the details of the ongoing certification requirements at the end of the market review and will work with the CMA and the Technical Panel to make the changes required to the Market Code after its final decision is published.

The Commission plans to set out how it will use the Market Health Checks to assess the fitness of a recently licensed entity in a separate consultation on the scope and use of Market Health Checks.

5. Mergers and acquisitions

5.1 Comments received on mergers and acquisitions

The Commission has received the following comments from stakeholders:

- All respondents welcomed the Commission's proposal to introduce a bulk transfer process. One respondent did not agree that the transferee should also take on historic liabilities with respect to the transferred customers.
- Several respondents supported the proposed measures on multiple licence holders. Three respondents suggested that the measures will increase the costs to retail with little benefits to customers.
- One respondent suggested that the central systems should allow licensed providers to have more than one Organisation ID with the CMA and use multiple billing systems under one licence.
- One respondent suggested that the Commission's proposal are disproportionate to the risk identified by the Commission and that customers are already sufficiently protected through the terms and conditions that retailers offer their customers.

5.2 Commission's view and initial decision on mergers and acquisitions

Licensing arrangements

The Commission believes that it is important to promote transparency and trust in the market. Considering the governance issues and the risks identified, the Commission has made an initial decision to:

- prohibit licensed providers who are controlled by the same parent company (or companies) from retaining separate licences in the market. Licensed providers controlled by the same

parent company (or companies) are expected to consolidate their licences within 6 months from either the date of the change of control, or the date of publication of the Commission's final decision on these measures – whichever is later.

- Allow licensed providers controlled by the same ultimate controller(s) to opt in to the ability of retaining separate licences. This is aimed at ensuring that the measures are fair and proportionate. Licensed providers who opt in would have to write to the Commission and demonstrate:
 1. A clear and sound rationale for retaining separate licences in the market; and
 2. That there are material benefits to customers (as a whole) as a result of retaining separate licences in the market.

Bulk transfer of customers

In light of the responses received the Commission has made an initial decision to:

- Introduce a process that allows licensed providers to transfer its customers in bulk.
- Require the transferee to take on rights and obligations with respect to the Supply Points, including historic obligations prior to the transfer date wherever possible. This ensures that any retrospective amendments or historic billing disputes can be dealt with by the incoming licensed provider.

As part of this bulk transfer process:

- a) The transferor and transferee write to the Commission to request a bulk transfer of Supply Points in advance of transferring the customer book;
- b) The transferor provides the Commission with a written assurance signed by its board that it will write to all affected customers and inform them about the transfer in advance of the transfer date; and
- c) The transferee provides the Commission with a written assurance signed by its board that it will offer all transferred customers equivalent terms to those in place prior to the transfer and that the transferee takes on all rights and obligations with respect to the Supply Points, including historic obligations prior to the transfer date wherever possible.

6. Level playing field

6.1 Comments received on level playing field

The Commission has received the following comments from stakeholders:

- Stakeholders' representations on this matter were mixed with a number of supportive responses but also some concerned with the burden of compliance.
- The majority of respondents supported the Commission's proposals to introduce a set of principles designed to ensure that customers are not unfairly disadvantaged by the activities of licensed providers (or their affiliates) in the English market.

- Some respondents asked the Commission to clarify whether its proposals require licensed providers operating in the English and Scottish market to use separate billing platforms and/or to put in place arrangements to separate financial and operational activities across the two markets.

6.2 Commission's view on level playing field

Having considered all of the responses, the Commission has asked itself whether this amendment is burdensome. Licensed providers and their ultimate controller should, as a matter of course and already in line with Standard Licence Condition A9, review their compliance in these areas regularly, and ensure compliance with these obligations as part of their day-to-day business. On this basis, the Commission has concluded that a principle-based approach is proportionate and consistent with its EBR approach.

The Commission would like to clarify that it does not expect market participants who are licensed in both the Scottish and English market to separate financial and operational activities in the two markets. The Commission, however, expects licensed providers to evidence that:

- there is no financial support to a licensee from a related undertaking in the market in England, unless the support is provided on an arm's length, commercial basis; and
- there is no cross subsidy across the English and Scottish market that has detriment to Scottish customers.

6.3 Initial decision on level playing field

Having considered all of the consultation responses, the Commission has decided to proceed with its proposals. In light of the responses received and in line with its statutory duty to promote the interest of customers, the Commission has made an initial decision to:

- amend Standard Licence Condition A9 and require licensed providers to comply with a set of principles designed to ensure that customers are not unfairly disadvantaged by the activities of licensed providers (or their affiliates) in the English market. These principles would be designed to ensure that:
 - the business of each licensed provider is operated independently of, and at arms' length from, a related undertaking in the market in England and does not give (or receive) any cross-subsidy to (or from) them;
 - the business is financially viable and has an appropriate financial structure having regard to the nature of the Scottish market; and
 - the business is operated in such a way as to avoid participating in, or facilitating, any breach of competition law or other similar requirements imposed in relation to those other activities.

7. Revisions to licence fees

7.1 Comments received on licence fees

The Commission has received the following comments from stakeholders:

- The majority of respondents supported the Commission's proposed measures.
- One respondent commented that licensed providers who do not have any registered Supply Points are not granted access to the market dataset. As a result of this, trading parties who do not have any registered Supply Points should not contribute towards the costs of maintaining the central systems.
- Another respondent questioned whether the proposed increased fee of £60,000 for the full access to the market dataset would be sufficient to restrict unauthorised use of the data.

7.2 Commission's view on licence fees

The Commission notes that self-supply licencees already have restricted access to the data relative to its registered Supply Points. In light of this and of the representations received and having considered the objective of this review, the Commission believes there is scope for simplifying its proposals.

The Commission has also concluded that it would not be consistent with its principles of EBR to allow licensed providers access to the full market data for an increased licence fee.

The Commission believes that it should instead restrict access to the market dataset until market participants have evidenced their commitment to participate in the market.

7.3 Initial decision on licence fees

In line with EBR principles the Commission has made an initial decision to restrict access to the market data set until a licensed provider has registered a minimum of 499 Supply Points or 0.1% of total market volumes. This threshold takes into account both the number of customers and customers' consumption levels.

The Commission also plans to increase the fixed charge for all market participants to cover the additional cost of the Market Health Check. The Commission will make a more detailed proposal on the revised licence fees when it consults on the scope and approach of the Market Health Check.

8. Gap site incentive scheme

8.1 Comments received on gap site incentive scheme

The Commission has received the following comments from stakeholders:

- All respondents supported the Commission's proposed changes.
- One respondent observed that in the majority of cases, the second incentive payment instalment is not paid because the total wholesale revenue generated in the two years after

registration is less than the combined value of both instalments⁴. As a result of this, the payment appears to be set too high and suggested reducing the payment to reflect the lower value of wholesale charges generated by the gap sites.

- Two respondents asked that the gap site incentive payment⁵ for sites located through the CMA SAA project is eliminated given that the Silver Tassie portal is no longer available.
- One respondent suggested reducing the proposed incentive payment restriction period from 12 weeks to 4 weeks from the Assessor's Valuation Notice Issue Date.

8.2 Commission's view on gap site incentive scheme

The Commission acknowledges that the incentive payment for sites on the CMA Silver Tassie portal receive a lower incentive payment and that several market participants do not have access to this portal. The Commission also notes that the value of gap sites has reduced over time.

In light of this, the Commission believes it is now appropriate to review the level of payment to ensure it continues to be fair and proportionate.

The Commission believes that 12 weeks represents a reasonable time period from the Assessor's Valuation Notice Issue Date. During this time, Scottish Water is also expected to verify that the premises are receiving a service and seek to arrange a meter installation, whenever possible and viable in line with the code obligations.

8.3 Initial decision on the gap site

In light of the responses received from all stakeholders, the Commission has made an initial decision to:

- Revise gap sites' eligibility criteria and allow licensed providers to claim an incentive payment only where a new Supply Point has not been created within 12 weeks from the Assessor's Valuation Notice Issue Date published on the Scottish Assessor's website.
- Update the Operational Code to allow registration of a Supply Point as unmeasured whenever Scottish Water has verified the presence of services at the premises or if it is not practical or possible to install a meter at the premises. The Commission plans to update the Operational Code⁶ at the next Technical Panel meeting after the publication of its final decision.
- The Commission recognises that it may not be practical or possible (in the event of a shared supply) to install a meter at all gap sites. In these cases, the Commission expects Scottish Water to register these Supply Point(s) with unmeasured services.
- Eliminate the reduced incentive payment for sites on the CMA Silver Tassie portal.

⁴ The current incentive payment is structured into two equal payments, the first paid following registration of the Supply Point and the second one paid two years later, provided that the wholesale income generated by that point exceeds the combined value of the two instalments.

⁵ Gap sites published on the CMA's Silver Tassie portal receive 2 instalments of £750 for meter size 40mm or above, or 2 instalments of £750 for meter size 40mm or above.

⁶ As per the Operational Code Supply Point Registration, Verification and Deregistration, Process 28 and Process 29 and relevant footnotes.

Scottish Water will continue to accept applications for gap sites from licensed providers, provided these premises have been on the Scottish Assessor's Association website for a period exceeding the 12-week timescale.

The Commission also plans to review the incentive payment offered to licensed providers for registering gap sites to ensure the incentive is effective and proportionate.

9. Next steps

The Commission wants to ensure the market framework continues to work well for customers, licensed providers and Scottish Water. This consultation has set out the Commission's initial decision of changes to the non-household retail market framework.

The Commission has arranged a roundtable session with all stakeholders on 16 September 2019 to discuss the next areas that we propose to consult on as part of the market review.