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Our ref: 08-06-18 Comm consult  
Your ref:

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Water Industry Commission for Scotland  
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Dear Alan

## **Review of the water and sewerage non-household retail market**

Thank you for the opportunity to comment on your consultation, which comes at a time when the CMA Board is also reviewing the performance of the market from the perspective of our own role and obligations. The Board's deliberations cover much of the same ground as the Commission's review. This response will provide an update on the Board's thinking, including some of the questions that it has posed itself and the approach it is taking to finding answers.

The Commission's focus is on the customer, and includes retail interactions and issues which are outside the scope of the CMA. We will not comment on these issues. However, it also includes Market issues that are relevant to the CMA's activities, which we will comment on here.

### Responses to selected questions

*3. Are all licensed providers contributing fairly towards the costs associated with managing the competitive framework?*

*a. Is the current methodology for calculating the fixed and variable elements of the licence fees proportionate and fair to all market participants?*

*b. Are licensed providers who are not actively trading in the market contributing towards the costs of operating and maintaining the central market systems? What further controls could be put on access to, and use of, the market data set?*

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*c. Are licensed providers paying a licence fee commensurate with the value of the market data set? If not, what should we do to remedy this?*

*d. Should the Commission be recovering from individual retailers directly attributable costs that have been incurred when deemed unreasonable that all retailers contribute towards those costs?*

CMA costs are met by members, with one third of the budget being paid by Scottish Water and two thirds being paid by Licensed Providers (LPs). The CMA charges structure for LPs has only a variable element, with the liability for charges being determined by an LP's Market share. An LP without any registered customers therefore does not pay any CMA charges under the current arrangements.

The main benefit of CMA and Market membership to an LP without registered customers is access to Market data. Non-specialist LPs without customers have access to the Central Systems and the Market Data Set (MDS) (note that 'specialist' self-suppliers do not receive the Market Data Set). At market opening, it was decided that provision of the MDS to all entrants would help make their entry into the market orderly, as required under the 2005 Act. In the past, some LPs have used the MDS to support their efforts in identifying gap sites and vacant properties, with a view to benefiting from the Commission's incentive frameworks. For some, this became their core line of business and they registered few if any customers, and the benefit from access to market data was significant.

The provision of the MDS to a new entrant LP does not impose a marginal cost on the CMA. However, from time to time there are development costs associated with changing or improving the MDS, costs which are not borne by all beneficiaries. The same argument applies with respect to access to the Central Systems; a new entrant LP may not impose a marginal cost, but there are significant ongoing costs which must be met.

Because LP contributions are based on market share, and many active LPs have only a modest number of SPIDs, more than half contributed less than £5,000 each in CMA charges in 2017-18. The smallest two LPs that were active for the full year contributed £950 and £354 respectively. In this context, the scale of lost revenue from non-paying beneficiaries looks small, and the number of cases has not been sufficiently great to prompt a call for change in the market.

The Board is becoming increasingly focused on data protection and GDPR issues. With a growing membership receiving access to the full MDS, the issue of how that data is controlled is becoming more pressing, and the Board recognises that there is a risk that market data could be passed on inappropriately or without the necessary safeguards. The CMA is considering:

- Options for restricting access to the MDS and Central Systems look-up facilities; and

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- Options for limiting the delivery mechanism for market data – for example, replacing file download with on-line look-up.

Approaches such as these, while being directed towards mitigating against data protection risks, could as a by-product also go some way to addressing the issue of non-contributing beneficiaries.

*4. The Commission has responded to consolidation, changes of ownership and retailer failure over the past ten years. What changes are appropriate in the light of this experience – bearing in mind the Commission’s duty to promote the interest of customers and orderly participation in the non-household retail market. For example, should the Commission review the arrangements for handling changes in ownership?*

*a. Are there governance issues and risks associated with having two or more licensed providers who are controlled by the same Ultimate Controller(s)? Should we require the cancellation of one licence in such circumstances?*

*b. Should licensed providers be allowed to transfer their customers to another licensed provider without customers’ explicit consent?*

*c. Licence conditions<sup>1</sup> require licensed providers to notify the Commission of any change of control or any material change in circumstances of the licensed provider as soon as practicable. Should the Commission also reassess licensed providers’ adequacy to perform the activities they have been licensed for in the event of a change of ownership or any other material change in circumstances?*

Consolidation and changes of ownership raise issues of governance, system implementation, and compliance with Market rules. The Commission highlighted some of the potential governance issues at the February Technical Panel meeting. If there has been a consolidation event, but each of the parties to that event has retained their licence, an organisation operating as one entity in the Market may exercise two or more votes with respect to LP nominations (s8.3.1) and Market change (s8.6.15). These issues can be addressed by amendment of the Market Code governance arrangements

Consolidation where two organisations become one has raised practical issues of system implementation, such as the best way to transfer large numbers of SPIDs from one organisation to another. The CMA has worked with participants and developed on-system routines that support both licence and customer transfers.

Consolidation of control where the parties retain individual licences and/or organisational identities can raise issues with respect to market rules. These should be addressed as part of the approval process for any non-standard structural arrangement. For example:

- POLR and Gap Site allocator opt-in/opt-out is carried out at the level of the organisation registered on the Central Systems. If the Commission intends that each ultimate controller should have only one organisation in these mechanisms, it may need to direct that one or more organisations opts out if it has the same ultimate controller.
- For any given set of SPIDs, the interaction between performance standard failures and performance charge caps could mean that the liability for performance charges is different, depending on whether the SPIDs are registered to one organisation or split between two. This could happen if performance failures were disproportionately associate with one organisation – analogous to a ‘good bank’ ‘bad bank’ model, where the ‘bad bank’ hits its cap but records further failures.

CMA is confident that technical solutions can be found to solve these problems and support the different structural arrangements that might be endorsed by the Commission. However, we note that for some of the issues that are likely to emerge, the technical solutions will involve changes to the Central Systems, the impact of which will need to be subject to a full assessment.

*5. If a licensed provider goes out of business the continuity of the services is guaranteed through the Provider of Last Resort (PoLR) mechanism. How can the PoLR mechanism be further improved to secure a smooth reallocation of customers? What arrangements should be in place for participation in the Provider of Last Resort mechanism?*

We had two POLR events early in the market, both of which proceeded without major disruption, but which also provided some important lessons on the value of having a well-defined and scalable procedure for this type of event. In response to these early events, the risks around POLR were quantified, monitored and managed through the company’s risk register and risk management policy. Ultimately, the allocation of SPIDs under POLR rules was brought onto the Central Systems in September 2014, and the opt in/opt out choice for LPs followed in September 2015. As a result, POLR works technically for all possible scales of failure in the Market, and this is subject to an annual test.

It should be noted that rules have been applied to POLR allocation to avoid counter intuitive outcomes. Water and sewerage SPIDs are allocated in pairs rather than separately. Further, so far as possible, the SPIDs of multi-site customers are kept together, the limiting factor being the

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quality of customer name data that is used to support the allocations. These rules were applied to actual POLR events, and are built into the Central Systems allocation routines.

From an administrative perspective, the Board recognises the importance of acting swiftly, and is committed to triggering the POLR process within 3 days of notification of a default event.

*7. The Gap Site Scheme incentivises retailers to seek out and register non-household customers at sites which should be part of the market. Does the Gap Site Scheme provide proportionate and effective incentives to register new customers in the market?*

In June 2012 the CMA launched the SAA Project, which matched the Market Data Set to the Scottish Assessor's data set. Through this project CMA identified and published a comprehensive list of potential gap sites. High value gap sites were 'claimed' by Licensed Providers, using a web-based portal created by the CMA as part of the SAA Project. The remaining lists of potential gap sites (split by postcode area) were notified to Scottish Water. Our understanding is that Scottish Water has processed most of the feasible gap sites. We would therefore expect to see much lower levels of activity than over the past three years.

*9. Market data has now reached a higher level of quality than at market opening. How can we ensure market data continues to improve?*

Encouraging and supporting improvements in market data quality is a core element of CMA Board strategy. Of the £4.1m of Market-enhancing projects that have so far been funded by Performance Charge revenues, £3.8m worth have been directed towards data quality improvement. These have had a demonstrable impact on the completeness and accuracy of data, to the benefit of all participants. The Board welcomes cost-effective proposals from all participants to continue with this work.

In January of 2018, the CMA consulted with participants regarding the future approach to the Market Audit. Following this consultation, the Board resolved that the CMA should take on responsibility for delivering the part of the audit that looks at participant compliance and data quality (the CMA itself continues to be subject to an independent audit). An important objective of this new arrangement is that the Board should continue to receive a clear briefing that:

- Quantifies how data quality, across a range of market-critical items, has changed over the medium term; and
- Identifies any areas where data quality currently could have an adverse impact on registration and settlement.

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The completed Market Audit will be presented to the CMA Board in September, with a view to informing the Board's thinking on data quality initiatives that might follow on from the work done to date. The Board will be happy to share its observations with Commission in due course.

*10. How can the Commission support retailers in providing excellent service to customers?*

*a. How can the market arrangements (including the expectations on licensed providers) contribute to high standards of conduct? How can the Commission ensure those high standards are met and that customers are put at the heart?*

*b. What information about a retailer's performance could be made available to customers on an ongoing and consistent basis to promote greater transparency?*

*c. Should we consider an accreditation scheme to provide customers with greater transparency of the levels of services that are being offered by retailers? If so, how should this work? Where would we make the information available? Should it be compulsory?*

*d. What role should the Market Audit play? Could it, for example, confirm that retailers are committed to appropriate behaviour towards their customers?; have upheld their service commitments?; have provided contract terms that are written concisely and are easy to understand?; and that are fair?*

Data on performance against Market Code Performance Standards is made available to Licensed Providers and Scottish Water, but is not published outside the Market. Performance Standards cover 11 areas such as 'late meter reads' and 'inappropriate £0 RV', these being referred to in the relevant Code Subsidiary Document as the 'context'. Some areas include several measures, so that overall there are 24 Performance standards, 13 of which apply to LPs and 11 of which apply to Scottish Water.

Performance Standard data is provided monthly to individual LPs and Scottish Water on a measure by measure basis. This data contains sufficient information to allow individual participants to understand their performance in detail. Performance Standard data at a Market level is presented to all participants, allowing them to compare their performance to the Market average. This information is reported at the Technical Panel.

The CMA's capacity to draw data reliably from the Central Systems goes far beyond the Performance Measures, and this will be required to discharge the data quality and participant

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compliance elements of the Market Audit function. The CMA Board has in the past reviewed data relating to specific operational and compliance issues.

To date the CMA has not published compliance and data quality information outside the Market. The CMA Board has balanced opposing considerations in determining what information to release. On the one hand, it is recognised that there are non-participant stakeholders with an interest in the performance of the market, and that the release of information could provide participants with significant incentives for improvement. On the other hand, there is the risk that technical information is misinterpreted and/or causes serious reputational damage to the Market. In the past, the Board has taken the view that the risk of reputational damage warrants a conservative approach. However, it anticipates that the new approach to Market Audit may provide a basis for reviewing this position, particularly if it provides a coherent narrative showing that material improvements have been achieved.

Yours sincerely

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