

# Summary of Responses and Initial Decision of the Commission on Measures to protect customer prepayments and updates to the Provider of Last Resort

December 2018

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This document summarises stakeholders' responses to the consultation launched in November 2018 on Measures to Protect Customer Prepayments and Updates to the Provider of Last Resort (POLR) mechanism 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 revised measures to protect customer prepayments and a decision on updates to the POLR mechanism. The Commission's initial decision on measures to protect customer prepayments will be subject to a final decision at the end of the market review.

This document has been sent to:

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

This document is also available on the Commission's website: [www.watercommission.co.uk](http://www.watercommission.co.uk).

## **1. Introduction**

The Commission has reviewed the risks associated with customer prepayments and has consulted with stakeholders on its proposed measures to protect customer prepayments. We thank all stakeholders for their comments.

We received eleven responses to the consultation on Measures to Protect Customer Prepayments and Updates the Provider of Last Resort<sup>1</sup>. These comprised responses from Scottish Water, Citizens Advice Scotland and nine Licensed Providers. Having considered all of the consultation responses and in view of its functions and duties, the Commission has set out its initial decision on measures to protect customer prepayments and its decision on updates to the POLR mechanism below.

## **2. Measures to protect customer prepayments**

We set out below a summary of the comments received together with the Commission's views on those comments.

### **2.1 Comments received on customer protection measures**

All respondents acknowledged that customers who pay in advance for water and sewerage services may suffer a material loss in the event that a Licensed Provider enters an insolvency process. Most respondents agreed that customers should be made aware of this risk and welcomed measures to protect customers.

Two respondents questioned whether the proposed protection measures were an appropriate response to the risks and one respondent questioned whether non-household customers should receive any protection measures. Most respondents commented that requiring Licensed Providers to ring-fence prepayments or to implement an industry-wide insurance scheme would increase the costs to Licensed Providers, reducing customer choice and increasing charges.

Two respondents suggested that the Commission could take a credit-based approach and differentiate between Licensed Providers based on their credit-worthiness. One respondent suggested that the Commission could consider implementing an industry-wide scheme that could offer refunds to prepayment customers and recover monies from the wider customer base following the insolvency event through a one-off adjustment to wholesale charges.

### **2.2 Commission's view on customer protection measures**

Given its statutory duty to promote the interest of customers as a whole, the Commission considers that it is appropriate to introduce measures to protect customer prepayments and mitigate the risk to prepaying customers. Having reviewed all of the stakeholders' responses the Commission appreciates Licensed Providers' concerns regarding being required to ring-fence prepayments or implement an industry-wide insurance scheme, and agrees that these measures should not be required.

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<sup>1</sup> The full consultation can be found on the Commission's website at:  
<https://www.watercommission.co.uk/UserFiles/documents/Consultation%20Customer%20Protection%20final.pdf>

The Commission's view is that a credit-based approach would be impractical, requiring ongoing monitoring of Licensed Providers' financial position, and would fail to protect customers effectively given that Licensed Providers' financial condition may deteriorate quickly. Such an approach may also impact the Commission's ability to ensure that there is a level playing field.

The Commission considers that an industry-wide scheme requiring all customers to pay towards the protection of prepayment customers in the event that a Licensed Provider enters an insolvency process would not be fair and would not be in the interest of customers. It could benefit customers who had knowingly contracted with a failing supplier.

In light of the risks identified, the Commission has initially decided that as a default position, Licensed Providers should be prohibited offering prepayment terms to their customers. This position would protect customers from a loss incurred from a Licensed Provider's financial failure. The Commission is aware that prohibiting Licensed Providers from offering prepayment terms could reduce payment options available to customers and may, in some cases, increase the price that customers pay their Licensed Provider for water and sewerage services. For this reason and having carefully considered all the responses, the Commission considers that Licensed Providers could be permitted to offer prepayment terms if a specific set of circumstances, as set out in Section 3 of this document, are met.

To mitigate the overall risk to customers, the Commission has initially decided to cap the amount of prepayments that Licensed Providers, who have already taken all the necessary steps required to be allowed to offer prepayment terms, can collect from customers. The cap will be set at a maximum of three months' worth of charges. This ensures that Licensed Providers can meet their obligations to pay wholesale charges to Scottish Water two months in advance. This capped approach will provide customers with the choice of prepayment whilst mitigating customers' risk exposure. It will also help to ensure there is a level playing field across all market participants.

### **2.3 Comments received on the customer protection criteria**

Most respondents were not supportive of additional protection measures for small businesses and considered the requirement to obtain a written statement, signed by the customer accepting the risks and countersigned by an auditor or lawyer, to be costly and disproportionate.

Some respondents suggested that Licensed Providers should only be required to provide a written statement signed by a duly authorised representative of the customer.

### **2.4 Commission's view on the customer protection criteria**

Having carefully considered all responses, the Commission has decided not to propose additional protection measures for small businesses and recognises that requiring customers to provide a statement countersigned by a third party auditor or lawyer could be impractical for small businesses.

The Commission wants to ensure that Licensed Providers have informed their customers of the risks associated with prepayments, and have offered customers a choice between prepayment terms and payments in arrears. The Commission considers that Licensed Providers who wish to offer prepayment terms should also demonstrate that they are not exposing customers to any undue, unreasonable or material risk. Section 3 of this document sets out the Commission's initial decision on revised customer protection measures for prepayment customers.

### **2.5 Comments received on timescales**

Two respondents invited the Commission to further engage with stakeholders before a final decision is reached. One respondent asked the Commission to put in place a timeline for the review of the retail market.

Four respondents were supportive of the Commission's proposal to implement the customer protection measures from 1 April 2020 and believe it would provide Licensed Providers with sufficient time to prepare for the changes.

## **2.6 Commission's view on timescales**

The Commission has pre-consulted on the issues that would form part of the water and sewerage non-household retail market review in May 2018, and published an indicative timescale and scope for the review in September 2018.

Consistent with the published timeline for the market review, the Commission has set out in this document its initial decision on measures for protecting customer prepayments, subject to a final decision at the end of the market review.

The Commission wishes to ensure that these customer protection measures do not automatically nullify existing contracts between Licensed Providers and their customers. To this end, the Commission is minded to allow fixed term prepayment contracts that have been agreed before 1 December 2018 and have a fixed end date after 1 April 2020 to continue to remain in force until the agreed end date, subject to the Licensed Provider meeting certain requirements. This is explained in more detail in Section 3 of this document.

## **3. Commission's initial decision on measures to protect customers prepayments**

In light of these considerations and after having carefully reviewed all stakeholders' responses, the Commission's initial decision is to prohibit Licensed Providers offering prepayment terms to, and taking prepayments from, customers in order to protect customers from any loss incurred from a Licensed Provider's financial failure. However, the Commission recognises that a complete prohibition may limit customer choice and could impact charges, therefore the Commission is willing to create a process whereby Licensed Providers can explicitly opt in to the ability to offer prepayment terms subject to certain conditions.

### **3.1 The opt in process**

Licensed Providers may opt in, on an annual basis, to be permitted to offer prepayment terms to customers using the following two step process.

#### Step 1

The Licensed Provider writes to the Commission (on an annual basis) with an explanation of the following:

- a) The Licensed Provider's strategy and reasoning for offering prepayment terms to customers; and
- b) Why the Licensed Provider believes that there is no material, undue and/or unreasonable risk to the customer in making prepayments to that Licensed Provider.

Once the Commission is satisfied that, for the relevant Licensed Provider, offering prepayment terms to customers is both justifiable commercially (1a) and carries an appropriate amount of risk for the

customer (1b), the Licensed Provider may offer prepayment terms to customers in accordance with Step 2.

### Step 2

If the Licensed Provider wishes to offer prepayment terms to customers, the Licensed Provider must make the customer two offers at the same time:

- a) One offer based on payment in arrears; and
- b) One offer based on prepayment of no more than 3 months' worth of charges.

The discount available for customers on prepayment terms can be no more than 2% of the total cost of the quarterly bill for the payment in arrears option (2a). Furthermore, the customer terms for prepayment must contain a warning to the customer of the risks of prepayment on the signature page, in a manner that draws the customers attention to it (for example, in bold red block capitals).

### **3.2 Existing prepayment contracts**

Prepayment contracts that have been signed before 1 December 2018 with a fixed end date after 1 April 2020 will continue to remain in force until the agreed end date, provided that the Licensed Provider complies with the following requirements on or before 1 April 2020:

- a) the Licensed Provider must issue a letter to the customer which contains a warning of the risks of prepayment in a manner that draws the customer's attention to it (for example, in bold red block capitals); and
- b) the Licensed Provider must offer the customer the opportunity to switch their payment terms under the contract from prepayment to payment in arrears – the annualised cost of exiting the pre-payment term cannot exceed 8% of the annualised bill.

### **3.3 Evidencing compliance and timeline for implementation**

The Commission's Market Audit will be used to evidence compliance with the Licensed Providers obligations in relation to prepayment customers. For example, for new prepayment contracts Licensed Providers will be required to evidence that both offers were presented to the customer at the same time, and that the price difference between the two options was not more than 2%.

These measures would take effect from 1 April 2020.

## **4. Updating the POLR mechanism**

We set out below a summary of the detailed comments received together with our views on those comments and the Commission's decision.

### **4.1 Comments received on updating the POLR mechanism**

All respondents were supportive of introducing a maximum threshold rule for Licensed Providers who have opted-in to the POLR mechanism. Under the proposal, a Licensed Provider will only receive a

maximum number of POLR Supply Points<sup>2</sup> equal to twice<sup>3</sup> the number of the Supply Points registered to the Licensed Provider when the POLR process is triggered.

One respondent suggested introducing a sliding scale to account for the size of Licensed Providers.

#### **4.2 Commission's view and decision**

The Commission considers that the introduction of a sliding scale would add unnecessary complexity to the POLR mechanism.

Instead, the Commission has decided to update the POLR mechanism in line with the proposed updates in the consultation issued in November 2018. The Commission will make the necessary Market Code<sup>4</sup> changes to cap the maximum number of POLR Supply Points to twice the number of Supply Points registered to the Licensed Provider.

The Commission will work closely with the Central Market Agency (CMA) to make the necessary Market Code changes in line with this decision to present them at the CMA Technical Panel meeting. The Commission will also publish, on annual basis, the names of the Licensed Providers who have opted in to the POLR process.

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<sup>2</sup> Paragraph 5.3.6 of the Market Code defines POLR Supply Points as Supply Points that are still, or were at the designated time registered with the Defaulting Party.

<sup>3</sup> For example, a Licensed Provider with 1000 registered Supply Points could only receive 2000 POLR Supply Points and as a result end up with a total of 3000 registered Supply Points after the allocation process is complete.

<sup>4</sup> The Provider of Last Resort arrangements are contained in Paragraph 5.3.6 of the Market Code and CSD 0003 (Provider of Last Resort).