

# Market Review: Consultation on Changes to the Market Framework

## July 2019

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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.

As part of that review, this document consults on new proposed changes to the market framework to ensure the market keeps on functioning well for customers, Scottish Water and market participants. The Commission is seeking stakeholders' views on these proposals.

The Commission welcomes comments on these proposals which should be sent by email by 6 August 2019 to [competitionteam@watercommission.co.uk](mailto:competitionteam@watercommission.co.uk)

This consultation 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](http://www.watercommission.co.uk).

## 1. Background

The retail non-household market has now been operating for eleven years and there are 29 retailers competing in Scotland. As more licensed providers have entered the retail market, the Commission has seen the market develop and customers benefit from greater choice, more tailored service and lower prices.

The Commission, however, is not complacent and wants to ensure that the market framework in Scotland continues to serve the interests of customers and works well for licensed providers and Scottish Water. The Commission understands that markets evolve and that, to be properly effective, the regulation of those markets must evolve with them. To this end, the Commission is undertaking a review of the non-household retail market and is considering further steps to strengthen the market framework.

The Commission consulted and published a scope and indicative timeline for the market review in September 2018<sup>1</sup>. In December 2018 the Commission published an initial decision on measures to protect customers' prepayments and updates to the Provider of Last Resort mechanism<sup>2</sup>. This document sets out a revised scope and indicative timeline for the review, and proposed changes to the retail market framework for consultation.

## 2. Review of the non-household retail market

The Commission has continued to monitor the market closely and has started observing changes in the behaviour of some market participants as a result of the increased competition in the market. This has included, for example, increased complaints about retailers' communication with their customers and complaints about retailers blocking customers' transfer requests.

In light of this, and as the review has progressed, the Commission has asked itself the following questions:

1. How should the Commission refine its approach to regulating the non-household retail market? How can the Commission ensure that the market framework encourages retailers to act in a transparent and honest way with their customers?
2. How can the licensing regime be amended to strengthen the Commission's ability to assess a licence applicant's capacity to perform the activities for which it is being licensed?
3. Since the opening of the market, we have experienced changes of ownership, acquisitions and joint ventures amongst licensed providers. What are the governance issues and risks to customers associated with having two (or more) licensed providers who are controlled by the same parent company and retain separate licences in the market?

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<sup>1</sup> The Commission published its initial scope and timeline of the market review at:

[https://www.watercommission.co.uk/UserFiles/documents/18\\_19%20Market%20Review%20Timeline.pdf](https://www.watercommission.co.uk/UserFiles/documents/18_19%20Market%20Review%20Timeline.pdf)

<sup>2</sup> The Commission published its initial decisions on measures to protect customer prepayments and updates to the Provider of Last Resort at:

[https://www.watercommission.co.uk/UserFiles/documents/18\\_19%20Market%20Review%20Timeline.pdf](https://www.watercommission.co.uk/UserFiles/documents/18_19%20Market%20Review%20Timeline.pdf)

4. How can the Commission build confidence and retain trust among all market participants in a level playing field?
5. Several retailers who have been granted a water and sewerage licence in the retail market are not actively trading in the market. What measures could the Commission implement to ensure that all licensed providers contribute fairly towards the costs associated with managing the competitive framework?
6. Does the gap site incentive scheme provide proportionate and effective incentives to register customers in the market?
7. Are self-supply arrangements consistent with the Commission's statutory duty to promote the interest of customers and make no detriment to the core (wholesale) business of Scottish Water?
8. How can the Commission support retailers in providing excellent service to customers? Should the Commission consider an accreditation scheme to provide customers with greater transparency of the levels of services that are being offered by retailers?
9. Are the current market arrangements for new connections fit-for-purpose? How can the Commission encourage a more innovative use of asset capacity?

This consultation document focuses on the first six questions. In light of these issues, this consultation sets out several proposed changes to the market framework. These changes complement the changes to customer pre-payment measures and provider of last resort arrangements referred to above.

The Commission welcomes the views of market participants, customers and other stakeholders on the proposed changes.

### 3. Timeline and scope of the review

Considering the issues identified, the Commission has set out a revised scope and indicative timetable for the remainder of the market review.

Review	Indicative area of scope	Timeline
Improving market arrangements	<ul style="list-style-type: none"> <li>- Market Health Checks</li> <li>- Mergers and acquisitions</li> <li>- Licence application process</li> <li>- Level playing field</li> <li>- Licence fees</li> <li>- Gap site incentive scheme</li> </ul>	<ul style="list-style-type: none"> <li>- Commission is consulting on changes in July 2019.</li> <li>- Commission publishes provisional decision in August 2019.</li> </ul>
Improving customer service	<ul style="list-style-type: none"> <li>- Accreditation scheme / Retail Code of Practice</li> </ul>	<ul style="list-style-type: none"> <li>- Commission consults on changes in September 2019</li> </ul>

	- New connections	- Commission publishes provisional decision in October 2019
Licensing regime	- Self-supply licence arrangements  - Specialist licence arrangements	- Commission consults on changes in September 2019.  - Commission publishes provisional decision in October 2019.
Final review	- Publish final overall market review proposals bringing together all provisional decisions	- Commission consults on final review in October 2019.  - Commission publishes final decision in November 2019.
Implementation	- Commission publishes legal drafting in support of policy decision in December 2019	- Consultation and go live timeline will be confirmed by the Commission for each document.

The Commission welcomes comments from market participants and other stakeholders on the revised scope and timeline for the review.

## 4. Proposals for consultation

### 4.1 Measures to build and retain trust in the market

#### Objective

The Commission has published its intention to carry out a market audit at the end of this review to ensure that market participants are compliant with the market arrangements. At this stage of the review it is timely for the Commission to reflect on its approach to regulating the retail non-household market.

The Commission wants to ensure that market participants contribute to an orderly and effective market and treat consumers fairly and honestly.

#### Issues identified

The Commission<sup>3</sup> has adopted the principles of Ethical Based Regulation (EBR)<sup>4</sup> and has committed to act in a transparent way with all stakeholders. The Commission also expects licensed providers to act in an open and transparent manner with the Commission and their customers.

<sup>3</sup> '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](https://www.watercommission.co.uk/view_Approach_2021_27.aspx)

<sup>4</sup> Hodges, C. (2016), 'Ethical Business Regulation: Understanding the Evidence', February.

In line with EBR the Commission would expect 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. This requires licensed providers to take responsibility for high standards of conduct towards their customers and to:

- uphold their customer service commitments;
- offer contract terms that are fair to customers and easy to understand; and
- provide complete and accurate information to customers whenever they request to switch to a new licensed provider.

The Commission believes that its EBR approach will facilitate ethical and fair behavior in the market, and establish a supportive and open culture amongst market participants.

### **Proposals**

With that in mind the Commission will consult on proposals that place greater focus on incentivising the right behaviours by market participants. These proposals are aimed at reducing enforcement actions and encourage market participants to take pro-active steps that support a well-functioning market which customers can benefit from.

The proposals that the Commission will consider in advance of preparing a more detailed consultation on this topic include the following:

- The Commission may propose to monitor the behaviour of market participants actively through annual Market Health Checks carried out by an independent Reporter. The Commission will engage with market participants on proposals to define the scope of Market Health Checks.
- The reporting function could be carried out by a professional appointed by the Commission on the basis of his/her expertise and experience. The Reporter would provide a set of recommendations to each market participant, who could then use the findings to target improvements in their systems and processes.
- The outcome of the Market Health Check could be a requirement to remedy any weaknesses identified by the Reporter, therefore the Commission will consult further on how to achieve that. The Commission believes this could allow market participants to identify and correct weaknesses and could reduce the need for the Commission to pursue an enforcement action.
- Licensed providers would be required to take appropriate steps to rectify any identified weakness before the next Market Health Check (or within a shorter period depending on the materiality and significance of the weakness).
- In order to encourage a 'no blame' culture, the Commission would propose not to normally sanction market participants who report cases of non-compliance or breaches of their licence conditions. Instead, the Commission would monitor licensed providers' corrective actions and expect them to demonstrate a record of sustained and embedded good behaviour.
- EBR establishes a supportive and open culture but carries a substantial sanction when behaviour is inconsistent with the principles of openness and honesty. As a consequence:

- The Commission could publish the results of the Market Health Check and consider taking enforcement action in cases where retailers have not acted in a transparent manner with the Reporter and failed to address the issues identified within the agreed timescales.
- In addition, the Commission would note in its enforcement policy that it would not look favourably on any licensee where any Market Health Check uncovers a breach of any licence condition.

An enhanced approach to these issues should give greater confidence that market participants contribute to an orderly and effective market and treat consumers fairly and honestly. In developing these proposals further, the Commission will be mindful of its policy for licence contraventions<sup>7</sup> and of the need to exercise its judgement on a case-by-case basis and to be proportionate.

The Commission welcomes comments from market participants and other stakeholders on these proposals. The Commission will discuss these proposals further with the Central Market Agency and market participants and will bring forward a more detailed proposal for consultation.

## 4.2 Licence application process

### Objective

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 licence<sup>5</sup>. In making that assessment, the Commission is to have special regard to the knowledge, expertise, experience, financial acumen and business viability of the applicant<sup>6</sup>.

The Commission is authorised by the Act to issue guidance (either generally or in a particular case or category of case) in relation to its assessment of licence applicants<sup>7</sup>. In 2016 the Commission<sup>8</sup> updated its licence application policy and standard licence conditions to ensure licensed providers are able to undertake their licensing functions in the event of a change of control /senior management /direction at a licensed provider.

### Issues identified

The market has been operating for eleven years and there are 29 licensed providers in the retail non-household market. In light of the increased number of market participants, the Commission wants to ensure that retailers are able to undertake their licensing functions.

The Commission has reviewed its licence application policy and believes it is now appropriate to strengthen the application process to ensure the market continues to work well for customers. Other

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<sup>5</sup> Section 7(1) of the Act.

<sup>6</sup> Section 7(2) of the Act.

<sup>7</sup> Section 7(3) of the Act.

<sup>8</sup> The Commission's updates to the licence application process and licence conditions can be found at: <https://www.watercommission.co.uk/UserFiles/documents/Application%20Policy%20Condoc%20final.pdf>

regulators<sup>9</sup> have also implemented changes to their retail licence application policy to ensure their assessment of licence applicants is sufficiently robust.

## **Proposed changes**

### *Information requirements*

The Commission wants to ensure that the information requirements are proportionate and continue to be useful in carrying out the assessment of a licence applicant against the requirements in the Act. The Commission has now reviewed the application template and believe that some of the information requirements can be simplified. In light of this, the Commission is proposing to update the information requirements at the licence application stage and cease to require a business plan and financial forecasts in support of an applicant's business plan.

The Commission plans to place greater focus on the knowledge and expertise of the applicant both at the time of application and, following licence grant.

### *Assessing licence applicants' knowledge*

The knowledge and expertise of the applicant in understanding the regulatory framework and the duties that fall on a licensee are important. The Commission believes that, in assessing applicants' capability at the point of application for a licence, the market assurance process could be strengthened.

To this end, the Commission is consulting on proposals to:

- Introduce a formal certification at the end of the Central Market Agency (CMA) Training Process<sup>10</sup> to ensure that licence applicants can evidence that they have a good understanding of all relevant regulations and market code obligations. This certification could form part of the CMA Assurance Process and could be funded on a cost-reflective basis by the applicant.
- Update the Commission's licence process so that a licence grant decision would be taken after the certification has been successfully completed by the applicant. This certification would have to be completed successfully by the applicant within three months from the date of the licence application.
- Require the licence applicant to provide a written statement of compliance with all relevant regulations and licence conditions, signed by the ultimate controller(s)'s board of the licence applicant and by a named director of the licensed provider.

### *Criteria for assessing a licence application*

In assessing a licence application the Commission must determine whether or not it is minded to grant a licence. The Commission proposes to refocus its determination around the following principles:

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<sup>9</sup> 'Supplier Licensing Review: Final proposals on new entry requirements', April 2019:

[https://www.ofgem.gov.uk/system/files/docs/2019/04/slr - final proposals on entry requirements.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/04/slr_-_final_proposals_on_entry_requirements.pdf)

<sup>10</sup> According to Market Code Section 6.2.7, the CMA can already require that "a Trading Party carries out further training and/or Market Tests in accordance with the Training Process and/or Market Assurance Process where that Trading Party persistently fails to meet some or all of the Performance Standards relevant to it."

1. Provision of information: The licence applicant provides all the relevant information required, as set out in the Commission's guidance to general water and sewerage licence applications. The Commission does not propose to increase the information requirements.
2. Compliance statement: The Commission is proposing that the licence applicant provides 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 director of the licensed provider.
3. Understanding of the market arrangements: the applicant successfully completes certification as part of the CMA Assurance Process to demonstrate a good understanding of the relevant regulations and code obligations.

### *Ongoing assurance*

Looking beyond the time of granting a licence, the Commission is considering how it might carry out ongoing assurance of the applicant's ability to undertake the activities for which it has been licensed. In exercising its licensing responsibilities, the Commission believes that the Market Health Checks could provide a more detailed ongoing evaluation of a licensed provider's ability and fitness.

In exercising its licensing responsibilities, the Commission proposes, as noted above, to make an initial assessment based on the information provided at the time of the licence application to consider whether to grant a licence. The Commission could, however, also review its initial assessment of a licensed provider's ability to undertake its licensing functions using the results of the Market Health Check.

The Commission proposes to introduce a new licence condition requiring licensees to participate in a Market Health Check within 12 months of commencing trading. This licence condition would confirm that, pending a successful first Market Health Check, the Commission may impose transitional requirements on the applicant's trading activity. These requirements could include for example restrictions on the licensed provider from opting into the Gap Site Allocator or the Provider of Last Resort mechanism. It could also include restrictions on the licensed provider from providing service to new customers after the Market Health Check until the licensed provider has demonstrated that it has taken all necessary steps required to address any material weaknesses identified by the Reporter.

The Commission is also proposing that, on an ongoing basis, licensed providers must demonstrate that they have retained and continue to update the required technical and regulatory knowledge within their organisation. The proposed new licence condition could require licensed providers to demonstrate that they have a minimum number of staff members who have been certified and have demonstrated that they have the relevant regulatory and technical knowledge required to carry out the licensing functions.

The Commission welcomes the views of market participants and other stakeholders on the proposed changes to its approach to assessing the expertise and knowledge of applicants, assessing licence applications and ongoing assurance.



## 4.3 Mergers and acquisitions

### Objective

The Commission notes that some licensed providers are associated with regional English water and sewerage companies, and that others have come from other industries including energy and telecoms. Since the opening of the market, we have experienced changes of ownership, acquisitions and joint ventures amongst licensed providers.

Considering this increasing licensed provider activity, the Commission wants to ensure that market arrangements are consistent with the Commission's duty to promote the interests of customers and with the orderly participation of licensed providers in the non-household retail market.

### Issues identified

The Commission notes that there are several licensed providers who are controlled by the same parent company (or companies). This has occurred as a result of acquisitions or joint ventures amongst licensed providers. The Commission also notes that licensed providers controlled by the same parent company can retain separate licences and, therefore, offer different terms and service levels to customers.

The Commission has reviewed this situation and has identified risks to customers and governance issues associated with this situation and concluded that:

- There is a material risk that customers could be transferred between two licensed providers controlled by the same parent company (or companies) without customers' explicit consent and put on different terms to those in place prior to the transfer;
- There is a significant risk that customers may switch between two licensed providers controlled by the same parent company without understanding the full terms of the transfer. This may create confusion for customers and undermine customers' trust in the market. The Commission also notes that several regulators have implemented additional measures to protect customers<sup>11</sup> during the transfer process to avoid mis-selling practices;
- Licensed providers controlled by the same parent company (or companies) who retain separate licences in the market could opt in to the Provider of Last Resort mechanism and the Gap Site Allocator as separate licensed entities. As a result of this, licensed providers can increase the number of reallocated Supply Points compared to the number of Supply Points that they would have otherwise received had they opted in as one combined entity; and
- Two (or more) licensed providers who are controlled by the same parent company (or companies) and retain separate licences in the market, can transfer Supply Points from one entity to the other through the Market Code transfer process. The Commission notes, however, that transferring Supply Points could affect the cap and, ultimately, the calculation of the CMA's Performance Standards Charges<sup>12</sup>. This has the potential to change the charges that licensed providers must pay for failing to meet the CMA performance standards, had they not transferred those Supply Points from one licensed entity to the other.

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<sup>11</sup> Ofcom has implemented measure to protect customers from mis-selling practices by modifying retailers' licence conditions: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0026/58247/statement.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0026/58247/statement.pdf).

<sup>12</sup> Market Code Schedule 7, Code Subsidiary Document No. 0002, Performance Standards.

## Proposed changes

### *Licensing arrangements*

Considering the governance issues and the risks to customers identified, the Commission proposes to prohibit licensed providers who are controlled by the same parent company (or companies) from retaining separate licences in the market. The Commission proposes that licensed providers controlled by the same parent company (or companies) could 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.

The Commission is aware that a complete prohibition may limit customer choice. For this reason, the Commission proposes that licensed providers controlled by the same ultimate controller(s) may opt in to the ability of retaining separate licences. Under this proposal, licensed providers who are controlled by the same ultimate controller(s) 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 customers (as a whole) would not be worse off as a result of retaining separate licences in the market.

The Commission welcomes the views of market participants and other stakeholders on these changes to its approach to the licensing framework.

### *Bulk transfer of customers*

Since market opening the Commission has put in place a process for the bulk transfer of Supply Points<sup>13</sup>. The bulk transfer process requires licensed providers to apply for a licence transfer. The Commission<sup>14</sup> can then issue a notice to consent to the licence transfer from a licensed provider (the transferor) to another licensed provider (the transferee).

As part of this process, the transferor submits a resignation notice from the CMA and the transferee assumes responsibility for all contraventions of the terms or conditions of this licence which occurred prior to the transfer date. All rights and obligations with respect to the transferred Supply Points, including obligations with respect to services provided before the transfer date, are transferred over to the transferee. This ensures that any retrospective amendments or historic billing disputes can be dealt with by the licensed provider transferee.

The Commission believes this process has worked well and has ensured an orderly transfer of Supply Points whilst protecting customers and Scottish Water. It is important to note that the bulk transfer process always requires retailers to apply for a licence transfer. The Commission is aware that the Market Code does not set out a process for a bulk transfer of Supply Points if a licensed provider wants to transfer its customers in bulk without also transferring its licence.

To this end, the Commission proposes to extend the use of a bulk transfer process to allow a licensed provider who has, for example, sold its customer base to another licensed provider, to transfer these

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<sup>13</sup> The Commission's Application Guidance to general licences can be found at:  
<https://www.watercommission.co.uk/UserFiles/Documents/Application%20Guidance%20Transfer.pdf>

<sup>14</sup> Section 1.4.4 of the Market Code sets out in the licence transfer and bulk transfer of Supply Points.

Supply Points in bulk. The process would still require the transferee to take on all rights and obligations with respect to the Supply Points, including historic obligations prior to the transfer date.

The Commission wants to ensure that customers are not worse off as a result of a transfer and, therefore, proposes that:

- The transferor and transferee write to the Commission to request a bulk transfer of Supply Points in advance of transferring the customer book;
- 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
- 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.

The Commission welcomes the views of market participants and other stakeholders on these proposed changes to the bulk transfer process.

#### 4.4 Measures in support of a level playing field

##### **Objectives**

The Commission wants to build and retain the confidence of all trading parties in the Scottish non-household market and ensure that there is a demonstrable level playing field in the market.

When the retail market opened in 2008, Scottish Water's subsidiary, Business Stream, served all non-household customers. The Commission included additional obligations in Business Stream's licence and required it to comply with a Governance Code<sup>15</sup>. These steps were designed to ensure that there was a level playing field.

In 2016 the Commission revised Business Stream's licence conditions<sup>16</sup>. It also implemented changes to the licence conditions of all other general licensed providers to restrict cross subsidisation between licensees in the market and related undertakings in the market in England and Wales. It also required that all licensed providers make an annual declaration that they are complying with UK and EU competition law and State aid law in the Scottish market.

##### **Issues identified**

The changes implemented have served well in supporting a level playing field in the market. The statements of compliance build confidence among all market participants that there is a level playing

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<sup>15</sup>The Governance Code can be found at:

<https://www.watercommission.co.uk/UserFiles/Documents/080111%20Governance%20Code.pdf>

<sup>16</sup> 'Measures to ensure the Scottish water and sewerage non-household retail market works well', May 2016: <https://www.watercommission.co.uk/UserFiles/documents/Governance%20and%20SLC%20Consultation%20-%20May%202016%20-%20Final.pdf>

field in the Scottish retail market. The Commission has now reviewed these requirements and has asked itself whether these annual declarations are sufficient.

It is not clear the extent to which all licensed providers have monitored and ensured compliance against these requirements. For this reason, the Commission believes that additional evidence in support of these annual declarations is necessary to demonstrate there is a level playing field for all licensed providers in the Scottish market. The Commission also notes that other regulators require certain statements from the boards of all licensees and their ultimate controllers<sup>17</sup>.

### **Proposed changes**

In order to ensure that all licensed providers are taking appropriate steps to promote a level playing field in the market the Commission proposes to introduce a licence change. This could be implemented with a change to licensed providers' standard licence conditions, specifically Standard Licence Condition (SLC) A9.

The Commission proposes to amend SLC A9 to 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, those other activities 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.

The Commission envisages that licence providers would be required to put in place arrangements designed to secure compliance with these principles (and to monitor compliance), in line with guidance from the Commission as to any specific requirements.

The Commission proposes that licensed providers provide an assurance statement signed by the board of the licensed provider and their parent company confirming compliance with the principles. The Commission proposes to use Market Health Checks to evidence licensed providers' behaviours are consistent with these principles.

The Commission welcomes the views of market participants and other stakeholders on the proposed new measures to support a level playing field in the market.

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<sup>17</sup> For example, in 2017 BT plc committed to Ofcom's requirements to adopt governance changes and adopted a Governance Protocol which details governance arrangements relating to Openreach Limited. For example, Ofgem require that each licensed network companies provide annual statements that it has adequate resources to carry on its regulated business and to meet its licence obligations, and that it must evidence annually that specified undertakings from its Ultimate Controllers are in force. For example, see Conditions 30 and 31 of the Standard conditions of the Electricity Distribution Licence – 30 October 2015.

## 4.5 Licence fees

### Objective

The Commission believes it is important to ensure that all licensed providers are contributing fairly towards the costs associated with managing the competitive framework.

Licensed providers who have become trading parties under the Market Code are also granted access to the dataset of all the eligible premises registered in the market. The Commission wants to ensure that all trading parties are contributing towards the costs of maintaining the central systems.

### Issues identified

The Commission levies an annual fee on licensed providers to recover the costs incurred in monitoring compliance with licensing conditions and administering the market. In accordance with the Fees Scheme<sup>18</sup> and the Commission's related licence fees policy statement<sup>19</sup>, the Commission charges an application fee of £4750 (designed to cover the Commission's costs of processing applications for licences) and an annual levy, designed to cover the ongoing costs of the Commission's licensing activities.

At present, for the annual levy, the Commission calculates the relevant proportion of costs that each licensee is required to pay. The calculation has two components: a fixed component of £3,000 per annum that applies to each licensee, and a variable component that depends on the licensee's market share.

Separately, the CMA charges licensed providers a monthly charge based on their market share<sup>20</sup> to recover the costs of its activities and operations. Licensed providers with no registered Supply Points, therefore, have access to the market dataset by becoming trading parties under the Market Code but do not make any financial contribution towards the CMA's costs incurred in maintaining the central systems.

The Commission is aware that several retailers who have been granted a water and sewerage licence in the retail market are still not actively trading in the market. These licensed providers are not paying a fee commensurate with the value of the market data and make a very low contribution towards the costs incurred in monitoring the licensing regime. This does not appear to be fair to all those market participants who are contributing in full towards the costs of managing the market framework.

### Proposed changes

The Commission proposes to apply an increased fixed component to the annual levy fee which would apply when a licensed provider is not participating actively in the market. More specifically, the

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<sup>18</sup> The Commission's Fees Scheme can be found at:

<https://www.watercommission.co.uk/UserFiles/Documents/Approved%20fees%20scheme%20v1.pdf>

<sup>19</sup> 'Licence fees for the retail market – a policy statement', Water Industry Commission for Scotland, January 2010:

[https://www.watercommission.co.uk/UserFiles/Documents/Fees%20scheme%20policy%20statement%20revised%20October%202009%20\(final\).pdf](https://www.watercommission.co.uk/UserFiles/Documents/Fees%20scheme%20policy%20statement%20revised%20October%202009%20(final).pdf)

The Commission's Policy Statement for Licence Fees can be found at:

[https://www.watercommission.co.uk/UserFiles/Documents/Fees%20scheme%20policy%20statement%20revised%20October%202009%20\(final\).pdf](https://www.watercommission.co.uk/UserFiles/Documents/Fees%20scheme%20policy%20statement%20revised%20October%202009%20(final).pdf)

<sup>20</sup> Market Code Section 7.8.2.

Commission proposes to charge an increased fixed component when a licensed provider fails to meet the following thresholds as reported by the Central Market Agency.

The Commission is aware that licensed providers are likely to scale their operations and register new customers progressively over time. For this reason, the increased fixed component will apply if the licensee fails to register the following Supply Points or fails to supply the following percentage of total volumes as reported by the Central Market Agency within the indicated timescales from the later of the date of the licence being granted or the date of publication of the Commission’s final decision on these changes:

- At least 1 registered Supply Point within 6 months, or
- At least 100 registered Supply Points or 0.075% of total market volumes within 12 months, or
- At least 300 registered Supply Points or 0.11% of total market volumes within 18 months, or
- At least 500 registered Supply Points or 0.13% of total market volumes within 24 months, or
- At least 500 registered Supply Points or 0.13% of total market volumes after 24 months.

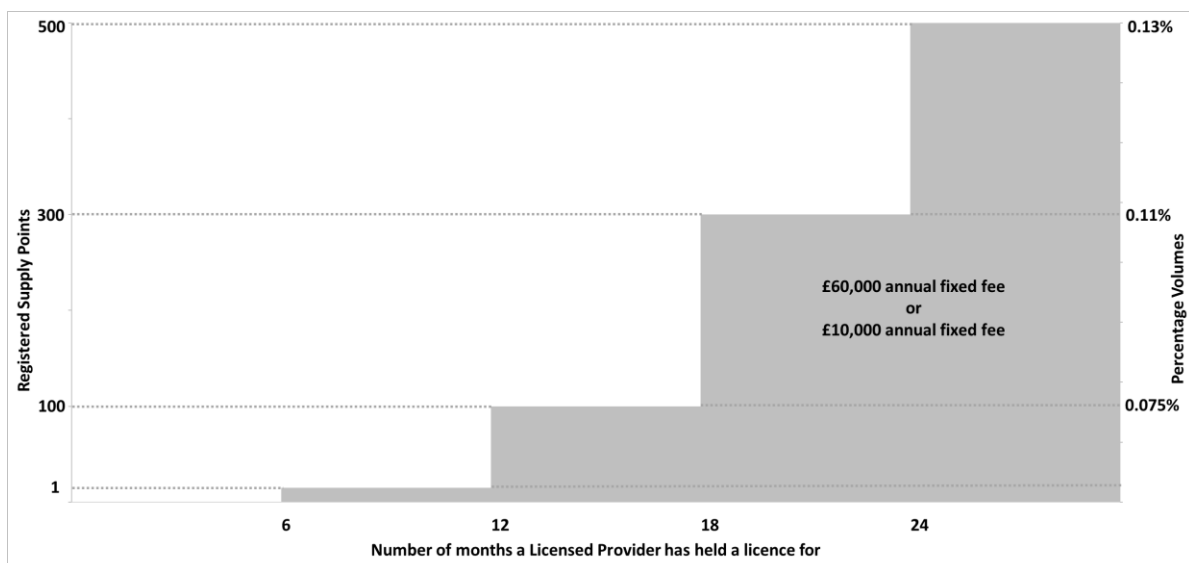
The Commission proposes that licensees who do not register the minimum number of customers within the above indicated timescales will pay an increased annual fixed component of either:

- £60,000 per annum; or
- £10,000 per annum provided that the licensee accepts that it will have access only to market data with respect to the Supply Point(s) for which it is the registered licensed provider.

Licensed providers who opt to pay £60,000 may subsequently decide to limit their access to market data with respect to their own Supply Points only after a minimum period of 12 months.

The graph below shows the proposed minimum thresholds and timescales. Under this proposal licensed providers who fall in the shaded area will pay the increased fixed component.

**Graph 1 - Proposed minimum thresholds**



Under this proposal, all licensed providers in their first six months of being granted a licence will pay the same fixed fee<sup>21</sup> regardless of their market share. The Commission does not propose to make any change to the licence variable fee.

The Commission will also liaise with the Central Market Agency to look at any additional control measures available on access to, and use of, the market dataset.

The Commission welcomes the views of market participants and other stakeholders on the proposed changes to the policy on licence fees.

## 4.6 Gap Site Incentive Scheme

### Objective

The Gap Site Incentive Scheme has been effective in incentivising retailers to seek out and register eligible premises which should be part of the market. The Commission wants to ensure that the scheme keeps on providing effective and proportionate incentives to register new customers in the market.

Since the Commission revised the Gap Site Incentive Scheme in 2014<sup>22</sup>, the Commission has received feedback from market participants on the effectiveness of the scheme. As the CMA's Scottish Assessors Association matching project has now concluded, it is timely to review the operation of the scheme.

The Commission set out below the issues that it has identified in its review of the scheme and the changes that it proposes for consultation.

### Issues identified and proposed changes

#### *Eligibility criteria for gap site incentive payments*

Since 2018 Scottish Water has become responsible for updating the data with respect to the rateable value of all eligible premises registered at the CMA central systems. As a result, Scottish Water now periodically updates the market dataset in line with any change made by the Scottish assessors. As part of this process if Scottish Water identifies new gap sites it sends a letter inviting the customer to select a licensed provider or have one allocated to them, as per the Market Code<sup>23</sup>. Under the current rules, the retailers who then become the registered licensed provider at those premises can still claim an incentive payment even though they have made no efforts in identifying these gap sites. This appears to be inconsistent with the intent of the scheme.

The Commission is aware that Scottish Water is now more likely to identify most vacant premises as a result of its role in updating the market dataset to reflect the most up to date rateable value of eligible premises. Scottish Water has processes in place which aim to ensure that all sites new to the Scottish Assessors Association database, which are eligible, are made chargeable in as short a time-scale as possible. The Commission wants to ensure that the Gap Site Incentive Scheme keeps on

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<sup>21</sup> This corresponds to £1,500 ie six months' worth of the annual fixed fee of £3,000 ( $£1,500 = 6/12 \text{ months} * £ 3,000$ ).

<sup>22</sup> Details of the Commission's changes to the Gap Site Incentive Scheme can be found at:  
<https://www.watercommission.co.uk/UserFiles/Documents/140304%20Gap%20Site%20Update.pdf>

<sup>23</sup> As per the Market Code at 5.4.9-11 and CSD0101.

providing effective and proportionate incentives to bring unidentified gap sites into charge as quickly as possible. To this end, the Commission proposes that eligibility to claim an incentive payment should only be available 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.

This change will ensure that Scottish Water has enough time to bring the premises into charge. It also continues to incentivise licensed providers to actively register gap sites that have been identified by the licensed provider or that have been identified by Scottish Water but have not been registered in the market within a reasonable time period.

### *Administration fee*

Scottish Water incurs various costs when processing gap sites. To recover these costs, Scottish Water can charge the licensed provider an administration fee whenever a licensed provider has made a material error in its gap site application. However, the Commission recognises that there may be instances where such an error has not been caused by the licensed provider. This may occur if there is an error in the data recorded by Scottish Water. The Commission recognises that in this case it would not be appropriate to levy an administration fee on the licensed provider.

The Commission believes that the administrative fee charged by Scottish Water in the event of a material error in the application continues to incentivise retailers to submit correct applications. However, the Commission proposes to update the scheme to clarify that the administrative fee should not apply if the error has been caused by Scottish Water.

The Commission welcomes comments from market participants and other stakeholders on these changes to the Gap Site Incentive Scheme.

### **Other considerations**

There are two further practical considerations which currently limit the effectiveness of the Gap Site Incentive Scheme:

- As per the Operational Code, before a Gap Site can be registered, Scottish Water is required to verify<sup>24</sup> the services provided at that Supply Point and to survey the site. The Commission is aware that if a Gap Site is vacant or unmanned, or if the occupant refuses to provide access, Scottish Water may fail to complete a site visit. In line with Scottish Government's Principles of Charging, it is important that all eligible premises are brought into charge swiftly. The Commission therefore expects Scottish Water to exercise its legal powers to access the premises where access has been refused within the timescale set out in the Operational Code in order to ensure that the Gap Site Incentive Scheme operates as effectively as possible for all sites. The Commission will monitor this and seek periodic reports from Scottish Water.
- 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.

The Commission welcomes comments from market participants and other stakeholders on these additional proposals.

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<sup>24</sup> As per the Operational Code Supply Point Registration, Verification and Deregistration, Process 28 and Process 29.



## 5. Next steps

The Commission wants to ensure the market framework continues to work well for customers, licensed providers and Scottish Water. This consultation has summarised the Commission's review of some areas of the non-household retail market framework. The Commission has suggested changes to strengthen the market framework and to build trust among market participants.

The Commission welcomes the views of retailers, customers and other stakeholders on the proposed changes to the market framework. Please reply to [competitionteam@watercommission.co.uk](mailto:competitionteam@watercommission.co.uk) by 6 August 2019.