



Severn Trent Connect's response to Ofwat's Consultation

Application of the new non-household retail market framework to new appointees, small companies and companies based wholly and mainly in Wales

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Issue 1: New appointees setting non-household charges in a 'retail exit' scenario

Explanation of issue

Underlying the no worse off principle is the inclusion of condition B1A.3, which requires the NAVs' charges to not exceed the "Relevant Charges" of an Incumbent. The potential for retail exit creates a gap for non-household customers insofar as there will be no "Relevant Charges" to peg to.

1. Do you agree with the options we have considered?

We agree that you have considered the right scope of options.

2. How else could charging for non-household customers be set and why is this approach more suitable?

N/A

3. Are there any other issues that we need to take into account? What is your preferred option?

We believe that there is a simple solution to the identified risk that an incumbent may pursue retail exit and therefore no longer publish retail charges:

- In the short term, all incumbents have published retail charges valid until 2020, therefore the 'no worse off' principle should be compared against those published charges. I.e. option 3b but as stated this is not a long term solution.
- In the medium term option 3a (require the NAV to set prices that are not unduly onerous) should be available to any NAV that wishes to alter its prices from that of the exited incumbent; this is a lighter touch regulatory approach but it should not be a long term solution.
- In the long term, option 1 (do nothing) is the most appropriate option as it is based on the premise that a competitive market is the most efficient method of setting prices. To run a regulated approach for newer appointees while the older/larger appointees are allowed to operate in competitive market will be onerous for Ofwat and potentially the appointees.
- We do not support options 2 or 4.

Issue 2: Small companies setting wholesale charges

Explanation of issue

If a customer of a NAV or small company wants to switch, NAVs and small companies will be required to offer a wholesale charge. Ofwat is not intending to look at bulk supply prices this year (bulk supply is the basis of most NAVs).

1. Do you agree with the options we have considered?

It is difficult to discuss this issue without some resolution on the access price/bulk supply price. There is also a wider issue that competition is being promoted for the retail market to the detriment of the existing and operational NAV market.

2. How else could charging for non-household customers be set and why is this approach more suitable?

No comment.

3. Are there any other issues that we need to take into account? What is your preferred option?

- The diagram produced is slightly misleading in the context of NAVs as it appears to suggest that the wholesale charge must be calculated from the bottom up, and that the wholesale price will

automatically be based on the bulk supply price for incumbents. This should not be the case and will stifle efficient competition in the NAV market.

- During the workshop on 11th March 2016, a concern was raised that if a NAV is required to calculate wholesale costs from the bottom up (and it has its own assets) then the retail margin will be falsely high due to the new network/assets that the NAV owns. However, it is irrelevant that a NAV's network may be newer than the local incumbent; it is appropriate that a NAV is able to retain income today for its infrastructure investment tomorrow. There is competition case law that supports this approach.
- A more appropriate approach for all NAVs will be to use the retail costs apportioned between household and non-household plus an appropriate allocation of profit. All NAVs should have this information already.
- In terms of the options, we would support option 2 on the basis of our response above. However, if Ofwat's guidance indicated that wholesale charges should be set based on actual cost on a site by site basis then we would oppose this approach as it does not support efficient competition.

Issue 3: Licensing and interactions with market systems

Explanation of issue

Small companies have questioned the requirement to fully comply with market systems. This is also an issue for Welsh companies with a small number of eligible non-HH customers.

1. Do you agree with the options we have considered?

We do agree that the scope of options considered is appropriate.

2. How else could small and Welsh companies interact with the market systems and why is this approach more suitable?

N/A

3. Who should be responsible for managing any decisions on derogations? What is your preferred option?

- We would prefer Ofwat to be responsible for managing any decisions on derogation as they have greater involvement in the NAV market and more understanding of the particular concerns a small company may have. The market operator is solely concerned with the operation of the retail market.
- Our preferred option will be either options 2 or 3, allowing for a certain degree of derogation to be applied, however, until we have gone through the market documents we are not in a position to state which areas should be exempt.
- We support the suggestion made during the workshop on 11th March 2016 to have a working group where this issue is explored in further detail.

Issue 4: Company eligibility

1. Do you have any views or comments?

At the moment this issue does not apply to Severn Trent Connect.

2. Do you think there are any outstanding issues to be resolved?

The biggest issue at the moment is due to primary legislation. There may be a future issue; if a NAV has exited retail and then becomes the appointee for a site in Wales, it will have to have a retail function, i.e. re-enter the retail market. At the moment, there is only one opportunity to exit retail and the NAV would then be forced to retain its retail function.