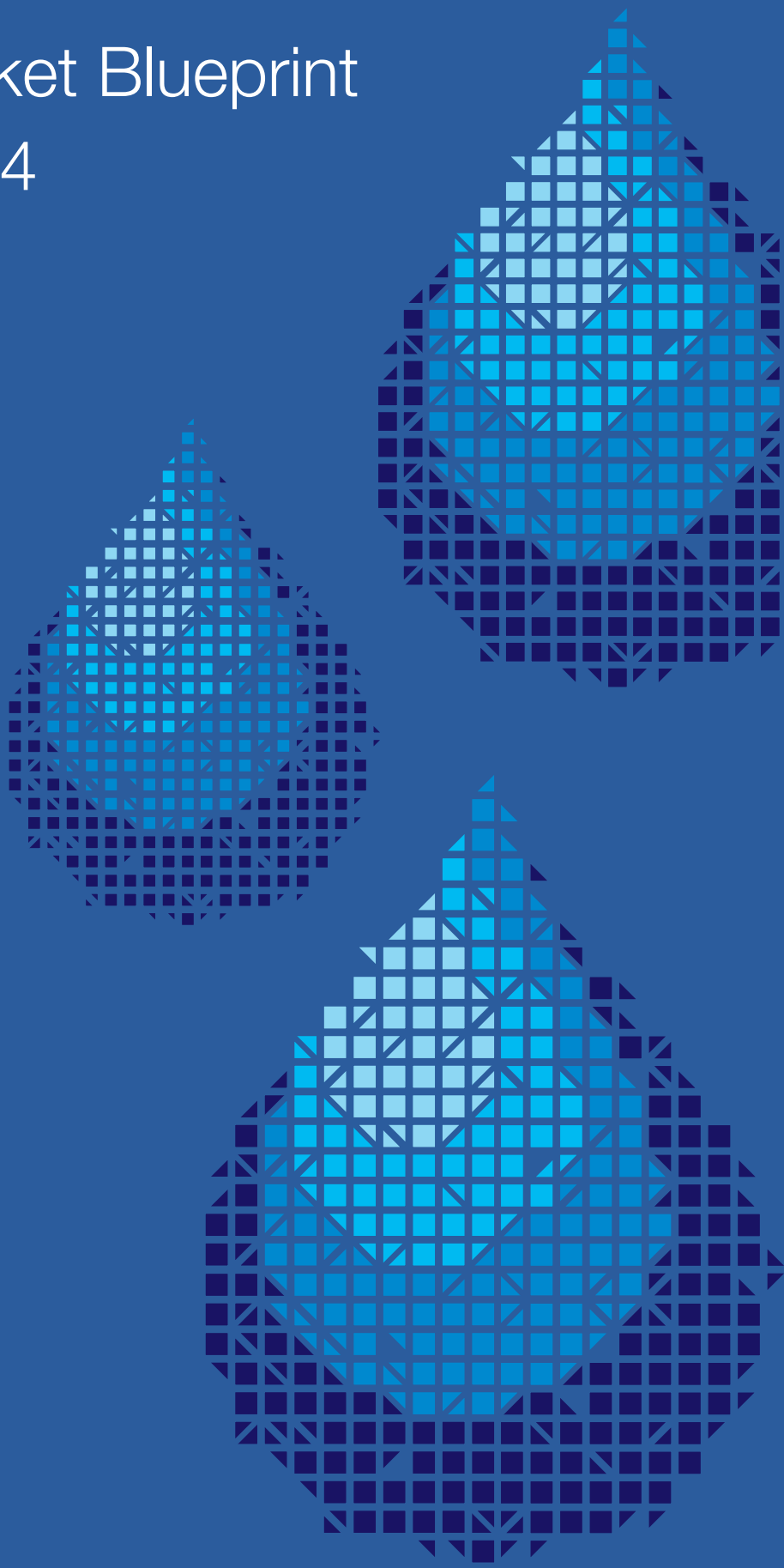


Executive Briefing Note

Open Water Market Blueprint

2nd January 2014





INTRODUCTION

One of the key measures in the Water Bill 2013-14¹, currently progressing through Parliament, is the introduction of a competitive market for all non-domestic water and sewerage customers in England with effect from April 2017. Working with market participants, Defra and Ofwat, the Open Water Programme has been established to develop the design for the new market arrangements. On 2nd January 2014, Open Water published its initial version of the Market Blueprint, with a supporting suite of documents. The Market Blueprint provides recommendations for the structure of the future market, including identifying the proposed roles of different participants. Responses to the associated consultation questions are due by 14th February.

Gemserv is a leading provider of consultancy, governance, market assurance and advisory services in the utilities and environmental sectors, and has been an incumbent Market Operator in the GB retail electricity market since 1998. Having worked with the Water Industry Commission for Scotland (WICS) to design and implement the initial arrangements for the competitive water market in Scotland, we are presently supporting various water companies in their preparations for retail competition in England.

With our experience in market design and implementation, Gemserv is well placed to offer comments and would be pleased to offer our support to the Open Water Programme, and its stakeholders (including Ofwat and incumbent water service providers) in further developing the details of the market arrangements and design.

This Executive Briefing Note provides a summary of a number of key features of the Blueprint alongside Gemserv's initial observations, which we believe will be of benefit to stakeholders reviewing the Market Blueprint and considering a response to the consultation. As such, it considers;

- Customer choice;
- The evolution of market arrangements;
- Operational services;
- Market Operator;
- Registration and switching;
- Financial settlement; and
- The market system and data model

OVERVIEW

Gemserv welcomes the Open Water Programme's publication of the initial version of the Market Blueprint, which provides additional detail regarding the work of the Programme to date in developing a comprehensive package of recommendations. The Blueprint is intended to facilitate wider discussion about the market arrangements that will ultimately underpin the introduction of competitive market arrangements in April 2017.

It is noted that a number of the recommendations made in the document fall within Ofwat's regulatory remit (for example the areas of market governance and possible content of the market codes), and will require a regulatory decision in due course. Further, the Programme recognises that further development of the strategy for metering, contracts and tariffs, and upstream considerations will take place prior to the publication of an updated version of the Blueprint in early summer 2014.

The successful introduction of full non-domestic market competition will change the way that water and sewerage services are delivered to customers. There is now an opportunity for affected organisations to consider and respond to the recommendations made, and to propose additional design detail in line with the Programme timetable.

Using our extensive understanding and experience in a number of competitive utility markets, we have a number of observations regarding the proposals and recommendations contained within the Blueprint, at both market and individual stakeholder level, and would welcome the opportunity of sharing some of these in more depth during both the consultation period and the subsequent refinement stages.

1. The draft Bill and associated documents are available at: <http://services.parliament.uk/bills/2013-14/water/documents.html>



MARKET BLUEPRINT

The initial Open Water Market Blueprint comprises seven documents, along with a consultation response pro-forma². This document suite includes:

- The **Market Blueprint**, setting out the high level view of the scope for market reform, recommended market arrangements, switching, settlements, the Market Operator (MO) target operating model, and market systems architecture;
- The **Financial Settlement Strategy**, providing the proposed scope of products and services in scope, calculation and timing, payment and credit terms, and roles and responsibilities;
- A **Switching Options Paper**, looking at the current arrangements in Scotland, potential volumes in England, and the proposed scope of services to be contestable;
- A **Registration Switching Paper**, looking at how registration and switching might work in the new market;
- An **Operational Services Strategy**, setting out scope for both standard and non-standard operational services to be included in the market design;
- The **Market Operator Target Operating Model**, setting out the proposals for services, the delivery model, ownership and the commercial models;
- A **Systems Architecture** paper setting out the initial IT system requirements for the MO, the data interface approach, and the high level conceptual data model; and
- A **Response Pro Forma**, containing all 105 questions that are included across the seven main documents.

KEY POINTS

The Market Blueprint makes a number of recommendations in relation to the proposed market arrangements, and associated operations.

Customer Choice

Customers will be able to choose their retailer for water and sewerage services, with the ability to select individual retailers for each of the service types provided to their premises. These service types are proposed to comprise:

- Potable water;
- Non-potable water;
- Foul water;
- Surface water drainage; and
- Trade effluent.

In theory, therefore, a customer could choose to have a single provider for all services, or a different provider for each individual service available to them, although the latter may be unlikely in practice.

This key design recommendation will offer a wide range of options for customers, and is intended to encourage flexibility, and allow specialisation in the retailers' offerings in the new market. This will be an important element to be taken into account in the more detailed design of activities such as switching and settlement. The proposed level of switching is different to the arrangements both in Scotland and other competitive retail utility markets, and may add a level of complexity which will require a higher emphasis on good process governance and data quality.



2. The Market Blueprint documents are available from the Open Water Programme website: <http://www.open-water.org.uk/>



Evolution of Market Arrangements

Water and sewerage companies (WaSCs), water only companies (WOCs) and new appointments and variations (NAVs) will continue to provide both retail and wholesale functions within their area of appointments. They may also choose to set up their own competitive retail arm, seeking to acquire customers outside of their area of appointment; the removal of the current in-area trading ban, expected in 2015, will allow greater scope for multi-area offers.

The obligations set out in legislation and in the licences which WaSCs and WOCs have, will continue into the new market. WaSCs and WOCs will need to continue to satisfy themselves that they are complying with their licence obligations and other statutory obligations, including providing wholesale services to their own incumbent retailer and new entrant retailers on a non-discriminatory basis.

The Water Supply Licensing (WSL) retail only arrangements are expected to evolve directly into the new retail market arrangements. The WSL combined supply licence arrangements will be unbundled into separate retail and upstream elements. Such unbundling as will be needed, and the management of any upstream arrangements are outside the scope of the planned 2017 market.

Gemserv observes that it is highly likely that compliance with the new market arrangements will be linked to obligations in the new market's licences, codes and governance, yet to be defined by Ofwat. There will be a requirement for Ofwat to have the expertise available to understand and ensure that these licences, codes and governance are robust enough to cope with the new market arrangements.

A range of proposals are made relating to arrangements for Trade Effluent, Developer Services, and sub-contracted and associated services. Overall, the recommendations allow for an evolution of current arrangements such that a transparent level playing field is established. The Blueprint sets out the scope and responsibilities for interactions with customers in these areas; it also proposes arrangements relating to areas such as scope of roles and services, charging and payment, compliance, and market interaction with organisations providing associated services, all whilst considering existing arrangements and their evolution.

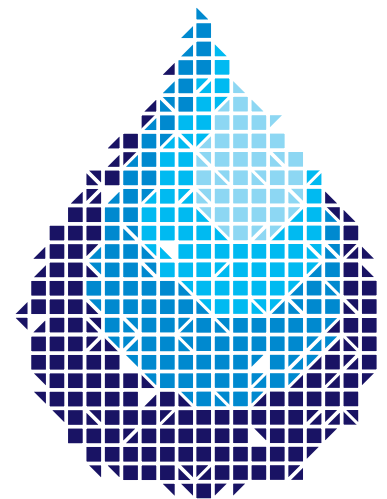
Operational Services

Open Water recommends that a catalogue of operational services provided across England should be created, and will seek to make the definition of services consistent. This will ensure that it is possible for stakeholders to have a clear view of operational services that are available, via a centrally published and maintained list. Ofwat will be carrying out work on service levels in this area.

The Programme also recommends that market participants should be able to negotiate non-standard services and/or service levels, and that Ofwat should consider a requirement to publish details of such arrangements.

It is also proposed that, as far as is possible, service requests and notifications should be communicated between market participants through the MO, except where a derogation has been granted in circumstances where (for example) the wholesaler and retailer involved are related.

Whilst many of the proposals are similar to the market design in Scotland, a differentiating factor is the plan to create flexibility for different retailers to offer specialist services; in Developer Services, for example, this is reflected in proposals to create a role for a retailer of developer services, separate from the retailing of water and sewerage services.





Market Operator

A single Market Operator (MO) for the new retail market is proposed.

The MO will provide services relating to:

- Market governance;
- Financial settlement between wholesalers and retailers;
- Service point registration;
- Customer switching; and
- The exchange of industry data required for market operation.

Subject to Ofwat's work relating to MO delivery, governance, and ownership model, Open Water recommends that some services delivered by the MO should be insourced, with others being procured:

- Insourced services
 - Strategy;
 - Procurement and contract management;
 - Business operations; and
 - Governance and change management.
- Outsourced services
 - IT systems;
 - Registration system and database;
 - Charge calculation system and associated databases;
 - Management information/ business intelligence system; and
 - Industry data exchange hub.
 - Market operations - largely activities using the outsourced IT systems.

Gemserv notes that the consideration of the MO role, and the timing of setting up these services, needs careful consideration to avoid unnecessary costs, and to ensure appropriate skills are in place at the optimal time. For example, given lead times it may be tempting to procure IT at an early stage, but without clarity on governance and change management there may be sub-optimal decisions made on business requirements. Also, skills required in the lead up to 2017 will be different from those needed on an enduring basis.

To achieve a level playing field, Open Water recommends market participants should be required to make use of the MO services for standard services, agreements and interactions.

It is suggested that the MO should be a company limited by guarantee, owned by market participants, and governed by an independent board. Neither Ofwat or customer representatives would be members of the Board of the MO under the model proposed, but rather would be members of Panels governing the market itself.

The MO would be a not-for-profit entity funded on a cost recovery basis from members/owners, via agreed formulae for both pre- and post-operational go-live costs.

The Blueprint refers to set-up costs being incurred prior to market opening in 2017, and it is clear that there is an expectation of some development of the MO functionality in the period leading up to full market opening.

Gemserv notes that many of the principles of the MO scope and role are similar to those of market operators in other utility markets in GB, with the scope of insourced and outsourced services proposed for the MO being similar to the model now employed by the Central Market Agency (CMA) for the competitive water market in Scotland.



Registration and Switching

Customers will be able to choose (at premises level) their retailers for each service defined as being within the market scope. In order to support this, a central register of service points and the premises to which they are related will be established to be maintained by the MO.

Open Water recommends that in order to complement any direct marketing by retailers, a centralised marketing campaign should take place to raise customers' awareness of switching.

Recommendations are included for a standard switching process initiated by the new retailer, with all messages between participants passed via the Market Operator. Gemserv believes that such an approach will mitigate the risk of communication problems. Utilising a standard data transfer methodology will assist in maintaining and improving data quality, and support high standards of service for customers, which is high on the agenda of many key industry stakeholders, including the regulator.

Financial Settlement

Ofwat published an Information Notice in November 2013³, which set out that the settlement period for charges will be one calendar day, with the billing periods to be per calendar month. This Information Notice also set out standard payment terms of 30 days from the last day of the billing period or 15 days after the invoice is deemed to be received, whichever is the later.

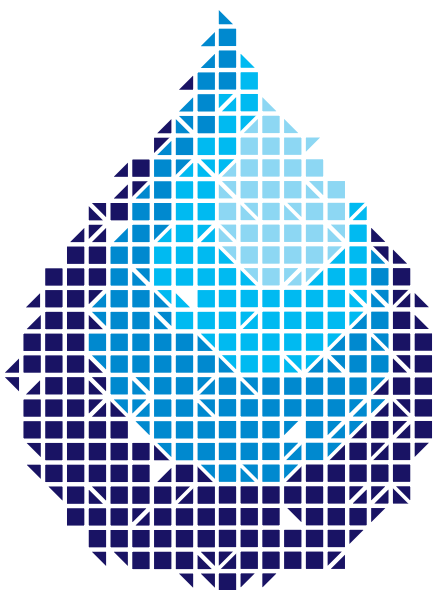
The Blueprint recommends that participants should be able to negotiate non-standard terms provided that, in the interests of transparency, these are published.

Charges due will be based on wholesale charges schemes, with standard consumption profiles used for the calculation of estimated charges.

The MO will have overall responsibility for calculating charges due, but billing and payment will be a bi-lateral matter between the relevant participants.

The Blueprint sets out that there would be a total of four settlement calculation runs for each period, with volumetric elements subject to a final calculation run 13 months after the relevant day, and the non-volumetric element being settled at the first run. We note that this is a similar model to that used successfully in the GB electricity market, although it does differ to the model used in the water market in Scotland.

The requirement that billing and payment activities will continue to be delivered between the market parties reflects the approach used in Scotland, where Scottish Water as the wholesaler bills for water and waste services delivered to retailers. The implication for incumbent water companies in England is that they will need to consider their wholesale billing arrangements and infrastructure to reflect the new market in 2017.



3. Available at: http://www.ofwat.gov.uk/competition/review/prs_in1321pr14paymentterms.pdf



Market System and Data Model

Open Water are proposing a central data exchange with which participants and the MO will interact, this is not dissimilar to the arrangements used in other markets.

Three types of interface covering differing volumes of interactions are proposed in order to cater for the wide range of numbers of transactions that will be sent and/or received by each participant. These will allow for:

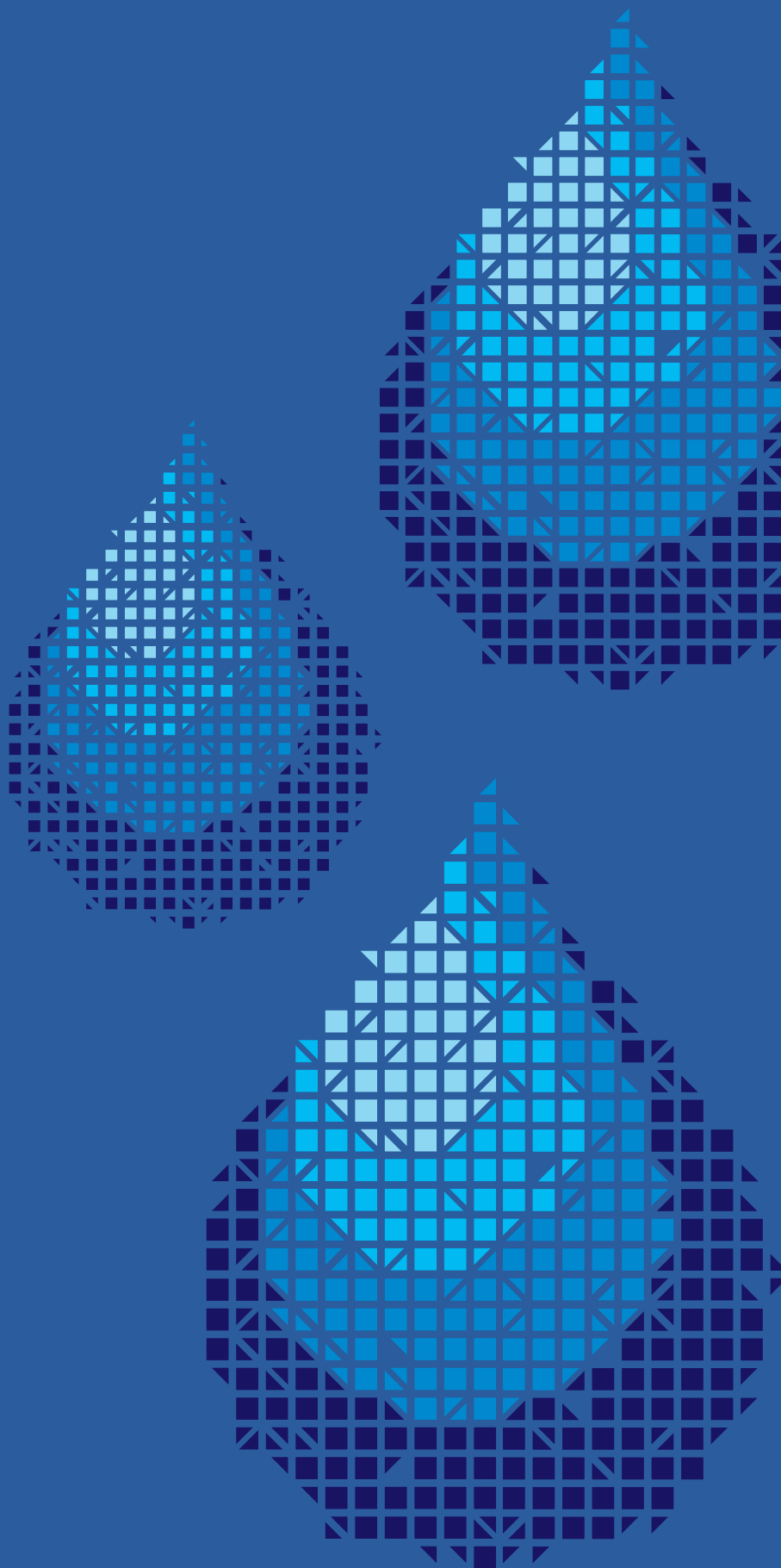
- Human interaction via user screens;
- Bulk transfer of data via Secure File Transfer Protocol (SFTP); or
- Transfer of information via web services or similar using defined messages.

Gemserv notes that, at a high level, this reflects arrangements in other markets including the competitive water market in Scotland, with a balance between structured transactions and the flexibility required to ensure that participants of all types and sizes can interact with the market in an effective manner.

Gemserv supports this approach, to meet the needs of potentially, as in Scotland, a wide variety of different licensees entering the market, with different strategic goals and scales of operations.

Having the right communications infrastructure in place is essential, but this has to be accompanied by having high quality data underpinning the market. On this aspect, we believe strong emphasis needs to be placed in the planning and preparation for market opening. This is a key learning point from other utilities markets.





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