

## **MOSL's response to Ofwat's consultation on strengthening customer protections in the business retail market: the interim supply process**

### **Summary**

As market operator for the non-household (NHH) water market in England, MOSL welcomes the opportunity to respond to this [consultation](#). The risk of a large retailer failing and customers being stranded without a retailer is the highest priority risk on our risk register. We are pleased to be working closely with Ofwat to try and deliver more robust interim supply arrangements to both protect customers and promote competition in the market.

We are mindful the proposals will not entirely remove the risk of interim retailers not stepping forward which will remain voluntary and require retailers to 'opt-in'. We believe these proposals should form part of a wider programme of changes to ensure the market has a clear and credible process to protect customers in the event of a retailer failure.

We believe the proposal put forward to recover costs from all NHH customers - over just those transferred from the failed retailer - is a positive step forward. This reduces the risks of costs being recovered from a sub-section of customers which could become smaller if the additional costs encourage some of those customers to switch away from the interim retailer.

MOSL generally supports an ex-post levy approach. However, we believe recovering costs through the Central Market Operating System (CMOS) settlement arrangements would be a complex process requiring timely and expensive CMOS changes. There would also be significant challenges associated with calculating and recalculating these payments for each settlement run.

To avoid the need for CMOS changes, we propose an interim supply levy outside of settlement for MOSL to recover costs directly from retailers. MOSL would calculate the charge to be applied by retailers to customers. Retailers would pay this to MOSL and in turn collect such charges through an additional item on customer bills. We are happy to provide more detail following the consultation on how we think this could work.

We also have some concerns around the risk of retailers not being able to raise finance to take on customers, either at all, or on a timely basis that would avoid long delays in the allocation of customers. We encourage Ofwat to further consider mechanisms to defer wholesale charges alongside the ex-post recovery of an interim supply levy from retailers mentioned above. This could involve interest on deferred charges being funded by the levy. We recognise that Ofwat needs to assess the balance of credit risks between wholesalers and retailers but note that a failure of retailers to 'opt-in' would have a substantial impact on wholesalers.

We note that there will also be a financing challenge for the incoming retailers given the potential lag between incurred costs and recovery as we expect the claim, decision and reclaim process could take a year or two – we feel that minimising this lag as far as possible needs to be prioritised.

We note that a high-level of uncertainty for retailers about the criteria Ofwat would use to assess whether costs were efficiently incurred could deter retailers from opting in. Increasing clarity on the principles that will be applied in such an assessment and the methodologies that could be used, even if this is for certain cost types, could help improve the likelihood retailers opting in.

We believe the charge on NHH customers should be set at a fixed level for each consumption banding, with the information in CMOS used to determine these bandings. We think this would be fairer than a flat fee across all NHH customers - which would disproportionately burden the large number of low usage customers in the market - but less complex than a fully variable charge.

Our answers to the consultation questions are below. We have only answered the questions we believe we are well placed to provide value. We look forward to continuing the work with Ofwat to deliver more robust arrangements in the event of retailer failure. If you have any questions on our response, please email [comms@mosl.co.uk](mailto:comms@mosl.co.uk).

## Answers to consultation questions

### **Question 1: What are your views on our overarching aim for a cost recovery mechanism and the criteria outlined above? Do you have any additional suggestions?**

MOSL supports the overarching aims to protect customers while promoting competition. Also, that any costs are shared across all non-household customers but ring fenced within the NHH market.

### **Question 2: What are your views on how the levy should be funded? Do you think that there are any other options?**

We believe the most suitable option would be an interim supply levy outside of settlement for MOSL to recover directly from retailers – similar to option 5a. This would remove the complications of recovering through the settlement process that would be time consuming and expensive due to the number of CMOS changes (and subsequent testing) that would be required.

We believe the proposal put forward to recover costs from all NHH customers - over just those transferred from the failed retailer - is a positive step forward. This reduces the risks of costs being recovered from a sub-section of customers which could become smaller if the additional cost burden encourages some of those customers to switch away from the interim retailer.

### **Question 3: If the levy were added to Wholesale Charges, do you think this should be a flat fee or a variable fee based on consumption? What would be the advantages and disadvantages of each, and do you think there are any potential unintended consequences of this approach?**

While we do not think adding the levy to wholesale charges is the approach that should be taken forward, we believe the charge on NHH customers should be set at a fixed level for each consumption banding, with the information in CMOS used to determine these bandings. We think this would be fairer

than a flat fee across all NHH customers - which would disproportionately burden the large number of low usage customers in the market - but less complex than a fully variable charge.

**Question 4: What are your views on the impacts of our proposed approach on the legal and regulatory framework (i.e., interactions with the price control) and what potential changes do you think would need to be made?**

We recommend that Ofwat ensures that the additional levy applied by retailers is outside of the price caps set within the Retail Exit Code (REC), so that they can be fully recovered from customers subject to the REC price caps.

It is likely that changes to the market codes will be required if MOSL is involved in the collection and distribution of a new ISA fund. However, the implications of requiring code change(s) are, we believe, more manageable than if the solution were to require a CMOS change.

**Question 5: What are your views on the options for the cost recovery mechanism?**

MOSL generally supports an ex-post levy approach. However, we believe recovering costs through the Central Market Operating System (CMOS) settlement arrangements would be a complex process requiring timely and expensive CMOS changes. There would also be significant challenges associated with calculating and recalculating these payments for each settlement run. To avoid this, we propose an interim supply levy outside of settlement for MOSL to recover costs directly from retailers. MOSL would calculate the charge to be applied by retailers to customers. Retailers would pay this to MOSL and in turn collect such charges through an additional item on customer bills. We are happy to provide more detail following the consultation on how we think this could work.

We also have some concerns around the risk of retailers not being able to raise finance to take on customers, either at all, or on a timely basis that would avoid long delays in the allocation of customers. We encourage Ofwat to further consider mechanisms to defer wholesale charges alongside the ex-post recovery of an interim supply levy from retailers mentioned above. This could involve interest on deferred charges being funded by the levy. We recognise that Ofwat needs to assess the balance of credit risks between wholesalers and retailers but note that a failure of retailers to 'opt-in' would have a substantial impact on wholesalers.

We note that there will also be a financing challenge for the incoming retailers given the potential lag between incurred costs and recovery as we expect the claim, decision and reclaim process could take a year or two – we feel that minimising this lag as far as possible needs to be prioritised.

We note that a high-level of uncertainty for retailers about the criteria Ofwat would use to assess whether costs were efficiently incurred could deter retailers from opting in. Increasing clarity on the principles that will be applied in such an assessment and the methodologies that could be used, even if this is for certain cost types, could help improve the likelihood retailers opting in.

**Question 6: Do you agree with our assessment of each option against the aims and criteria set out in chapter 3? If not, please explain why.**

While we considered the potential benefits of an ex-ante levy, on balance we agree there would be challenges in terms of determining how big the fund should be and a risk of customers paying into a fund that may never be needed.

**Question 7: Are there any additional factors that need to be considered that we have missed? Do you have any other suggestions?**

It's important that the impacts on CMOS and the settlement process are taken into account in the proposed solution. We have concerns that the current proposals could add additional complexity and cost to a process that has already been identified as burdensome and in need of simplification.

**Question 9 – Should there be a minimum time period before a claim could be submitted, and what should the maximum time limit be for submitting a claim?**

As highlighted in our answer to question 5, we have some concerns about the impact on the incoming retailers' finances given the potential lag between incurred costs and recovery. We believe it would be helpful to at least set a maximum time limit for submitting a claim to provide certainty but believe retailers are better placed to advise on what an appropriate timeframe would be.

**Question 10 – What costs do you think should, or should not, be claimable and what evidence should be provided to show that these costs have been efficiently incurred?**

We believe retailers are best placed to answer this question. However, clarity on what costs are allowed and the tests that will be applied by Ofwat to determine whether costs are incurred efficiently will be crucial to provide retailers with the confidence to opt into the process.

We assume Ofwat will need to try and benchmark a level of costs it deems to be efficient for a particular type of cost incurred e.g. onboarding costs. We believe this assessment would need to be tailored by the sizes/types of customers being transferred.

The mechanism may also need to consider any costs incurred to allow MOSL to take on any role in holding and passing on funds. It could be these charges are recovered through an increase in Market Operator (MO) charges but these costs still need to be factored into Ofwat's thinking as they form part of MOSL's annual business plan which is approved annually by wholesalers and retailers.

**Question 12 - What are your views on the introduction of a materiality threshold? If you agree, how should it be set – for example, as a proportion of the Retailer's turnover to acknowledge size differences, or as an absolute amount? Please explain your answer.**

If introduced, the level any threshold is set would need to be set carefully to acknowledge the size differences between retailers and the level of incurred costs that would therefore have a material impact on affected retailers' financial viability. We are aware of new entrant retailers in the market that have encountered cashflow challenges as a result of their high rate of growth. Any threshold would also need to account for the number of, and different types of customers transferred.

**Question 13 – Do you think Ofwat should consult on any claim submitted under this mechanism?**

We believe having clear guidance up front on how claims will be assessed, and then clear guidance on how claims have been assessed against principles could avoid the need to consult. However, we see the ability for retailers and other parties to challenge where they don't believe these steps have been fully followed by Ofwat as an important part of the ISA process.

**Question 14 – Should only one claim be made/allowed?**

A one claim restriction would make the process of recovering the associated costs more complex. However, there are downsides with this approach. We believe this needs to be linked with the final decisions on the timeframe(s) permitted to make a claim.

It is possible to foresee a situation where a retailer needs to make a claim shortly after taking over customers under the ISA process but at that stage the full costs may not be known / able to be fully recovered. A one claim restriction could force a retailer to go early to recover some of the incurred costs in order to ensure financial viability in the knowledge it would disallow them from claiming costs incurred later.

**Question 17: Can you foresee any unintended consequences of introducing a cost recovery mechanism for Interim Retailers? If yes, please explain your concerns.**

Ofwat's preferred proposal that intends to use the settlement mechanism to gather the levy would pose different issues depending on how it's implemented:

- If it is a CMOS change affecting all wholesale charges it would affect all planned and unplanned settlements, potentially harming customer refunds from Unplanned Settlement Runs (USRs) and causing additional charges to retailers for accounts now closed (deregistered, transferred) which they could not recover. The CMOS changes required to collect the levy via the settlement process would be time-consuming, complex and costly. We, therefore, advocate an interim supply levy approach recovered by MOSL direct from retailers as set out in previous answers.

- If it is a tariff or service component change in CMOS, there would be significant work required from wholesalers to implement these changes (both at the start and end of the process) as well as audit/checks required to ensure that these have been implemented correctly. A change to the tariffs of all wholesalers would be complex and could create new inefficiencies in the market.

Additionally, communication with customers is important, as this would be a market mechanism rather than a choice for specific retailers to impose a levy. This could help mitigate the risk of an increase in complaints on the back of the new interim supply process.