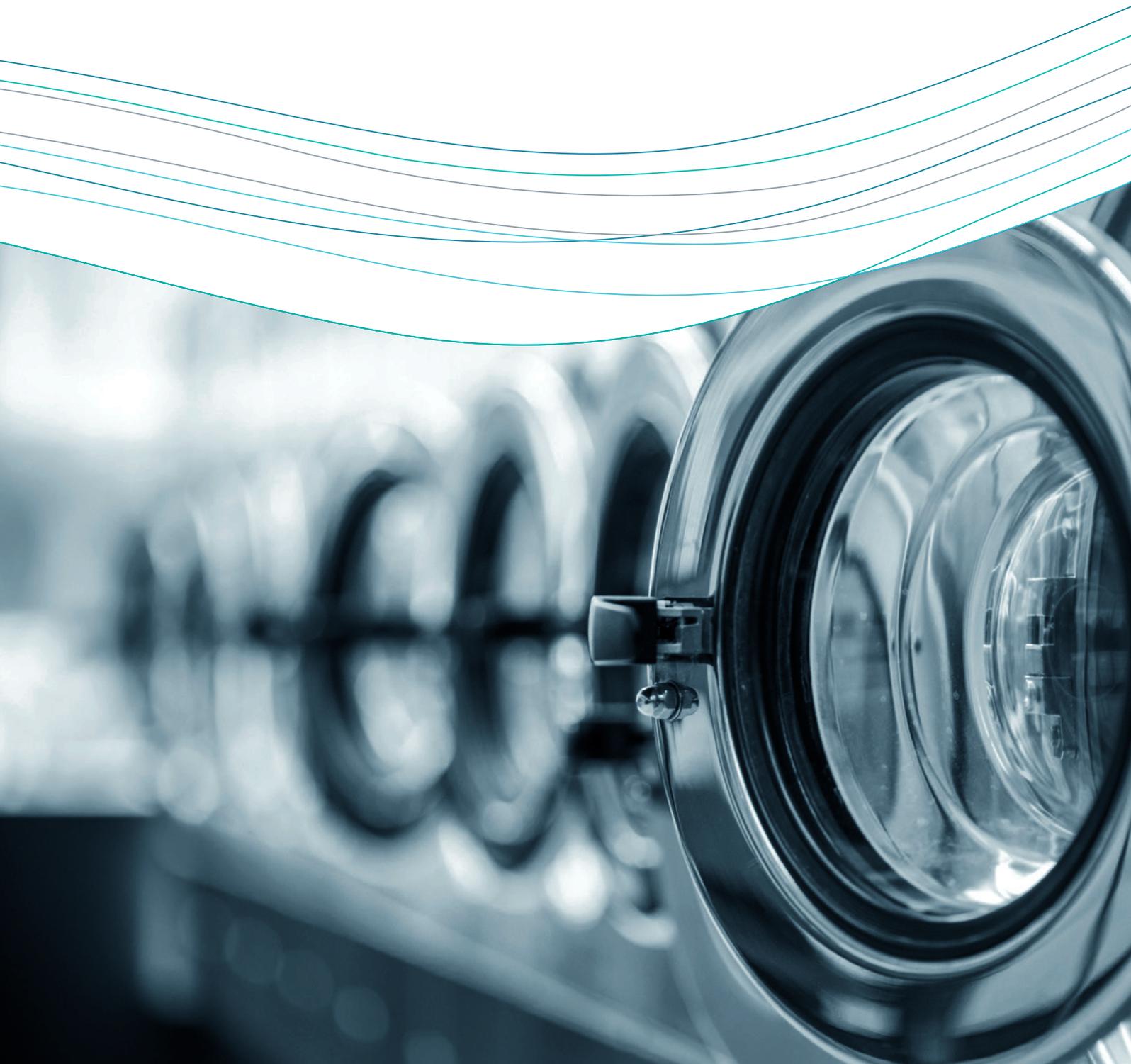


CEO Quarterly Market Review
Q1 2017/18



Q1 2017/18 in numbers



25
wholesalers

35
retailers
in the market



1 self-supply retailer

22 national retailers

12 regional retailers

2.6m
supply points

1.5m
transactions¹



over
36,000
services switched



11 code changes
considered by the Panel

2
approved

0
disputes

Financial settlement of around



9 planned
settlement runs

6 corrective
settlement runs

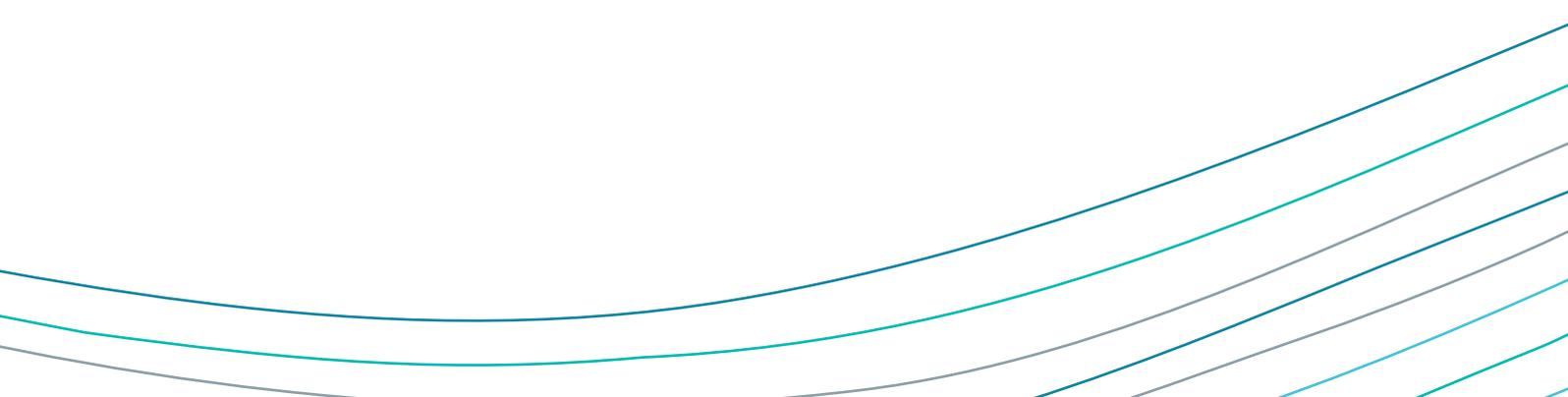
cost of
£3.25m
to operate the market
for the quarter²

¹ Transactions relate to all interactions by trading parties with the central system (CMOS), e.g. switches, meter readings, etc.

² Market Operator charges for Q1 2017/18.

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Foreword



As Chief Executive Officer of Market Operator Services Limited (MOSL) I am delighted to present our first Quarterly Market Review, following the opening of the non-household retail water market on 1 April 2017.

The new market is the largest of its kind anywhere in the world and 1.2 million business customers, from the smallest charities to the largest public authorities, are now able to shop around for the best deal.

During the preparations to open the new market, MOSL's primary responsibilities were to design, build and implement the central IT systems at the heart of the new market and to support the finalisation of the market codes by the Interim Code Panel. MOSL also played an important role in supporting water companies to ensure that they were all ready at the same time so that the market could open.

Having successfully achieved this, we at MOSL have taken up our responsibilities as market operator, providing the governance, infrastructure and information to enable the water market to operate and evolve for the benefit of non-household customers.

It is still early days in this nascent market. Nonetheless, we have seen some encouraging developments. Three months into the new market we have 35 retailers – national, regional and self-supply – including 10 new entrants. More than 36,000 water or wastewater services have been switched, and we have seen customers of all sizes taking advantage of the opportunity to switch supplier. This number does not include new contracts negotiated between customers and their existing suppliers.

Good progress has been made on the governance arrangements, and trading parties have already been using these arrangements to affect positive change in the market. The Panel is now fully appointed and has been extremely busy considering potential improvements to the market codes. May and June played host to the first of the Panel committee meetings, with the Market Performance Committee, Trading Disputes Committee and the General Data Protection Regulation Issues Committee commencing their work in earnest. I would like to thank all trading parties for their continued involvement in these committees, the working groups and for their responses to the 9 change consultations.

From a systems perspective, we completed two system enhancements to the Central Market Operating System (CMOS) which, taken together, have fixed 85% of the system defects that existed at market opening. The team continues to work to enhance and improve the central systems and are focused on preparing for CMOS version 3.0, which is due for release in October 2017.

Of course the first quarter has not been without its challenges, as to be expected during these early months of 'bedding in' the new market. One important challenge is that of data quality. Improving data quality is critical to smooth market operations and to providing real-time performance data to our water company members. We will continue to work with the market to identify, prioritise and resolve data issues to the benefit of the end customer.

“ IT IS STILL EARLY DAYS IN THIS NASCENT MARKET. NONETHELESS, WE HAVE SEEN SOME ENCOURAGING DEVELOPMENTS ”

The first quarter of the new market has also seen some big leadership changes at MOSL. I joined MOSL as Chief Executive in mid-June and have had a busy yet enjoyable first month meeting with several trading party CEOs and other key stakeholders who have shared their perspective on the market and industry landscape. These meetings are a personal priority for me. For those of you whom I have not yet had the opportunity to meet in person, I look forward to doing so in the coming weeks and months.

Our former Chair Andrew Pinder sadly passed away in April following a period of ill health. Margaret Beels took up the role of Acting Chair in March until such time as a permanent appointment could be made. On 25 July, following a competitive recruitment process, we announced the appointment of Jim Keohane as Chair. Jim will assume his responsibilities from 1 September this year. Margaret will continue to serve as an independent non-executive director on the MOSL Board and will continue to chair the Codes Panel until the end of the year. We have also started the election process for our non-executive industry directors. This process is expected to be completed by the end of August 2017.

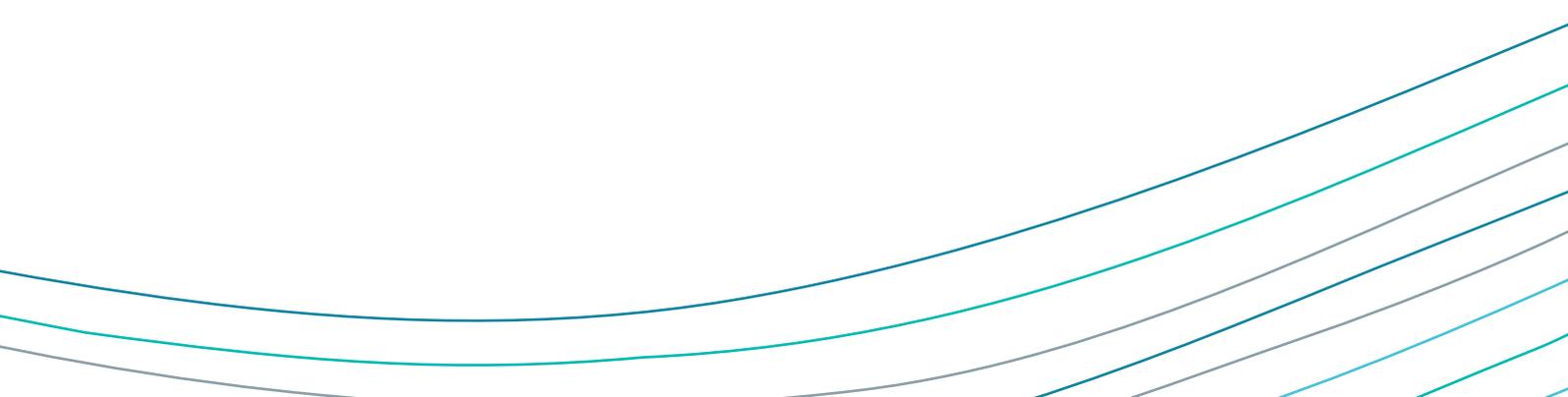
We are turning our attention to the future needs and expectations of our members and the wider market in respect of our role as market operator. In June, I wrote to member company CEOs to inform them that MOSL will be undertaking a strategic review. I will be reaching out to members and stakeholders shortly to gather views on MOSL's role and will continue to seek input through the business planning cycle that will result in the MOSL Board recommending a business plan and budget for 2018/19 to members in December 2017.

I am looking forward to continuing to work together to ensure the ongoing success of the new market. In the meantime, I hope you find our first Quarterly Market Review useful.



Chris Scoggins

Chief Executive Officer,
Market Operator Services Limited (MOSL)



Review of the first quarter

The market landscape

Prior to the opening of the non-household retail water market, there were 25 regional providers of wholesale and retail services in England. Only the largest consumers (those using more than 5 megalitres of water per year), representing less than one percent of business customers, could choose from an additional 12 licenced retailers.

These pre-existing providers have adopted a diverse range of retail strategies in the run up to market opening on 1 April 2017 with some starting to compete nationally, some continuing to operate regionally, and others choosing to exit the market altogether. We have also seen 10 new retailers enter the market.

At the end of the first quarter, there were 25 wholesalers and 35 retailers in the market, of which 22 are national, 12 are regional and 1 is a self-supply retailer.

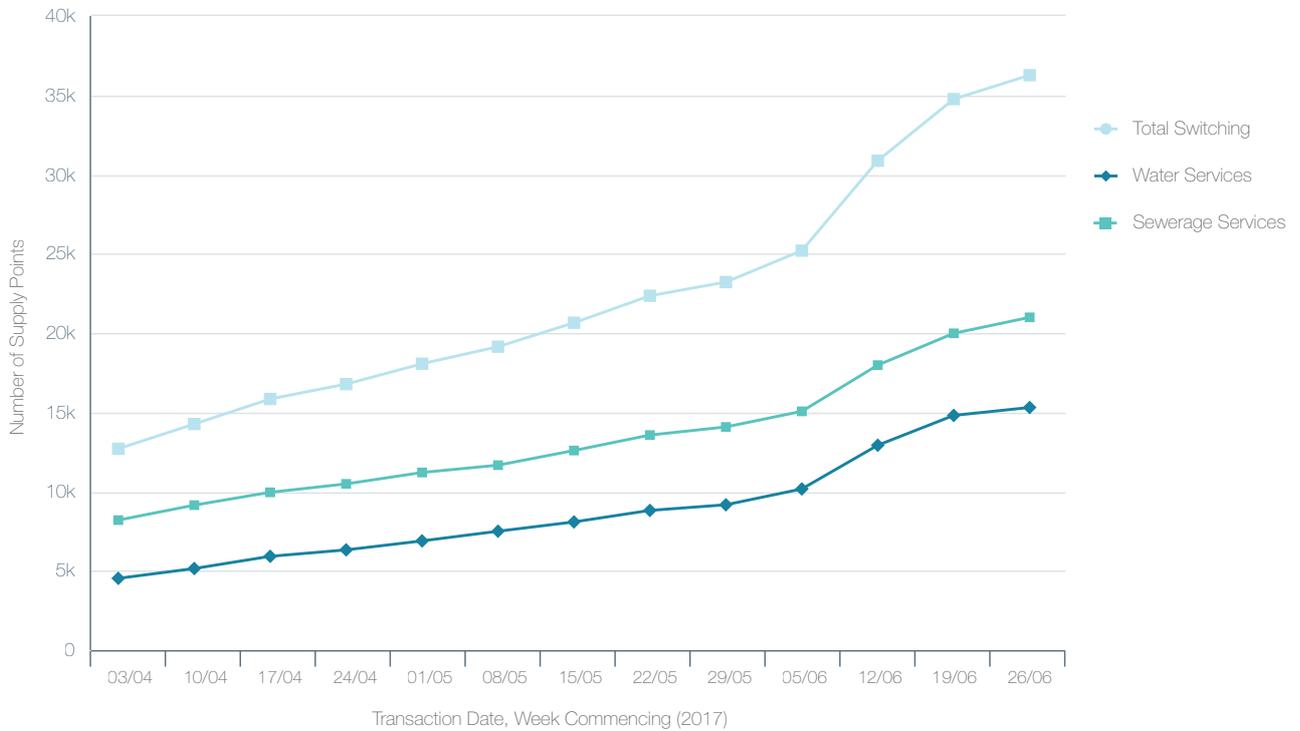
We expect the market landscape and the strategies of retailers to continue to evolve as the market matures.

Switching

36,301 supply point switches were processed during the first quarter, with over 10,000 of these occurring on the first day of the live market. This represents 1.4% of the 2.6 million supply points in the market. Of the total number of switches that have taken place so far, around 35% more have been for sewerage than water supply, largely due to previously water-only retailers acquiring the associated sewerage service for the supply point.

Cumulative Switching of Service

As at 30 June



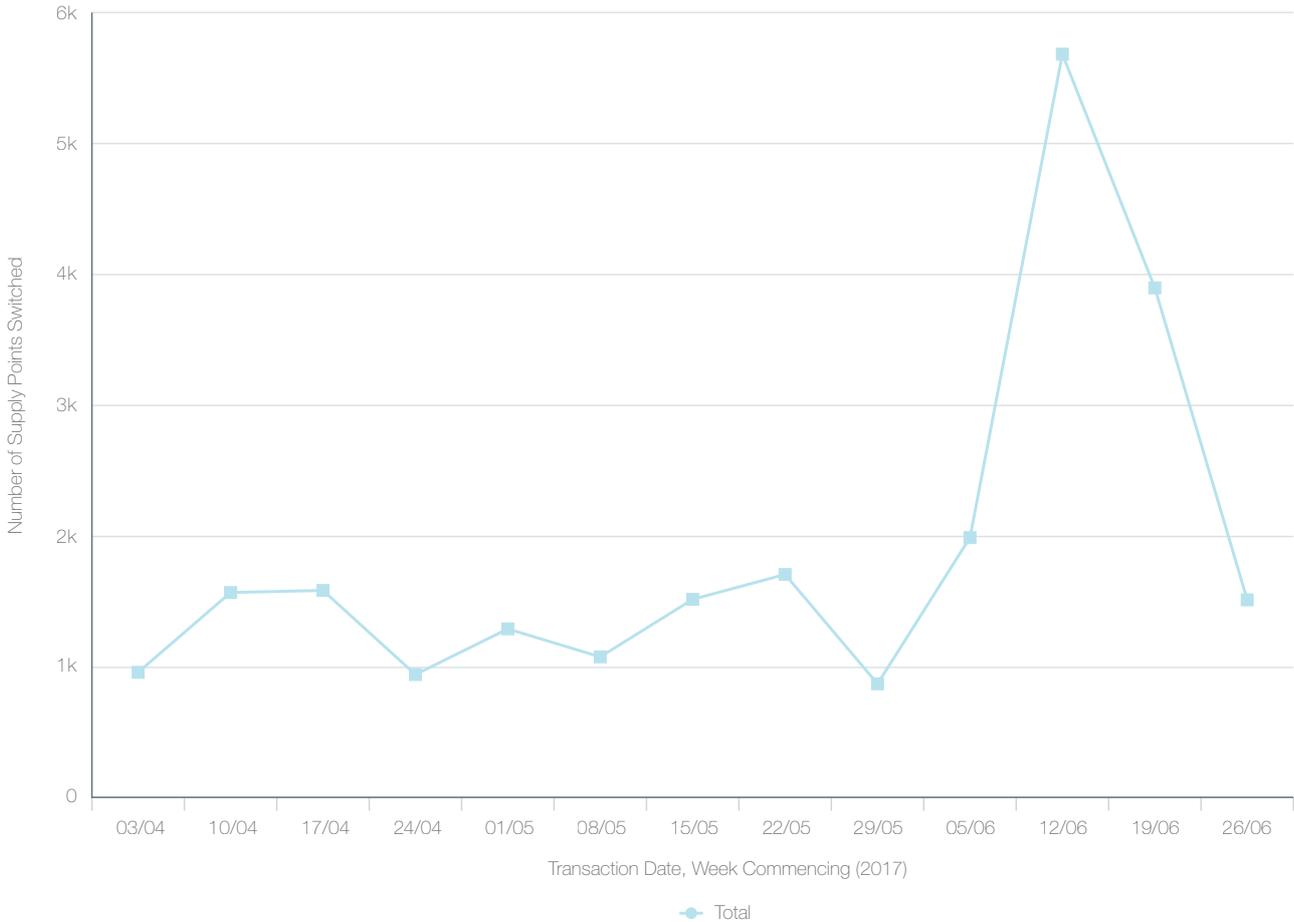
36,301 SUPPLY POINT SWITCHES WERE PROCESSED DURING THE FIRST QUARTER, WITH 95% OF ALL SWITCHES EITHER COMBINING OR KEEPING BOTH WATER AND SEWERAGE SERVICES WITH ONE RETAILER

The rate of switching has fluctuated between 1,000 to 2,000 switches a week, excluding the pre-processed switching that took place on the first day of the market.

There have been a couple of significant spikes in switching levels during June. This was due to switching of several large multi-site customers.

Weekly Switching Rate

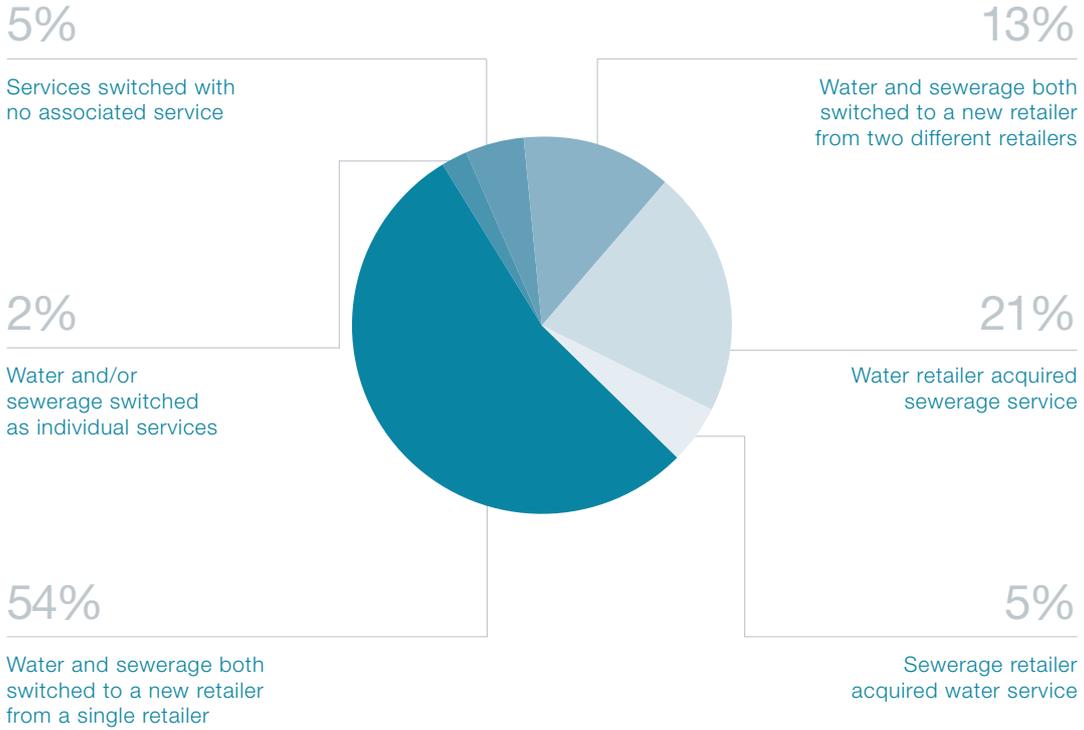
As at 30 June



Note: This does not include supply points which were processed in advance of market opening

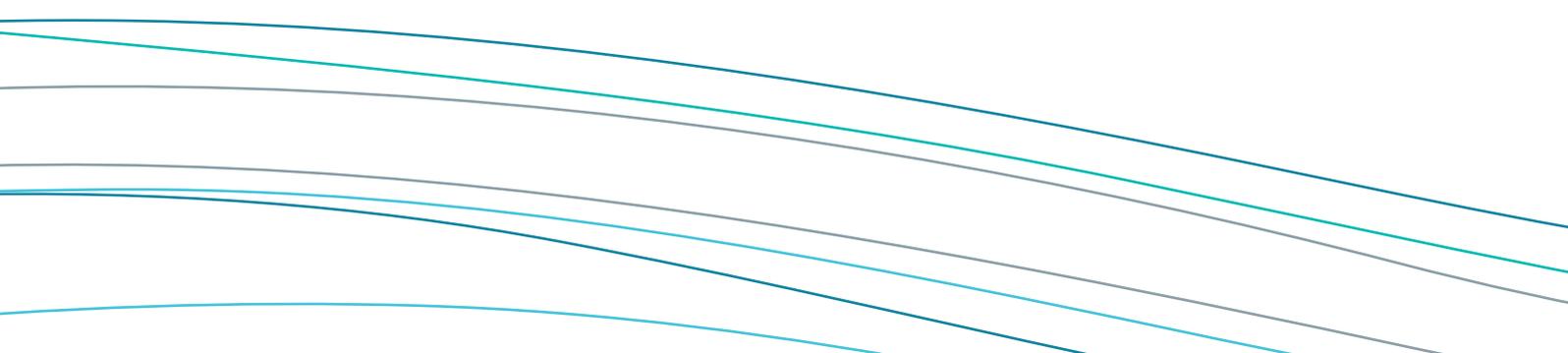
Switching behaviours

As at 30 June



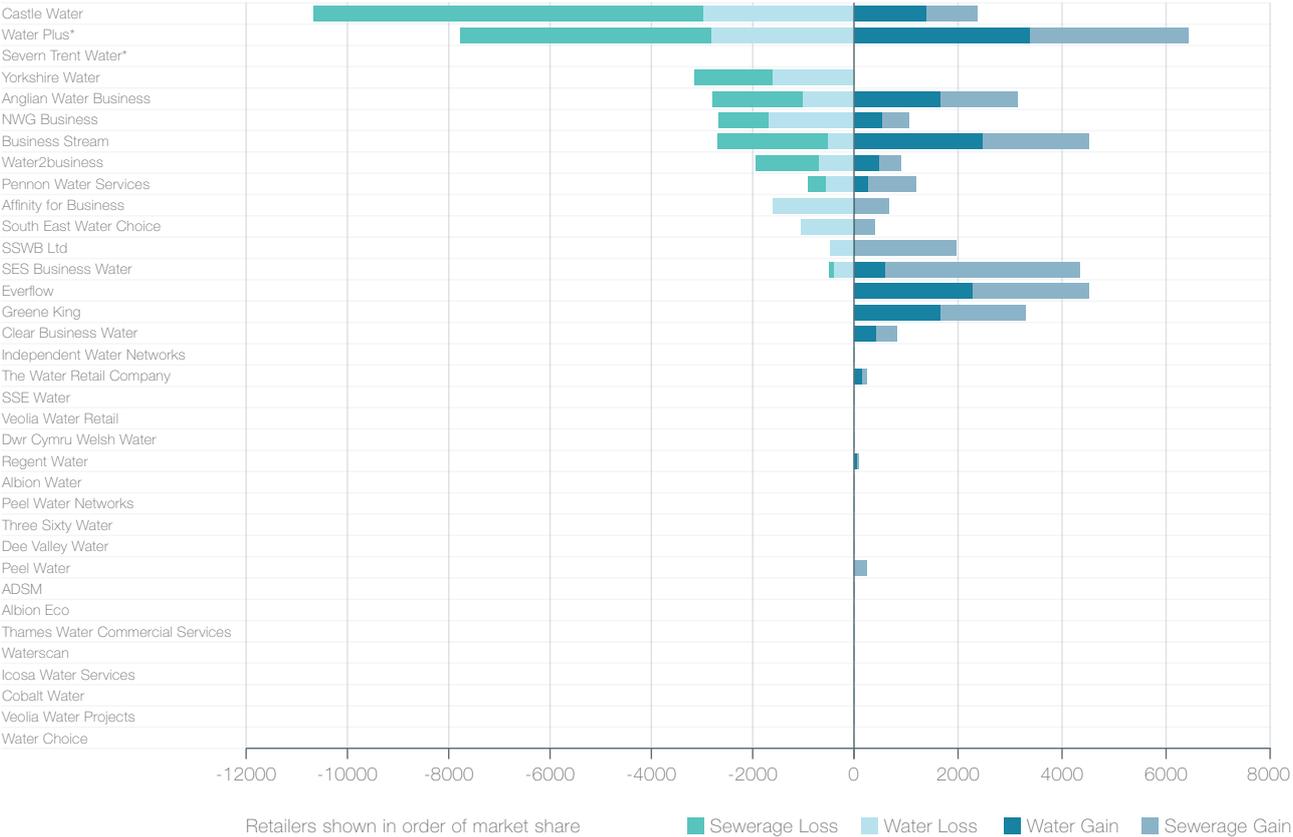
The data from the first quarter since market opening suggests a preference by customers to have one retailer for both their water and wastewater services with 95% of all switches either combining or keeping both services with one retailer.

Only 2% of switching has resulted in water and wastewater services being served by two separate retailers.



Retailer gains and losses

As at 30 June

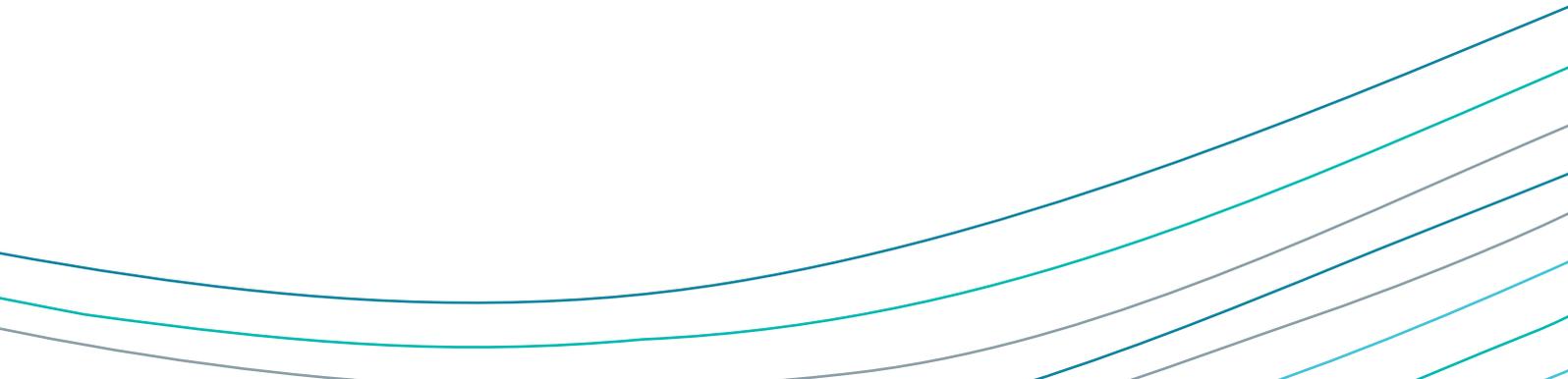


*Note: Gains and losses logged against Severn Trent Water have been shown against Water Plus. Severn Trent Water intend to exit the market.

New entrant retailers have been active in the early stages of the market, gaining over 15,000 supply points over the first three months.

A minority of retailers are yet to gain or lose a supply point.

The largest retailers in the market have seen both gains and losses although on average these do not exceed more than 2% of their market share.



Consumption profiles

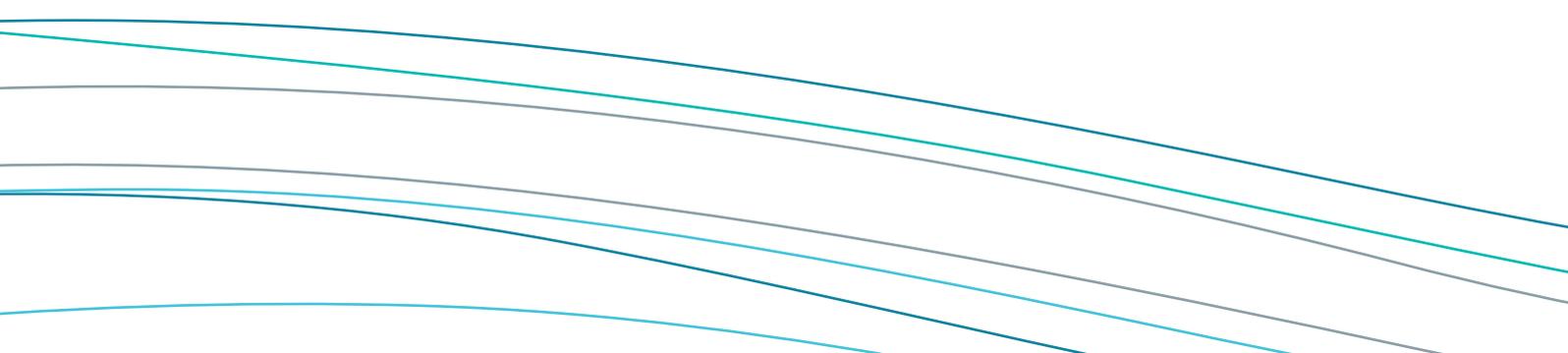
MOSL monitors switching activity according to water consumption per supply point.

There are 9 consumption profiles:

Consumption Profile	Threshold - Water Consumption Per Supply Point, Litres Per Day (l/d)		Trade Effluent	Customer Example	% of Total Switching Activity ¹
M1	less than 100 l/d	💧	No	Church, local shop	15%
M2	100 l/d to 1,000 l/d	💧💧	No	Pub, hairdresser	42%
M3	100 l/d to 1,000 l/d	💧💧	Yes	Residential building site, local garage	1%
M4	1,000 l/d to 3,500 l/d	💧💧💧	No	Hotel, warehouse	18%
M5	1,000 l/d to 3,500 l/d	💧💧💧	Yes	Farm, mine	1%
M6	3,500 l/d to 13,700 l/d	💧💧💧💧	No	Supermarket, university	17%
M7	3,500 l/d to 13,700 l/d	💧💧💧💧	Yes	Chemical factory, brewery	1%
M8	greater than 13,700 l/d	💧💧💧💧💧	No	Airport, power plant	5%
M9	greater than 13,700 l/d	💧💧💧💧💧	Yes	Oil refinery, port	1%

¹ As at 30 June

AROUND 21,000 OF THE SWITCHES HAVE BEEN OF SUPPLY POINTS USING LESS THAN 1,000 LITRES A DAY, REPRESENTING 58% OF TOTAL SWITCHING ACTIVITY IN THE QUARTER



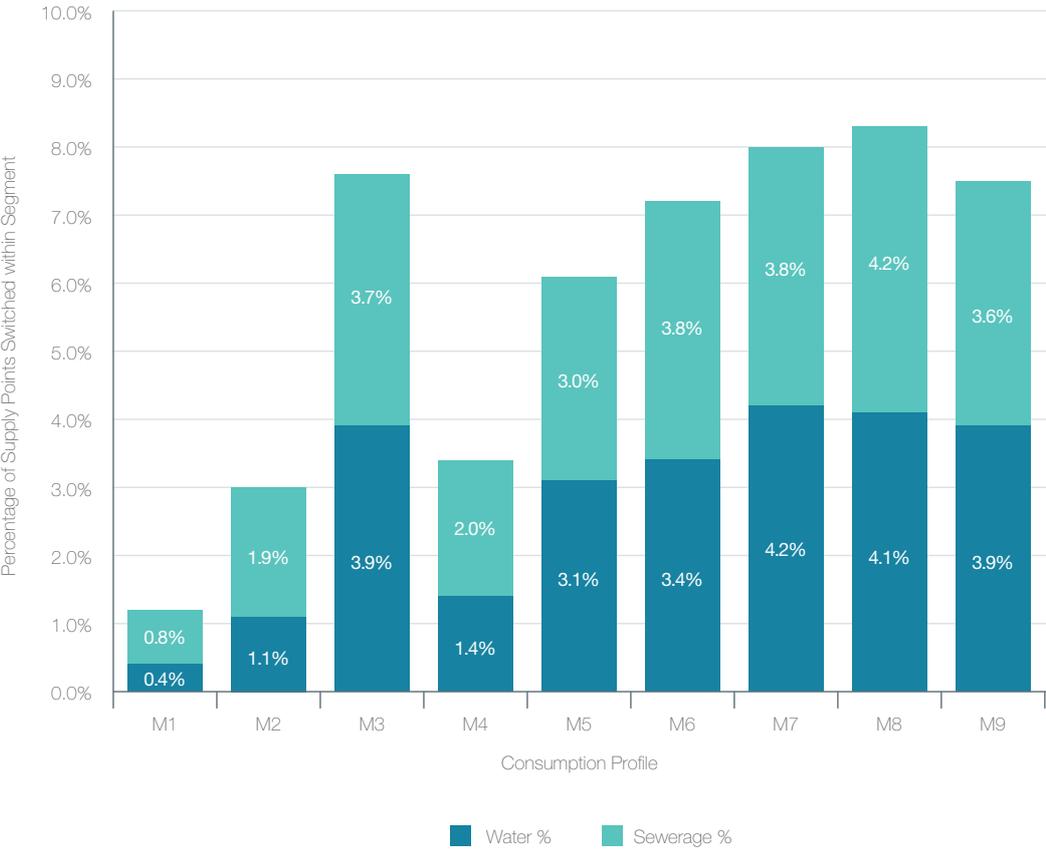
Switching has taken place across all consumption profiles. Around 21,000 of the switches have been of supply points using less than 1,000 litres a day, representing 58% of total switching activity in the quarter.

There is also a higher proportion of switching for those supply points with trade effluent compared to those without trade effluent, within the same consumption band.

Nevertheless, it is the largest consumers that have had the higher propensity to switch. 4% of supply points using over 13,700 litres a day (5 million litres a year) have switched compared to 1% of those using less than 1,000 litres.

Proportion of Supply Points switched within segment

Total Supply Points as at 30 June: 36,301



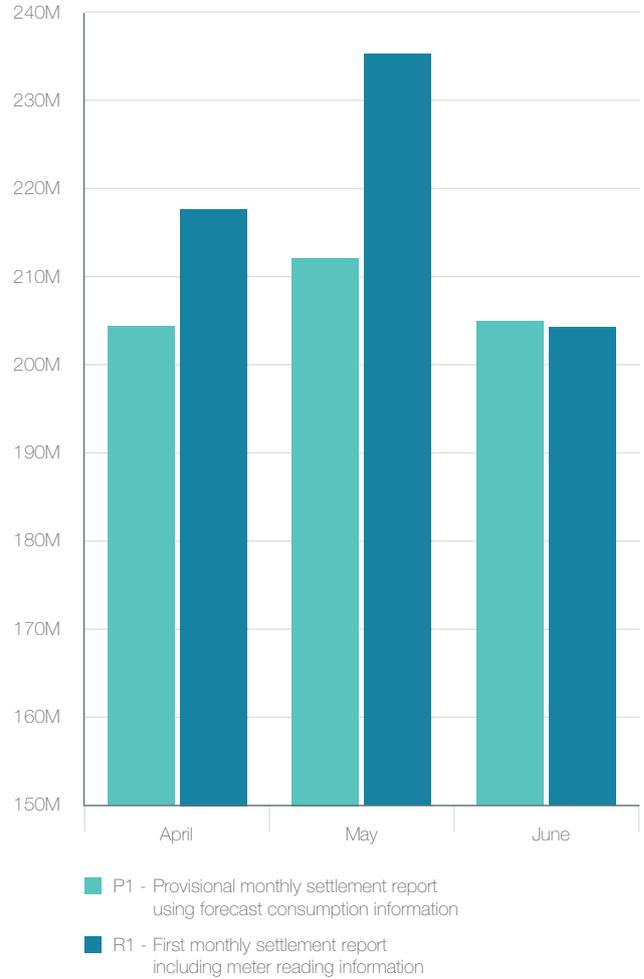
Settlement

Around £215 million is settled each month between retailers and wholesalers.

During the quarter, the vast majority of supply points settled correctly. There have been some instances of a variance in the overall value of settlement which have arisen from errors when trading parties have entered data into the central system.

At the end of the quarter, 3% of supply points had missing data required for the calculation of settlement, meaning that whilst this is an area where we have seen progress over the quarter, there is still more to do.

Aggregate value of settlement



Note: May R1 includes a corrective settlement run

Market change

MOSL and the market continue to focus on improving and simplifying the market codes. During the quarter, two change proposals were recommended by the Panel and approved by the market regulator, Ofwat. These changes were implemented on 3 July in the first new code release following market opening.

The Panel considered 11 change proposals during the quarter, of which 6 were raised by trading parties. Whilst these changes have covered a broad range of topics, 2 have related to clarification of the credit terms between retailers and wholesalers.

This has been an area of emerging issues during the quarter and will require further attention from the market going forwards. Of the 5 change proposals which MOSL has raised, 4 have been to clarify the technical aspects of the market codes relating to the interface design.

A key area of potential change relates to data protection provisions within the market codes. The Panel has established an additional committee to ensure that the codes are aligned with the new upcoming General Data Protection Regulation which comes into effect in May 2018.



Looking forward

Market performance

We will continue to manage services, including settlement, to ensure that trading parties can enter, exit and trade in the market.

One key area of focus for us moving forward is increased transparency in the market.

Effective markets rely on accurate and timely information being available. To enable effective competition we will start to publish market performance information publicly, unless it is confidential or could be misleading. The focus over the next quarter will be on the core market services of settlement, switching and data quality.

The Market Performance Committee is currently undertaking its review of the market performance standards and operational performance standards under the market code, which trading parties will be consulted on in October 2017. This provides the opportunity to ensure that the performance standards are simple, transparent and proportionate for the market.

We will be publishing information on our own performance against our obligations and, as with trading party performance, this will be made publicly available. The information on our performance will focus on the services that we provide to the market and include a combination of service-level agreement (SLA) based reporting and reporting by exception.



User forum

The User Forum will be established during the summer and will meet for the first time in September. This monthly meeting will provide a forum for trading parties to consider market operations and discuss any potential issues. The User Forum will be chaired by MOSL and will be the primary forum for engagement with the market as a whole.

Code changes and emerging issues

We are committed to reducing barriers to entry and exit, and to facilitating innovation in the market. We will be working with trading parties, Ofwat and the Department for Environment, Food and Rural Affairs (Defra) to identify opportunities to simplify the market arrangements and the framework that governs them.

Areas of focus for the coming months are likely to include self-supply, code governance, trade effluent and credit terms. The Panel has also requested that MOSL gives consideration to the suspended provisions around new connections in Part A of the Operational Terms (Developer Services) before these provisions become effective in October 2018.

Ofwat has indicated that it will further consider credit provisions via a workshop with trading parties in the autumn. We will liaise with Ofwat and trading parties to support this review.

Business Plan for 2018/19

As part of our strategic review, we will consult with members on our plans for the next two to five years. The views of members will be used to shape our Business Plan for 2018/19. This plan, along with the budget, will be presented to members for approval at a general meeting in December 2017.

CMOS 3.0

In October 2017, we will release CMOS version 3.0. This new release will implement 15 CMOS-affecting code changes and provide further defect fixes. The changes that are to be implemented will provide new functionality, improve existing functionality and align CMOS with Ofwat guidance.

Market audit

The market audit is being carried out by PwC, who will publish an initial report on the market in November 2017. PwC will provide early sight of its findings from the risk assessments and site visits which it will conduct over the next few months. It will also provide its view on MOSL's compliance including in the operation of settlement.

WE ARE COMMITTED TO REDUCING BARRIERS
TO ENTRY AND EXIT, AND TO FACILITATING
INNOVATION IN THE MARKET



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