MEUC Conference: Competition comes to Scotland

London 13/2/2008

water industry commission FOR SCOTLAND

Transcript of speech given by

Alan Sutherland, Chief Executive, Water Industry Commission for Scotland
at the MEUC Event, Glasgow on the 7 February and London on the 13 February

Introduction

Not so long ago, I did not look forward to talking to businesses about the level of service they received from the water industry in Scotland or the price that they were being asked to pay. But, as they say, that was then and this is now.

To-day, I am very happy to talk to you about probably the most significant change in the water industry in Great Britain for some 20 years. Perhaps it is the most significant change ever to affect the industry in Scotland.

Real choice...Competition is coming to the water and sewerage industry in Scotland. Competition in the Scottish water industry will help ensure that customers see further significant improvements in value for money. In the Scottish framework, the rules of the game, the level of prices are all clear and published. They do not depend upon negotiation between a new entrant and the incumbent.

Organisations in Scotland will be the first, anywhere in the world, to have such a genuine opportunity to choose their water and sewerage supplier. Competition is also likely to bring innovation.

On 1 April this year, all organisations in Scotland from the smallest newsagent in the Western Isles to the largest industrial sites; from small council offices to leisure centres and hospitals will be able to choose who supplies their water and sewerage services. And before anyone raises it, this is no April Fool's Day joke. It is a further small step in helping improve the competitiveness of businesses operating in Scotland.

But you will only get best value for money by actively considering the price and service package that are most appropriate to your organisations. Competition does require customers to make decisions- there is no more "one size fits all".

I want to spend the next few minutes explaining some of the benefits that will be available to businesses in Scotland. I will then be happy to answer any of your questions.

Background

The introduction of competition should build on the step function improvement in Scottish Water's performance over the last several years. We recently published our assessment of that improvement. In summary the average household is about £90 better off than they would otherwise have been. Levels of customer service, environmental and public health performance have also improved markedly.

However, there is no room for any complacency.

Firstly, Scottish Water is charged with delivering the largest investment programme (on a per connected property basis) in the United Kingdom.

Second, Scottish Water still has scope to reduce its costs and improve its level of service. There is still a gap between its performance and that of the best companies in England and Wales.

Competition is likely to help narrow this performance gap more quickly.

Current prices....Future prospects

Scottish Water's improved performance over the least 6 years is already being felt in bills. Non-household customers' bills will increase annually (on average) by 1.5% less than retail price inflation until 2010. The Commission will announce wholesale prices for the period after 2010 late next year. However we expect that customers will continue to benefit from a very benign pricing environment.

But, I must sound one word of caution. Trade effluent customers will see increases in their bills. The extent of any increase will be greater for those organisations, which are currently paying less than the published tariff. We consulted on these adjustments at the end of 2006. And, before anyone suggests differently, these increases would have happened even if we had not given businesses the right to choose their supplier. Indeed, the likely increases would have actually been even greater.

The flip side is that customers who do not use trade effluent services can look forward to relatively lower bills. Their bills will increase less quickly than the RPI-1.5% cap set by the Commission and may even reduce.

How does this new market work?

Since 2002, Scottish Water has provided water and sewerage services to all customers in Scotland. Under the new arrangements, Scottish Water will continue to provide services to its 2.1million household customers. It will also retain control of Scotland's publicly owned network of pipes, sewers and treatment works.

The market will operate in much the same way as in other utility services (although it is worth noting that wholesale charges will be regulated and hence there will not be the volatility in retail prices that have recently characterised the energy markets). The new suppliers will buy wholesale services, (the physical supply of water and removal of sewage) from Scottish Water.

A new organisation- the Central Market Agency- will administer the market codes, calculate wholesale bills and register switches of supplier by customer. I am reliably informed by the Service Provider that they are confident that they can cope with several thousand switches per day- if, of course, that is what customers decide to do.

You may already have noticed a change in your bills. This is because we required Scottish Water to create a separate organisation to supply retail services to non-household customers. Scottish Water established Business Stream during 2006 and it is now supplying all of Scottish Water's non-household customers. Perhaps they have explained the changes in the Scottish water market to you. But we must emphasise that, in the future, Business Stream will have to compete on an equal footing with the other licensed suppliers.

So far, we have licensed two other suppliers: Aquavitae and Satec. Others will follow. The Commission is aware of interest from other potential entrants ranging from the small to the very large. I expect that we will have an important announcement to make in the very near future.

In the run up to 1 April 2008, licensed suppliers may approach you for your custom. Should you wish to transfer to one of these licensed suppliers during this period, you can do so, with the agreement taking effect when the market opens in April.

We are confident that this competition for your business should ensure you get the very best service and price deal possible. And, if by any chance, you do not find what you are looking for from one of the licensed suppliers, you could consider taking up a self-supply licence. A self-supply licence would allow you to buy at wholesale prices from Scottish Water, but you would forego any of the convenience and services provided by the retailers.

If the retail activity is separated, it is more likely that customers will receive appropriate advice on water efficiency. In a competitive market, the retailer will not be concerned by the wholesaler's level of capacity utilisation (even if they are under the same ownership). A company under the same ownership as the local infrastructure company cannot afford to worry because, quite simply, other retailers will not.....

What will this mean for you?

As I have already said, this is an end to the "one size fits all" approach. For example, I am aware of some customers, operating complex sites, who can receive several hundred bills a year. Not only does that make it difficult for the customer to understand whether it is using water in an efficient and environmentally friendly way, but each of these bills needs to be processed with all the resulting overhead.

Consolidated billing whether for single sites with complex water supply arrangements or for organisations with very large estates could result in savings on the current level of bills and in much reduced administration costs.

For small businesses, there may be the prospect of a future single utility bill, covering electricity, gas, water and sewerage. Some of the other value added service offered by utilities (such as emergency assistance, boiler and pipe repairs) may also be coordinated, improving the value for money offered to customers.

For other larger customers, there may be an opportunity to agree an improved and tailored service that could be substantially cheaper. There is provision in law that new suppliers and their customers will benefit if they help Scottish Water to reduce its costs. Discounts may be available to organisations that can plan their water use or waste disposal (for example by restricting their use of water at certain times of day); there may also be opportunities for developers to work with Scottish Water and realise benefits.

This is an important opportunity as it increases the area of activity and level of potentially contestable costs very significantly. The potential is limited only by the scope for the customer to reduce Scottish Water's costs. Another example could be where a customer has access to water in an area where abstraction restrictions apply.

The Commission has taken steps to ensure that proposals to reduce Scottish Water's costs are dealt with as quickly and efficiently as possible. Scotland's new competition framework shares the reductions in Scottish Water's costs between those who identify the savings and all other customers (including households).

Safeguards for customers

And with all these potential benefits, let me be clear- no customer will be worse off as a result of the introduction of competition. The Commission has made it a license condition that all new retailers are obliged to offer a "default" level of service and tariff to any customer, anywhere in Scotland. There can be no question of smaller customers, or of those living in remote areas, being excluded from the benefits of choice. They too will be able to choose the supplier who best meets their needs.

Responding to the critics

There are those who say that the reductions in bills are not sufficiently large to be interesting. And, there are those who say that the benefits are insufficient to justify the upheaval. But is an incumbent monopoly ever likely immediately to welcome competition? Will they not always raise fears about the potential risks of introducing competition?

But to give credit to Scottish Water, it has moved quickly from expressing its doubts and worries to embracing the new potential on offer. This is good for customers and, moreover, it will contribute to the very benign outlook for prices over the next several years.

You can be assured that the Commission will ensure that the Scottish Water regulated wholesale business will be no higher than is absolutely necessary. And I repeat- they will not increase as a result of the introduction of competition.

I can actually go further. I am pleased to tell you that the initial evidence is that the industry's costs have already fallen as a result of its preparation to deal with the threat of competition. We will shortly publish the results of our analysis. It is interesting to note how Scottish Water's support for the new arrangements has grown as it has realised the savings to be made!

But let me now turn to the vexed subject of margins. Our approach to water and sewerage competition in Scotland is different from that in England and Wales. On average, the gross retail margin (the difference between the default retail tariffs and wholesale prices) is between 10 and 11 percent. It is at least 5% for all non-household customers in Scotland. This may be less than in the early days of energy competition - but we expect that further activities (currently in the wholesale business) will become contestable over the next several years.

But is the available margin sufficient? Are the potential reductions in price meaningful to a business customer?

Let us consider an average Scottish supermarket. A 2% saving in its water bill is equivalent to growing its annual revenue by 0.1%. Given recent announcements by the retail sector of same store sales growth, the equivalent of a tenth of a percent sales gain could be very useful. And this does not include any of the environmental and administrative cost benefits that could also accrue to the customer.

Supermarkets may also benefit from improved information about their use of water services. This could help them reduce their consumption (hence further lowering bills). No less important, reduced water use may contribute to the company's green credentials.

Supermarkets may also benefit from aggregated billing, which could contribute to reduced administration costs.

In our view, many businesses on tight budgets and/ or with large and/or complex water supplies may similarly benefit to the supermarket in this example. But the exciting thing about competition is that customers typically benefit in all manner of unexpected ways. And remember, we have ensured, with our requirement that suppliers offer "default tariffs" that no business can be worse off as a result of our introduction of competition to the water and sewerage industry in Scotland.

Looking forward, the Commission has required Scottish Water to provide detailed information about its costs and activities across its whole value chain. This information will be available in October. We expect that this will further increase the scope for competition in the Scottish water industry.

Conclusion

No more will business in Scotland be faced with the unenviable choice: the "take it or leave it service". They will be the first in the world to be able to exercise real choice about what they want from their supplier.

It will be for the customer to decide what level of service he wants and is prepared to pay for. The water industry in Scotland is making its own small contribution to improving the competitiveness of businesses in Scotland. I encourage you to consider your options.

I will now be happy to answer any questions.

13.02.08

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