

Building on success: the future for Scottish water

Introductory remarks

Good morning, Ladies and Gentlemen, it is a great pleasure to be here for what I am sure will be a very interesting and informative day.

Over the next 15 minutes or so, I am going to take stock of what has been achieved so far in the Scottish water industry and consider what the next developments and challenges will be for this public sector success story.

And I am going to leave time at the end of this short presentation to answer any questions you may have.

If I could start by looking back over the seven years since Scottish Water was formed from the three water authorities in 2002. It is no exaggeration to say that during that time, Scottish Water has been transformed from a financial basket case – where the company's value was less than its outstanding debt – to one of the most financially secure companies in the UK's water industry. We as economic regulator set tough efficiency targets for Scottish Water and it must be said that Scottish Water has risen to the challenge.

The achievements are much to the credit of Scottish Water's first Chief Executive, Jon Hargeaves' (now replaced by Richard Ackroyd), and to his management and employee team.

While this transformation has been taking place, it has also been possible to keep customers' bills below the rate of retail price inflation. And since 2002 Scottish Water has invested around £2.4 billion in improvements to drinking water quality, customer service and the environment. Perhaps three of Scottish Water's greatest achievements are the significant reductions it has made in its running costs, the way it is now tackling leakage, and the material improvements it has made in customer service (this last as measured by the OPA, the framework we use to score customer service).

In relation to customer service improvements, I should mention that an important factor has been the clearer understanding on the part of Scottish Water's employees of the impacts of their actions on service. Bonuses are now linked to performance and the latest position is prominently displayed in Scottish Water's buildings.

Opening up the market

When we came to set efficiency and customer service targets for Scottish Water we took as our benchmark what had been achieved by private water and sewerage companies south of the border. These comparisons were very helpful. However, our regulation of the Scottish water industry has not been simply to copy what had already happened south of the border. We wanted to use competition to benefit customers and so have exposed the relationship between the industry and the market by opening up the retail water and sewerage market to competition. Initially we met with deep scepticism from many stakeholders. But the changes that have been introduced are already bearing fruit.

Since April 2008, all business and public sector organisations have been able to choose their suppliers. And even though Scottish Water's subsidiary, Business Stream, started in a dominant position, around a third of customers have already renegotiated the terms of their supply or switched supplier – accessing either lower bills or more tailored customer service. Among the big name organisations to have switched supplier are Ladbrokes, Debenhams and the Belhaven pub chain.

It has been gratifying too to see that a number of licensed providers have already entered the market, and we expect further suppliers to come forward in the coming months.

It is also good to see that our seemingly pioneering ideas are becoming mainstream, and it is now likely that a similar framework for competition will be adopted south of the border.

Further developments

I will turn now to what I see are the likely future developments for the Scottish water industry. The Commission recently published its draft determination of charges for the period up to 2015. Published at a time of great economic uncertainty, the draft determination demonstrates the benefits of the hard work that has gone into improving Scotland's water industry: it proposes to cap the increase in non-household tariffs at 1.5% below the rate of retail price inflation each year.

The caps on prices are conditional on retail suppliers offering improved and more tailored services to their customers. Those customers who would not benefit from an improved level of service should expect to see their bills at even lower levels.

In the draft determination, we proposed to make three relatively small adjustments to the scope of activities for which the new water and sewerage retailers are responsible. These include: new connections; metering services and trade effluent advice.

New connections

A customer wanting a new connection should now approach the retailer of his choice. Under our proposal, these retailers would be able to offer a turnkey service and offer the developer the best value connection that is suitable to his needs. Developers would still receive a reasonable cost contribution from Scottish Water and would still have to meet the full costs of the connection.

In effect the transfer of responsibility to the retailer should ensure that there is a much more streamlined customer experience. It should also ensure that all options are thoroughly examined. This could, for example, lead to the final connection being made in a different place or potentially a more tailored solution, which could reduce the wholesale charges that are payable.

Metering services

Managing water use is becoming increasingly important to businesses that are keen to cut their costs and to demonstrate their green credentials to their customers. Many organisations have leaks on their sites which would be cheaper to fix than allowing leaking to continue. These can be most easily identified by measuring consumption at night or at weekends when there is no, or much reduced, on-site activity. Retailers can help customers identify savings by installing loggers on to meters. These allow consumption to be measured over the course of the day. There may also be an opportunity to install a better meter on a customer's site, which would make it easier to monitor water use.

Monitoring water use is important too because a substantial amount of the water that is used is heated. So saving water can reduce not only the water and sewerage bill but also the customer's energy bill and carbon footprint. This change in the responsibility of retailers should make it more likely that customers receive an appropriately tailored level of service.

Trade effluent advice

Under our proposals in the Draft Determination, trade effluent customers could expect their retailer to provide them with more advice about how to manage their discharge to sewers and help them find ways to reduce their bills. Customers would not have any reason to contact Scottish Water directly. Scottish Water would only approach them if it had reason to believe that the customer has not complied with its discharge consent and if Scottish Water hadn't been able to resolve the matter with the customer's retailer. As such the retailer is the de facto agent of the customer and Scottish Water's role is that of the policeman.

Our draft determination also signals our plan to consult on the unwinding of cross-subsidies both between trade effluent customers and between trade effluent customers as a group and other non-household customers. Our analysis has shown that there is a cross-subsidy in favour of trade effluent customers generally, and that many trade effluent customers are paying more than is appropriate. Those customers that discharge the most polluting effluents are most likely to face increases in their bills. We will be

consulting on this in early 2010, but any changes in tariffs would not be implemented until the start of the 2011-12 financial year at the earliest.

Looking forward

These are just some of the changes that we hope to see in the competitive market in the next regulatory control period. But what of the challenges?

Perhaps the biggest challenge is the Scottish Government's ability to provide the debt finance that Scottish Water will need over the next several years. In our draft determination, we propose that Scottish Water should borrow £140 million a year for each of the next five years. Furthermore, there would have to be an increase to around £200 million a year in 2015-16 if the level of investment in improving our environment is to be maintained. This is in addition to the approaching £3,000 million debt already being financed by customers.

All of this debt represents Scottish public expenditure. If the Government were to be unable to make this debt finance available, either prices would have to rise (in our view unnecessarily) or investment in our environment

would have to be reduced – unless the Government can use the Scottish Futures Trust or allow borrowing on a commercial basis (as, for example, is allowed in the case of Network Rail). This is clearly a crucial issue of major significance.

Closing remarks

Our draft determination is published at a time when the economic prospects of the country are as unpredictable as anyone can remember. We have proposed that bills will increase by less than the rate of inflation for the next five years while there are substantial enhancements in the level of service provided to customers. We have also allowed Scottish Water sufficient finance to build on its achievements over the past seven years – particularly in the area of capital expenditure delivery. If it achieves the efficiencies we expect, Scottish Water would end the regulatory control period in a strong financial position.

The consultation on the draft determination has now closed and we are currently in the process of reviewing carefully the responses from

stakeholders. These will be taken into account when we publish our final decisions on 26 November.

So, in closing, I would say that while the turnaround from basket-case to UK leading company is ahead of schedule, there is more work to be done both by developing regulation and strengthening the competition framework. In particular, it is important that Scottish Water is able to borrow from the Government at a steady rate throughout the regulatory control period.

Providing the Government is able to make the necessary public expenditure available, customers should be able to look forward to many more years of improved levels of service, continuing improvements to our environment and prices that will not increase above the rate of retail price inflation.

Thank you.