

Independent assessment of the relationship between the Wholesaler and the Licensed Providers of retail water and sewerage services in Scotland

Keith Harris, Independent Assuror

February 2012

The Water Industry Commission for Scotland (WICS) asked the Independent Assuror (IA) to consider whether there is an effective relationship between retailers of water and sewerage services in Scotland (the licensed providers or LPs) and the wholesaler, Scottish Water (SW). An effective relationship is considered to be one which fosters efficiency and value for money, high quality customer service, and sustainable delivery for business consumers.

In order to consider this the Assuror met with SW, three LPs and the organisation that administers the market for water and wastewater retail services in Scotland, the Central Market Agency Ltd (CMA). During the course of the discussions the IA has not sought to delve deeply into individual processes and transactions other than to seek illustration. Rather, the focus has been on the nature of the relationship and how it may be improved.

Whilst a range of detail issues were aired, two specific points came to the fore – culture and data. This report considers these points and makes some recommendations for improvement.

1. Culture

There is general consensus that the relationship between SW, the LPs and the CMA is working adequately, albeit imperfectly. Moreover, all sides consider that relationships are positive and improving.

The major concern of the LPs is that SW remains a paternalistic and operationally driven organisation that does not regard LPs as customers, nor does it really understand the needs of “end customers”. The LPs recognise however that there is a deeply embedded culture within SW – as there is in wholesalers south of the border – that is hard for any management to change. The LPs further recognise that SW is sincere in its desire to become customer focused. They are also complementary about their relationships with key individuals in SW.

SW are aware of these cultural challenges. Management is open that they have in the past been unduly focussed on regulatory expectations, often at the expense of ‘real’ customer issues. They consider, however, that this is changing following the introduction of retail competition and that moves to create a Customer Forum will help further.

It seems evident that the need to focus more on customers is being taken seriously. The remuneration of key staff is increasingly tied to customer service delivery, IT improvements are being made, and staff seem open to change. But there are obvious differences of opinion between the LPs and SW about how far and how fast these changes have been made, and what more needs to happen.

From the point of view of the LPs, SW is slow to respond and change and takes full advantage of the rules of the regulatory scorecard. This perceived lack of speed is thought to add to transaction costs and to inhibit the potential to improve service. Specific examples given include:

- SW finding reasons to make access for new development difficult until challenged by the LPs;
- Frequent amendments to quotations for connection;
- SW's people working in silos, with issues being handed-off between one department and another and no overall accountability for delivery;
- SW not being willing to change or differentiate metering services; and
- A general lack of transparency on costs, prices and system capacity which precludes LPs from contributing to the development of Section 29e and other related opportunities.

Problems are perceived to be most acute in relation to new development and connections.

In response SW argues that:

- It must act in an even-handed and transparent way to all LPs; and
- The nature of the relationship with the LPs has been co-designed with them, and that there are clear “dispute resolution and change” processes that can be used to resolve issues and improve future outcomes. In SW's view the LPs have not used these processes to their full extent.

There may well be something in this last point. LPs do seem reluctant to force issues with SW, particularly if it means they need to expend significant amounts of time or money. There may be different reasons for this, including the extent to which the Scottish market is currently a true business venture as opposed to a learning experience and, potentially, the fact that the largest retailer is part of the wider SW Group. Of course it may also be the case that the issues are not that significant and not really hampering their business.

In summary, what is faced here is a cultural issue. SW is being expected to change from a paternalistic organisation dominated by engineering outputs and focused on regulatory outcomes, to one which delivers the services that the LPs and their customers want when they want them. This is a significant challenge and one which is far from unique to SW. The same behaviours were found in gas and electricity when it was liberalised and will be observed in wholesalers south of the border as we move to an Anglo-Scottish retail market in water. It will take time and determination to resolve.

Whilst there is no reason to assume SW's management will not deliver the necessary changes, it will be important that LPs play their part by continuing to push SW. It would be a concern if LPs continue to not exploit the existing channels to the full extent possible and could suggest the relationship is in practice quite comfortable. This in turn may suggest that there is not enough competitive pressure amongst the LPs. An Anglo-Scottish market with a range of significant players may encourage retailers to be more demanding of SW and other wholesalers.

As there is some ambiguity as to whether existing procedures are being fully utilised it is recommended that a six monthly meeting is offered by a senior SW Board member – preferably the CEO or CFO –to the CEO's of the LPs. The purpose of the meeting would be to allow the

parties to put forward and resolve substantive, but generic, policy issues. It should be up to the LP to determine whether the meeting is necessary and to suggest the agenda. If the LPs do not take up the offer then a conclusion would be that existing procedures are deemed to be working adequately.

Ultimately, where issues are substantive and could affect the wider operation of the market, WICS may also have a role to play. To that end WICS should maintain its dialogue with the market participants and should also have the right to attend the meetings between the senior executives of SW and the LPs.

2. Data

A common theme through all of the conversations with market participants was data. There were two major points:

- What information should SW provide to LPs?
- How to make customer information accurate, reliable and complete?

What information should be available to LPs?

LPs consider that were more high quality information made available to them by SW then they would be able to offer more efficient services and will be able to contribute more readily to Section 29e and related innovations. Specifically they would like:

- A more detailed breakdown of the cost of contestable (or potentially contestable) services provided by the wholesaler;
- More specific information as to which customers are affected/going to be affected by service interruptions; and
- Information about spare capacity in the network by time and location.

Some of this information is available – for example recent IT developments has allowed retailers to know in real-time about service failures, albeit down to the postcode level only. Other information would cost much to develop – for example network models. Currently SW only develop network models for areas where they – rather than the LPs – consider capacity to be stretched and / or new development to be likely.

Innovation happens best when multiple participants can contribute. However, this requires there to be transparency of information. It therefore seems sensible that SW should:

- Be more transparent about the pricing of contestable services – actual or potential;
- Progressively seek to complete its network models, concentrating first on areas of greatest population and least capacity. These network models should be made available to LPs and, potentially, licensed upstream providers if requested; and
- Continue to develop its proposed dialogue with LPs on Section 29e opportunities such that LPs can influence the downstream behaviours of their customers. Progress should be reported to WICS on a six monthly basis.

It also seems sensible that SW should know which LP serves which customer so that it can inform the LP specifically about operational issues.

Making customer information accurate, reliable and complete

During the course of the conversations with market participants it became apparent that there are ongoing, and deep rooted, concerns about the accuracy, reliability and quality of customer and asset data. It seems that:

- Properties connected to SW's network were not necessarily on the database initially transferred by SW and now used by the CMA and the market;
- Meter data, particularly location, is often missing or inaccurate;
- There is a dispute about whether properties that are occupied should be subject to a fixed wholesale charge when it is not possible to establish who is liable for the retail charge; and
- It is not clear that data is being updated in an accurate and timely fashion.

Whatever the specifics it seems evident that the data is not all that it should be and this is potentially hampering the efficient and effective operation of the market. In particular, customers may not be paying the appropriate charges leading to inaccurate billing, and there may be unnecessary transaction costs¹. This could draw into question the effectiveness of the market and of the players within it.

With that in mind it seems sensible to embark on a data cleanse exercise and a review of the market processes used to maintain the quality and integrity of data. This should involve all market participants. It may also be sensible to consider changing the way in which wholesale charges are levied with a view to creating the right incentives to keep data accurate, reliable and complete. More specifically:

- SW should be able to identify all properties that are connected to the network, where they are located and what services they receive;
- The LPs should be able to inform the CMA about which properties are occupied and therefore liable for retail charges;
- SW should be able to charge the LPs a wholesale standing charge for each connected property, irrespective of whether it is occupied or not;
- The LPs should be required to prepare an annual reconciliation between the prices they charge, based upon the volumes registered by the CMA, and the revenues shown in their accounts.

The LPs should be given the responsibility and the lead for the data cleanse. However, they should be able to call on the resources of SW as necessary. Given the problems of the original data set, SW should not charge for this service.

¹ For example SW continues with a process of “void inspections” to ensure the LPs are paying the appropriate charges

Conclusion

There are no apparent fundamental problems in the relationship between SW and the LPs. The issues that exist seem to be relatively minor and not unexpected. However, this does not mean there is no room for improvement. There is. But improvement requires there to be an effective dialogue between the existing players, and continual and effective pressure on SW from the LPs. In turn, this requires there to be an effective market amongst LPs and, where necessary, continued scrutiny from WICS.

Recommendations

The following recommendations are made.

Relationships

Senior members of SW's Board should offer to meet with the LPs every six months to allow the parties to put forward and resolve substantive, but generic, process issues. SW should offer the meeting to the LPs, however, it would be for the LPs to determine whether the meeting is necessary and to propose the agenda.

SW should place a particular focus on improving relationships and service in respect of new connections.

Providing new information

SW should:

- Be more transparent about the pricing of contestable services – actual or potential;
- Progressively seek to complete its network models, concentrating first on areas of greatest population and least capacity;
- Continue to develop its proposed dialogue with LPs on Section 29e opportunities such that LPs can influence the downstream behaviours of their customers. Progress should be reported to WICS on a six monthly basis; and
- Inform the LPs as to which customers will be affected by operational issues.

Improving data quality

The LPs should lead and take responsibility for a data cleanse exercise, calling upon the resources of SW as necessary with a view to:

- Identifying all properties that are connected to the network, where those properties are located, and what services that they receive; and
- Informing the CMA about which properties are occupied and liable for retail charges.

SW should be able to charge the LPs a wholesale standing charge for each connected property, irrespective of whether it is occupied or not.

The LPs should be required to prepare an annual reconciliation between the prices they charge, based upon the volumes registered by the CMA, and the revenues shown in their accounts.