

## Section 9 – Retail development

This section is divided into 2 parts:

- Wholesale to retail allocation (Tables 1 and 2)
- Section 29E activities (Tables 3 and 4).

### Wholesale to retail allocation

#### Introduction

The 2001 and 2005 Strategic Reviews of Charges provided analysis of the Scottish water industry value chain. The 2005 Review in particular analysed the allocation of costs to retail and wholesale activities. In this review, WICS set out in detail its initial views on the retail costs of service and set levels of wholesale charges for providing services to licensed retailers. In doing so, it recognised that it was putting forward an initial view of the split of retail and wholesale activities: the wholesale element was likely to decrease through time as market entrants and customers reviewed it.

Since the 2005 Review: the detail of the competitive market has been set out in licence conditions, various market documents and a wholesale charges scheme; the Market Agency (CMA) has been established; the first two new entrants have been licensed by the Commission and the market will “Go Live” on 1 April 2008.

The 2009 Strategic Review of Charges will therefore be a timely opportunity to review whether there remain wholesale activities to be allocated to retail in the Scottish water industry value chain.

#### Potential retail activities

Some wholesale activities, listed below, have been identified that may be better classified as retail. Scottish Water is asked to give its views, in its commentary, on the allocation of these activities to retail and also to provide detail, both in the table templates and in its commentary, of any further activities that it considers could be moved from wholesale to retail.

Wholesale activities that have been identified as potential retail activities include:

1. Trade effluent sampling: Scottish Water is responsible for taking samples to confirm the strength and type of effluent, however, this activity is analogous to meter reading and could be undertaken by Licensed Providers.
2. Trade effluent consent monitoring: Currently, Scottish Water is responsible for monitoring trade effluent discharges to check consistency with the consent limits. This could be undertaken by Licensed Providers. Any legal enforcement would continue to require to be carried out by Scottish Water.
3. Metering services: Scottish Water currently provides all metering services apart from meter reading (for example, meter installation, meter maintenance, meter repair and accuracy checking). These could equally be provided by Licensed Providers. Scottish Water currently owns all

water meters, but customers own their own effluent meters. The Energy markets rely on Licensed Suppliers to own meters and argue that this can result in innovation. This would also seem true for water. For example, Licensed Providers may face an incentive to adopt remote metering solutions if they were required both to own and read the meters.

4. Verification of service provision: Scottish Water currently charges to visit a site and verify the services received. Licensed Providers could perform this service and inform Scottish Water of the results of an inspection.
5. Water connections: It may be possible for Scottish Water to specify connection standards and for Licensed Providers to undertake the physical connection.
6. Disconnections: Provided that disconnections met specified standards, Licensed Providers could carry out their own disconnections.
7. Reconnections: As per Disconnections, Licensed Providers could carry out their own reconnections.
8. Water byelaw inspections: Scottish Water currently both carries out Byelaw Inspections and any enforcement of the inspections. This duty to carry out Inspections could be placed on Licensed Providers (subject to confirmation of the legal framework and Scottish Water's guidance on inspections to be undertaken), with the legal enforcement part remaining with Scottish Water.
9. Network adoption: Currently developers are responsible for providing part 2 and 3 water assets, with Scottish Water adopting the assets if they meet a defined standard (in return for a reasonable cost payment). It could be possible for this adoption process to be a competitive, with different retailers competing to adopt network assets. Clearly, there would need to be a differentially lower wholesale charge for premises served through adopted assets.
10. Standpipes: Standpipe licences and access to Scottish Water's network is currently provided by Scottish Water. However, provided sufficient protection could be built into the market documentation, there may be no reason why this customer-facing activity could not be competitive.
11. Septic Tanks: Scottish Water currently provides domestic septic tank emptying services to both business and household customers. The services to business customers are classified as part of the competitive market (potentially the entire service).
12. Capital and 3<sup>rd</sup> party lead pipe renewals : This activity is customer facing and relates to specific customers. Arguably, therefore, it could be classed as retail.
13. CCTV inspection: This is a specialist field for which there are a number of third party providers. Licensed providers could thus also provide this service to customers.
14. Regulatory and non regulatory sampling: Scottish Water currently carries out sampling for both regulatory and non regulatory purposes. Standards

are laid down for frequency and samples have to be tested at accredited laboratories. There is already market competition for the testing of samples and it seems reasonable to extend this market to the taking and delivering of the samples themselves. This is thus an activity which a licensed provider could also provide instead of Scottish Water.

This list is not exclusive and Scottish Water should use its business knowledge to identify other such activities. Scottish Water should detail:

- its method for identifying other such activities; and
- the outcome of its review (regardless of whether a re-classification from wholesale to retail is proposed).

### **Table completion**

Scottish Water is asked to complete an individual table for each of the above activities and also for any activities that it suggests. The templates included as table 1 (water) and table 2 (wastewater) should be used for this.

### ***Household/non household retail***

Note that rows in the table are split between household and non - household retail. This is because the reclassification of wholesale activities as retail activities impacts on the reporting of information about both household and non-household customers.

There is a single definition of retail used across all of the Regulatory Accounting Rules (set out in RAR4). However, Scottish Water is asked separately to report household and non-household information about retail costs (set out in RAR3). Household Retail costs and activities are classified as core, but subject to separate reporting of transactions as a separate core entity (set out in RAR5).

As the classification of activities is changed from wholesale to retail, therefore, the household retail element will increase. This will not change the definition of core or non-core activities.

### ***Table lines***

Tables 1 and 2 are split into 4 blocks:

Block A. Non-household retail. Income and expenditure impact.

Block B. Non-household. Balance sheet impact

Block C. Household retail. Income and expenditure impact.

Block D. Household retail. Balance sheet impact.

Scottish Water is asked to complete each block, allocating the appropriate proportion of costs described in each line to the named activity for which the table is being completed.

## **Section 29E activities**

### **Introduction**

There is a requirement within The Water Services etc (Scotland) Bill that the wholesale price to any customer including those covered by Special Agreements shall not be lower than that agreed under the price determination. The only

exception to this rule is where it can be demonstrated that the customer has taken action that will reduce the cost of supply to all customers i.e. a Section 29E activity.

### **Potential Section 29E activities**

Scottish Water's commentary should include a detailed account of activities that it considers could lead to Section 29E options being pursued. This to include:

- The nature of the activity.
- The likely financial impact.
- Where schemes could be deferred as a result, the amount of expenditure being deferred and the length of delay.
- Its opinion as to which of the activities being described are more likely to be undertaken by customers or licensed retailers.

In your commentary please could you also outline your strategy for facilitating Section 29E departures, including information that will be provided to a customer/licensed retailer.

### **Table completion**

Scottish Water is asked to complete an individual table for each potential Section 29E activity that it identifies. The templates included as table 3 (water) or table 4 (wastewater) should be used for this. The tables are split into 4 blocks:

- Block A. Revenue impact
- Block B. Income and expenditure impact
- Block C. Balance sheet impact
- Block D. Deferred capital expenditure

Scottish Water should complete each block allocating the appropriate proportion of costs, described in each line, to the named activity for which the table is being completed.

### **Reporter Guidance**

The Reporter is asked to comment on Scottish Water's response to both parts of Section 9 and in particular to:

- Check that Scottish Water has complied with the guidance when completing this section in relation to both the tables and also detail given in the commentary.
- Identify key assumptions and confirm whether or not they are robust.
- Give an opinion on the appropriateness of the methodology used to compile the table data.