

Market reform: interests aligned?

Introduction

We welcome the UK Government's intention to work with the Scottish Government to create a seamless and genuinely competitive Anglo-Scottish market.

In our view, the market will have succeeded if the interests of all market participants are met through the new arrangements. This has been the experience in Scotland, where substantial benefits have been delivered to customers and the environment since market opening in 2008.

For this reason we consider it makes sense to start with what was done in Scotland, making changes where this is necessary to deliver a better, more effective market on both sides of the border.

Our stakeholder analysis

The draft Water Bill set out high-level policy objectives for market reform. The priority now is to consider how these proposals will be delivered in practice. This role is to be taken forward by the Defra-chaired High Level Group, of which we are a member.

To help develop our thinking in relation to the practical steps that must be taken, we recently undertook a stakeholder analysis exercise. Going back to first principles, we asked ourselves: What is it that each participant wants from the market, and what could help or prevent the successful delivery of these hopes and expectations?

This exercise provided a useful cross-check, and highlighted to us what needs to be in place to deliver an efficient, seamless market from which all participants will benefit. This briefing note provides a summary of our findings.

Who are the stakeholders, and what do they want?

We first identified all of the parties with an interest in an efficient and sustainable water and sewerage market. We took this to be: customers, investors, the environment, the UK and Scottish Governments, wholesalers and retailers.

We then considered what it is that they might want from the market – so, what are their interests and what do they need to pursue those interests? This highlighted a number of common requirements:

- A genuinely competitive market, where participants can enter (and exit) the market, earn a reasonable return on a sustainable basis, build scale, control costs, and offer value added or specialist services to customers.
- A transparent and efficient market, where customers, retailers and wholesalers have the information they need to pursue their interests and where the 'rules of the game' are clearly set out. This would include detailed information about wholesale charges, settlement and registration procedures, how transactions are made between retailer and the end customer, and the management of customer information.
- A sustainable industry that is able to meet its legal obligations and access financing in order to continue to invest in improving our environment. This requires access to capital to be maintained, as well as current levels of risk.
- An orderly and well-managed transition towards market opening, with minimal upheaval and a clear transition plan, combined with certainty about how the market will work in practice.

These factors, taken together, are likely to improve customers' perceptions of the legitimacy of charges, which benefits not only the investor but also our environment.

What would help ensure a successful market?

As a next step we considered what might prevent these requirements from being met. This highlighted a number of issues.

- Will retailers of water and sewerage services earn a reasonable return on their investment? If not, can they exit the market?
- Can households share in the benefits of improved service but be fully insulated from the pressures that could develop on the contestable retail activities of the incumbent water companies?
- Will the wholesale and retail businesses be sustainable and self-standing on day 1?
- How can we ensure that the wholesale business suffers no detriment?
- What should be regulated, what should be left to the market?
- How can we ensure that key players work together collaboratively?

Conclusions

In our view the proper empowerment of the High Level Group and its governance arrangements are likely to be critical to the successful delivery of market reform. This will require not only clarity of purpose and focus on delivery but also full recognition of the work that needs to be done to achieve the White Paper's policy objectives.

We are encouraged that water companies are no longer debating the pros and cons of retail reforms outlined in the White Paper and are increasingly focused on how the desired outcomes could best be delivered. It will be important to build on this support. Ultimately, however, we need to work hard to align, as far as possible, the interests of consumers, investors and the environment. Work must now start in earnest to deliver the practical, pragmatic framework that is required.

From our perspective much could be gained from starting with the main elements of the market in Scotland – which we know to work. This should keep risks and costs to a minimum and allow for a retail market opening by April 2017. Our experience in Scotland is that market participants will identify changes to the initial arrangements. We should allow them to decide how best the market should develop to serve customers.

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