All non-household customers (every business and public sector organisation) can choose who supplies their water and waste water services (including trade effluent) – regardless of the customer’s size or location

- Scottish Water continues to operate the network of pipes, resources and treatment assets
- Scottish Water’s retail activities (to non-household customers) are carried out by a separate company, Business Stream
- New entrants compete with Business Stream, purchasing wholesale services from Scottish Water at regulated prices and providing retail services to customers
- Retailers offer value added services to customers (often reducing the total bill) as much as offering lower tariffs
- Self-supply licences are available to non-household customers, allowing them to purchase wholesale services directly
There were a number of reasons for pursuing retail competition:

- **Customers wanted choice**: Meeting customers’ expectations is important if the level of charges is to be seen to be legitimate.

- **Role of retailers**: Retailers can maximise customer benefit by championing the customers’ interest in their interaction with the wholesaler.

- **Efficiency**: The focus on areas of comparative competence was likely to increase efficiency.

But to achieve these goals we had to:

- **Ensure access was regulated, not negotiated**: New entrants do not need to negotiate terms of access individually with Scottish Water.

- **Ensure there were no losers**: Introducing competition had no adverse impact on prices to customers (whether contestable or not) or on service standards.

- **Recognise that competition is a means not an end**: Competition is not an end in itself, but is the best means to achieving value for money for customers alongside environmental, public health and other goals.
As a public corporation (and no overall holding company) the 2005 Water Services (Scotland) Act required the separation of Scottish Water’s retail activities

Business Stream – the retail arm of Scottish Water – was established as a wholly owned subsidiary in November 2006

- Legal separation was easier than unpicking the statutory duties placed on Scottish Water (which has no licence).
- Provisional licences were granted in November 2006
- Permanent licences were granted in January 2008 after assessment against three tests (in addition to normal licensing criteria):
  - Business operations are demonstrably separate
  - Business Stream can take decisions independently
  - There was a level playing field for competition between Business Stream and new entrants
- There is a published Governance Code (which new entrants were able to, and did, influence). This ensures that decision making in each activity is discrete and does not favour the other Group activity.
- Ring fencing arrangements between Business Stream and Scottish Water are established by licence and the Governance Code
  - Cross-subsidies are prohibited
  - Intra-group contracts require Commission approval
- Business Stream also has three special licence conditions
  - Charges must be published
  - Charges must be cost-reflective
  - Governance arrangements – independence from Scottish Water, governance is through holding company

ACHIEVING ARM’S LENGTH OPERATION (WHETHER THE WATER COMPANY OPTS FOR SEPARATION OR NOT ) WILL TAKE TIME-BUT IT IS ESSENTIAL TO THERE BEING THE LEVEL PLAYING FIELD WHICH IS A PRE-REQUISITE OF AN EFFECTIVE COMPETITIVE MARKET
From the beginning we sought to adopt a collaborative approach....

- The first step was to agree a definition for retail activities. It may seem obvious now, but we defined retail as all those activities which “touch” the end customer. The devil is in the detail, however, in designing processes that would work for new entrants and were consistent with the on-going effective operation of the wholesale business.

- The Commission, Scottish Water, the Scottish Government, potential new entrants and even interested parties who did not intend to enter the market all worked together as members of the Licensing Framework Implementation Group. This Group was independently chaired.

- Without the active cooperation of the members of this Group, it would have taken even longer and been even more difficult to implement the retail competition framework successfully.

- The Group agreed a workable plan, with a clear date for market opening. This helped maintain a single-minded focus on delivery for all parties.

- It also meant that new entrants could plan and customers were clear about when choice would become available to them.
The result was that roles and responsibilities were well defined and agreed by all market participants.

Wholesale (Scottish Water)

- Operates the publicly owned resources, treatment and network assets
- Retains responsibility for drinking water quality and environmental standards
- Manages trade effluent consents

Retail (licensed providers) undertake all customer-facing activities, including

- Billing
- Value adding services such as water audits, grey water harvesting and automatic meter readers
- Customer enquiries
- Liaison with the wholesaler

The Central Market Agency

- Maintains the central customer register, with all connection and charging information
- Registers customer switches between licensed providers
- Calculates wholesale charges based on the customer’s consumption
The market framework has a number of elements - the development of each element involves at least two of wholesaler, retailer, regulator and customer

- Operational Code sets clear accountabilities for situations where a customer needs to approach its licensed provider for a service that is Scottish Water’s operational responsibility:
  - New connections
  - Metering operations
  - Trade effluent consents
  - Customer enquiries and complaints
  - Emergency handling
  - From 1 April 2012, new retail activities will be included in the market, including: trade effluent consent management; new connections and disconnections and the fitting of new meters. From 1 April 2013, repairing and replacing existing meters will also become a retail activity

- Market Code sets out the governance rules for the market, and the procedures for settlement, payment and registration. It positions the CMA as the settlement and registration hub for the market

- Wholesale services agreement: a template on which new entrants can count if they are unable to negotiate something better

- Disconnections Code: sets out the rules for disconnection

- Governance Code: sets out the rules for separate governance of Business Stream and Scottish Water in order to demonstrate that the playing field is level
For the framework to be successful, a solid foundation is required. This requires that the interest of all customers are protected.

**Default tariffs and standards of service ensure that no customer is worse off than they would have been...**

- Licensed providers bear a universal service obligation – they cannot refuse to serve any customer who requests the default services at the common default tariff (agreed by the Commission and consistent with the Determination of Charges)
- Default tariffs are set at the level Scottish Water would have charged if competition had not been introduced
- This provides an important safety net – no customer can be worse off because of competition

**Geographical harmonisation of charges**

- Charges cannot vary between customers just because of their location

**Non-discrimination**

- Licensed providers cannot show undue discrimination between customers within the same class

**Provider of last resort**

- Where a licensed provider exits the market, customers can switch to another licensed provider
- Outgoing licensed provider (or its administrator) can sell the customer list
- In the last resort, the CMA allocates customers amongst the other licensed providers – default tariffs and services apply
The licence process is quite straightforward...

• Applicants must demonstrate
  o Knowledge, expertise and experience
  o Business acumen and financial viability

• A key factor is that retailers have to pay wholesale charges in advance, so there is no need for extensive credit checks (which could quickly become out of date) in order to process the application

• We have developed a tailored approach such that even a company with no trading history can successfully enter the market

• The application process includes opportunities for interested parties to make representations to the Commission on the applicant’s suitability - as such it takes about six weeks to complete the process
There are numerous opportunities for new entrants to provide specialist offerings

Departures from standard wholesale charges (section 29E)

- Where a customer has done, or agreed to, something which reduces Scottish Water’s costs
- Scottish Water may apply to the Commission for a departure from the charges scheme
- This provides potential to uncover details of Scottish Water’s costs and to introduce some contestability into the wholesale business

Specialist licences

- For retailers wishing only to serve customers with a section 29E departure
- Universal service obligation lifted

Self-supply

- For customers wishing to provide their own retail service
There were four substantially new, and time-consuming, activities....

**Developing wholesale charges**

- These needed to reflect wholesale cost drivers and then be averaged for each class of customer across Scotland.
- They set the prices Scottish Water may charge to retailers for its services, i.e. the provision of water and sewerage services and the removal of trade effluent.
- We had to ensure that the gross retail margin (i.e. the gap between the wholesale and retail charge) was appropriate for each class of customer. The proportion of a customer’s bill represented by retail costs is much higher for smaller customers than it is for larger customers (in percentage terms an order of magnitude different!)
- We concluded that wholesale charges included fixed, capacity related and volumetric elements.
- But retailers may achieve lower wholesale charges if they lower Scottish Water’s costs.

**Allowing for changes in retail tariffs**

- The retail tariffs which are appropriate to a class of customer may be different in a competitive market.
- This could happen because cost items like bad debt may be skewed to particular categories of customer (for example smaller/micro-sized businesses), but at a default level it prevents discrimination against certain industries or locations (although there may ultimately be less discounts available to such customers).
- The costs of retention or customer acquisition may be quite different across different categories of customer.
There were four substantially new, and time-consuming, activities (con’t)....

Improving market and customer information

• Each competitive utility market has experienced data quality issues
• These can surround items as basic as names and addresses (differences, for example, between site addresses and billing details)
• Retailers are unable to rely on local operational experience (where is the meter located?); what services are provided to a customer?; what services is the customer billed for?
• There may be many different types of meter (five figure reads or six figure?)
• Dealing with vacant premises and changes in occupancy
• “Muddling through” is not an option if there is to be a level playing field!
• This is an issue in which we should have invested more time and resource as we were preparing for market opening.
• It has to be the responsibility of the water company and sufficient time has to be allowed for.

Establishing Market Settlement and Registration Systems

• The approach needs to be collaborative as all market participants have to buy into the settlement systems
• The settlement and registration systems should be separate from the incumbent wholesaler- in order to reassure that the playing field is level
• They need to be consistent with the way in which the wholesaler operates its business
• The lead time in establishing the systems is substantial (just under two years in Scotland- despite having used an expedited tender process)
• There is scope for too much complexity and for substantial costs to be incurred. Our contract received bids which were in excess of 5 times the winning bid
• Quality staff need to be recruited to operate the systems