

The introduction of retail competition

Lessons learnt from the opening of the retail market in Scotland

Andrea Mancini, Head of Retail Competition
European Forum on Regulation of Water Services
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In 2008, Scotland became the first country in the world to open retail water and sewerage services to competition...

- All non-household customers can choose who supplies their water and waste water services (customer service and billing) regardless of the customer's size or location.
- Scottish Water continues to operate the network of pipes, resources and treatment assets. Scottish Water's non-household retail activities 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.



The contestable activities in the retail market include...

Wholesale – Scottish Water



Retail – Licensed Providers



150,000 non-household customers



Competitive retail include...

- Billing and payment handling
- Collection and debt management
- Customer contact
- Customer complaints
- Meter reading
- Administering new connections

Benefits from the opening of the market include lower prices and both better and more tailored services...



- Lowered the overall industry costs.



- More tailored services - bill consolidation and data loggers.



- Water-efficient residential development.



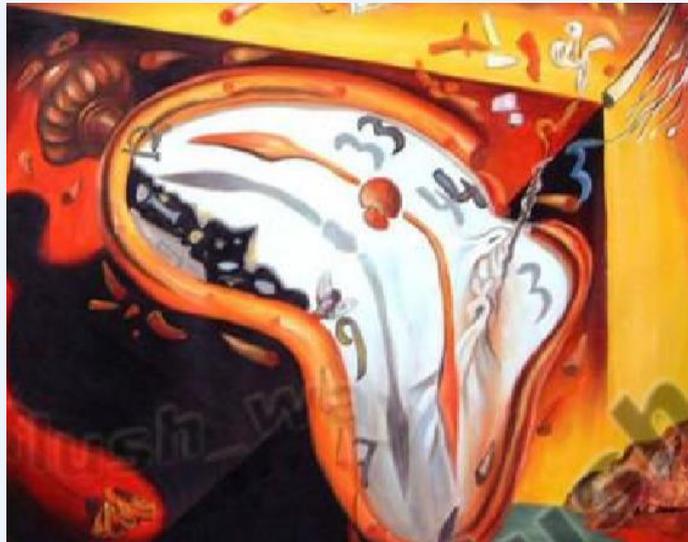
- More accurate billing.



- Reduced water consumption and carbon emissions

Lesson 1: it takes time to introduce a competitive market!

- It took us around five years to complete the project from first steps to market opening in April 2008.
- It takes time to disentangle some of the cost allocations of the industry and to understand disaggregated activities.
- We spent a lot of time on the separation between wholesale and retail activities.



Lesson 2: strong leadership with a lightness of touch

- Effective registration and settlement processes are fundamental to a smoothly functioning market.
- The Commission played a strong role in ensuring that all market codes were available and consulted upon prior to 'go active'.
- The Commission identified a process for handover to the central market body that ensured that any outstanding issues could be addressed via the industry governance processes.



All parties (the Government, the regulator and the companies) need to work closely and collaboratively together.

Lesson 3: creating a level playing field in the market.

- The incumbent retailer was required to demonstrate it is operating on a fully arm's length basis in governance, managerial and financial terms from the incumbent wholesaler.
- Legal separation of the retail activities from the wholesale activities.
- Regulated access rather than negotiated access reduces barriers of entry.



Lesson 4: implementing customer safeguards to ensure there are no losers.

- All retailers are required to offer a default range and quality of retail services at regulated default tariffs.
- Regulated wholesale charges are set on a geographically harmonised basis in line with Scottish Ministerial policy.
- The Provider of Last Resort mechanism to support continued supply and customer protection in the event of retailer failure.



Lesson 5: ensuring appropriate margins in the market... the devil is in the detail!

- Retailers need to consider the profits to be made from different classes of customer.
- The Commission did a proper and thorough analysis of the costs to serve each class of customer, including the incidence of bad debt.
- The result was that if a new entrant would incur a lower level of costs or could offer a better level of service for the same cost as Scottish Water's retail arm then it could enter the market.



Lesson 6: ensuring there is no detriment to the core business.

- The regulatory capital value and associated returns of the water companies are allocated in full to the wholesale side of the business.
- The retail business bears the risks associated with customers' bad debt.
- Retailers pre-pay the wholesaler.



Lessons learnt from the opening of the retail market...

1. Recognise it takes time
2. Strong leadership but lightness of touch
3. Take appropriate steps to support a level playing field
4. Set appropriate margins
5. Implement customer safeguards
6. Protect the core business



Collaborate to compete: the success of each market participant depends on the overall success of the market

Questions?

Water Industry Commission for Scotland

First Floor, Moray House, Forthside Way, Stirling FK8 1QZ

E: enquiries@watercommission.co.uk

T: +44(0) 1786 430200

www.watercommission.co.uk

www.scotlandontap.gov.uk

@WICScotland