water industry commission FOR SCOTLAND

Competition in the Scottish water industry

ACHIEVING BEST VALUE FOR WATER AND SEWERAGE CUSTOMERS · 2009-10

Contents

Introduction

Two years ago Scotland became the first country in the world to open up water and sewerage services to competition for all public sector, non-profit and business organisations. Since then there have been significant improvements for customers, with more options and better services.

This report summarises these achievements for customers and the subsequent benefits for the environment, which have exceeded all expectations.

For those who have not yet taken advantage of the new opportunities, we explain how the retail market works for you and where to find out more.

Since April 2008, all 130,000 businesses, public sector and other organisations across the country – from the smallest corner store to the largest international company – have been able to choose the retailer that best suits their needs.

How the market works for you

The water and sewerage market in Scotland operates in much the same way as in other utilities, where retail suppliers compete for your business by offering the best deals. There are currently five active retailers, including two major English companies, in the market:

- Aimera,
- Business Stream,
- Osprey (a subsidiary of Anglian Water),
- Satec, and
- Wessex Water.

To make sure that you can benefit easily and quickly from all that the market has to offer, an independent organisation – the Central Market Agency – controls the flow of information within the market and registers switches by customers between retail suppliers. Unless you have reached a separate arrangement with your current retail supplier, the market allows you to move, without penalty, to a new deal by giving one month's notice.

As well as switching, you also have the option of taking a self-supply licence. This allows you to buy your water and pay for your sewage to be removed direct from the wholesaler, Scottish Water. As part of this arrangement you only pay Scottish Water's wholesale prices for the services you take. However, you must also take on responsibility for providing all other services, such as billing and meter reading, yourself.

As the economic regulator we have a role in overseeing the operation of the market. An aspect of this is to process and assess licence applications from potential retailers and self suppliers.

Safeguarding customers

When introducing the framework for competition we took steps to protect all customers and to ensure that no customer would be worse off as a result. This included introducing a licence condition that requires retailers to offer a 'default' level of service and tariff to any business or public sector customer, anywhere in Scotland. This means that smaller customers or those living in remote areas cannot be excluded from the benefits of choice.

The default tariff is regulated by us and both this year and next (2011-12) will rise by less than the rate of inflation.

Finally, unlike the gas and electricity industries, Scottish Water's wholesale charges are regulated by us. This means they will not see the same volatility as has been experienced elsewhere. It also means that there can be no question that Scottish Water has the funding it needs to deliver the environmental and drinking water quality improvements required by Scottish Ministers.

Competition of this kind, where Scottish Water's wholesale and retail activities are made separate, is driving a more efficient industry in four ways:

- First, new retailers compete for customers by offering more competitive prices and seek out more cost-effective and innovative ways to serve customers.
- Second, new retailers place pressure on Scottish Water to improve the wholesale service it provides.
- Third, new retailers are able to identify where inefficiencies exist and can put pressure on Scottish Water to make improvements.
- Fourth, there are now clear incentives available to customers and their retailers to innovate and reduce their own and Scottish Water's costs.

Since April 2010 the margins between the regulated 'default' retail tariffs and the wholesale charges levied by Scottish Water have increased and will continue to do so until 2015. We expect retailers to respond by offering fresh incentives to customers, for example lowering bills for those who opt to pay by direct debit or choose e-billing.

Benefits for customers

Two years on and the retail competition framework in Scotland is working well. More than 45,000 customers in Scotland have renegotiated the terms of their supplies – receiving either better prices or more tailored levels of service, and in many cases both. Discounts are often offered to customers who sign up for direct debit or a multi-year supply contract. The number of supply points switched by customers to one of the new retailers has also increased by 40% in the last year.

Around 40% of the market is enjoying the direct benefits of the new arrangements

Providers are offering a range of new and expanded services to customers. These include easier billing, water saving measures, ways to identify and reduce leaks, and quicker responses to customer enquiries.

Having choice empowers customers to pick and choose a price and service package that best meets their needs. It means they do not have to accept the 'one size fits all' approach to service provision that often characterises monopolies and had previously existed in the Scottish water industry.

More than
14,000
customers now receive their bills electronically

It is not only businesses and public sector organisations that benefit from competition. The additional scrutiny placed by retailers on services, and the keener focus on operating processes and procedures required by the retail framework has identified savings that will also benefit household customers.

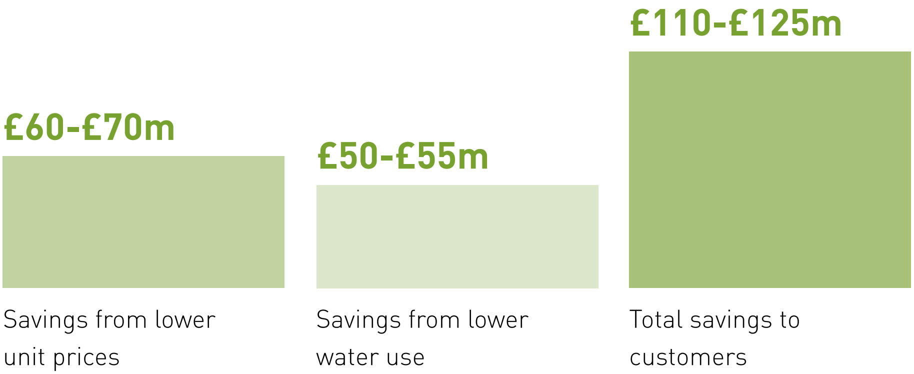
New initiatives are helping customers keep a close eye on their bills. Services include online account management, online payment and meter reading, and e-billing. For organisations such as councils that operate a number of different sites, switching to one consolidated e-bill can save literally thousands of pounds a year. Customers are also able to switch online and carry out price comparisons immediately.

Quantifying the benefits

We commissioned independent consultants Grant Thornton to review the likely benefits from competition for customers and the environment both now and in future. They forecast that competitive pressures will drive down charges and there will also be lower levels of water use as customers use water more efficiently.

Grant Thornton's report attempts to quantify these benefits. It predicts that over the period to 2020-21 customers will benefit from lower bills to the tune of around £110 million.

The report also anticipates that the development of further innovation will deliver enhanced value for customers over time.



Forecast savings for customers over the next decade:

£110m

Water competition generates innovation. The framework in Scotland ensures that new suppliers and their customers are able to benefit if they help Scottish Water reduce its costs. For example, discounts may be available to organisations that can plan their water use or waste disposal.

Procurement Scotland estimates that the value of the public sector portfolio for water in Scotland is approximately

£73m

A developing market – driving value in the public sector

It is still early days for the market. However, we are pleased to see increasing interest from businesses and, in particular, Scotland's public sector organisations.

For example, last year Advanced Procurement for Universities and Colleges Scotland issued a tender worth £45 million to supply water and sewerage services to Scotland's university and college sectors.

More recently, Procurement Scotland issued a much wider formal tender, encompassing not only universities and colleges but also all other public sector organisations in Scotland. The tender represents around 20% of the total non-household market in Scotland.

By setting up a national public sector contract for water and sewerage, Procurement Scotland aims to get best value for the public sector. Such a move is only possible because of the existence in Scotland of the competitive retail market.

Procurement Scotland plans for the contract to be in place for the coming financial year (2011-12).

Aimera advises that it has a number of ongoing initiatives aiming to reduce sewerage charges for customers. To date it has reduced customer charges by £57,000 by offering lower unit costs on all tariffs.

CASE STUDY 1

An Enterprise Trust that provides business accommodation, training, financial management and property management services was able to take advantage of the automatic tariff adjudications offered by one retailer. This service identified a meter sizing anomaly and led to a reduction in their bill of around £1,500.

Public sector organisations in Scotland – which comprise some 30% of non-household customers – are waking up to the potential benefits for them of the new market. Some of the new retailers have specifically targeted these opportunities.

Benefits for the environment

Customers are being given advice about how to reduce their water consumption. This is leading to other initiatives to recycle waste and drainage water and is bringing environmental benefits in both lower abstraction and through lower energy use.

One of the key achievements of the introduction of competition is that there is now greater awareness among business customers of the environmental benefits and cost savings to be made from being more water efficient.

Increasing numbers of companies – not only large bulk users of water – are interested in reducing their water consumption. This is not just a response to cost pressures but also a genuine awareness of environmental issues. These pressures apply equally on the sewerage side.

Although water efficiency advice has been available in the past it tended to be on an ad hoc, small-scale basis. Now retailers are competing to offer services that allow consumers to monitor how much water they use, when they use it, what for and how they dispose of it. Such initiatives are not limited to large businesses or multi-site businesses only but are being pursued by small and medium-sized businesses looking to save money.

CASE STUDY 2

An independent salmon producer asked their retailer to help them improve the discharge performance at an eight-year-old plant. They wanted to make sure that they continued to comply with strict environmental requirements. The solution was to install a biological treatment plant – an approach never before used in this sector – to act as a more rigorous, second stage treatment. As a result, the seafood company has dramatically improved its environmental performance and at the same time is saving money by using less water.

Bespoke environmental advice and solutions are being offered by retailers, along with an increased commitment to water saving measures and to leakage reduction at the customer's property. Retailers also provide the services of specialist staff to work with customers to enhance their water efficiency and drive bills down further. Such activities not only result in reduced costs but also make a significant contribution in helping to reduce Scotland's carbon footprint.

> Retailers now offer a wide range of water efficiency measures and products, from simple devices that control taps to complete rainwater harvesting systems.

Separating retail activities also makes it more likely that customers will receive a more tailored service in waste management and surface drainage.

A retailer provides a 'water health check' service which involves taking a snapshot of the customer's water and sewerage system. The customer is told if there are any problems and given advice about how to make efficiency savings that can be effected easily, along with other longer term options. To date the service has revealed significant opportunities to cut water use at around half of the sites reviewed.

Cutting carbon emissions

As competition supports reductions in consumption it means that less water is used. In turn this means less water has to be treated then pumped around the distribution system. This is all the more relevant in Scotland, with its diverse geography and sparsely distributed population, where distribution is even more energy-intensive.

The benefits of reducing your water consumption are not just limited to your water bill. By reducing the amount of hot water used, you are also reducing your energy bill and your carbon footprint.

According to sustainability experts Envirowise, "significant reductions in environmental costs can often be made through no-cost and low-cost measures and by adopting these, a company can [...] cut water and effluent bills by up to 50%."[1] These measures will vary from business to business, but include checking for leaks, more efficient process management, and introducing water-saving devices such as urinal controls and tap flow regulators.

1 www.envirowise.gov.uk/scotlandmeasurement

Quantifying the benefits

The independent report by Grant Thornton attempts to put an economic value on the benefits to society of using less energy from treating and distributing water. It bases its calculations on standard data about the costs of carbon. Their report assumes that reductions in water use as competition develops could also lead to a reduced capacity requirement. Some treatment works, for example, may no longer be required – delivering additional carbon savings over time. So the environmental benefits associated with competition, in addition to all of the other savings, are significant.

Businesses that are able to reduce the amount of hot water they waste will also see a reduction in their energy costs. According to the Carbon Trust, a 20% cut in energy costs represents the same bottom line benefit as a 5% increase in sales in many businesses[2].

In Scotland, 1.7 tonnes of CO_2 is emitted, on average, for every million litres of water that undergoes water and sewage treatment

Business Stream advises that so far it has helped customers make around £10 million worth of efficiency savings overall. In terms of carbon, that is a saving of more than 5,000 tonnes of CO_2 – the equivalent of taking 1,400 cars off the road.

2 Better Business – Management Guide, http://www.carbontrust.co.uk/Publications/pages/publicationdetail.aspx?id=CTV034

How the market is operating

By 2020-21 the benefits of competition will exceed the costs
by 3:1

The arrangements that we put in place in April 2008 are working well.

- Since the market opened in 2008, a number of new retailers have entered the market and are now serving customers in Scotland.
- Customer awareness of the opportunities that are available to them is growing. Research by the Federation of Small Businesses indicates that awareness has doubled in the past year and is now almost 50%.
- Customers appear to find it easy to switch between retail suppliers and to deal directly with their chosen retailer. Over the last year there has been a 40% increase in the number of supply points that have been switched from one retailer to another.

We have always been conscious of the need for the benefits of competition to outweigh the costs associated with establishing the framework and continuing to oversee and develop the market. In its report, Grant Thornton estimates that the benefits will outweigh the costs of the market by around 3:1.

Looking forward

Next steps to bring further benefits

Although customers are already benefitting from competition, we have recently begun to examine how the current framework might work more efficiently and bring further benefits for customers. This includes consulting with stakeholders on the ways in which three further areas may best be organised in the new retail framework. These are: trade effluent sampling, connections activities and metering.

Developments south of the border

In relation to possible changes to the water and sewerage industry in England and Wales, the Department for Environment, Food and Rural Affairs has recently announced that it will publish a Water White Paper next summer.

This will focus on the future challenges facing the industry and is likely to include the recommendations from Professor Martin Cave's 'Independent review of competition and innovation in water markets'. We strongly support Professor Cave's recommendations and look forward to contributing to the White Paper's development over the coming months.

Scottish customers are already benefiting greatly from competition in Scotland, and we believe that customers in England and Wales should too. We shall continue to work closely with our colleagues at Ofwat to ensure that all customers in the UK are able to benefit from the opportunities available from competition both now and in the future.

Can the Scottish market be replicated in England and Wales?

You may have heard that the arrangements in England and Wales are different from those in Scotland and, as a result, that the model developed here is not suitable south of the border.

- It is sometimes said that customers will not benefit as the companies in England and Wales are already more efficient than Scottish Water. However, scrutiny and pressure from retailers is still likely to identify new areas where improvements can be made.
- It is also argued that customers are not interested in switching. Yet all of the evidence from Scotland suggests that there is a strong demand from customers for the benefits of competition to be extended to their sites south of the border.
- Similarly there are those who believe that competition is very expensive and the benefits are not great. As we outlined on page 16, the independent report undertaken by Grant Thornton estimates that the benefits of the market will exceed the costs by a 3:1 ratio by 2021. Grant Thornton also estimates that customers in England and Wales could see substantial cost savings through a similar system.
- Finally, the argument is sometimes made that Scotland's market arrangements are not suitable for application in England and Wales given the large number of companies. In fact our market arrangements could easily be modified to work with multiple companies as they already address the interactions between retailers and wholesalers that would take place daily in any market.

It is for these reasons that we believe that the experiences from our market can be applied in England and Wales, so that all customers across Britain can benefit in the future.

To find out more

For contact information for the retailers that are operating in Scotland and for further information about how the market works, visit www.scotlandontap.gov.uk

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