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Dear Phil

Consultation on the review of non-household retail price controls – Scottish Water response

Scottish Water is pleased to submit a response to Ofwat's consultation on the approach to the review of non-household retail price controls.

Scottish Water is keen to ensure that the retail market arrangements on each side of the Anglo-Scottish border provide a seamless customer experience as far as practical and that arrangements being developed for England do not create unintended incidence effects for the Scottish market and Scottish customers. We have played an active role in the development of the market codes, and have been pleased to share our key learning and experiences.

We have not been closely involved in the discussions around the retail price controls and the structure and level of tariffs to date. However the key questions posed in this consultation, about the scope of the forthcoming review, rest on the accuracy of Appointees' cost allocation between their wholesale and retail activities. Scottish Water has also had to address the challenges of cost allocation, and the rebalancing of tariffs to ensure cost-reflectivity, so we believe it is worth sharing our views based on this experience.

Cost Allocation [Scope of the Review, Questions 1 and 2]

Scottish Water agrees that the scope of Ofwat's review should be broadened beyond the non-household price controls and default tariff price caps.

Prior to market opening in Scotland, Scottish Water undertook a review of its costs and made an initial allocation between wholesale, household retail and non-household retail. Simultaneously, an independent analysis of the cost of individual activities was conducted by Ernst and Young to understand the level of costs incurred by the non-household retail business.

As a matter of public record, the retail margin allowed at market opening in Scotland was between 10 and 11% while the data in England seem lower than that. This would suggest that undertakers may have taken a different approach to that in Scotland at the time. It may be helpful to consider the reasons for that, and whether the approach taken is appropriate for the English market.

To the extent that changes in the non-household price control would have consequences for the household price control, it would be sensible to look at both together.

Cost-reflective Tariffs [Questions 3-8]

Cost-reflective tariffs, both at the wholesale and retail level, are a fundamental pre-requisite of a competitive market. If charges for particular services (e.g. drainage or trade effluent) or particular customer groups do not accurately reflect the costs incurred in providing a service to that group, it will create distortions in the market and segments of customers will be disadvantaged.

In Scotland, a rigorous exercise involving both the regulator and Scottish Water, was undertaken to structure tariffs from the outset to ensure that adequate margins could be earned by retailers on all services and from all customer types – regardless of size – to ensure they were all ‘attractive’ to competitive retailers. Nevertheless work has continued over a number of years to refine and rebalance tariff levels in order to reflect our improved understanding of the relative costs of providing the range of water and waste services to customers with different consumption levels.

This process was largely driven by the regulator, so as to ensure a level playing field for all licenced providers. In England, where there are multiple wholesale and retail pricing structures, the role of the regulator will be vital to ensure a consistent approach to cost and margin allocation between tariff bands.

The consultation seeks views on whether greater consistency across default tariff cap structures would be beneficial. Whilst consistency will reduce the risks faced by retailers, and hence the costs of market participation, we suggest that it is more important to develop a consistent method for allocating costs and margins between tariff groups than to have consistency of default tariff cap structure per se.

Scottish Water would be happy to share our experiences in Scotland in greater detail. Please do not hesitate to contact Neil Hemings, our Tariff & Charging Policy Manager (neil.hemings@scottishwater.co.uk).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon Parsons', written in a cursive style.

Simon Parsons
Director of Strategic Customer Service Planning