



BRIEFING PAPER

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Increasing competition in the water industry

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Summary

The water industry in England and Wales has been a regulated regional monopoly business since privatisation in 1989. This means that, with limited exceptions, customers cannot choose their water supplier and the sector cannot function as an open competitive market.

After a long period of review and consultation, the Coalition Government introduced a legislative framework for a significant degree of market reform in England and Wales, including increasing competition in the provision of water and sewerage services. This followed the introduction of similar market reforms in Scotland in 2008. There are currently no plans to introduce similar reforms in Northern Ireland.

The framework for the market reforms is set out in the [Water Act 2014](#). The reforms aim to make it easier for non-domestic users to switch their water suppliers and to open up the water and sewerage market to new companies. A cross-border English-Scottish market will also be established.

In addition, in November 2015, the Government [announced](#) that it would seek to extend retail competition to domestic customers in England, beginning the transition before the end of this Parliament. Ofwat published an [assessment](#) of the costs and benefits of this approach in September 2016.

The relevant reforms in the Water Act 2014 are focused in two key areas:

- **Retail competition** (non-household) – the reformed retail market is due to commence in England in April 2017 for non-household customers (businesses, charities and public sector). This stage of retail reform will allow all non-household customers to be able to switch water supplier (currently only customers using more than 5 megalitres of water use can switch). The reforms will also make it easier for new entrant companies to enter the market and will allow incumbent companies to stop providing retail services to customers and exit the non-household retail market. Relevant secondary legislation came into force in October 2016.

The Welsh Government has postponed introduction of non-household retail competition in Wales.

- **Upstream competition** – the upstream end of the supply chain relates to the supply of raw or treated water into a company's network or the removal of waste water or sewage for treatment. Once implemented, the reforms will enable new entrants to provide upstream services without being obliged to also provide retail services, thus introducing more potential for competition. The Coalition Government suggested that it would not implement changes until around 2019, once work was completed work on wider abstraction (removal of water from water sources) reform.

1. Background

At present, there are 35 regulated companies in the water and sewerage sector in England and Wales.¹ With limited exceptions for very large users of water, customers are unable to switch their water supplier. This means the majority of customers are served by monopoly suppliers. The lack of competition is argued to hinder innovation and efficiency, and can be time-consuming and expensive for businesses with several suppliers across the country who have to process multiple bills.

Scotland established retail competition for non-household water users in 2008. There are currently no plans to introduce competition in Northern Ireland.

Limited use has been made of previous attempts to introduce competition into the market. The [Water Act 2003](#) established a framework for a limited retail market in England and Wales for water enabling very large customers using 50 megalitres or more of water per year (later reduced to 5 megalitres a year) to switch suppliers and for new players to enter the market in limited circumstances.

However, the Department for Environment, Food and Rural Affairs (Defra) acknowledged that the regime had not worked well: restricting the ability to switch to very large water users meant the competitive market was too small to develop effectively; barriers in legislation made the market unattractive to new entrants and frustrated customers that wanted to switch suppliers. Only one customer had switched supplier under this regime in the six years to 2011² and in November 2013, Defra confirmed that only four customers had switched their water supplier on certain sites: C2C, Bernard Matthews, First Milk and Tesco.³

In the regime as it existed in 2011, very large users of water could also replace their water and sewerage supplier under the “inset” regime, which had been used by developers of greenfield sites to choose a supplier to lay down water and sewerage infrastructure and then remain as the local water company.

The Labour Government commissioned three major reviews of the water sector—the Pitt review on flooding, the Walker review on affordability and the Cave review on competition. The Labour Government took forward the *Flood and Water Management Act 2010* to legislate for many of the issues identified. However, constraints on parliamentary time meant that the Act did not address all the issues identified by the reviews, including the need for more competition.

¹ See Ofwat [Water companies](#) [accessed 18 November 2016]

² Defra [Water for Life](#), CM 8230. December 2011, p68

³ Defra, [Reform of the water industry: retail competition](#), November 2013

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The Coalition Government said that it would examine the findings of these reviews. It also commissioned a review of Ofwat (the economic regulator for the water industry in England and Wales) and consumer representation in the water sector to assess whether the regulatory arrangements were fit for purpose.

In 2011 the Coalition Government described how it would respond in its White Paper [Water for Life](#) which included proposals for increasing competition in the sector. It accepted the Cave Review conclusion that competition would increase efficiency and drive innovation in the sector, leading to a better service and lower bills for customers. The Government believed that competition reforms could deliver a net monetised benefit of around £2 billion over 30 years.⁴

⁴ HC Library Research Paper 13/67 [Water Bill](#) 21 November 2013, section 2.4

2. 2009 review of competition—the Cave Review

The Labour Government commissioned Professor Martin Cave to lead an independent review of competition and innovation in water markets between March 2008 and April 2009. Cave recommended a number of changes to the sector that would increase competition, including in relation to upstream and retail activities.⁵

Professor Cave found a lack of competition in the sector that may have a negative impact on innovation, water bills and the environment. The review recommended a number of changes including the introduction of retail and upstream competition, which he calculated could deliver some £2.5 billion in benefits to the economy over 30 years (this was a little higher than the Government's estimate of £2.0 billion).⁶

2.1 Why competition?

It was thought that greater competition in the water sector could stimulate innovation and efficiency. For example, customers could be offered:

- lower prices through offering a single bill for multiple sites;
- alternative price structures for water to better reflect the cost of water;
- alternative waste disposal services; and
- advice on reducing water costs through using water more efficiently.⁷

Cave proposed the introduction of competition for all non-domestic customers in the retail market i.e retail customers should be able to buy water from any company they chose.

Legal separation of wholesale and retail activities

To support retail competition, the Cave review recommended the "legal separation of both the household and non-domestic retail arms of water companies from the remainder of the appointees' business".⁸

This separation was intended to ensure that incumbent water companies selling retail services did not have an unfair advantage, and that the benefits of retail competition were realised. He argued that, as part of a larger organisation, a retail function may lack the incentives, and even be shielded from the pressures that an independent

⁵ Professor Martin Cave [Independent Review of Competition and Innovation in Water Markets: Final report](#) April 2009

⁶ HC Library Research Paper 13/67 [Water Bill](#) 21 November 2013, section 5.1

⁷ Professor Martin Cave [Independent Review of Competition and Innovation in Water Markets: Final report](#) April 2009

⁸ Professor Martin Cave [Independent Review of Competition and Innovation in Water Markets: Final report](#) April 2009

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organisation would be subject to. It may also struggle to secure the resources or make the changes needed to achieve its objectives within a larger organisation, especially when its aims are in conflict.

Cave also found that new entrants may also face, or perceive they face, price or non-price discrimination if the incumbent's retailer could be treated preferentially. This could lead to a poorer outcome for customers, particularly where there is a dominant supplier. Where a company has a strong incentive to sell water, rather than water services, the environment may also suffer.⁹

2.2 Response to Professor Cave

The Labour Government's initial response to the Cave Review said it would consult on the recommendations.¹⁰ Defra conducted a detailed consultation on the proposed changes and published the responses in August 2011.¹¹

Ofwat then re-assessed the case for retail competition and published its assessment in December 2011. Its assessment set out evidence on the costs and benefits of retail competition which largely supported the Cave analysis.¹²

⁹ Professor Martin Cave *Independent Review of Competition and Innovation in Water Markets: Final report* April 2009

¹⁰ HM Treasury *Budget 2009* Chapter 4, box 4.5 on page 78

¹¹ Defra *A summary of responses to the consultation on the Cave Review of competition and innovation in water markets*, August 2011

¹² Ofwat *Ofwat's review of the evidence base for retail competition and separation* December 2011

3. Implementation of market reforms

The Coalition Government published its proposals for market reform in its White Paper, [Water for Life](#) (December 2011) and implemented some of the White Paper's proposals in the [Water Act 2014](#).

3.1 White Paper: *Water for Life*

The proposed market reforms were part of a wider review of the water industry; these other elements were set out in the December 2011 White Paper [Water for Life](#).

The White Paper had followed two wide-ranging independent reviews of challenges facing the sector which had been commissioned by the previous Government.¹³ The White Paper set out the Coalition Government's intended policy direction for the water sector in the light of these reviews and detailed proposals for the implementation of most of the recommendations of the Cave review.

However, the Coalition Government rejected Professor Cave's recommendation relating to the legal separation of those parts of the water companies selling services to non-household customers from those selling to domestic households of water companies due to the risk that such a change would upset investor confidence. It said that its reforms would take an 'evolutionary approach' in order to reduce the risks of change to the sector.¹⁴

The Environment, Food and Rural Affairs Select Committee (EFRA) examined this recommendation as part of its pre-legislative scrutiny of the draft Water Bill and concluded that "in the absence of legal separation, every effort must be made to reassure new entrants that they will compete on a level playing field." It recommended the functional separation of incumbent companies' wholesale and retail arms and further recommended that the principle of non-discrimination be included in the Bill.¹⁵

The White Paper proposed a package of reforms aimed at increasing competition in the sector, including the introduction of market codes and charging schemes to encourage new entrants to the sector. A major aspect of the White Paper was its recommendations to reform the water market by allowing all non-household customers to choose their water supplier.

¹³ Anna Walker's [Review of Charging for Household Water and Sewerage Services](#) Professor Martin Cave's [Review of Competition and Innovation in Water Markets](#).

¹⁴ Defra [Water for Life](#), Cm 8230. December 2011

¹⁵ Environment, Food and Rural Affairs Committee [Draft Water Bill](#) Sixth Report Session 2012–13, HC 674, 1 February 2013, Para 20

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The White Paper also set out how Government intended to approach the challenges posed by increased water scarcity. Areas covered included:

- reform of the water abstraction regime, including the creation of a more open market for the buying and selling of abstraction licences;
- development of infrastructure such as greater interconnection between water sources and users where there is greater scarcity with bulk transfer of water; and
- improving water efficiency by reducing usage and leakage.

3.2 The Water Act 2014

The [Water Act 2014](#) established a new legislative framework in England and Wales as regards competition in the water industry that will reform the market to:

- enable all business, charity and public sector customers in England to switch their water and sewerage supplier;
- establish a cross-border arrangement with Scotland;
- enable businesses to provide new sources of water or sewerage treatment services;
- develop a national water supply network by making it easier for water companies to buy and sell water from each other;
- enable owners of small-scale water storage to sell excess water into the public supply; and
- enable new water or sewerage companies as well as developers to connect new building developments to the water mains and sewerage system.¹⁶

The new provisions broadly relate to two forms of competition:

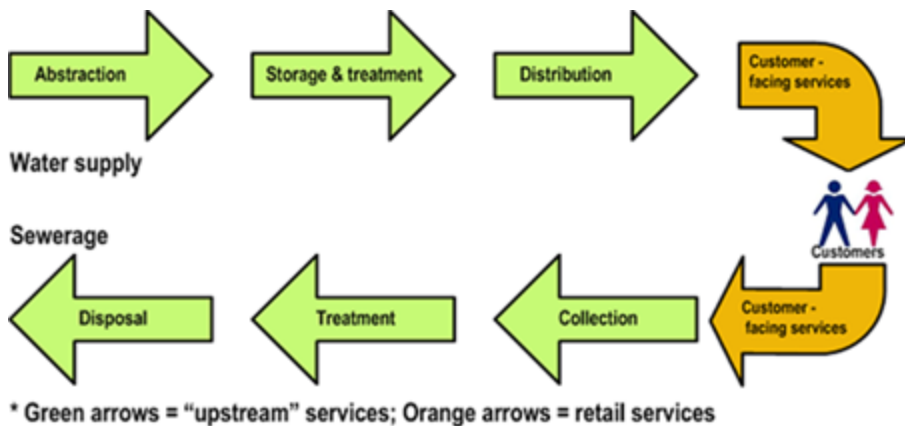
- Retail competition
- Upstream competition

The *Water Act 2014* does not provide for the legal separation of the retail and wholesale parts of a water company's business (as recommended by the Cave review) (see Section 2.2 above).

There was considerable discussion and scrutiny of this approach during the passage of the Water Bill, which is detailed in the [Library Briefing Paper on the Water Bill](#).

¹⁶ Defra, [Reform of the water market - the Water Act 2014](#)

The diagram below distinguishes between the different retail and upstream services at different points in the supply chain.



Source: Defra, Water Bill Reform of the water industry, November 2013

The Draft Water Bill was developed in conjunction with the Welsh Government and the *Water Act 2014* applies in both England and Wales. However water policy is largely a devolved issue and there are differences of approach between the UK and Welsh Governments. The Welsh Government does not agree with introducing competition into the non-household retail market in Wales.

More information on the Water Industry in Wales (including the approach to competition) is provided in the Welsh Assembly Research Service Note on the [Water Industry in Wales \(April 2015\)](#). In addition, the Welsh Government published a [Water Strategy for Wales](#) in May 2015 which sets out more detail on the approach for Wales¹⁷

3.3 Non household retail competition

What is non-household retail competition?

Essentially retail services are those services relating to customer services such as customer care, billing, selling, metering and advice. New companies with retail authorisations will be able to buy water or sewerage services from the incumbent companies, and then sell on those services to non-household customers. This could lead to bill reductions and other benefits such as enabling businesses to get a single bill for all their sites.

As explained by Defra in its [Retail Exit Fact Sheet](#), retail competition will not mean that the water that comes out of customers' taps will be any different, or that it will come through different pipes. Rather, it means that new companies (licensees) will be able to enter the market to provide all the customer-facing services that an undertaker typically

¹⁷ Welsh Assembly Government [Water Strategy for Wales](#) 21 May 2015

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provides. This includes billing customers for the provision of their water supply and the removal of their wastewater and sewage, handling their payments, reading meters and taking calls from customers about the network or other related issues. Licensees entering the market to provide retail services will have to pay the undertaker an agreed price for the water and for their use of the network.¹⁸

It could also lead to large environmental benefits from reduced water consumption. This is because retail licensees may have a greater incentive to support customers in reducing their water and sewerage consumption than the incumbent water companies, which have an inherent conflict of interest in maintaining use of their infrastructure. Retail competition should encourage incumbent water companies to improve their customer services in order to compete against new entrants, which it is hoped could have knock-on benefits for their household customers (see further Domestic water customers below).¹⁹

The Environment, Food and Rural Affairs Select Committee in its February 2013 report on the *Draft Water Bill* identified widespread support for the introduction of retail competition:

[...] it is clear that there is widespread support from customers for the introduction of retail competition. Network Rail told us that since the introduction of competition in Scotland they have seen a "significant improvement" in the service they receive and they looked forward to being able to choose their supplier in England as well. The Federation of Small Businesses said that it has been campaigning for greater competition "for some time", and Greene King and Asda were also supportive.

Water companies were also in favour of the Government's policy intention, with Water UK stating that it "fully supports giving choice to business customers... companies are committed to being an active partner in making this a reality".²⁰

Switching suppliers

Section 3 of the [Water Act 2014](#) provides for the removal of the 5 megalitres threshold requirement above which non-household customers can switch suppliers, making all non-household customers in England eligible to switch supplier regardless of consumption level. The provisions apply only to non-household customers as there were originally no plans to extend competition to household customers (see Domestic water customers below for recent developments).²¹

¹⁸ Defra [Water industry](#) and [Retail Exit fact sheet](#) December 2014

¹⁹ HC Library, Research Paper 13/67 [Water Bill](#), 21 November 2013, section 2.4

²⁰ Environment, Food and Rural Affairs Committee [Draft Water Bill](#) Sixth Report Session 2012–13, HC 674, 1 February 2013

²¹ [Water for Life](#), p70

The following table summarises the expected progress of non-household retail competition in Great Britain.

Opening up water competition - non-household customers

Date	Country	Business	Consumption limit	No. of customers
2005	England & Wales	Water only	50 megalitres	2,200
2008	Scotland	Water and wastewater	No threshold	130,000
2011	England	Water only	5 megalitres	27,000
2017	England	Water and wastewater	No threshold	>1,000,000

Source: Ofwat

Note: The Welsh Assembly Government has reserved the power to introduce full competition

New entrants

As well as increasing the number of customers able to switch suppliers, the Act also contains provisions intended to remove or simplify the legislative and regulatory barriers which previously made it difficult for new entrant companies to compete with incumbent water companies.

These changes include:

- Introducing separate retail and wholesale authorisations for new entrants;
- Replacing the “costs principle” used to determine the price that water companies can charge new entrants for access to water and sewerage with a transparent wholesale access pricing regime based on rules issued by Ofwat;
- Extending the current water supply licensing regime to sewerage services, allowing companies to tender for water and sewerage services at the same time; and
- Establishing statutory market codes and standard terms and conditions to increase transparency and make customer switching simpler.

Exiting the retail market

A natural consequence of competition is that whilst some companies will thrive, others will be less successful. Those incumbent companies with less efficient retail arms may decide that they would be better served by exiting the retail market and focusing on their wholesale operations.

Since 1991, all water industry legislation has been premised on the idea of vertically integrated companies that are required to provide bundled wholesale and retail services to all premises in their areas of appointment.

In a change to that approach, the [Water Act 2014](#) contains powers to make regulations that will allow undertakers to apply to the Secretary of State to exit the non-household part of the retail market. It is therefore

envisaged, from April 2017, undertakers that choose to exit will be able to transfer their non-household customers to one or more licensees for the provision of retail services. This will require the removal from the exiting undertakers of the legal powers and duties relating to the provision of these services to non-household customers. Once these powers and duties have been removed, the undertaker will no longer be able to provide retail services to non-household customers in their area of appointment.²² The undertaker will still be responsible for the provision of wholesale services to both household and non-household customers and for the provision of retail services to household customers.

Allowing retail exits will enable a greater diversity of licensees to enter the retail market. For example, some licensees will seek to specialise in serving specific classes customers while others will wish to maximise economies of scale by serving a larger customer base. It follows that the Secretary of State will need to be assured that an acquiring licensee has sufficient capacity and capability to serve the customers of the exiting undertaker before granting an exit application. Ofwat's licensing regime is expected to provide this assurance.

Exit will require the removal of certain powers and duties from the undertaker and some of these roles and responsibilities will need to be adopted by the acquiring licensee. Examples of such roles and responsibilities include engagement with regimes designed to ensure that all customers are always able to secure a retail service. The new entrant will therefore need to adopt:

- the "supplier of first resort" regime (covering new non-household customers emerging in an area of appointment where the undertaker has exited the non-household market); and
- the "supplier of last resort" regime (covering customers in the event that their licensee becomes insolvent).²³

3.4 Delivering the new non-household retail market

It is expected that the new retail water market for businesses, charities and public-sector organisation will be opened in April 2017. Detailed information on workstreams, progress and latest news can be found on Ofwat's webpages on the [Retail market for business customers](#).

Open Water Programme

The Coalition Government established the [Open Water Programme](#) to design and deliver the new retail market. It is led by Defra, Ofwat and the new market operator (Market Operator Services Limited), and draws

²² Department for Environment, Food and Rural Affairs [Retail Exit fact sheet](#) December 2014

²³ *Ibid*

on the expertise of existing market participants, new entrants and customer groups.

The Open Water Programme is co-ordinating the development of the framework, systems and key documents (market codes, processes and agreements) that are necessary for an effective market. In 2014, a number of high level workshops were held to explore the impacts for companies of the new market, including: ensuring a level playing field; demonstrating an arm's length relationship between the wholesale and retail business activities; and how companies will make a profit. More information, including useful summary documents and slides, is available on the [Open Water website](#).

A detailed timetable for opening the new market is set out in the [Integrated Retail Market Opening Plan](#); and the high level design and underlying principles for the new market is set out in the [Market Architecture Plan](#). These documents should be consulted for more detailed information.

To find out if business customers will be eligible to switch, please see the [Open Water eligibility guide](#).

New Market Operator

A new market operator (Market Operator System Limited (MOSL)) was set up by Anglian Water, Northumbrian Water and United Utilities in October 2014 as a partner to work with Defra, Ofwat and the market participants. MOSL is a private company, limited by guarantee.

MOSL is responsible for developing and delivering the core systems and processes that will enable customers to switch between suppliers, including:

- delivering the core IT systems that will enable registration, customer switching and settlement between wholesalers and retailers; and
- supporting its water company members on a range of market transition and business readiness activities.

More information is provided on the [MOSL website](#) and in its [Business Plan](#) (2015/16).

New entrants

The process for new entrants to apply to Ofwat for a water supply and/or sewerage licence (WSSL) opened in April 2016 in preparation for the retail market opening in April 2017.

By September 2016, it was reported that 16 organisations had applied for Ofwat licences and Ofwat expected around 30-40 applications for

WSSs over the course of the year.²⁴ In November 2016, Ofwat listed 15 holders of WSSs. A full list of current WSS holders is available on Ofwat's webpage on [Becoming a water supply and sewerage licensee](#).

The reforms include the introduction of statutory codes by Ofwat that will regulate the agreements between the incumbent water companies and the new entrants to the market (i.e. the new retail licensees).

Defra opened a [consultation](#) seeking views on the appeal mechanism that will allow both parties to challenge Ofwat's decisions to revise the codes that will regulate the market. The consultation closes on 13 December 2016.²⁵

Retail Exits

Defra completed a [consultation](#) on non-household retail exit reforms in February 2015 and the necessary draft regulations to permit retail exit were published for [consultation](#) in 2015. These Water and Sewerage Undertakers (Exit from Non-Household Retail Market) Regulations 2016 came into force on 3 October 2016 so as to allow for the submission of exit applications from that date in order to allow retail exits to take place from the retail market opening in 2017.²⁶

The following companies have confirmed they will exit the non-household retail market:

- **Portsmouth Water** has partnered with Castle Water since 1 April 2016 to provide its retail services to non-household customers on its behalf; and Portsmouth Water will transfer this business to Castle Water in April 2017 when it exits the business customer retail market.²⁷
- **Thames Water** announced that it will exit the non-household retail market when it opens and will transfer all of its business customers to Scottish retailer Castle Water.²⁸
- **Southern Water** applied to exit the non-household retail market in October 2016 and will transfer all of its non-household customers to Business Stream by 3 April 2017.²⁹

²⁴ Institute of Civil Engineers, [What the new retail market will mean for the water sector](#), 14 September 2016 [accessed 18 November 2016]

²⁵ Defra, [Consultation on code appeals for the water supply and sewerage licensing regime](#), 15 November 2016

²⁶ Defra consultation, [Retail exit reform: draft regulations](#), July 2015

²⁷ Portsmouth Water Press Release, [Portsmouth Water announces partnership with castle water to provide retail services to business customers](#), [accessed 18 November 2016]

²⁸ Utility Week, [Thames Water to exit business retail market](#), 18 July 2016 [accessed 18 November 2016]

²⁹ Southern Water news, [Southern Water retail exit application](#), 26 October 2016 [accessed 18 November 2016]

United Utilities and Severn Trent have received approval from the Competition and Markets Authority to merge their business water supply arms into a new joint venture known as Water Plus in preparation for the market opening up in April 2017.³⁰

3.5 Upstream competition

Upstream services are activities such as the storage and treatment of raw or treated water and the disposal of sewage or waste water. Currently all upstream services are under the sole control of the incumbent water company.

Alongside opening up the retail market to increased retail competition, the [Water Act 2014](#) intends to encourage upstream competition by opening up this part of the chain to new entrants. The ultimate aim of increasing this type of competition is to make the total cost of services cheaper. Defra has estimated that it will generate about £1.75bn of savings over 30 years.³¹

The current Water Supply Licensing regime does not permit current licence holders to provide solely upstream services but requires them to provide a retail service as well. This may discourage new entrants who could provide competitive upstream services but do not wish to deliver retail services.

Once implemented, relevant provisions in the [Water Act 2014](#) will “unbundle” these licences so that new entrants can sell either raw or treated water into an incumbent’s network, or remove and treat waste water from a network, without having to also provide retail services. The reforms will therefore allow companies to choose which services in the overall supply chain they wish to provide. This is much more in line with other markets e.g. the electricity market – which has generators, transmission companies, distribution companies and retailers all acting independently in an open competition.

New entrants will also be able to access water companies’ treatment and storage systems (rather than just their mains and pipes) and to hold a new network licence which will allow them to own and operate their own infrastructure which they can connect to an incumbent’s network.

New companies with wholesale authorisations will be able to provide a range of upstream services such as providing new infrastructure, or the selling on of surplus water to the incumbent water companies. For example, a farmer with surplus abstraction rights may be able to supply

³⁰ Telegraph, [Severn Trent and United Utilities win approval for joint venture](#), 3 May 2016 [accessed 18 November 2016]

³¹ Defra [Water Bill Reform of the water industry: Upstream Competition](#), November 2013

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untreated water directly into a reservoir, providing they obtained the appropriate water supply licence.³²

The Coalition Government suggested that it would not implement changes until around 2019, once work was completed on wider abstraction (removal of water from water sources) reform.³³

³² HC Library, Research Paper 13/67 [Water Bill](#), 21 November 2013, section 2.4

³³ Defra [Abstraction reform](#). Note the Government published its [response](#) on its 2013/14 consultation on reforming the Water Abstraction Management System in January 2016.

4. Domestic water customers

4.1 Introducing domestic retail competition

Originally, when the Water Bill was being debated and discussed, the Government did not intend to extend retail competition to domestic customers. Defra gave an explanation of this approach in one of its briefings as follows:

The Government does not intend to extend retail competition to householders at this stage. There is no evidence to suggest it would provide enough direct benefits for householders, given the low margins involved in water pricing. The circumstances in which business customers are most likely to benefit from retail competition are not relevant to householders (unlike multi-site business customers, for example, who would benefit from one national bill).³⁴

However, the Government announced in November 2015 that it intends to begin a transition to extending retail competition to domestic customers before the end of this Parliament.³⁵ This forms part of HM Treasury's wider plan to look for new ways to promote open and competitive markets set out in its Report [*A better deal: boosting competition to bring down bills for families and firms*](#).

This means that while domestic water customers will not have the opportunity to switch their water supplier as early as the non-household sector in 2017, the Government does intend to extend retail competition to domestic customers in due course.

More information and resources are available on Ofwat's webpage on [*Extending retail competition to residential customers*](#).

For more detailed information on Government action on water affordability for domestic customers, please see Section 5 of the [*Library Briefing Paper on Water bills: affordability and support for household customers*](#).

Ofwat assessment

The Government asked Ofwat to provide an assessment of costs and benefits of extending competition to household customers. Its interim findings were published in July 2016 and the final report on [*Costs and benefits of introducing competition to residential customers in England*](#) was published in September 2016.

Ofwat's headline findings included:

³⁴ [*Defra, Water Bill Reform of the water industry: retail competition, November 2013*](#)

³⁵ HM Treasury [*A better deal: boosting competition to bring down bills for families and firms*](#) November 2015 Cm 9164

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- The financial benefits of opening the market should exceed the costs —there are potential benefits worth around £2.9 billion over a 30 year period;
- Competition could promote innovation and choice to make life easier, for example multi-service bundles (such as dual utility offers); water efficiency services and leak detection;
- Reductions in customer bills could be limited, especially in the short term;
- Bad debt could be cut as retailers improve debt management and reduce the number of unidentified customers who use services but are not billed;
- There will be some significant set-up and ongoing costs which companies and customers will have to meet;
- It would be a competitive market not an unregulated market.³⁶

For detailed resources and further information, please see Ofwat's webpage on [Residential retail assessment and key findings](#).

The Ofwat review did not consider the potential for competition in the household retail market in Wales. Ofwat recognised that, should the UK Government decide to progress competition in the household market in England, Ofwat would need to work with the Welsh Government and stakeholders in Wales to consider the implications for Wales and ensure that the regime continues to protect the interests of Welsh customers.³⁷

Reactions to the announcement

There have been a range of reactions to the Government's announcement extending retail water competition to domestic customers.

At an Ofwat event in December 2015, Anglian Water Group's Chief Executive said:

Clearly, we need to work together to understand the costs and benefits. I know Ofwat has got an awful lot of work to do in that area, and we want to play our part. As a sector, you know, we want to be very mindful of the impact this has on vulnerable customers, the low income households, and about bad debt risks for customers. We have to have a particular focus on them.³⁸

Utility Week reported comments from industry:

On the face of it, the industry seems tentatively positive about the announcement. Some water firms have come forward to express their support for further competition in the market, saying they

³⁶ See Ofwat webpage on [Residential retail assessment and key findings](#) [accessed 18 November 2016]

³⁷ HM Treasury [A better deal: boosting competition to bring down bills for families and firms](#) November 2015 Cm 9164

³⁸ Ofwat [City briefing Water2020: Regulatory framework for wholesale markets and PR19](#) December 2015, p27

will “actively engage in reform of the sector” and work alongside the government and Ofwat to ensure the “best possible deal for our customers”. Ofwat, too, has welcomed the decision.³⁹

and from the legal sector:

Pinsent Masons environment lawyer [...] calls the announcement a “positive step” and “encouraging” for customers and the water industry with the potential of increasing engagement with customers, lowering water prices, and increasing the resilience and efficiency of water services.

However, the “devil is in the detail”, she adds, and this is “yet to be made clear”. “The development of tailored and robust secondary legislation is crucial,” she tells Utility Week. “In the meantime, Ofwat will continue to closely regulate the water companies and ensure their efficiency and water charges are closely controlled through the regular five-yearly price control reviews.”⁴⁰

Utility Week went on to say that, speaking privately, the companies were more willing to express concern:

Certainly, the timing of the announcement came as a surprise, and there was no industry consultation. Whether supportive of competition or not, companies are anxious that the many implications of market opening are worked through thoroughly, rather than rushed to fit a tight timescale.

They are also keen that the lessons of non-household market opening are learned – it’s been far from a smooth process, and there are ongoing questions about whether it will be ready on time. Whatever the companies’ stance, the announcement throws up a huge range of issues that must be addressed before the domestic retail market could be opened, such as the cost of market opening and the need to protect consumers.

The opening up of the non-household retail market means the sector wouldn’t have to start from scratch. However, many of the challenges presented would be larger because of the sheer size of the customer base.⁴¹

The Consumer Council for Water (the independent consumer body) explored the views of a sample of domestic customers in England and in May 2016 found that:

- two-thirds of households would like the freedom to shop around for a different retail supplier to handle their water bills, meter reading, complaints and enquiries;

³⁹ Utility Week [Domestic water competition in full flow](#) 1 December 2015 [accessed 1 March 2016]

⁴⁰ Utility Week [Domestic water competition in full flow](#) 1 December 2015 [accessed 1 March 2016]

⁴¹ Utility Week [Domestic water competition in full flow](#) 1 December 2015 [accessed 1 March 2016]

- one third of customers said they were likely to consider switching when they were informed that actual savings could be as little as £4 to £8 on the average annual water and sewerage bill.⁴²

4.2 Current situation

In the meantime, and in the absence of competition in the retail water market for domestic customers, Ofwat will continue to closely regulate the water companies and ensure their efficiency and that water charges are closely controlled through the regular 5 yearly price control reviews which set price limits that the incumbent water companies can charge in the next 5 year period.⁴³

The measures introduced by the *Water Act 2014* are complemented by changes to the price control process introduced by Ofwat in the latest price control review (PR14) for English and Welsh water companies. As part of this review Ofwat introduced a strict separation of the wholesale and retail parts of the business and the household and non-household parts. This is designed to ensure there is no cross subsidy between the various parts of the business.

Non-household retail competition should encourage incumbent water companies to improve their customer services in order to compete against new entrants, which it is hoped could have knock-on benefits for their household customers.

Upstream competition is expected to deliver about £1.75 billion of savings over 30 years and, in a similar way to the wholesale competition in the electricity market, this type of competition is expected to make the total cost of services to all consumers cheaper.

For more information on the regulation of water companies please see the [Library Briefing Paper on Water Bills – affordability and support for household customers](#).

⁴² Consumer Council for Water, [Household support for water competition hinges on bill savings](#), 20 May 2016 [accessed 18 November 2016] See also [CCWater Household Competition Report](#), 18 May 2016

⁴³ Ofwat [Price Reviews](#)

5. Lessons from Scotland

Retail competition was introduced for non-household customers in Scotland in 2008, where it has already delivered reductions in water bills.

The Scottish regulator, the Water Industry Commission for Scotland (WICS) estimated that competition in the retail market there would deliver £138 million in net savings to Scottish customers over thirty years (based on 2009-10 prices).⁴⁴ It also identified key non-monetised benefits from the change such as water efficiency improvements. WICS calculated that the benefit of a similar retail market in England “could be as high as £768 million”, with a payback period of “around seven years”.⁴⁵

During its inquiry into the Water White Paper, the EFRA Committee took evidence from WICS on what lessons could be learnt from the introduction of competition in Scotland. WICS drew attention to various lessons that they had learned from implementing the Scottish retail market, commenting that the following aspects of the reforms had been particularly complex and time-consuming:

- development of competitive retail tariffs, reflecting appropriate retail cost drivers and scope for savings;
- design of wholesale charges, taking into account the definition of wholesale activities and the results of the next price review and the appropriate retail margin for each customer class;
- ensuring that data accuracy issues were ironed out before market opening; and
- agreement of registration and settlement processes and transparent governance rules to enable efficient market entry, exit and alteration of market codes.

In its report, the EFRA Committee recommended that “The experience of introducing a competitive water market in Scotland and the lessons learned from it must be fully exploited as the White Paper’s proposals for market reform are implemented.”⁴⁶

The [Water Act 2014](#) will introduce a cross-border English-Scottish market. It provided for regulations which will allow an application for a retail water supply licence in England and Wales to also be treated as an application for water services in Scotland, and vice versa. This will facilitate cross-border supplies and make it easier for suppliers who want to operate in both markets and provide a more seamless service for customers with sites in both England and Scotland. The introduction

⁴⁴ HC Library, Research Paper 13/67 [Water Bill](#), 21 November 2013, section 5.1

⁴⁵ HC Library, Research Paper 13/67 [Water Bill](#), 21 November 2013, section 5.1

⁴⁶ Environment, Food and Rural Affairs Committee [The Water White Paper](#) Sixth Report Session 2012–13, HC 374, 20 June 2012

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of a joint English-Scottish market will require close working between the respective Governments and regulators.

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