



CEPS Task Force presentation:
The UK water sector

David Pearson
Senior Analyst, Market Reform

Monday 5 March 2012

UK water and sewerage industry



Wales

Privately owned
company
limited by guarantee

Fully customer
funded



England

Privately owned
companies

Fully customer
funded

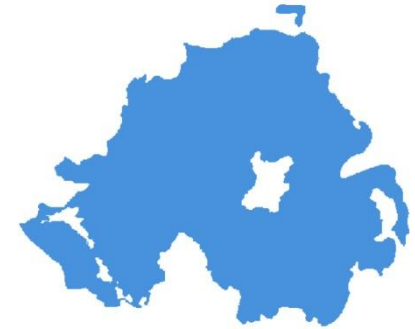


Scotland

Publically owned
wholesale company

Privately owned
retailers

Fully customer
funded



Northern Ireland

Publically owned
authority

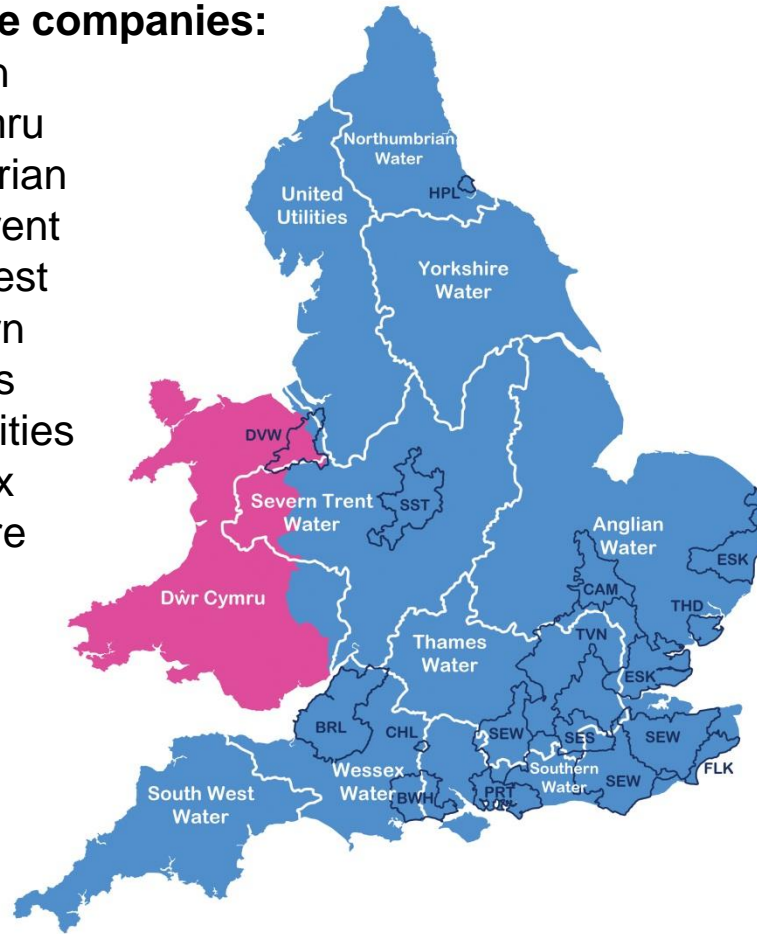
Regional
government grant
funding

Water and sewerage companies in England and Wales

Water and sewerage companies:

- Anglian
- Dŵr Cymru
- Northumbrian
- Severn Trent
- South West
- Southern
- Thames
- United Utilities
- Wessex
- Yorkshire

=10



Water only companies:

- Bristol
- Cambridge
- Cholderton & District
- Dee Valley
- Portsmouth
- Sembcorp Bournemouth
- Sutton & East Surrey
- South East Water
- South Staffs Water
- Veolia Central
- Veolia East
- Veolia South East

= 12

Who are we?



Economic regulator

Small, independent, accountable department

Concurrent competition authority (CA98 and EA02)

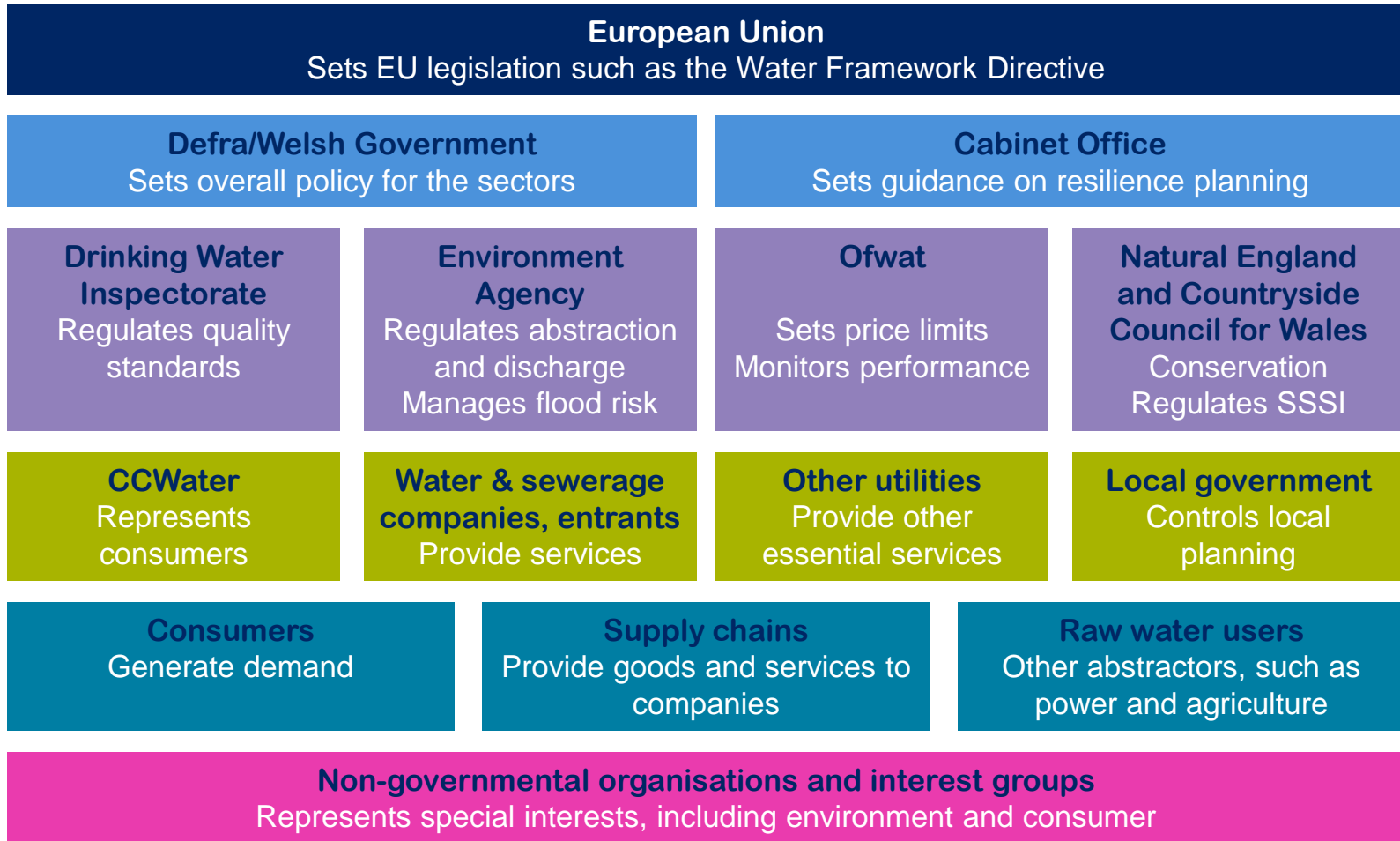
Primary duties:

- protect interests of consumers, wherever appropriate by promoting competition
- ensure that companies properly carry out functions
- ensure that companies can finance functions

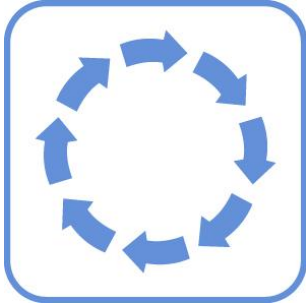
Secondary duties:

- promoting economy and efficiency
- contributing to achievement of sustainable development

Ofwat in the wider context



Why consider changes to the regulatory approach?



Current system has achieved much

Drinking water 99.95% compliance with EU standards

Leakage levels 35% below peak in mid-1990s

98.6% of bathing water meet EU standards

Bills £110 (130€) lower than otherwise

Litre of tap water costs less than half a penny

But there are challenges

Changing and more extreme climate

Rising environmental standards and need for climate adaptation

Population growth

Affordability issues

Rising consumer expectations

Why markets?



Context – uncertainty and unpredictability

Markets:

Reveal new information

Allocate scarce resources efficiently

Innovate and experiment

Responsive to customers

Flexible process suited to responding to uncertainty

Why wholesale markets?



Allocate scarce water resources most efficient way

Best use of water resources, reduce environmental risks

Increase security of supply (eg interconnections)

Innovation

Improve other regulatory reforms

Why retail markets?



Choice to all non-household customers

Benefits to customers

Help support competitiveness of economy

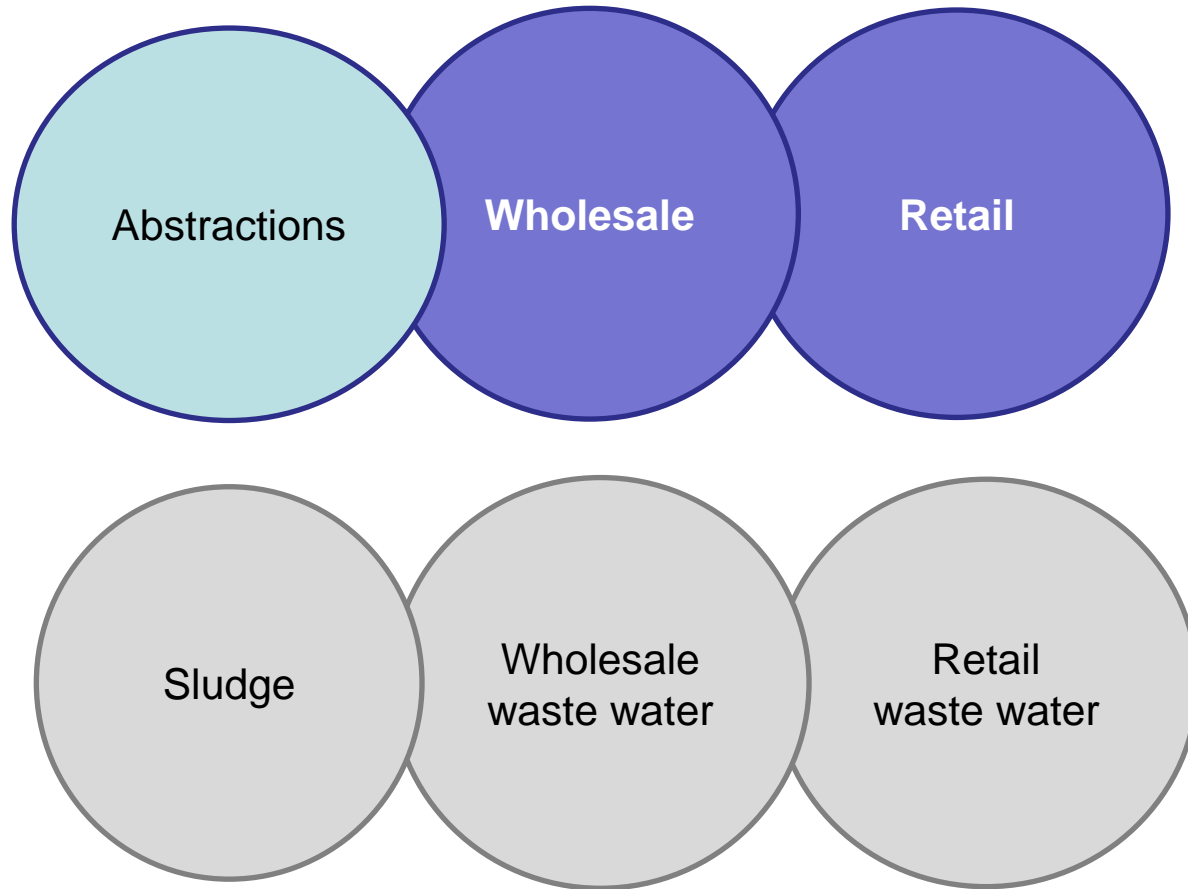
New entrants competing on equal terms

Drive cost-effective behaviour upwards through value chain

Expose costs

Market Reform Project

Objective of project – to **harness market forces**, using a **step-by-step** approach designed to **maximise net benefits**

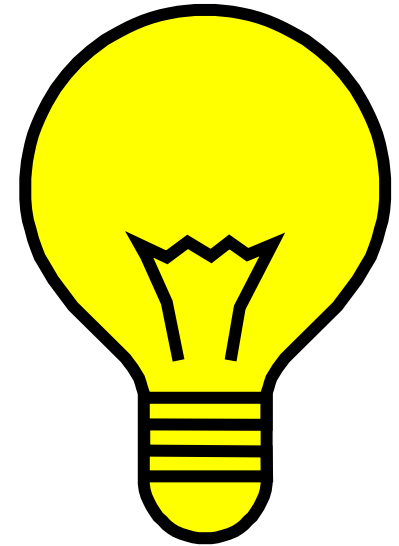


Develop a retail market for water

- Eliminate threshold for non-household customers
- Extend Water Supply Licensing (WSL) regime to sewerage
- Introduce self-supply licence
- Introduce statutory market codes

Increase upstream competition

- Create upstream resources licence by unbundling combined supply licence
- Extend access to treatment and storage facilities
- Create upstream sewerage licence



Underpinning these objectives are reforms to access pricing rules

Wholesale reforms



Water trading

AIM (Abstraction Incentive Mechanism)

Upstream licence

Network licence

→ contingent on Water White Paper

Water trading and AIM



Water trading

Where feasible, move water from plentiful to scarce areas

Incentivise more efficient investment

→ allow companies to buy and sell water from each other

Increase resilience of water supply

AIM (Abstraction Incentive Mechanism)

Incentivise water companies to reduce abstraction

Vulnerable sources

Notional scarcity charging system

Merit order of abstraction



Increase size of market (threshold drop)

Increase scope (sewerage)

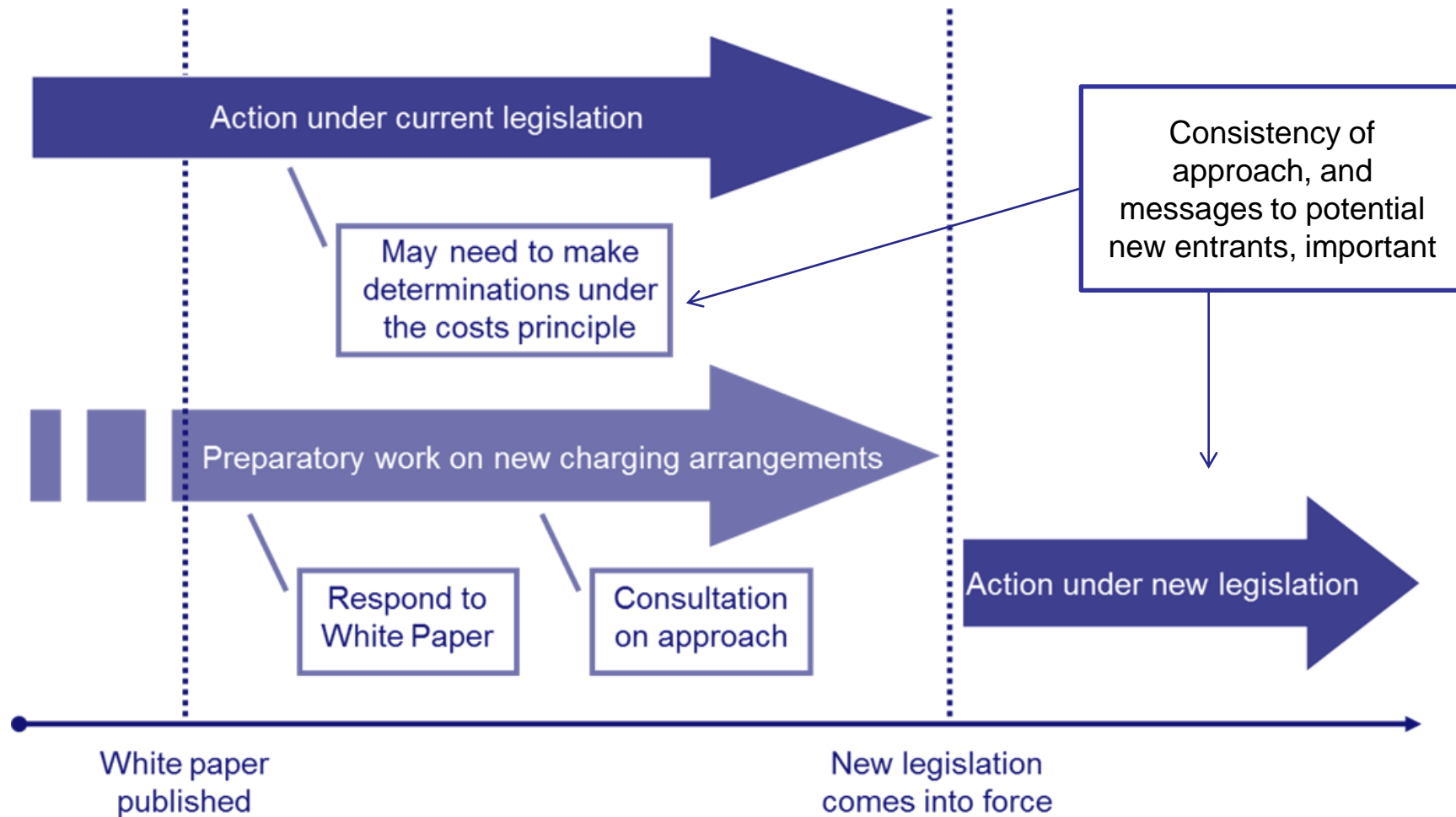
Increase area (joint market)

Increase efficiency (codes)

Increase transparency (access pricing)

Decrease obstacles to entering (trading bans)

Current and future legislation



BACKUP

Historic context of water in England and Wales

Today's challenges are different from those encountered at privatisation two decades ago

Time	Challenges	Responses
1989	<ul style="list-style-type: none">• chronic underinvestment in infrastructure• inefficiency	<ul style="list-style-type: none">• privatisation• continued vertical integration and industry consolidation (40 incumbents, now 22)• economic regulation (of monopolies)• engineered infrastructure solutions
2011+	<ul style="list-style-type: none">• climate change• population growth• consumer expectations• affordability• environmental standards	<ul style="list-style-type: none">• review of approach to regulation (Sustainable Water strategy)• investor community gearing for change• Water White Paper proposals• demand management