

Water today, water tomorrow

Defining retail services A discussion paper



Defining retail services



About this document -

This discussion paper summarises the issues we are considering in defining the services that should be offered to non-household customers by water retailers in England and Wales. In it we discuss:

- why the definition matters;
- how retail services could be defined;
- the views of our stakeholders;
- comparisons with other markets; and
- the advantages and disadvantages of potentially defining some activities as retail services.

The paper is intended to stimulate debate among all interested parties. It is particularly intended to aid a discussion at our 'What do non-household customers want?' breakfast briefing on 10 May 2012.

We will be publishing a formal consultation on the definition in summer 2012.

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1. Introduction

The water and sewerage sectors in England and Wales have made significant progress since they were privatised more than two decades ago. Services are safer, better and more secure. But together we now face major challenges that threaten the progress we have made and our long-term water security. These challenges mean that relying on the solutions of the past will not be enough to deliver the services of the future.

To play our part, in 2010 we launched our future regulation programme of work to develop fresh ideas for regulating the sectors that build on past successes. Our work, and the proposals in the UK Government's Water White Paper – which was published in December 2011 – provide a number of complementary ways in which we can begin to meet these challenges and address customers' needs.

One of the UK Government's proposals is to allow all non-household customers in England to choose their retail supplier of water and sewerage services. In Wales, only the very largest customers will have this choice. This is to achieve benefits like:

- potential efficiencies for customers with multiple sites;
- better tailored services that suit customers' needs; and
- opportunities for water companies to develop value-added services.

Providing effective choice to customers matters. Across England and Wales, most people buy the goods and services they require in competitive markets. Individual customers can choose which company they want to supply them, at a price they are willing to pay. Companies compete with each other to win and retain customers' business. In this way, companies have strong incentives to provide what customers want at the lowest possible price. For water, this means helping customers to be more water efficient or reduce their bills – which has environmental benefits. Choice also gives companies incentives to innovate – searching out

Figure 1 The main challenges we face

- Customers are (rightly) expecting better value and better services.
- Regulation has kept bills down, but they are difficult to afford for some people.
- Climate change could result in less water being available when and where we need it. Our water resources are already under pressure in some areas.
- A growing population, and changing lifestyles, are increasing our demand for water.



new products or services and new ways of providing them. Also, retail companies can put pressure on wholesale companies – on behalf of customers – to deliver more efficient resource and network management. And as well-performing companies become more efficient, they can improve returns to their investors.

The UK Government's proposal to introduce more choice for non-household water customers will require new legislation. As the economic regulator we are starting prudent preparation to implement the Government's plans, working together with our stakeholders. This includes considering the definition of retail services in an expanded market.

2. Why does the definition of retail services matter?

An important step in introducing more choice for customers – and making sure we maximise the benefits that choice delivers – is defining the type of services that retailers will provide.

It matters to customers because the definition will influence:

- the overall benefits available to them from having a choice of supplier; and
- the services they may be offered by companies competing to serve them.

The definition matters to the wholesale monopoly water companies because it will define the scope of activities that are not protected through the wholesale price control.

For retailers, the definition will determine the range of services they are able to provide. This in turn will determine the extent to which they are able to offer new and innovative services to customers – and the contribution they can make in finding the solutions to the challenges that the sectors face.

Also, having strong retailers will place additional pressure on wholesalers. This is very important

as wholesale costs are the largest part of customers' bills.

If retail services are not defined correctly there is also a risk that the market would not function effectively. Customers would lose the ability to drive improvements that would flow from them being able to choose their supplier. We want to mitigate that risk by engaging further with customers and other stakeholders.

We already know that our stakeholders have a diverse range of opinions on the definition of retail services – from our work on future price limits¹ and accounting separation². So, we have decided to seek more detailed, informal views from them on the issues ahead of us consulting formally on this area in summer 2012.

Our formal consultation, which will explain the options we are considering, will be published in summer 2012. This is after we publish 'Future price limits – our statement of principles' in May 2012.

1. <http://www.ofwat.gov.uk/future/monopolies/fpl>

2. <http://www.ofwat.gov.uk/future/monopolies/separation/>

3. How could we define retail services?

At the moment, water companies are responsible for delivering the whole range of services needed to make sure that their customers have a complete water and sewerage service. This includes:

- Securing 'upstream' supplies and carrying out water treatment;
- transporting water;
- reading meters; and
- sending customers bills for the services they use.

Put simply, we can think about 'retail' activities as those that involve a direct interaction between a company and its customers. In defining these services, we must consider whether the retail part of

the company (or the wholesale) should be responsible for providing that particular activity.

The work we have done so far, and the input we have received from our stakeholders, led us to put the proposed retail services into two groups:

- those areas where there is broad agreement among our stakeholders that an activity is a retail service ('non-contentious'); and
- those that are more contentious.

The services within both of these categories are shown in the table below.

Table 1 Non-contentious and contentious activities

Non-contentious activities

				
Billing	Payment handling	Non-network calls	Debt management	Meter reading

Contentious activities

				
Network calls	Metering	Disconnections	Demand management	Customer-side leaks

4. Activities requiring further consideration

Other utility sectors and the Scottish water market have gone through the process of deciding which activities should be carried out by retail companies. We can learn from their experiences. All of the non-contentious activities set out in table 1 are carried out by retail companies in the electricity, gas and telecoms sectors.

The most useful comparison we can make is to look at the Scottish water market, because in Scotland there is a fully-operating retail market for all non-

household customers. We can look also at the experiences of the markets for electricity and gas, as these have undergone the process of phased market opening where retailers (known as ‘suppliers’) are responsible for providing the service to customers.

Table 2 shows in simple terms whether the contentious activities are carried out by retailers in the Scottish water sector and other sectors.

Table 2 Contentious activities that are carried out by retailers in the Scottish water sector and other sectors

Activity	Scottish water sector	Electricity	Gas	Telecoms
Contacts and investigations into network issues (‘network calls’)	Yes	No	No	Yes
Meter ownership, maintenance and installation (‘metering’)	Yes ¹	In part	In part	N/A
Disconnections	Yes ¹	In part	In part	Yes
Demand management	Yes	Yes ²	Yes	N/A
Customer side leaks	Yes	N/A	No	N/A

1. Not part of retail at market opening, but added with effect from 1 April 2012. Meter ownership will remain with the wholesaler, but the retailer controls the metering process.

2. Some networks are playing an increasing role in demand management and over time it will become a shared responsibility between retailers and the networks.

Below we discuss each of the ‘contentious’ activities. For each one, we:

- define what the activity is;
- summarise the views that have been expressed by stakeholders;
- make comparisons (where possible) with other markets; and
- set out the arguments for and against potentially defining that activity as a retail service.

4.1 Network calls

Definition

A 'network call' is a contact from a customer about a network issue, such as low pressure or discoloured water. It includes communication in both directions. For example, it includes customer reports of supply interruptions ('inbound communications'). It also includes companies giving notice to customers that they plan to interrupt their supply to carry out maintenance ('outbound communications').

Views of our stakeholders

Respondents to 'Future price limits – a consultation on the framework' (our future price limits consultation), which we published in November 2011, were divided on whether network calls were a retail service. Some respondents thought that network calls should be considered a wholesale activity because they involve the resolution of a query or complaint regarding a wholesale part of the business (the network). So, costs would be incurred by the wholesale part of the business in resolving the problem.

Other respondents thought that network calls should be a retail activity because the retailer would usually handle the contact from the customer in the first instance. Ultimately, they would also be responsible for chasing up the issue and keeping the customer informed of progress in resolving their query or complaint.

Customers who attended our Business Customer Forum meeting on retail activities in 2010 expressed a preference for having a single point of contact (a 'one-stop shop') where retailers would deal with all of their water issues and liaise effectively between the customer and the network.

Relevant lessons from other markets

In the Scottish water market, network calls from - customers are handled by the retailer. Outbound -

communications are also handled by the retailer. Scottish Water (which manages the network) notifies retailers of any planned interruptions to supply and they pass on that information to their customers.



Making network calls the responsibility of retailers enables them to provide a single point of contact for their customers, and has allowed them to take up the position of the customers' champion. It also makes the retailer a more informed buyer of wholesale services. They are then well placed to represent the priorities of customers and exert pressure on the wholesaler to improve efficiency over the medium to long run. This will deliver benefits to customers (such as lower prices) and investors (higher returns).

In the electricity and gas sectors, network contacts are generally handled by the network operator, rather than the retailer. Network contacts have remained the responsibility of the network operator because it was important for networks to remain responsive to customers. There was also a risk that including network calls in retail would add transaction costs. This is because the retailer would be unlikely to add any value to calls concerning issues such as gas leaks or power cuts.

There will be some instances where a customer calls their supplier first, rather than the network. But in these cases the supplier will simply pass the call on. There has been very little change to these arrangements over the years.

Table 3 Arguments for and against defining network activity as a retail service in the water sector -

✓	Arguments for	✗	Arguments against
	<ul style="list-style-type: none"> • The retailer can act as a single point of contact for its customers. It may end up initially taking these calls whether they are about the retail or wholesale service. • The retailer has a greater incentive to resolve network calls quickly because it could lose the customer. The wholesaler does not have this incentive. 		<ul style="list-style-type: none"> • It could potentially take a long time to resolve the contact, because often the wholesaler will need to take action. • Making the retailer responsible for logging network calls could create extra data flows as it acts as the 'middleman' between customer and wholesaler. • Several potential retailers say that they do not want to be responsible for network calls as they do not have the power to control how quickly they are resolved.

4.2 Metering

Definition

There are two parts to the metering service:

- the responsibility to provide a metering service (who would co-ordinate between the customer and the meter provider and arrange installation); and
- the provision of the meter (who would install the meter and who would actually own the meter put in the ground).

Views of stakeholders

This activity prompted the most responses to our future price limits consultation on the scope of retail services.

Most monopoly companies thought that the provision of the meter should be considered a wholesale service. The main reason given by respondents for this was that defining this service as a retail activity would act as a disincentive for installing meters. This is because the main driver to install meters comes from wholesalers who use metering as a demand management tool to balance the supply and demand for water. It was also suggested that wholesale companies will have more of an incentive to upgrade meters – when they have reached the end of their life and are no longer registering accurately – compared with a retailer.

A small number of respondents from the monopoly companies thought that metering should be considered a retail service. This is so that customers have a single point of contact for all of the services they might want.



Views among new entrants – new companies that have entered the limited market for water services that already exists in England and Wales – were divided. One respondent thought that metering should be included as a retail service. The other thought that the provision of the meter should (in the early stages of the expanded market at least) remain a wholesale service.

Relevant lessons from other markets

In Scotland, metering became a retail service on 1 April 2012. The reason for the change was that the Water Industry Commission for Scotland (WICS), the economic regulator in Scotland, thought that including all customer-facing activities, such as metering, within the retail market was critical to ensuring that benefits continued to accrue to customers, licensed providers and Scottish Water. The change would allow those best placed to

understand customers’ needs– the retail companies and customers themselves – to tailor services to meet customers’ individual needs to a greater degree than ever before. As a result, customers should see better, more responsive and faster services. They will also have greater choice.

In the energy sector, the retailer is responsible for ensuring that the customer has a meter. The market for providing that meter is fully competitive. Retailers will engage a company in that market to provide the meters for their customers. Those meters will remain the property of the company that provided them.

When metering was introduced as a retail activity in the energy sector, Ofgem (the economic regulator of the UK energy market) considered that it could introduce a number of advantages such as greater choice and the promotion of innovation. There have been some difficulties in practice and metering has remained a contentious issue within the sector.

Competition to provide metering services has been made to work in the energy sector. It has resulted in a reduction in charges and some new companies entering the market, but only after regulatory intervention.

If retailers are responsible for installing new meters for customers, it would be harder to deliver a mass installation programme of new meters (such as the UK Government’s smart meter programme). This is because even a single street is likely to have customers of several different retailers on it. This reduces on the efficiency of the process because co-ordination is needed between all the parties.

The views of some industrial customers that we have spoken to are that metering competition in energy has been a “step too far”. They think the market would operate in a much simpler way if metering was the responsibility of the network operator.

Table 4 Arguments for and against defining metering as a retail service in the water sector

✓	Arguments for	✗	Arguments against
	<ul style="list-style-type: none"> • 'It may help create a market for competition in providing metering services. • 'Meters, and add-on equipment, may be a key part of the service that new retailers would want to offer their customers. • 'Retailers may have a greater incentive to reduce customers’ water demand by installing more sophisticated metering technology because they could share in the benefit. 		<ul style="list-style-type: none"> • 'Customers can switch between retailers, so retailers could have less of an incentive to install new or upgraded meters if they could not re-cover the cost. • 'Meters are part of wholesalers’ demand management tools, so the drive to install them may come more from the wholesaler who has regulatory pressure (from us) on it to meet targets for balancing the supply and demand for water.

4.3 Disconnections

Definition

Disconnections involve a company stopping a customer's supply, at the customer's request or as a result of the failure of the customer to pay money they owe to the company.

Views of stakeholders

The definition of this activity drew a small number of responses in our future price limits consultation.

One respondent suggested that disconnections should be a retail service as they formed part of revenue collection. Another thought that the activity could be divided into two parts.

- The identification of the customer that needs to be disconnected. This could be defined as a retail service.
- The physical act of disconnection could sit with wholesale companies because it concerns part of their network.

Relevant lessons from other markets

In Scotland, temporary disconnections were part of the retail market from 1 April 2012 and permanent disconnections will be part of the market from 1 April

2013. By making this change, the WICS considered that giving retailers choices for disconnections should increase competition in this area and reduce costs.



In our future price limits consultation we suggested that only disconnections could be defined as a retail activity. In Scotland, the change in definition included defining re-connection (following temporary disconnection) and new connections as retail services too. We will consider whether these are activities that should be part of retail in England and Wales too.

In the energy sector, unless the supply to a property is not needed for an extended period of time, disconnection is primarily used as a debt management tool. Debt issues are for retailers to resolve and so they control the disconnection process. They can also disconnect some customers themselves via the meter. In other cases, the network operator will carry out a physical disconnection of the supply, at the request of the retailer. The network operator cannot reconnect that customer without the retailer's approval. These arrangements have seen very little change over time.

Table 5 Arguments for and against defining disconnections activity as a retail service in the water sector

✓	Arguments for	✗	Arguments against
	<ul style="list-style-type: none"> • The retailer can keep control over the supply of water it provides to a customer. • Retailers can use the disconnection process as a debt management tool. 		<ul style="list-style-type: none"> • The wholesaler may still carry out the physical act of disconnection, as it is responsible for protecting its network. • It requires a legislative change as the law does not currently allow licensees to disconnect customers.

4.4 Demand management

Definition

‘Demand management’ usually means reducing the demand for water. This activity commonly involves providing services or products to help customers use water more efficiently.

Views of stakeholders

The opinions of monopoly water companies – those that addressed this issue in their response to our future price limits consultation – were divided. Some thought that this activity should be defined as a wholesale service because it relates to the efficient use of water, so it is more of a concern for a wholesaler. Other respondents suggested that it should be a retail service. This is because it is a service to customers that new retailers are likely to want to compete with the monopoly companies to provide.

New entrants responding to our consultation agreed that this activity should be included within retail.

Large customers have explained to us in the past that they would expect retailers to help them identify cost and consumption savings. This includes:

- gain-share opportunities (where a customer and retailer share the benefits of a water efficiency scheme);
- water efficiency advice; and
- discounts on the wholesale price.

Relevant lessons from other markets

In Scotland, there is a statutory (legal) mechanism that allows reductions in supply-side costs resulting from activities of the retailer to be reflected in individual reductions for customers in wholesale

costs. This could include retailers achieving sufficient demand-side efficiencies to make a material impact on wholesale costs and being able to seek a reduction in the wholesale price.



Demand management and water efficiency are areas where Scottish retailers have been able to differentiate the services they offer to customers. Business Stream – operating as a retailer in the Scottish market – reports that it has saved its customers £19 million by helping them to reduce their consumption.

In the energy sector, efficiency obligations were imposed on retailers. The retailers were responsible for generating those efficiencies because they had the relationship to be able to incentivise the efficient use of energy by their customers. Between 2005 and 2008, under the Energy Efficiency Commitment gas and electricity suppliers were required to achieve targets for the promotion of improvements in domestic energy efficiency. This was superseded by the Carbon Emissions Reduction Target which has the primary aim of cutting greenhouse gas emissions by 12.5% below 1990 levels by the end of 2012.

In the gas sector, the value of demand management goes to the retailer, so it is logical for this activity to sit with them. The value of the gas (the wholesale price) fluctuates and there is an economic incentive for the retailer to influence the customer’s demand. When the network operator has made the connection, it has provided capacity and that becomes a sunk cost. Subsequent operating costs of supplying gas are very low.

Table 6 Arguments for and against defining demand management as a retail service in the water sector

✓	Arguments for	✗	Arguments against
	<ul style="list-style-type: none"> • This is likely to be a key service offered by retailers to their customers and a way of differentiating the service they provide from that provided by other retailers. 		<ul style="list-style-type: none"> • The wholesaler may have a greater incentive to reduce demand if, in the long term, it could consequently reduce the amount of investment needed on new sources of water and treatment.

4.5 Customer-side leaks

Definition

This activity relates to leaks occurring on pipes that fall within the responsibility of customers to fix, rather than the company.

Views of stakeholders

Monopoly companies that commented on this activity in their response to our future price limits consultation generally viewed it as a wholesale activity. In their view the objective of reducing customer-side leaks is to reduce water loss and so improve the supply demand balance for water.

New entrants that expressed an opinion thought that this activity should be a retail service.

Relevant lessons from other markets

In Scotland, this activity was defined as a retail service because tackling customer-side leaks was seen as a central part of the service that retailers can offer. This decision has been shown to be right given the savings that customers have been able to

make. For example, Business Stream’s website carries the case study of customer that was able to save £11,000 by identifying leaks on their property.



In the electricity sector, there is no direct equivalent to a ‘leak’, but retailers are responsible for dealing with the theft of electricity because they are responsible for paying the network operator for electricity consumed. This is not a ‘leak’ in the usual sense, but is a way for the product in question to leave the network and not be paid for.

In the gas sector, the network business has a responsibility for stopping leaks on customers’ pipes because leaking gas is a public safety issue. If the repair can be completed within 30 minutes, it will do the work for free. If it would take longer, it will make the leak safe by shutting off the supply but then it becomes the customer’s responsibility to make the repair.

Table 7 Arguments for and against defining customer-side leaks as a retail service in the water sector

✓	Arguments for	✗	Arguments against
	<ul style="list-style-type: none"> • Retailers would be able to offer this as part of their value-added services to customers. 		<ul style="list-style-type: none"> • Defining this as a retail service would mean new flows of data are needed between retailers and wholesalers to report and monitor leakage on the wholesaler’s network.

5. Your views

We have not set out our preferred approach for defining retail services in this document. We are keen to hear your views either at, or after, our breakfast briefing on 10 May. In particular we would welcome your opinion in the following areas.

- **Are there any activities we have missed?**
- **Have we correctly identified all of the options?**
- **What are your views on the scope of retail services?**

If you wish to discuss these issues following our event, please contact Matthew Halden of the Market Reform Team on 0121 6447576 or email matthew.halden@ofwat.gsi.gov.uk.

We will formally consult on our proposed approach for defining retail services in summer 2012.

We will do this after we publish 'Future price limits – a statement of principles' in May 2012. This will set out our conclusions to 'Future price limits – a consultation on the framework'.

Ofwat (The Water Services Regulation Authority) is a non ministerial government department. We are responsible for making sure that the water and sewerage sectors in England and Wales provide consumers with a good quality and efficient service at a fair price.



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