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Dear sir / madam

Review of non-household retail price controls

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to this consultation. We acknowledge the effort that Ofwat has made to engage with stakeholders ahead of the 2017 water market opening.

FSB is the UK's leading business organisation. We exist to protect and promote the interests of the self-employed and all those who run their own business. FSB is non-party political, and with around 200,000 members, we are also the largest organisation representing small and medium sized businesses in the UK.

FSB believes competition in utility markets is the best way to promote customer engagement, raise consumer standards, promote innovation and additional services, and keep prices as low as possible. However, we recognise that the transition to an open water market must also ensure that certain customer groups are not unfairly impacted. In this regard, we acknowledge that Ofwat have abandoned plans for default tariffs in favour of control based on average revenue per customer for each tariff (the 'default tariff cap').

A functioning market must balance customer protection against competition and customer engagement. In the energy market, the CMA has explored the potential for setting a default tariff, a baseline that no customer can exceed. Although Ofwat have not proposed to go as far as this, a policy of setting restrictions on tariffs does raise the same question: how do we promote switching and market engagement while, at the same time, protecting the vulnerable disengaged? In the case of a price-controlled water market, this dynamic will be largely dependent on how frequently these prices are reviewed and what expectation is placed on water companies to proactively engage with customers to encourage them onto a better deal. We would

reiterate that, under a functioning market, we would expect water companies to offer deals to customers that improve upon any basic minimum captured by the default tariff cap. The default tariff cap should be the exception, rather than the norm.

It is worth noting that the CMA suggests that microbusinesses may not be properly benefitting from competition in the energy retail market. There are some similarities between energy retail and water retail markets and so this reinforces FSB view that a form of backstop protection for customers in the non-household water and wastewater retail market remains appropriate (until there is evidence that competition is sufficiently developed to protect the interests of customers).

Q2. In considering non-household retail issues, should this review allow for the reallocation of costs and margins between default tariff price caps, but with the constraint that aggregate levels of non-household retail costs and margins remain the same as in the existing controls, consistent with the expectations set out in our final determinations?

In an open and transparent market, retailers should be able to provide the most competitive package to their customers, as long as this does not unfairly impact on the more vulnerable parts of their customer base. As the market develops, we would expect to see water retailers reallocate costs and margins as they innovate and seek to offer additional and improved services to customers at the best possible price.

In principle, FSB is not concerned about how retailers choose to allocate these costs and margins, but we do believe that this process should be transparent so that customers are empowered to make an informed choice.

Q4. Do you consider it appropriate to encourage companies to increase the consistency in default tariff cap structures and consider carefully whether the diversity in the present levels of default tariff caps is properly justified?

Under the new water market, the pricing mechanism may resemble the gas market, in that infrastructure investment in any given area will add these costs on to the distribution and retail side. The number of pump stations to and from a postcode will also impact this cost base.

From this point of view we would be concerned if prices varied widely with geographical location, but recognise the need for a sensible, balanced approach. We also recognise the need to minimise cross-subsidy from other geographical areas which could result in price rises for those where costs have traditionally been lower.

Q5. What information should companies be asked to provide and publish in support of any proposals (including for no change) they make in respect of their default tariff caps?

In an open market, the costs and tariffs should be driven down by market pressure and competition. However, there are two areas where this will require close monitoring to ensure that:

- 1) vulnerable and disengaged customers are protected
- 2) any cross-subsidy is transparent

In terms of what information should be provided to inform decisions about default tariff caps, transparency around cross-subsidy will need to be particularly closely monitored. Market competition will increase the pressure on retailers to creatively manage their costs and margins. This will be particularly relevant when assessing the value of combined and additional services, like wastewater.

We acknowledge Ofwat's view that it is not always straightforward to understand how published charges map to default tariff caps, particularly in relation to wastewater services. We welcome Ofwat's commitment to publish further price comparisons across the market, including in relation to the default tariff caps for wastewater services, later in the price review.

From the customer's point of view, published information must be clear and transparent. Experience in other markets has shown that trust is a critical factor for promoting customer engagement. Therefore, customers should be provided with clear and simple information about how their bill has been calculated, including distribution costs. That said, most customers will be less interested in how their tariffs have been calculated and more interested in how the overall tariff offered by one retailer compares to their competitors.

Q6. Do you consider it appropriate to allow companies the option not to update their cost and margin attributions and allocations, and so retain their existing default tariff price caps?

In an open, functioning market, companies should be given the option of not updating their costs and margin attributions and allocations. However, this must be kept under review as the success of this policy would depend on how empowered and how motivated customers were to switch to a better deal. As with our response to Question 2, FSB is less concerned about how retailers choose to allocate these costs and margins than we are with the transparency of this process for customers.

Q7. Is a three-year duration appropriate for the next non-household retail price control and if not what is the most appropriate duration and why?

A three-year period for non-household retail price control is reasonable as the market opens to competition. However, as the market matures, a five-year period may be more sustainable.

Q8. Do you agree with the proposed timetable for this review, with a statement of method in April 2016, draft determinations in September 2016 and final determinations in December 2016?

Given the market is due to open in April 2017, we do not foresee much room for manoeuvre in terms of the timescales proposed above.

I hope this helps to adequately clarify FSB's position. If you would like any further information or input from FSB, please do contact our policy advisor, Andy Poole at andrew.poole@fsb.org.uk.

Yours sincerely,



Allen Creedy
Chairman of FSB Environment and Water Policy Unit
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