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Dear Iain,

Re: Review of retail household markets in the water and wastewater sector: Call for evidence

We welcome the opportunity to comment on the call for evidence for assessing the costs and benefits of the introduction of household retail competition. As stated previously, we continue to support progressive reform and the introduction of competition where there is clear positive long-term benefit to customers.

As stated in our response to the draft terms of reference, the evidence base that Ofwat uses to inform the potential for household retail competition must transparently and sequentially capture both the actual changes embedded in the sector post-Cave (e.g. the PR14 review and 2017 non-household retail market opening) and those currently being explored through the Water 2020 in-flight work.

We would also re-emphasise the need to ensure that the full suite of costs, benefits and risks linked to household competition are captured. On this basis, we are pleased to see that Ofwat has committed to publishing all the information and evidence received as part of this call for evidence.

We are committed to providing timely input into Ofwat's assessment. Reflecting on the successes of the 'market place for ideas', which captured the sector's contribution to the recent Water 2020 consultation, we consider that a similar approach for seeking contributions to the analysis for household retail has merit.

On this basis, we have been engaging with the sector through the Water UK Board and advocated that companies contribute to a 'market place for ideas'

approach to developing further analysis on a number of critical areas. Many of these topics are referenced in the call for evidence.

The following have been agreed as proposed areas for investigation:

Distributional Impacts	Costs of implementation
Role of metering in HH retail	Implications for ban on disconnection
Customer appetite for reform	Lessons from other markets (e.g. energy)
Credit rating / counter party risk impact	Impact on Wholesale customer contact

Specific Anglian contributions – Distributional impacts and vulnerable customers

As we said in our response to the draft terms of reference, the distributional effects on customers, especially vulnerable customers' needs greater prominence in the scope of Ofwat's analysis.

As you know, we are committed to protecting the interests of vulnerable customers. Working with Water UK, we will shortly be commissioning a piece of work, working with a number of other companies, to consider the distributional impacts of introducing household competition. This will consider the likely unwinding of current cross subsidies and the impact on vulnerable customers in particular. The outline scope of this project, which is timetabled to deliver by 24 March 2016, is appended to this letter and I hope this is helpful.

Costs of implementation

On behalf of Water UK, we have drafted a template for companies to capture the costs of implementing non-household retail competition. Water UK are collating the results of this exercise and we expect this to be completed by the end of February.

Customer appetite for reform

We are working with CC Water, via Water UK, on a survey of customers' attitude to retail competition. We have also committed to funding an extended sample in our region to make sure that it is representative of our customers. The final CC Water report on household views on water market reform will be published on 6 May 2016.

Lessons from other markets

We are working with the Centre for Competition Policy (CCP) at the University of East Anglia to understand consumer behaviour, specifically switching habits, from other household retail markets. This will include amongst other things, the levels of savings that are likely to be required in order to incentivise customer switching.

The output of this workstream will be a short report produced by Anglian and reviewed by CCP. We anticipate this will be available at the end of March.

In addition to our contributions, a number of other companies across the sector have committed to providing input and resource into the remaining workstreams identified above.

We remain committed to supporting this review and providing high quality and impartial evidence, data and analysis as best we can, both in an individual capacity and through industry-wide collaboration as required.

We look forward to discussing these issues with you shortly. In the meantime, if you have any queries, please contact Darren Rice (dRice@anglianwater.co.uk, 01480 323906).

Yours faithfully,

A handwritten signature in black ink that reads "Jean Spencer". The signature is written in a cursive, slightly slanted style.

Jean Spencer
Regulation Director

Appendix one – Terms of Reference – Distributional Effects

The sector is committed to suitable protection of customers in vulnerable circumstances. This piece of work therefore needs to consider the impact of HH retail competition and the potential impact of unwinding existing cross subsidies affecting different classes of customer, in particular customers in vulnerable circumstances.

Consideration of all of the issues below should be framed against both “thin” models of household retail, and “thick” models, and “narrow” or “wide” approaches as set out in Ofwat’s Terms of Reference. In general, we assume that the quantum of cross-subsidies increases the “thicker” the model chosen, and the incidence effects would also likely be greater. This piece of work should test this hypothesis and, where relevant draw on sector’s experience.

The analysis should also assess how best to segment the different customer classes across the customer base in those different models of retail competition.

Identifying and quantifying cross subsidies

- To what extent cross-subsidies exist within the current HH retail model. The analysis should consider where the most material cross subsidies exist. This should include, *inter alia*, considering the unequal distribution of costs associated with social and discounted tariffs, doubtful debt, and debt management
- How the ban on disconnection drives retail costs, and the extent to which these costs are reflected in the charges for specific customer groups or spread across customer groups through cross subsidies
- How existing cross-subsidies across the HH customer base will be impacted by different models of HH retail competition; and
- How existing cross-subsidies across the HH customer base will be impacted by different market rules on bad debt – e.g. the impact of allowing only debt-free customers to switch?
- Consideration of specific cross-subsidies such as South West Water’s Government Contribution £50 customer payment
- How other sectors have dealt with such issues, including potential mitigation measures.

Protections and constraints for customers in vulnerable circumstances

- How customers in vulnerable circumstances can continue to be protected under HH retail competition (e.g. the role of social tariffs in the market);
- Whether the existence of bad debt will prohibit customer switching;
- The role of creditworthiness, payment terms, existing WaterSure arrangements and other eligibility criteria within the potential HH retail market;
- Whether customers with a history of debt might suffer impediments to switching (particularly considering the experience of energy customers on pre-payment meters);

- Review of recent relevant publications, such as those linked to the Cave Review in 2009 (e.g. “Independent Review of Charging and Metering for Water and Sewerage Services”, 2009, Defra. Also “Cross subsidies, price structures and competition in the England and Wales water industry”, 2009, Reckon LLP)
- Assessment of impacts on cost to serve of the customers in the most vulnerable circumstances if household competition introduced

Impacts for wholesalers

- Implication for competition law compliance and pressure on wholesale averaging linked to creation of HH markets?
- Implications for wholesalers’ costs of delivering demand side solutions with household customers (e.g. the cost of delivering water efficiency schemes, SUDS programmes, education campaigns, etc.)

In addition this piece of work needs to consider the following:

- The role of metering:
 - Is a high level of meter penetration a pre-requisite to HH retail competition?
 - What are the impacts of high variance in meter penetration levels for market outcomes, both regionally and nationally?
 - Impact of metering on incentives for customer participation in the market and the net benefits of introducing HH competition
 - Likely strategies of entrants in relation to metered/unmetered customers and effects on incumbent companies
- What is the role of disconnection ban in:
 - The creation of a fully functioning HH retail market;
 - The incentives for market participants – entry or exit

The expectation is that consideration of these topics will be addressed using first principles, economic analysis and financial modelling as appropriate, and drawing on relevant experience from other sectors.

Relevant experiences from other sectors

Where the work identifies potential distributional impacts from the introduction of household retail competition, the work should identify examples from other sectors where similar issues have been considered, which may be relevant in seeking to address or mitigate any distributional impacts. In doing so, account will need to be taken of differences between sectors, such as the prohibition of withdrawal of service for non-payment in the water sector.

Outputs and timetable

The output of the project will be prepared for Water UK, on behalf of the sponsoring companies.

The outputs of this piece of work would include:

- A detailed analysis of the distributional impacts of different potential household retail market proposals;
- A final dissemination report; and
- Slide deck of the main findings.

The final report is scheduled for the week ending 25 March 2016.