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17<sup>th</sup> February 2016

Dear Ofwat,

Please find attached our response to your call for evidence on the potential for retail household competition.

Please let us know if we can be of further assistance on this.

Yours Sincerely,

Tom Kiedrowksi  
Strategy and Regulation Director

**Bristol Water plc**

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## **Ofwat Retail Household Call for Evidence - Introduction**

When the UK Government published 'A Better Deal'<sup>1</sup> last November, it was clear from its call for Ofwat to provide the costs and benefits of extending household competition to the water and wastewater sectors that the Government saw an eye-catching opportunity to improve choice for people and driving efficiencies that will positively contribute to the productivity of the economy. This is understandable given that the very foundation of effective functioning and efficient market relies on consumers being able to choose to trade with the supplier that best suits their needs at the best price. A move to providing such a choice to domestic consumers in water and wastewater would be unique in a world these services are still provided either by the public sector or through private concessions, even in countries where functioning markets are a commonplace. England is already distinct from other EU countries in having a fully privatised water industry and Scotland has pioneered non-household retail competition which will be extended fully to England in 2017.

Should Ofwat conclude and the Government accepts subsequently its recommendation that such a move is indeed desirable, the possible timetable for the introduction retail household competition is also bold (i.e. a 2020 launch before the end of this Parliament), particularly when compared to the approaches previously taken in other sectors such as energy and telecoms, where there was an initial liberalisation of business/non-household services and once those had bedded down was there a subsequent move to liberalise fully services to domestic consumers. As it stands, non-household competition is still in the throes of preparation ahead of the initial launch in April 2017.

Three decades of such privatisation, regulation and promotion of competition and consumer engagement within a range of sectors, domestically and overseas, provides us with a solid evidence base to tailor consider the costs, benefits and constraints of extending retail household competition sector. It is worth noting that independent academic research has found that even in well established markets, the ability of consumers to choose accurately between alternative suppliers is limited and that many consumers are what the Chief Executive of the CMA, Alex Chisholm, described as 'sleepy' with respect to limited switching and engagement with their service providers<sup>2</sup>.

The purpose of our initial response is to contribute to Ofwat's evidence base, pointing to lessons learnt from other sectors and drawing on the operational, day-to-day experience that Bristol Water enjoys daily with its customers. We consider these examples should be treated carefully prior to the initiation of a bold social and economic experiment that will impact on the lives of millions of consumers as well as investors and providers if implemented. Our contribution has been grouped around the themes identified in the call for evidence document.

## **Initial Observations**

We are not aware of any jurisdictions which has facilitated switching for domestic consumers in the water and wastewater sectors: for the most part market reforms have focused on abstraction and wholesale reforms, with the exception of Scotland where full non-household retail competition only

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<sup>1</sup> <https://www.gov.uk/government/publications/a-better-deal-boosting-competition-to-bring-down-bills-for-families-and-firms>

<sup>2</sup> <https://www.gov.uk/government/speeches/alex-chisholm-on-consumer-engagement-in-a-digital-world>. See also Wilson and Waddams (2007) 'Do Consumers Switch to the Best Supplier?', CCP Working Paper 07-6.

has been in force since 2008 and which is now being prepared for in England ready for launch in 2017, after limited competition previously.

We note that during the passage of the Water Bill, Defra stated that:

*“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).”<sup>3</sup>*

In relation to non-household competition the case for extending choice has generally been considered more compelling because of the frustration expressed by some non-household customers with multiple sites having to deal with a patchwork of 22 different suppliers across the country.

### **Evidence for the potential for domestic retail competition in water and wastewater**

In the original Cave proposals for reform of our sector<sup>4</sup> and in relation to the reforms implemented in Scotland household competition was not envisaged. Indeed the Cave Review for the Government made it clear that the case for extending choice to households remained weak. Nevertheless it was predicted that household customers would nevertheless benefit from the reforms, such as improved processes and efficiency that would transfer across a retail business benefiting household customers as well. Any future impact assessment reviewed by the Regulatory Policy Committee (RPC) would of course have to discount the benefits accrued by households from the introduction of non-household competition to avoid double counting.

In other cases we believe that smaller enterprise customers tend to behave like domestic customers where they are single site and low volume customers. We are not aware from the experience of Scottish non-household customers that there has been significant switching among this customer group. Similarly the experience of such customers in the energy sector is that significant numbers do not to engage in switching, and to remain on default tariff. A study by Ernst and Young (EY) found that of the half who do engage in competition in the energy sector, around 25 per cent do so actively, regularly re-tendering their supply, while the other 25 per cent did so passively, having re-tendered their supply 2-3 times since the market deregulated. EY noted that these customers were often intermediated, advised and buy through third parties such as brokers<sup>5</sup>.

The situation among domestic energy consumers is even less active: 34 per cent of respondents to a CMA-commissioned survey last year revealed that they had never considered switching energy supplier. This is in spite of the fact that energy bills constitute a far higher proportion of household expenditure than water and wastewater, on average. While in banking, 37 per cent of personal

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<sup>3</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/259662/pb14068-water-bill-retail-competition.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/259662/pb14068-water-bill-retail-competition.pdf)

<sup>4</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/69462/cave-review-final-report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69462/cave-review-final-report.pdf)

<sup>5</sup> <http://www.ey.com/UK/en/Industries/Power---Utilities/Energy-lessons-for-water---Energy-lessons>

current accounts (PCAs) customers were found to have been with their main PCA provider for more than 20 years<sup>6</sup>.

Northumbrian Water commissioned a paper by Economic Insight to review lessons learnt from competition in the UK energy market.<sup>7</sup> This paper identifies that there have been particular 'demand-side' issues in the market, leading to a lack of customer switching, largely related to the information provided to customers and lack of clarity in the variety of tariffs available.

The Centre for Competition Policy report from June 2010, *Consumer Choice in the Water Sector*, by Catherine Waddams and Kerry Clayton<sup>8</sup> explored the potential choices available to water customers in the UK. This study found that customers' current choice in water is largely limited to a decision on whether or not to be charged through a meter, and noted that in many cases where a meter has been installed that choice is no longer available. The CCP report also found that customers' estimates of their own consumption displayed a bias towards the average, and that consumer understanding of consumption, price and information displayed on bills is low. The study did not directly explore the option of retail competition for domestic customers, but looked at how that could be compensated for through collective choice, as expressed through customer research used for business plans, possibly extending to the use of negotiated settlements.

A much older paper published by Bath University, *Competition in Water Supply*, by Peter Scott, in response to the 2003 Water Bill.<sup>9</sup> It suggested that the arguments then made by Government to prohibit household competition in water could be overcome. Scott noted that whilst the market may not have been attractive to operate in, that was not a reason to prohibit it. Further, he noted that competition will not impact the Government's environmental or public health objectives, as these would continue to rest with the wholesaler.

### **The Views of Customers**

In our annual customer survey, we surveyed 300 customers from within our supply region. We asked customers to compare their satisfaction with Bristol Water with other utilities.

The results were as follows:

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<sup>6</sup> <https://www.gov.uk/government/speeches/alex-chisholm-on-consumer-engagement-in-a-digital-world>

<sup>7</sup> [https://www.nwl.co.uk/assets/documents/Competition\\_in\\_the\\_energy\\_retail\\_market\\_-\\_Economic\\_Insight\\_report.pdf](https://www.nwl.co.uk/assets/documents/Competition_in_the_energy_retail_market_-_Economic_Insight_report.pdf)

<sup>8</sup> [http://competitionpolicy.ac.uk/documents/8158338/8264719/rpt\\_com\\_1010fplchoice.pdf/5beb813f-db87-4af2-932d-a2ce8a62615e](http://competitionpolicy.ac.uk/documents/8158338/8264719/rpt_com_1010fplchoice.pdf/5beb813f-db87-4af2-932d-a2ce8a62615e)

<sup>9</sup> [http://www.bath.ac.uk/management/crri/pubpdf/Occasional\\_Papers/18\\_Scott.pdf](http://www.bath.ac.uk/management/crri/pubpdf/Occasional_Papers/18_Scott.pdf)

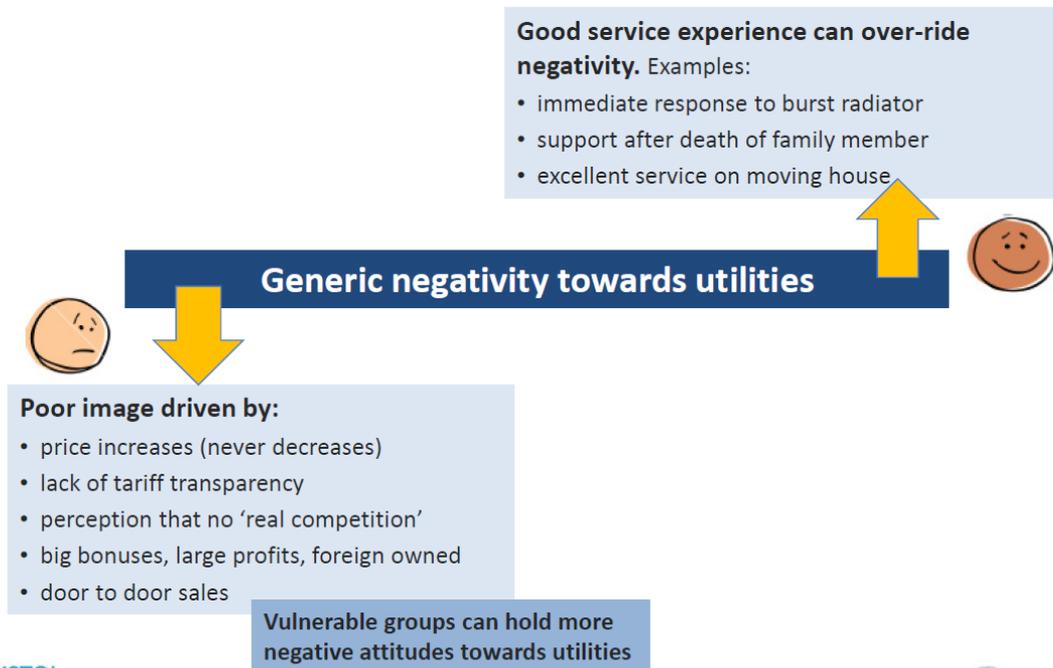
Utility provider	% 'excellent' + 'very good' + 'fairly good'							
	2014	2013	2012	2011	2010	2009	2008	2007
Bristol Water	93	93	87	93	85	84	87	88
Phone	89	89	83	85	76	79	79	86
Electricity	92	91	82	88	79	77	87	72*
Gas	82	80	70	75	73	68	68	

This suggests that the level of satisfaction has consistently been higher with Bristol Water compared to other utilities even where choice exists. To some extent this may reflect the price difference, with water services being generally cheaper than those for energy or communications. It does, however, demonstrate that customers are generally currently satisfied with the water supply service, and does not suggest a case for urgent change or reform.

#### **Analysis of Bristol Water Customer Priorities Research**

We undertook research on the priorities of our customers in May 2012, to support our PR14 business plan. Some of the findings of this research can be related to the potential for household retail competition.

Research on the general perception of utilities suggests that customers are generally negative towards them, but that this can be overcome by specific experiences of good service. The research suggested customers would prefer lower bills and greater competition in utilities.



The research explored customers' views on what makes for good customer service in utilities. Many of the areas identified relate to retail services, and so offer the potential for further innovation and improvements in service through opening of the competitive market.

## Characteristics of good customer service in utilities

<p><b>Billing &amp; Pricing</b></p> <ul style="list-style-type: none"> <li>• simple tariffs &amp; bills</li> <li>• <b>transparency</b>: easy to find cheapest tariff</li> <li>• <b>reward loyal customers</b> (not new ones)</li> <li>• value for money</li> <li>• fixed bills, no dramatic rises</li> <li>• real time billing &amp; no estimates</li> </ul>	<p><b>Customer Service</b></p> <ul style="list-style-type: none"> <li>• efficient (right 1<sup>st</sup> time)</li> <li>• responds quickly</li> <li>• service standards</li> <li>• knowledgeable, trained staff</li> <li>• advice on how to spend less</li> </ul>
<p><b>Call Centres</b></p> <ul style="list-style-type: none"> <li>• <b>English speaking, UK based call centres</b></li> <li>• local/free-phone number</li> <li>• real person (not IVR)</li> </ul>	<p><b>Metering</b></p> <ul style="list-style-type: none"> <li>• online meter reading</li> <li>• remote meter reading</li> </ul>
<p><b>To counter generic negativity...</b></p> <ul style="list-style-type: none"> <li>• lower profits, bonuses, salaries</li> <li>• no shareholders</li> </ul>	<p><b>Quality product</b></p> <ul style="list-style-type: none"> <li>• less relevant for utilities ....</li> </ul>



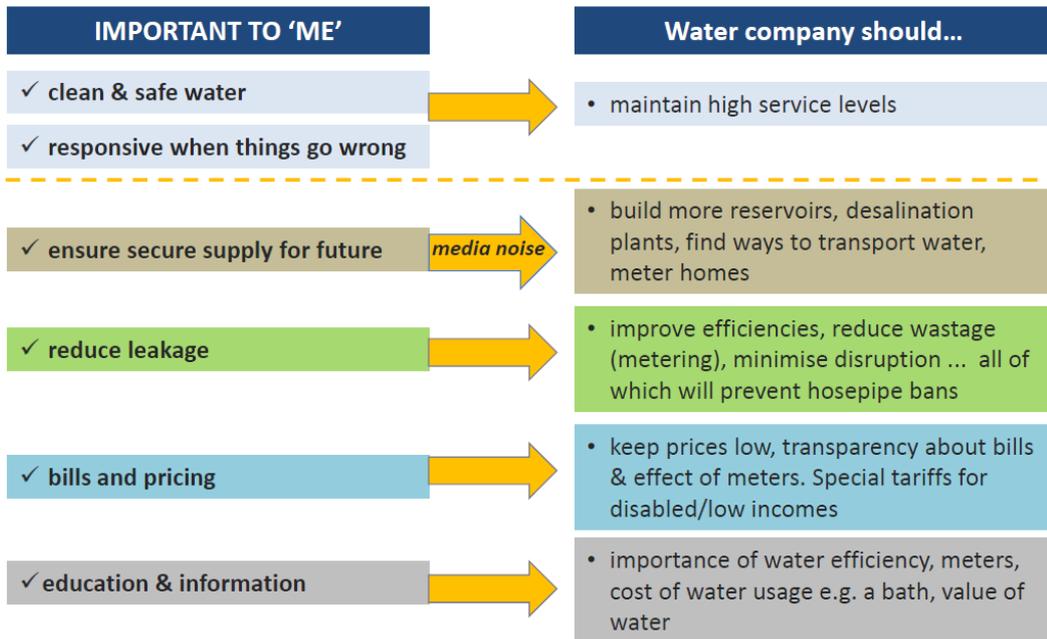
**Want to see evidence of honesty & integrity**



When thinking more specifically about water, customers are more concerned about the reliability and quality of their supplies. They also showed interest in the longer-term sustainability of water supplies, and in companies reducing leakage. These services would remain with the wholesaler (or be subject to upstream competition), which may be reassuring to customers that the services they regard as most essential would not be put at risk through competition. However, some customers may be disappointed that the potential incentives to improve service levels and reduce costs through competition would not apply to what they regard as the most important services.

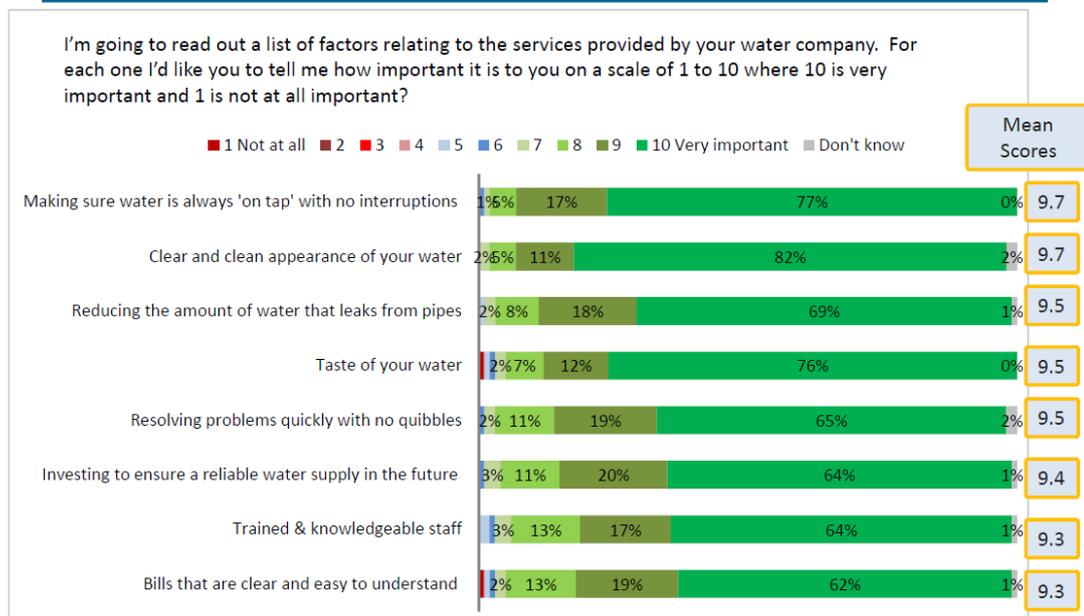
## What matters most to domestic customers? (spontaneous)

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## Customer priorities: most important

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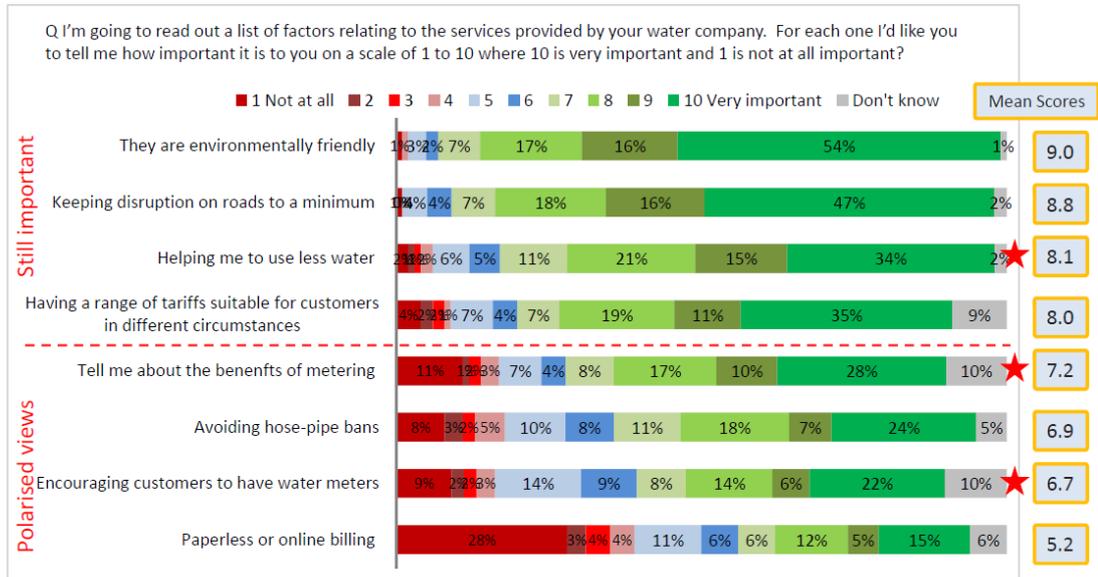


All issues considered very important by vast majority of customers



## Customer priorities: less important

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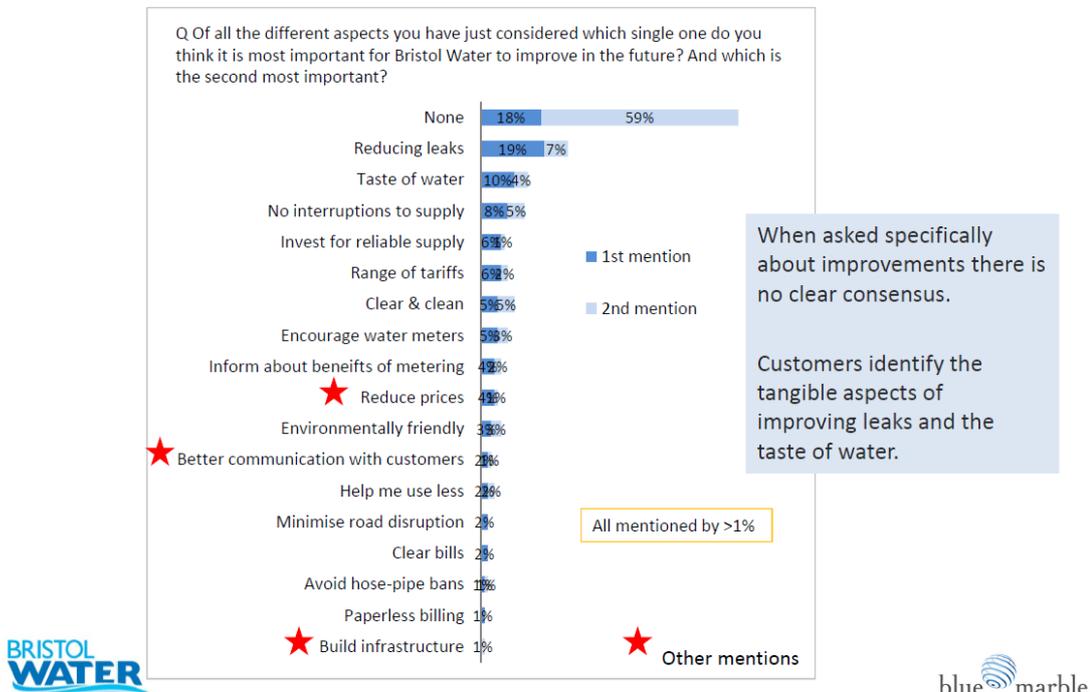


★ N.B. These issues become more important after discussion (from qualitative research)



## Customers find it difficult to identify potential improvements

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**The importance of choice to customers, including the kinds of choice that are important, and how competition can influence this.**

We would expect the most important benefit of competition to customers to be the ability to reduce bill levels. This is most likely to be achieved through customers switching retail provider to obtain lower tariffs. We are aware of evidence from the energy market, including the ongoing CMA inquiry, that customer switching levels remain lower than might be expected, and many customers prefer to stay with their current provider rather than search for the cheapest deal. We would expect a similar trend in the water retail market, perhaps even more so given that water bills are generally significantly lower than energy bills, and customers may be expected to display a more conservative tendency towards their water supply.

Further research could establish what level of bill reduction would serve as a sufficient incentive for customers to switch retail provider. This would need to outweigh the effort and perceived risk that customers may take on in choosing to switch. Given that retail allowances for households are currently c£25<sup>10</sup>, it may be the case that the level of reduction required as an incentive to switch may be greater than the entire retail allowance. This may in turn raise questions as to whether switching can be driven or incentivised through bill reductions alone.

Where bill reductions do not or cannot act as an incentive to switch provider, customers may instead seek benefits through improved service offerings. This may support a “thinner” scope of retail market definition, which would allow market participants to focus on their core service and potential improvements to customer service within it.

It should be recognised, that in many areas of their water service customers will not be able to express their choice through switching provider, in line with our customer priority research findings. For wholesale service issues these will continue to be managed by the existing undertakers. Companies have taken increased steps to incorporate customer views into their business plans and price determinations, including the role of Customer Challenge Groups introduced at PR14. These forums will continue to provide a necessary and important supplement to any competitive market, by allowing customers to influence the price and services offered by wholesalers.

***Metering***

Much of the potential benefit to customers from the introduction of competition relates to the ability to monitor consumption. This would enable retail service providers to offer innovative online tools to view consumption, potentially in combination with other utilities. This in turn could lead to opportunities to support customers in reducing their water consumption and therefore bills. However, in our region more than 50% of our customers are still unmetered, and we estimate that this proportion will reduce to around 35% by 2020. Where customers are unmetered this reduces the scope for realisation of benefits in bill reduction and water efficiency. We consider that whether for retail household competition to work there will need to be a significant extension to companies’ metering programmes in AMP7 to achieve near universal metering.

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<sup>10</sup> Bristol Water retail allowances 2015/16: measured household £25.56; unmeasured household £17.81

Smart metering would offer even greater support for consumption monitoring, with closer links between the consumption and information provided, possibly allowing for real-time monitoring, and matching usage to a daily budget, as is facilitated through energy smart meters. Again the experience of the rollout of smart meters under various Ofgem and DECC schemes has not been a happy one.

**What are the advantages and disadvantages of extending competition to retail services in the water and sewerage sector to household customers? How could this best be achieved?**

In theory, extension of competition in retail services could provide benefit customers, including:

- Lower bills, as retailers compete for market share by offering lower prices
- Improved service levels, as competition focuses on service offering – particularly if significant bill savings are not achievable
- Retailers offering services for several utility markets, allowing bundling of service and bill packages. This may lead to innovation in customer interaction and billing, particularly online.
- Retailers may also offer different service packages to suit different budgets, with potential discounted tariffs offering reduced guaranteed levels of service or compensation

However, experience of opening of competitive markets in other utilities suggests that these benefits may not be realised by all customers. Particular concerns would be:

- A wider choice of tariffs creates risk that customers may not select the tariff which is most financially beneficial to them.
- Customers have shown inertia in product switching in other industries such as banking. It might be expected that similar or greater inertia would apply to choices over such an essential service as water, and so the potential benefits of lower tariffs would only be available to those customers willing to research and switch providers to obtain the best deals
- The continuing operation of water undertakers as regional monopoly suppliers of wholesale services may create confusion for customers as to who their provider is and who to contact in the event of supply issues.

**What scenarios for retail competition could be considered in Ofwat's analysis? What are the advantages and disadvantages of each for water and wastewater services for customers, the environment, wider society and investors?**

We would suggest that if retail competition were to be extended to household customers, this should have the effect of allowing all water customers to choose their retail provider, rather than collective switching. We have observed that the process of defining eligibility for retail competition for non-household customers has required a significant amount of work and associated cost, and as such it would be more straightforward to make all customers eligible, unless there is a particular reason not to.

We would also suggest that alignment of the scope of the retail services for household customers should match that which is to be applied to the non-household market from 2017. This would avoid any complications that may arise on a legal basis from differences between the two markets, and remove scope for confusion between different service offerings in the two markets. The scope of the

non-household retail services has been carefully established and we consider it to be appropriate to the services which can be separated.

The principal benefit to the environment resulting from the introduction of competition would be through reduction in consumption. This could be achieved through retailers offering tools and incentives to customers to reduce consumption, including consumption monitoring and smart meters, and different tariffs. This potential benefit would be maximised by making the scope of the competitive market as wide as possible, to allow the greatest number of customers the opportunity to reduce consumption. The scope for environmental improvement through consumption reduction could be achieved within the definition of retail set for the non-household market, so extension of the same definition for households would be in line with this aim.

**With respect to potential competition scenarios used to support the analysis, what additional risks or opportunities should be captured in Ofwat's analysis? How should these be assessed? What would be necessary for each of the scenarios to be implemented successfully? Over what time period could implementation take place?**

### ***Timescales***

A key risk is management of timescale expectations, particularly from government and customers. The analysis should recognise how long implementation took in other sectors and the amount of work that has been required for introduction of non-household competition, and set the proposed timetable accordingly.

We would suggest that detailed work does not commence until the non-household market is open and established, and relevant lessons can be learned from it. Given the much larger number of customers involved in the household market, and the potential impact on customers of any problems, we would suggest that it is important to proceed carefully in establishment of the market.

### ***Allocation of statutory duties and responsibilities***

Water companies are currently responsible for a range of duties towards public health and the environment, as set out in company licenses. Our expectation would be that most of these responsibilities would transfer to the wholesaler, but consideration should be given to which areas retailers would have a role in supporting these. For example, obligations around water quality could be impacted by the loss of a direct communication channel between customers and the wholesaler. Retailers would need to maintain the facility to receive and pass on operational contacts 24/7. Where demand reductions form part of the water resources management plan, it should be established to what the extent the retailer(s) are expected to deliver these. We are aware that the inevitable consequence of this would be to limit the differentiation that could be offered by a downstream retailer.

### ***Support for Vulnerable Customers***

Bristol Water currently offers a range of support packages for customers with affordability problems. These include:

- WaterSure+ - a discounted tariff for customers on benefits with large families or certain medical conditions

- Assist – discounted tariffs means assessed for customers with problems paying their bills
- Restart and Restart+ - schemes to assist customers with significant debts to the company
- Pension Credit Tariff – a new tariff for 2016/17 to provide discounts to customers in receipt of pension credits

These tariffs are cross-subsidised by the rest of the customer base, and also subject to funding by the Company. When Assist was introduced it was on a “win-win” basis, with the intention that overall revenue collection would be increased through offering lower tariffs. Our analysis of payments received suggests that it has been successful in this aim. In addition, we make payments to local debt advice charities to help them to support our customers and assist them in applications for our support schemes.

A key concern for the establishment of the competitive market should be how these customers are to be supported going forwards. The separation of wholesale and retail price controls at PR14 moved the associated costs for these schemes to the retail controls. Where offering discounted tariffs results in an overall improvement in revenue collection, as seen in “win-win” tariffs, competing retailers may be incentivised to offer such schemes. However, it is unlikely that customers with affordability problems or a history of debt issues would be attractive targets for customer acquisitions by retailers. Consideration should therefore be given as to how these customers should be supported in a competitive market. This may be through mandatory requirements on retailers to offer support for vulnerable customers. It would not appear appropriate for the responsibility for support to be passed to wholesalers, as retailers would be expected to own the relationship with the customer.