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Dear Sir/Madam

Response to 'Review of retail household markets in the water and wastewater sector: call for evidence'

Thank you for providing us with an opportunity to comment on your call for evidence on the implications of extending retail competition in water in England to household customers. This submission is entirely non-confidential and may be published on your website.

Citizens Advice is open-minded on whether competition should be extended to households. We do not think that there is yet a compelling economic case to support such a fundamental change in the market, so we have focused our response on the issues we think would need to be explored to reach a balanced judgement, rather than suggesting a firm model that should be pursued.

We structure our response around the four groups of questions posed in your consultation document, and have used insights from the daily work of our local network with water consumers, and our role as the statutory watchdog in the energy and postal sectors, to inform our views.

"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?"

The introduction of competition to household customers would introduce choice where previously there was none. This could have a range of benefits for consumers. By creating competitive tension, it could strengthen incentives on water and wastewater suppliers to keep their costs down and to provide both the services, and the standards of service, that their consumers desire. Consumers would be able to reward those suppliers who provided good services and prices, and punish those who did not, by voting with their feet. This could create stronger performance incentives than the current system of regulated monopoly supply, where market share is guaranteed regardless of levels of performance.

Opening up the market could also prompt innovation, both by allowing existing players to provide new services and by allowing companies that previously had not operated in the sector to enter. This could bring valuable new thinking at a time when the water sector faces significant challenges with a combination of projected population expansion and

climate change putting significant pressure on resources. These sustainability challenges may mean that the sector needs to evolve from the provision of water supply to water services, including water efficiency and resource management.¹ This may be more possible under a competitive framework, where companies can respond relatively quickly to emerging challenges and innovations, than under a price controlled framework, where their commercial drivers may be largely agreed years in advance.

The benefits of competition could be limited if consumers do not wish to switch. This could be the case if the financial or customer service benefits of switching are not sufficient to overcome the hassle. The average annual household and wastewater bill during the PR19 price control period is expected to be around £376.² As a capital intensive industry the majority of that cost will relate to the construction and maintenance of physical network assets that would remain price controlled, and these costs are likely to remain cost pass through items for all suppliers. Only a small proportion of the total bill will relate to retail activities such as billing and customer service. While efficiencies in those areas may be possible, it is also possible that the bill savings associated with those efficiencies may not be sufficient to induce consumers to switch. For example, our experience in the energy sector suggests that the majority of consumers remain on standard tariffs even where savings of hundreds of pounds could be achieved through switching. If achievable savings in water are of a smaller magnitude - tens of pounds, or simply pounds - there may be a question mark as to whether consumers will respond to those signals. If they do not, the efficiency signals that competition can deliver in principle may not be delivered in practice.

As part of your study, we suggest that you develop and explore credible scenarios for the achievable savings that household consumers may be able to realise in a competitive market and, crucially, the likelihood that they will respond to those signals. You should draw on evidence from other markets, notably the energy market, and also the emerging evidence from behavioural science that seeks to understand consumer choices, behaviours and actions.

Water and wastewater services are currently sold to consumers as a 'plain vanilla' product, with no material differentiation between the price paid (per unit) and terms of supply of different consumers served by the same provider. If retail competition were introduced, we would expect to see increased segmentation of the market and of the terms of supply offered by suppliers. The most obvious area for this may be between the deals offered to sticky or disengaged customers ('standard deals') and those offered to those who switch ('acquisition deals'). For example, in the energy sector, the gap in the revenues suppliers derive from their standard deals and their acquisition deals is significant, with an average

¹ There are possibly some parallels here with the energy sector, where sustainability pressures around bill affordability and the need to decarbonise have resulted in energy retailers moving from a largely supply-only model to one where they also provide a range of energy services such as efficiency and demand management.

² <http://www.ofwat.gov.uk/pn-0914-water-bills-held-down/>

10-13% premium on the former.³ Vulnerable consumers are disproportionately likely to be on standard deals in that sector⁴ - with the result that some of the most vulnerable in society are paying the worst rates. If something similar were to emerge in water, it could undermine public confidence in the extent to which the sector functions in the public interest. It could also create burdens on the taxpayer and/or the billpayer if they are called on to fund schemes to reduce the effects of price discrimination on the vulnerable. We note that the Competition and Markets Authority ('CMA') has provisionally recommended the reintroduction of a form of price cap for standard energy tariffs because of concerns that consumers on these tariffs may be being overcharged, and you may wish to consider whether a similar form of price cap or maximum retail price may be appropriate for water. In the water market, a patchwork of social tariffs, which up until now have been applied on a regional basis rather than a national one, have been introduced. The existence of these tariffs could come under threat in a competitive market, but it will be important that vulnerable consumers do not suffer harm as the result of the introduction of competition - these tariffs should either be protected, or measures that provide an equivalent or greater level of support should be introduced.

So as part of your study, we suggest that you consider the extent to which segmentation may emerge in the market and the demographic characteristics of this segmentation. Would the market be likely to serve all consumers or only some? If the picture is mixed, you will need to consider ways to mitigate any negative impacts on worst served customers. This could include retaining some form of partially or fully regulated pricing for vulnerable consumers. Your study should set out how the protections currently provided by social tariffs will be protected or expanded in a competitive market.

Many households struggle to pay their bills, and a significant number of customers are behind with their water bills. The Consumer Council for Water estimated that in 2011, £1.45bn of household water and wastewater bills had been outstanding for more than three months.⁵ While switching supplier may not solve these households financial problems, if it gets them on to a cheaper deal it could help to mitigate them. Our experience in the energy sector has been that the way the market has evolved has made it unnecessarily hard for indebted customers to get a better deal - for example, the common installation of prepayment meters as a tool for debt management has created a deterrent to switching, as there are few attractive tariffs on the market for prepayment customers.⁶

³ 'Over the period 2011 to 2014, average revenue per kWh from the SVT was around 10 and 13% higher than average revenue from non-standard tariffs for electricity and gas respectively across the Six Large Energy Firms.' Summary of provisional findings report, CMA, 7 July 2015.

⁴ The domestic customer survey conducted by the CMA as part of its energy investigation contains a useful breakdown of those least likely to switch. Pensioners, those on low incomes, those with low levels of educational attainment, those in rented accommodation, the disabled, and those in rural areas were all less likely to switch than the mean. See Figure 2:

https://assets.digital.cabinet-office.gov.uk/media/559fb619ed915d1592000044/Appendix_8.1_Customer_survey.pdf

⁵ <http://www.ccwater.org.uk/waterissues/currentkeywaterissues/debtrecovery/>

⁶ Indeed, in December 2015 the CMA noted that 'it is our current view that no competitively priced acquisition tariffs (compared with the DD segment) are offered by suppliers to customers on a PPM'

https://assets.digital.cabinet-office.gov.uk/media/5672e30040f0b64732000007/Addendum_to_provisional_findings_v2.pdf

The findings of our State of Debt⁷ report show that water firms do well at engaging with advice services, and comparatively well at setting affordable payments and supporting customers in financial difficulty. We want to see a strong focus on tailored responses to individuals in financial difficulty that recognise their needs. If the water market is opened to competition and companies develop a more national focus, or move to share or outsource debt collection activity, then the guidance and supervision of those activities may need to be strengthened.

Disconnection of indebted consumers is currently prohibited and it will be important that this protection remains as consumers would now be formally contracting with water and wastewater companies for the first time.

So your study should consider how the introduction of retail competition will affect consumers in debt, and ensure that they can engage with the market if they wish to. You should also set out how consumer protections against disconnection would be maintained in a competitive market.

There will be costs involved in setting up and running the technical architecture that facilitates the switch from one supplier to another. While not a direct proxy, the costs associated with maintaining the switching arrangements in other utility sectors, for example in relation to running the central systems of ECOES and Xoserve in electricity and gas, should be something you can establish from discussion with their administrators. This may give you a sense of their possible magnitude in water. Likewise, you may be able to get a sense of the direct supplier specific costs associated with switching, such as sales and marketing and closing/opening accounts, from experience in other sectors. We believe the CMA will have data on this for energy from its current investigation, and may possibly have similar data for other sectors such as banking from previous inquiries.

The household water market is steadily moving from an unmetered market to a metered market. The introduction of competition may have implications for this. For example, in the energy sector we have seen some suppliers offer smart meters as an inducement to customers to switch to them - it is possible that something similar could occur with the offering of water meters to unmetered customers. Likewise, if the provision of water efficiency services comes to be a service that is valued by consumers, and commercially viable at household level, this could be something that drives meter rollout. With water network activities being separated from water retail activities, there is also the possibility that the charging methodologies applied by the former to the latter could influence commercial incentives on supply - for example, that customers with particular consumption profiles could be seen as more, or less, attractive to serve than the mean. The allocation of leakage and errors in energy has been problematic, with some disputes between retailers and networks on where fault lies, who should tackle it and how it should be apportioned - the vertical unbundling of the water sector may see it face similar

⁷ 'The state of debt collection - the case for fairness in government debt collection practice,' Citizens Advice, 8 January 2016. <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/debt-and-money-policy-research/the-state-of-debt-collection/>

challenges. Finally, there is the question of who owns and has responsibility for maintaining the meter - the regional network, the retailer, or a third party? The commercial incentives on each, and relationship with the customer, may greatly differ, impacting on how the market could develop.

So your study should consider the implications of the introduction of competition on incentives around the introduction of metering, and the impacts this may have on the services that consumers receive.

“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?”

You pose the question of whether a ‘thin’ or ‘thick’ model should be applied to the definition of retail activities. It would be helpful if you could set out more detail on the broader set of customer activities and interactions included in the latter in any future consultations, as it is not clear how materially the scope of activities that may be subject to competition differs between the two and this may hamper the clarity of the feedback you get from stakeholders. But we suggest that it may be desirable to avoid unbundling too many services for the purposes of your analysis. For example, it may be unlikely that a household would wish to procure water and wastewater services from different providers - noting that in other utility sectors such as energy (i.e. dual fuel) and telecommunications / entertainment (i.e. quad play) there is some evidence that economies of scale for business, and consumer demand, have tended to drive bundled retail products.

You also pose the question of whether you should consider the implications of a ‘narrow’ market that only includes some households, or a ‘wide’ one that includes most or all. Segmentation and price discrimination is an inevitable feature of markets but water and wastewater differs from most markets because it is an essential service. It is therefore essential that all consumers receive a good quality service at an affordable price, regardless of how engaged they are in the market and whether their socio-economic characteristics make them more or less desirable to serve than other customers. For those reasons, you should consider the price and customer service implications of introducing competition on those consumers who are unlikely to engage with switching processes, or to be unattractive to serve. These could be opted out of the market, for example through a ‘narrow’ definition that excludes them from retail competition, or protected within the market, for example by applying a price cap on standard tariffs, or requiring the introduction of social tariffs, within a ‘wide’ market. Either is possible, but both approaches would require significant design work.

“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?"

In general, the opening of the business market is both a risk and an opportunity for the introduction of competition into the household market - because it may demonstrate (or disprove) its costs and benefits in practice, and because the readiness (or not) of water companies to compete for business customers may help (or hinder) public confidence that the household market is also ready for competition.

The introduction of retail competition to the non-domestic market is imminent, with 1.2 million business customers in England able to switch supplier from April 2017 - only 14 months from now. While the characteristics of business and household consumers will differ, this should nevertheless provide some concrete evidence of the costs and benefits of water competition, and of the effectiveness of industry systems supporting the switching process. We recognise that you have been tasked by government to complete your review by this summer, but think it may be prudent if the final decision on whether to make that extension is deferred until after the business market has opened. This would allow any decision on the household market to be informed by early lessons learnt from the business market, including on implementation timing.

Our experience in the energy market suggests that the vast majority of complaints are in relation to billing, and that the most frequent cause of spikes in those figures is suppliers updating or migrating their billing systems. We would expect that many water and wastewater suppliers will be making significant amendments to their billing systems to facilitate the introduction of business competition, and that they may need to make further amendments to facilitate the introduction of household competition. A particular problem on market opening in that sector was poor sales standards, particularly in relation to doorstep selling, where initial management controls on what was at that time an unfamiliar activity were often lacking. So we would encourage you to pay particular attention to monitoring supplier readiness on billing and internal sales controls in the lead up to any opening of the household market.

"What are the interactions between household water retail and other markets in the water sector and beyond?"

In other utility sectors there has been a progressive movement towards the bundling of services. In energy, consumers were served by different monopolies for gas and electricity prior to liberalisation, but we have moved to a market where they will now typically take both services from the same supplier. In telecoms and TV, we have seen the emergence of dual, triple and quad play services where consumers take some combination of fixed line telephony, broadband, mobile and TV from the same provider. There are niche providers already bundling telecoms and energy services.⁸ This evolution appears

⁸ For example, Utility Warehouse.

principally driven by a combination of economies of scale and the ability to leverage brand recognition and customer service assets in one service to compete in another. Liberalisation of water retail markets could see this trend continue, with either water companies entering other utility markets, or participants in other sectors entering the water market, in order to provide bundled services.

There may be some other cross-sectoral synergies that are not currently being fully realised. For example, it is possible that the smart meter infrastructure that is being put in place for the energy sector could be used in future to retrieve reads from water meters.

We hope you have found this submission helpful. We would be happy to discuss any matter it raises in more detail if you would find that useful.

Yours sincerely

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