



Water today, water tomorrow

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July 2013

Dear Sir/Madam

Response to Defra and Welsh Government's consultation on the future management of private water supply pipes

We welcome the UK and Welsh Governments' consultation. They are seeking views and evidence to enhance an impact assessment on the policy options regarding the future management of water supply pipes. These are currently owned by private individuals and the consultation suggests they are poorly maintained because customers do not understand their responsibilities. Defra has proposed to create a power which will allow future regulations to be made to transfer ownership of those water supply pipes that are currently privately owned, to the incumbent monopoly water companies.

Whilst we recognise that the current arrangements may have a number of weaknesses and there is a clear gap in consumer understanding which is important, we believe that there is currently insufficient evidence available on the costs and benefits of the this particular solution (the transfer of ownership) to decide whether or not it is the best way to address those weaknesses. The evidence is limited to this single UKWIR report¹ and that work:

- itself suggests that the transfer would not be cost beneficial, placing a cost of over £4 on customer bills, in return for only £2 of benefit;
- does not provide any examination of the existing market for supply pipe maintenance and repair, including relevant insurance products, and how well or poorly this is currently protecting customers interests; and

¹ UKWIR, 2009, Issues regarding the potential adoption of supply pipes: Costs, Customer service and regulatory impacts, Ref: No, 09/CU/01/4

- does not examine any alternative options to addressing these issues except transferring ownership to incumbent monopoly companies.

Transferring ownership of supply pipes may not be necessary to achieve the proposed benefits. Companies can repair customers' supply pipes now with their consent and they have strong incentives to do so including to achieve their leakage reduction targets and wider cost savings such as reduced pumping costs and dosing to meet water quality standards - all of which are referenced in the UKWIR report². Under the regulatory regime if companies seized this opportunity then they would be able to keep a proportion of the savings gained. Indeed although approaches vary most companies currently offer either free or subsidised repair schemes for supply pipes.

There is already an existing market for the maintenance and repair of these assets, including both private individuals contracting with third party plumbing and construction contractors and through the protection provided to customers through general buildings insurance against the failure of their supply pipe. Within its impact assessment Defra have referenced this market but provided no analysis of it making it impossible to identify whether or not the market is working effectively for customers, and what, if anything might make this market work better. Much more work is needed on this. A preliminary investigation into the insurance side of that market suggests that most buildings insurance policies would include some cover against supply pipe failure as standard³. This existing market does have the advantage of allowing customers to choose the amount of risk that they wish to bear in this regard, maximising the consumer benefits- a solution that forced a fixed cost on all customers' by transferring ownership to the incumbent monopoly would introduce another cross-subsidy into customer bills and would fail to maximise the consumer surplus.

Fundamentally we believe that before a transfer of ownership is considered that will increase customer bills a market study should be undertaken into the existing market so as to identify a range of potential solutions.

² UKWIR, 2009, Issues regarding the potential adoption of supply pipes: Costs, Customer service and regulatory impacts, Ref: No, 09/CU/01/4

³ General information on the insurance market is provided by the Association of British Insurers (ABI) and also the British Insurance Brokers Association (BIBA). Much of the information on these websites is restricted to members but we have been able to find some limited data on the number of households with structural or contents insurance policies. This suggests that c.63% of households had structural insurance and c.74% of households had contents insurance in 2010. See 'Household spending on insurance' at: http://www.abi.org.uk/Facts_and_Figures/Facts_Figures.aspx

In addition, an independent Defaqto study conducted in the home insurance sector which reviewed over 300 different products highlights that in some 75% of cases supply pipe insurance is included as standard in the policy cover see: <https://www.defaqto.com/Documents/Press%20Releases/Simplicity%20is%20the%20key%20to%20engaging%20consumers%20when%20it%20comes%20to%20home%20emergency%20cover.pdf>

Once such a study was completed and a much better understanding was gained of the underlying issues and concerns it would be easier to identify a more sensible and proportionate range of policy responses. Similarly, if it transpired that the market was operating effectively but the Government nevertheless wished to intervene for other policy objectives- for example if it considered that there were social policy objectives it wished to pursue or (as may be the case) there were other environmental externalities that were currently not being effectively priced by that market- then it could consider appropriate policy responses that did not necessarily require additional costs to be automatically passed on to customers.

There are in fact a much larger number of alternative approaches which could be considered from the limited options put forward in the Government's consultation.

These range from softer information campaigns to increase customer awareness of their ownership over the supply pipe (which is a potential market failure for which there is some CC Water evidence cited in the IA⁴) to some form of Government intervention to upgrade these assets itself (if there was no evidence that customers were willing to pay for that maintenance currently) or, if third party ownership and maintenance was deemed appropriate, then as well as a transfer to water companies this could also be delivered through some form of competitive auction for these assets to ensure best value for customers. The latter approach is like the approach being taken by Ofgem to ensure the efficient provision and maintenance of new offshore network assets (Offshore Transmission Owners⁵). Each of these approaches might achieve the desired outcome (the more effective maintenance of these assets and associated benefits) at a lower cost to customers. If the transfer to water companies was still justified on the basis of the evidence then it might be sensible to limit the transfer to certain areas of high risk assets or to focus it only on household supply pipes (recognising that the introduction of non-household choice in Scotland has led to the more effective maintenance and repair of these assets at a much lower cost to customers and without ownership being transferred away from the customer).

We do not think that the options put forward in the consultation are complete. Nor have they been sufficiently considered or quantified to allow an informed choice to be made between them.

Pausing to complete this market study would also be helpful, there are already a large number of changes proposed to both the regulatory and legislative frameworks that we would expect to have some impact on this

⁴ Evidence presented in the IA in relation to customer awareness of their ownership or otherwise of supply pipes comes from the Consumer Council (CC) for Water's Annual Tracking Survey 2008-2009

⁵ See: <http://www.ofgem.gov.uk/Networks/offtrans/Pages/Offshoretransmission.aspx>

issue. Our price control reforms will already encourage companies to engage more with their customers⁶ in the future and we believe that these changes, coupled with the introduction of choice for non-household customers through the Government's Water Bill will further strengthen the incentives on companies to better address these issues.

This would also allow the full costs of the recent transfer of private sewers to become clearer, including the impacts on the SMEs who previously provided the maintenance of these assets. This is a particularly relevant precedent to this policy decision and it would therefore seem sensible to be able to gauge the effectiveness of this policy intervention before repeating it.

Furthermore, at the last price review several companies made significant investments in upgrading communication pipes and the upgrading of customers supply pipes is the next logical step- we could see some of these investments in companies' plans in 2015 and we would also expect to see more companies rolling out metering programmes which would also increase the level of information available to them around the state of these supply pipe assets.

Any impact assessment needs to adequately consider the counterfactual 'do nothing' case and this needs to adequately reflect the effectiveness of these changes at addressing the underlying problems. At present we do not see how this can be known with sufficient certainty to allow a fair assessment to be made of the base case.

We look forward to continuing our positive dialogue with both the UK and Welsh Government's about the best way to address the underlying weaknesses of the existing approach to supply pipe maintenance. We are happy to support the UK and Welsh Government's in any way we can to ensure that these important decisions are taken based on the best available evidence and analysis of their impacts on customers.

**Ofwat
July 2013**

⁶ See: <http://www.ofwat.gov.uk/pricereview/pr14/>