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## **Residential retail review – external stakeholder event summary**

### **Overview**

An external stakeholder workshop was held on 20th April 2016 in London to discuss the review of the residential retail market which Ofwat is undertaking at the request of Government. This note summarises the key points raised at the workshop. A full note providing greater detail on the workshop can be found [here](#).

### **Attendees**

There were around 60 attendees. These included representatives from water companies, consumer representatives, Government departments (including HMT, Defra and Welsh Government), other regulators (including Ofgem, ORR, CMA, and PSR), consultancies and members of Ofwat's Water 2020 advisory panel.

### **Introductory remarks**

The session was opened by Cathryn Ross, who welcomed the review and its timing, noting that it allowed for any decision to be factored into the PR19 process. She observed that Ofwat's CBA will assess options and issues and identify feasible policy choices, but it is for Government to take the decision whether to introduce competition, and if so, in what form. She said that since the last review by Martin Cave in 2009 the context within which the water industry is now operating has changed significantly; particularly given the rapid technological change that is being observed both within and outside of the sector. She emphasised that the focus of the review is not simply around the monetary benefits that could be delivered for customers but also on potentially positive social and environmental outcomes that could be facilitated via technological innovation. In this respect, Ofwat is keen to see how the water industry will respond to innovation for the household market.

Giles Stevens then set out how Ofwat is undertaking the review. He highlighted Ofwat's commitment to be open and transparent and to undertake an evidence-based review. To this end, Ofwat had consulted extensively with the industry and other stakeholders to seek evidence to inform its analysis. He noted that Ofwat had

been particularly keen to learn from the experiences of other sectors; to engage with consumers to understand their attitudes to different approaches; and to consider a wide range of possible approaches to competition. He stressed that the review would seek to capture future costs and benefits as well as considering the current data.

## **Consumer research**

Rob Sheldon (Accent) set out the findings from the first (deliberative) stage of consumer research undertaken for Ofwat. He noted that customers saw a read across between water and other utilities, in particular energy, and questioned why water was the only utility that they had no choice of supplier for. Customers also wanted any market to be as simple as possible and accessible to all. Price was a key factor for customers in any market, although technology has the potential to support dynamic gains that move beyond modest cost savings on the existing cost base.

Paul Le Masurier (Systra) outlined the preliminary findings of consumer research undertaken for CCWater. He said customers expected far higher price benefits (c£50+) to make switching worthwhile than the £4 - £8 both sets of research had used for the purpose of discussing the topic with customers. Customers were concerned about the potential confusion that a market might bring, particularly the time that switching might take for such a small saving. Some were reassured when they were informed about the distinction between retail and wholesale services.

## **Models of competition**

Michael Pollitt ([Ofwat Water 2020 Advisory Panel]) provided an overview of models of retail competition in international electricity markets. He provided an overview of retail competition models used within the EU, including competition for the market (Denmark), the regulation of incumbents within a competitive market (Ireland) and more targeted default tariff regulation (several Member States). Within the context of the English water market he noted that the biggest impact of competition might be on other sectors, with the potential for disruptive entry across both water and related markets (such as energy), as had previously happened with electricity and gas markets. He noted that bundling was generally popular with customers and the combination of water and other utilities might provide enough financial incentive to drive consumer engagement. Finally he observed that competition could also be used to leverage uptake of water meters which could drive further consumer savings (as well as environmental benefits from greater water efficiency).

Hannah Cook (Ofwat) set out the framework that Ofwat is undertaking in considering models for competition. She said that Ofwat has been considering whether

competition could be on an individual basis (in the market) on a collective basis (for the market) or contain elements of each (a hybrid approach). She outlined how Ofwat has been considering which elements of the value chain (including billing, customer service, metering services, meter provision, and some localised network assets) could be included within the scope of competition and whether competition could be market-wide or targeted at particular customer groups (such as metered customers, or customers not in debt).

## **Panel discussion**

The final session was a panel discussion with Eileen Marshall ([Ofwat Water 2020 Advisory Panel]), Alistair Buchanan (KPMG), Simon Carne ([Ofwat Water 2020 Advisory Panel]), Chris Hemsley (ORR) and David Black (Ofwat). Before taking questions from the floor, four of the panel members gave short presentations reflecting on experiences of introducing competition in other utility sectors.

Eileen Marshall spoke about gas. She noted that the gas market was one of the first utility markets to open to competition and had therefore learned some key lessons through experience. These included the necessity of separation of supply and transportation (owing to conflicts of interest); regulating the behaviour of former incumbents to avoid favouring affiliated retail businesses; the behaviour of new entrants in seeking to attract customers (which required the regulation of direct selling); encouraging new entry through preventing predatory pricing. She observed that the benefits of competition had been improved price, service, safety, and choice. She noted that price had not been the only driver of competition, with customers valuing the opportunity to bundle of gas and electricity (around 85% of customers who are able to have dual fuel deals) – they prefer receiving a single bill and having a single point of contact. She outlined how the sector had dealt with bad debt through pre-payment meters and assistance with debt management and that the number of disconnections had fallen consequently from 61,700 at market opening to 41 in 2015. She observed that suppliers leaving the market had done so via a trade sale despite supplier of last resort arrangements being introduced to maintain safety and continuity of supply. Finally on maintaining consumer confidence around safety, she noted that the introduction of a National emergency number had been very successful.

Alistair Buchanan spoke about electricity. He said that his key message of warning from the experience of the electricity market was to guard against over-promising and risk miss-selling the case for competition. He stressed the importance of creating the right perception of what competition will deliver, noting that in electricity initial promises over what the product would deliver were not realised. He then outlined some of the issues that compromised the case for electricity. These

included the conflict with Government's policy goals (in particular on green energy) and these had combined with rapid and sustained price increases driven by the wholesale market which had challenged both new entrants (some of whom were driven out of the market) and the Government's appetite for competition. Alongside this there had been some unhelpful interventions by regulators and Government (e.g. massive market codes, 5% price cut promises, single tariff suggestions). The cumulative impact of this activity had been to undermine investor and consumer confidence. He advised that any approach to introduce competition should be calm, calculated and transparent, with co-ordination between Government, regulators and the market to agree the way forward at the planning stage. He said that it was important not to rush in order to ensure customers were engaged from the outset.

Simon Carne spoke about fixed-line telecoms. His key observation was that choosing a competition model is not as easy as it can appear with hindsight. He noted that the telecoms market had made some significant errors before it reached the model which works in practice today. He noted that the initial plan to build up an effective duopoly pursued in the 1980s had been flawed because the network access arrangements, which strongly favoured the incumbent, prevented the second player getting a real foothold in the market. He noted that, although technological change had been relevant to the emergence of competition in this industry, the key had been a regulatory decision to permit multiple market players to use the incumbent's network on equivalent terms.

Chris Hemsley spoke about rail. He noted that the original model of competition had not been realised in practice and that key parts of the market design – such as charges – were designed to extract best value in the management of a declining asset base. However, usage had expanded rapidly rather than declined and the model had not adapted fully to this. In particular, the original model had been set-up to encourage 'open-access' competition on much of the network, but in reality over 99% of passenger services are now provided on a franchised basis. Franchises have some clear benefits, including that they are good at delivering social benefits and allow governments to generate income that is then used to fund loss-making but essential rural and off-peak services. However, open-access (non-franchise) operators bring a different mix of benefits. For example, they have a good record in finding new destinations and innovating in their service offering. This is reflected in their high levels of customer satisfaction. ORR and CMA had been considering the benefits of increasing competition 'in the market', with a view to the benefits of lower prices, improved choice, and new entry bringing new business models. He also highlighted a key lesson learned that competitive entry can positively affect the performance of the upstream provider, with experience in rail being that competitive service providers have more actively held Network Rail to account on the availability of additional capacity. This has parallels in airports and energy.

The panel then debated a number of questions from the floor around the role of metering in the market; what a “good” retail market might look like; whether competition can help reduce the complexity of regulation; and whether the benefits of competition may be limited in a market that already experiences good levels of customer satisfaction.

## **Next steps**

Rachel Wright wrapped-up the event by outlining the next steps in the process. She noted that Ofwat will consult on its initial findings in July and will hold a further stakeholder event as part of the consultation process. The final report is due to be submitted to Government in September.