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Household Review Project
Ofwat
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Dear Ofwat,

Re: Introducing retail competition to residential customers – summary of emerging findings

We welcome the opportunity to respond to Ofwat's emerging findings on the costs and benefits of introducing retail competition to residential customers.

We remain fully supportive of the introduction of competitive reforms where there are clear benefits to customers. As Ofwat will be aware, in order to further the discussion on retail household competition, we have provided evidence to help develop the modelling approach within challenging timescales. We hope this information has been useful to Ofwat as it has developed the evidence base to help Government make its decision on the best way forward.

Both the emerging findings documents provided by Ofwat and the stakeholder workshop held on 20 July have been useful to articulate the analytical framework within which the modelling has been conducted, and which decisions are considered beyond the scope of the initial modelling.

In developing the cost and benefit analysis, it was necessary to make decisions on the type of market for retail competition for household that may be adopted¹. This determined that a thin, wide retail competition in the market akin to that being developed for business customers from April 2017 be the basis of the cost-benefit analysis and supporting scenarios.

We acknowledge that determining which factors are captured in the modelling and which factors are for policymakers to determine is a matter of judgement. When presenting this evidence to Government in September, it will be critical for Ofwat to flag which factors have been included and which other relevant market design issues it considers are for subsequent consideration by Government.

Distributional impacts

¹ Ofwat (2016) Costs and benefits of introducing competition to residential customer in England – emerging findings technical appendix two.

The current modelling has determined the net present value of the introduction of retail competition for households at an aggregated industry level. We believe that this is reasonable starting point for modelling given the time available.

We share the view expressed at the dissemination workshop, that the most prevalent topic which needs to be considered *is the role of distributional impacts across a heterogenous customer base across highly variable regions*. This is important for several reasons:

- Firstly, individual customer characteristics such as age, education and income as well as experience in other retail markets will impact on the likelihood of customers engaging with the market and unlocking the potential benefits.
- Secondly, regional characteristics such as climatic conditions such as rainfall will affect customers engagement with their water company; for example the levels of meter penetration and water efficiency support currently offered to customers.

The combination of these factors will directly impact on both who engages with, and critically who benefits from the introduction of these reforms.

Further consideration needs to be taken into account to ensure that the benefit of such reforms is spread across the customer base, and that customers in potentially vulnerable circumstances are not disadvantaged or excluded from participating. As Ofwat will be aware, this has been an area of focus for us and we have contributed evidence in this area.

Costs incurred for the business retail market implementation

We note that Ofwat is looking to strengthen the evidence base for the costs companies would incur as a result of a potential household retail market opening. The estimate of these costs is driven by two main sources:

- An estimate of the costs companies are incurring as a result of the opening of the retail market for businesses from April 2017; and
- The relevant scale factor for these costs of creation of a household versus compared to the business retail market.

We understand that the information collated by Water UK has now been provided to Ofwat.

In order to aid Ofwat, appendix one contains a comparison between Ofwat's assumed costs of non-household retail market opening in the emerging findings and those values provided by Water UK. We have grouped these costs into the same categories as Ofwat used in the emerging findings

document. Overall the comparison shows that figures reached in the two analyses are broadly similar, but with some differences in the set-up and ongoing costs. The lower set-up costs (by £14.2m) are mostly due to the lower estimate of company costs by Water UK and the greater on-going costs (by £3m pa) are mostly due to Water UK's higher estimate of Wholesale Service centre operating costs and market operator costs based on the most recent estimate from MOSL.

Water Efficiency

Ofwat's emerging findings drew attention to the importance of encouraging and incentivising water efficiency. We believe that it is important for our customers to receive coherent messages about the importance of conserving water. Given the challenges of serving customers in the driest region of the UK and providing a reliable supply of safe drinking water at a time of changing climate and population growth, we are acutely aware of the vital role the industry must play in promoting water efficiency. As such, we have taken innovative steps to face up to these challenges and reduce our customers' water consumption. Appendix two highlights the coordinated approach we are taking to improve water efficiency and some of our achievements resulting from these efforts.

We hope the information provided helps to contribute to Ofwat's evidence base on the current state of play in terms of what is being done to promote water efficiency under the current regulatory regime. It is vital, particularly for those areas under high water stress, that such work underway to provide a coordinated approach to water efficiency is not put at risk as any reforms to retail markets develop.

Bad Debt

We note that Ofwat would welcome views to support their quantitative analysis of bad debt. Ofwat's analysis quantifies the potential bad debt reduction through the introduction of competition by comparison to levels of bad debt in other sectors. A short report comparing debt in water with that of other sectors (particularly energy bills and council tax) is attached as appendix three. We would particularly draw Ofwat's attention towards those areas where the nature of debt collection and the penalties in place for non-payment differ with the water sector.

For example, we note that although there is a threat of disconnection in energy unlike there is for water, such disconnections are very rare (only 233 cases in 2014). However, this number does not account for the incentive effect this has on behaviour or the fact that 15% of customers on pre-payment meters (around 60% of which were installed to manage debt) self-disconnect at some point as highlighted in Citizens Advice's "Staying Connected" paper.

Owat also highlight that the total amount of outstanding council tax in July 2015 was roughly the same as the amount of outstanding water bill payments despite annual payments for council tax being significantly higher. Whilst true, this does not account for the different enforcement powers that local authorities and water companies have i.e. local authorities have the ultimate sanction of custodial sentences via the Magistrates Court which water companies do not.

Owat notes in its emerging findings that retailers in a competitive environment may be more capable of reducing bad debt particularly through having better information on the identity of customers likely to fall into debt and therefore be in a better position to secure payment. Since 2009 we have worked with Experian to improve the way we obtain and analyse data on our customers. Over the period of this benchmarking review we have seen particular improvements in the way we maintain customer data, our use of external data sources and in predictive risk calculations against leading practice. We also make use of Credit Account Information Sharing (CAIS) data, which affects the credit risk of customers. This is helping us to improve the levels of debt collected within the constraints associated with the limited enforcement powers outlined above.

I hope that Owat finds the above information and attached appendices useful and valuable additions to the evidence base for the cost-benefit analysis to be presented to the government in September.

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 – NHH retail cost comparison

Central assumptions	Value	Ofwat assumptions for NHH	Comments	Water UK - NHH	Comments
Regulatory - Set-up	£m	5.6	Ofwat assume same costs for HH retail as NHH market.	5.6	WUK used the £5.6m for Ofwat costs as part of the overall OW budget.
Market Operator - Set-up	£m	30	Assumed approximately £30m.	32.6	Based on published central budget minus £5.6m costs for Ofwat above.
Government costs - set-up	£m pa	0		N/A	Water UK did not make any assumption for government costs.
Company operational costs - Set-up	£m	100			
Company separation - Set-up	£m	80		163.2	Captured in the "Internal programmes, Market readiness and WSC development" costs in template.
Totals - set-up		215.6		201.4	
Regulatory - On-going	£m pa	2.4		N/A	No assumption for on-going regulatory costs.
Market Operator - On-going	£m pa	5.6	2015 estimate.	8.4	Water UK estimate based on central estimate (2016) from MOSL.
Company operational costs - Ongoing	£m pa	10		16.6	WSC Operating costs.
Company separation - On-going	£m pa	5.5		1.5	Ongoing Compliance and equivalence costs.
Totals - On-going		23.5		26.5	

Appendix Two - Water Efficiency measures under the current regulatory regime

Ofwat's analysis of household retail competition examines the potential impact of retail competition on water efficiency. Anglian Water is particularly aware of the importance of this given that our region covers the driest areas of the UK. It is therefore vital for our customers that new technology and innovation are used to help reduce demand on water resources. Anglian Water has used a number of different approaches to help improve water efficiency across the region and this note illustrates some of the ways in which this is being done within the current regulatory regime. This has been done to help ensure that Ofwat has as full a body of evidence as possible on the current state-of-play with regards to efforts being made to improve water efficiency by water companies.

High meter penetration in the Anglian region has provided a clear economic incentive to our customers. In 2016/17 the average annual bill for Anglian Water customers will be £411, but those with a water meter will pay an average of only £378. Our Integrated Metering and Developer Services Programme Initiative aims to *'provide a coherent water saving message that inspires behavioural change towards water use and provides products and services to help our customers and communities to save water and save money on their water and energy bills'*. We are also running a range of innovative projects to help our customers to improve their water efficiency and reduce the cost of their water bill. A selection of these are summarised in the table below.

Initiative	Overview
Drop 20	<p>The Drop 20 campaign is about everyone helping each other save water for the future. Through Drop 20 we aim to:</p> <ul style="list-style-type: none">• Lead the way in raising awareness about the value of water, and to change fundamentally how our customers use it• To save water – if we can encourage everyone to drop 20 litres/day, that's millions of litres saved every day• To change habits and behaviours – for the longer-term we want our customers to look at water differently and to value even more every drop at home, at play, in the garden and at work• We also have an ODI target to reduce water consumption by 7/l/household/day by 2020

Initiative	Overview
Bits and Bobs	<ul style="list-style-type: none"> • Includes a visit which lasts around 45 minutes • The customer receives a personalised household report to show them where they can make savings on their water and energy bills • Further savings are provided by showing where we can fit water saving devices • Available to all customers, we are targeting 180,000 customers by 2020 as set out in our business plan
The Potting Shed Club	<ul style="list-style-type: none"> • Facebook page for hints and tips for saving water in the garden • Free water saving garden kit is available for all households • In partnership with RHS.
Community engagement	<ul style="list-style-type: none"> • Using social media to target water efficiency messaging to our customers • Newspaper articles – to raise customer awareness of opportunities such as Bits & Bobs • Community Engagement and Education – working directly with a number of community groups, such as the University of the Third Age, the WI, Brownies and Scouts, Schools (Primary and Secondary) and Further and Higher Education providers to help promote water efficiency.
Drop by 20	<ul style="list-style-type: none"> • Targeting 48,000 optant customers by 2020 • Each will receive a Drop by 20 water check-up visit by a Customers Service Representative (CSR) • The CSR provides advice on where households can save money on their water and energy bills • Fitting water saving devices where appropriate provides further savings.
Water Energy Calculator	<ul style="list-style-type: none"> • Partnership with energy saving trust • Provides customers with their water and energy consumption and carbon emissions and the potential savings to be made on their annual bills.
Smart metering	<ul style="list-style-type: none"> • We are currently developing a smart meter trial which will allow customers to view their water consumption.

Between 2010 and 2015, 85,000 water efficiency visits were carried out, the proportion of customers on a metered bill increased from 65% to 80%, and average per capita consumption in our area dropped from 145l/h/d to 133l/h/d with further reductions expected as a result of the measures in the table above. In addition, the 'Drop by 20' programme and the Water Energy Calculator (in partnership with the energy saving trust) help customers to make savings on their energy bills as well as their water bills.

It is imperative that such improvements continue to be made going forward, particularly given the greater strains on water resources expected from population growth and climate change. Regardless of any decision from the government on the household retail market, it is vital (particularly for the Anglian region) that coherent water efficiency strategies are not put at risk and that reductions in water consumption highlighted above continue in

order to maintain a sustainable and reliable water supply to all current and future customers.

Appendix 3 - Comparing customer debt in water with other sectors

This note comments on the comparisons Ofwat have made between customer debt in water and in other sectors in their emerging findings on the costs and benefits of residential retail competition.

1. Comparing customer debt in the water and energy sectors

Ofwat's emerging findings on the costs and benefits of residential retail competition includes² the comparison between customer debt in the water and energy sectors below:

£2.2bn of residential water revenue was outstanding in 2014, compared with around £475m in gas and £480m in electricity, despite average bills generally being two to three times higher than water across both fuels. Bad debt costs in the residential energy market have generally been less than 2% of earnings in recent years, which would roughly equate to around 27% of retail costs in water.

One argument sometimes put forward for high bad debt costs in the water sector is that residential retail customers cannot be disconnected. Though there is still a threat of disconnection for residential energy customers, in practice this risk is very slight (in 2014 a total of 233 customers were disconnected (192 electricity customers and 41 gas customers). Disconnection rules therefore do not appear to explain the difference in relative levels (and cost) of bad debt between the two sectors.

This comparison does not recognise that energy companies are able to, and do, use pre-payment meters to require customers to pay in order to receive electricity or gas supplies – an option which is not available to water companies as a result of the statutory ban on disconnection under the Water Industry Act 1999.

As Ofgem notes, there are a large number of pre-payment meters (PPM) in use by gas and electricity companies, most of which are installed to manage debt, and which they do effectively:

- *“As in previous years, the majority of newly-installed PPMs, around 60% for both electricity and gas, were installed to manage debt. This amounted to around 175,000 electricity PPMs and 195,000 gas PPMs in 2014.”³*

² “Costs and benefits of introducing competition to residential customers in England –emerging findings,” p56, Ofwat 18 July 2016

³ Ofgem, “Domestic Suppliers’ Social Obligations: 2014 annual report”, 8 September 2015, p.33.
<https://www.ofgem.gov.uk/publications-and-updates/domestic-suppliers-social-obligations-2014-annual-report>

- Ofwat have correctly noted that a very small number of energy customers *are disconnected* (that is, by their energy supplier).

Ofgem note⁴ that

- *"While disconnections declined, in recent years we have seen an increase in the number of PPMs installed for debt, which suppliers use as an alternative to disconnection. This allows them to maintain supply while providing customers with a way to repay debt. However, prepayment comes with a risk of self-disconnection"*.

Citizens Advice have noted:

- *"We have estimated that 15 per cent of all PPM users self-disconnect from their energy supply at some point."*⁵

The 2009 Independent Review of Charging for Household Water and Sewerage Service led by Anna Walker⁶ noted that the absence of a risk of disconnection in water meant it is assigned a lower priority than other utilities:

- *"Household debt is relatively stable in the energy sector, but energy companies are allowed to disconnect for non-payment of bills or install a pre-payment meter (PPM), which is a significant deterrent to non-payment. In 2008, 2.4 million gas customers and 3.6 million electricity customers were paying through a PPM and therefore unable to build up new debt.*
- *Citizens Advice has told the review team that in line with widely accepted money advice principles, CAB and other advisers in the free debt advice sector advise their clients to first pay debts that result in disconnection, imprisonment or eviction. It has been suggested that advice to give water debts a lower priority than other arrears is one of the primary reasons for the steep rise in the water industry's level of bad debt."*⁷

The review also noted that pre-payment meters were popular with water customers before they were banned, but afterwards became meaningless and debt recovery had to be pursued through other means:

⁴ Ofgem, "Consumer Vulnerability Strategy Progress Report", September 2015, p.56.

<https://www.ofgem.gov.uk/publications-and-updates/consumer-vulnerability-strategy-progress-report>

⁵ Citizens Advice, "Staying Connected", April 2016, p.2. <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/energy-policy-research-and-consultation-responses/energy-policy-research/staying-connected/>

⁶ Anna Walker, "The Independent Review of Charging for Household Water and Sewerage Services", 2009 <https://www.gov.uk/government/publications/the-independent-review-of-charging-for-household-water-and-sewerage-services-walker-review>

⁷ Anna Walker, "The Independent Review of Charging for Household Water and Sewerage Services", 2009, p.140. <https://www.gov.uk/government/publications/the-independent-review-of-charging-for-household-water-and-sewerage-services-walker-review>

- *“PPMs were used extensively before the ban on disconnection and were popular with customers. Dŵr Cymru had 25,000 customers on their ‘Watercard’ scheme, but following the ban, they found that once customers defaulted the concept of prepayment became totally ineffective and had to revert to current debt recovery processes.”⁸*

2. Comparing customer debt in the water and local authority sectors

Ofwat have also noted⁹ that:

- *local authorities collected 98.1% of 2014-15 council tax debt within the year⁶⁴. The total value of outstanding council tax stood at £2.7bn in July 2015, including arrears potentially stretching back to 1993. This figure is roughly the same as in water, despite annual revenue from council tax being significantly higher at £22.9bn for 2014/15.*

Ofwat however fail to note the different enforcement powers that water companies and local authorities have.

Anna Walker noted that local authorities have significantly powers to require payment – including an ultimate sanction of custodial sentences via Magistrates Courts. Full details were set out in Annex 9 of her report, the relevant section of which is provided below.

Anna Walker advocated providing water companies with similar powers to provide a stronger incentive for payment and to reduce bad debt levels in the water sector¹⁰:

- *the review team has considered whether penalties for non-payment should follow those available for non-payment of council tax, as a way of raising the priority status of the water bill. The situation is similar to local authority services, where services such as waste disposal continue even in cases of non-payment. Council tax can be pursued via a liability order in the magistrates’ court, provides a stronger incentive for payment than civil courts (see Annex 9). This process of debt recovery would have the added benefit of identifying customers that are struggling with affordability; it would also allow companies to recover or partially recover outstanding revenue, while*

⁸ Anna Walker, “The Independent Review of Charging for Household Water and Sewerage Services”, 2009, p.143. <https://www.gov.uk/government/publications/the-independent-review-of-charging-for-household-water-and-sewerage-services-walker-review>

⁹ “Costs and benefits of introducing competition to residential customers in England –emerging findings,” p55, Ofwat 18 July 2016

¹⁰ Anna Walker, “The Independent Review of Charging for Household Water and Sewerage Services”, 2009, p.133 <https://www.gov.uk/government/publications/the-independent-review-of-charging-for-household-water-and-sewerage-services-walker-review>

*preparing future debt prevention strategies with the customer. **The review team recommends that the UK Government and Welsh Assembly Government consider whether companies should be legally able to pursue debt through the magistrates' courts in the future.***