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Dear Household Review Team

Costs and benefits of introducing competition to residential customers in England – emerging findings - Response from Portsmouth Water Limited

Portsmouth Water is pleased to have the opportunity to respond to the Ofwat document.

The Ofwat document makes an assessment of the costs and benefit in a number of areas. We cannot offer any objective evidence on the validity of the retail savings assumed in the "active" and "inactive" share of the market. We understand that the efficiency savings for these items are largely based on the Cave Review. This report is now 8 years old and the report could be updated for recent relevant experience. Clearly the introduction of retail competition in the non-household water sector will provide a very useful insight, but we accept this is outside the Government's timescale for reporting on this matter.

We do agree that bundling of services will over time and with the development of multi-utility billing systems provide a reduction in costs for retailers and that possibly this could be explored further. There should be evidence available from energy and more recently for inset appointments and those preparing for the non-household sector.

There are however two elements of the analysis we would take issue with, the additional Bad Debt benefit estimates and one element of the research and these are explored in some detail.

Additional Bad Debt Benefit

The benefit for the reduction in bad debt is a significant element of the overall benefit assumed in each of the scenarios, as shown below:

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Assumed Annual Savings %	2%	1%	1%	-
Additional Bad Debt Benefit (NPV) £m	856	455	455	-
% of Benefits	22%	18%	18%	-
% Net Benefits	37%	37%	69%	-

The basis of the calculation is the relative level of debt in the Water Sector compared to the Energy Sector and Council Tax debt. The document states that "Disconnection rules therefore do not appear to explain the difference in relative levels (and cost) of bad debt between the two sectors" (Water and Energy). This statement is based on the statistics that in 2014 a total of only 233 customers were disconnected (192 electricity and 41 gas). This materially underplays the impact of the ability to disconnect in the energy sector and totally fails to reflect the reality of each sector, in particular the impact of pre-payment meters. We have the following observations:

1. The threat of disconnection was and is still more of a factor in debt collection than the actual number who are disconnected. This is not withstanding that the Energy Industry uses pre-payment meters so customers effectively self-disconnect (see later).

   Figures from Portsmouth Water demonstrate this. In 1997, the Industry was still allowed to cut households off for non-payment of debt and although Portsmouth Water cut off more households than anyone else, the number cut off was only limited to a handful of customers. The level of debt for Portsmouth Water in 1997 was approximately £0.6m and the bad debt provision only £16,000 including commercial properties. Following the removal of the ability to disconnect, debt rose steadily and by 2016 was £2.6m with a bad debt provision of £0.8m for that year. The threat of disconnection was therefore hugely important in the controlling of debt. The threat of disconnection is highly influential in the work of the Citizen Advice Bureau, where water industry debt is low on the list of priorities of payment because the customer cannot be disconnected, whereas energy debt is a high priority.

2. The Ofwat analysis fails to recognise that Energy companies use pre-payment meters (PPMS) to require customers to pay in order to use energy services. This option is not available to Water companies. According to Ofgem, in its "Domestic Supplies and Social Obligation 2014 Annual Report", 17% of all electricity customers accounts and 13% of all gas customers accounts in Great Britain 2014 were using pre-payment meters. In the same report, Ofgem notes *"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 PPMs in 2014".*

   The impact of this threat of disconnection and the use of prepayment meters when comparing debt in the water and energy sectors is recognised in the 2009 Independent Review of Water Charging for Household Water and Sewerage Service led by Anne Walker. It also addressed the impact of the inability of water companies to disconnect on the Citizen's Advice Bureau's advice to assign a lower priority to water debt. In particular the report stated:

   > *"Bad debt in the water industry is increasing at a significantly faster rate than other utilities and is more than three times that of the energy sector, where bills are three times higher. 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. However, Ofgem reports that around 70 per cent of the PPMs fitted in 2008 were installed to recover old debt".*
   >
   > *"From 2005/06 to 2008/09 Citizens Advice recorded a 42 per cent rise in water debt problems, suggesting that water debt is becoming increasingly problematic for customers. 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"*

   Furthermore, in "Pre-payment review : understanding supplier charging practices and bonuses to switching" (September 2015) Ofgem state *"It is worth noting that, while the majority of prepayment meters are installed due to debt, around just 7% of electricity prepayment customers and 10% of gas prepayment gas customers are currently in debt to their energy supplier"*

   Citizen's Advice have noted in their report "Staying Connected" from April 2016 (page 2) that "we have estimated that 15% of all PPM users self-disconnect from their energy supply at some point". It is therefore reasonable to suggest that whilst the ability to document or use PPM's at least this number would not pay their energy bill, but in all probability the number in would be closer to the amount using PPM's.

This clearly demonstrates the effectiveness of pre-payment meters in controlling debt that is simply not available to water companies. If one assumes that without prepayment meters and the ability to cut off customers, a large proportion of these currently with prepayment meters, but not in debt would not pay their bills, it would be plausible to suggest that debt would rise in the energy sector by between £2bn and £3bn for both energy and gas customers and could be more. If only the 15% referred to by the Citizens Advice Bureau did not pay this would be over £1 bm in each sector.

3. The Pre-payment review (September 2015) by Ofgem referred to above contains the following statement:

> *"However prepayment customers remain more likely to have never switched supplier. Only 34% have ever switched gas (compared to 48% DD) and only 33% have ever switched electricity (compared to 44% DD). (Page 13)*

A reasonable assumption would be that those customers in debt in the water industry would have a similar inertia to switching as described above. Indeed it could be argued that it would be less, as in electricity and gas prepayment customers do pay their bills and are still attractive to retailers, who will therefore seek to encourage such customers to switch. In the water sector this may not be the case. Unless these customers in debt choose to or are persuaded to switch, is difficult to see how the debt for these customers will reduce significantly.

We believe, therefore, that the Ofwat document significantly understates the impact of the ability and threat to disconnect and the use of prepayment meters in energy. There is little evidence to suggest that techniques in Debt Collection used by the energy sector are so different to enable the large reductions in debt estimated. Also if the techniques used by the Energy sector are so superior, why have these methods not been included in the Best Practice Guidance on Debt collection produced by Ofwat. Furthermore one cannot expect the Water Industry to stand still, if there are improvements to be made in debt collection it would be reasonable to suggest these would be adopted by the water companies at some stage, so should be included in the Counter factual.

Overall, therefore, we conclude that the savings in bad debt costs are severely overstated in each of the first three scenarios put forward by Ofwat and in fact in reality would be an insignificant amount.

Customer Research

First of all it is important to point out that we do not question the integrity or the quality of the customer research undertaken for the assessment of the costs and benefits of introducing household competition. In most cases it correlates with the research conducted by the Customer Council for Water (CCW). However one key finding from the research for Ofwat stands out which is that *"45% would be likely to switch if retailers offered additional services such as water efficiency or leak detection even if there was no price saving".* This finding is at odds with the CCW research and as far as we are aware has not been seen by customers in other sectors where competition has been introduced. The report from Accent is not clear whether those sampled were told of what is currently offered by companies, and what difference they might expect from retailers in a competitive market, It would be useful to have quantified, what higher level of service in this area would be appealing enough to be worthy of switching. It is also an odd result given that as we understand it, only 53% of those questioned in the survey were on a meter. To take advantage of water efficiency and leak detection one would need to be on a meter to make financial savings and therefore it is questionable whether a number of those questioned understood the implications.

We would recommend a degree of scepticism with this particular finding without conducting further research.

Distributional Impacts

The report contains little of the distributional impacts of introducing greater competition. This was addressed by the representative of Sustainability First at the recent Ofwat event and in the report for Water Uk – "Distributional Impact of retail competition" by ICS Consulting. We are pleased to see that Ofwat has taken the lessons from the CMA enquiry into Energy markets, but would recommend that Ofwat gives greater prominence to the likely distributional issues its final report.

Innovation

In its document Ofwat makes clear that the counter factual against household retail competition is business as usual (page 5). Whilst we would agree that competition is likely to lead to greater innovation, the alternative is not 'no innovation'. Water companies will continue to innovate albeit possibly more slowly and the introduction of TOTEX regulation is already encouraging this. This would have the greatest impact on water efficiency savings, but it is also likely that leakage detection for household will also develop without competition.

Costs of Implementing Competition

Portsmouth Water has supplied information to Water Uk on its costs of implementing non-household competition and we believe this has been consolidated and passed on for use in the Ofwat analysis. The costs incurred by Portsmouth Water was estimated over £1.5m and it is worth noting that a significant element of these costs have been paid by the Company not customers. For example, the costs of setting up the market operator were significantly understated in our business plan. It is difficult to estimate the cost of introducing competition relative to that incurred in the non-household retail sector, and we agree with the Ofwat document that in some cases it could be less. However there are differences and we can see higher costs of compliance with competition legislation and for dealing with vulnerable customers and affordability particularly in relation to tariffs.

Yours sincerely

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MANAGING DIRECTOR