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By Email Only

Dear Review Team

### **Emerging Findings on Costs and Benefits of Introducing Competition for Residential Customers in England**

We welcome publication of your emerging findings on this critical study and the opportunity you have provided for stakeholders to comment prior to completion of your final report for Government in the autumn. Our Customer Scrutiny Panel has considered your emerging findings and the Chairman is making a submission on behalf of the Panel. This Company response focuses principally upon areas where our particular experience can contribute to the most reliable assessment possible for Government to consider in making policy decisions.

#### **Policy framework for protecting customers**

Your emerging findings recognise that there are important policy decisions that need careful consideration in designing any competitive market for residential customers. In particular, the protection to be afforded to customers who may not be active in a market, the assistance to be provided to customers in vulnerable circumstances, and the future role of recently introduced social tariffs will be critical to maintaining customers' trust and confidence in the industry. Our own experience in successfully rolling out our Water Support social tariff, to supplement the range of payment options and debt management routes we offer our customers, underlines the importance of these decisions not only for legitimacy in the communities we serve, but for the cost of debt management and bad debt on our retail activities. The policy assumptions in these areas have a critical impact on the costs and benefits scenarios your emerging findings outline, and should have appropriate prominence in your final report to Government.

#### **Bad debt**

Sutton and East Surrey Water has had one of the best debt collection records in the industry for many years, with bad debt costs well below the industry average. We recognise that the relative affluence of some of the areas we serve contributes to this strong overall performance. There are nevertheless communities where customers do find themselves in difficult financial circumstances and struggle to pay water service bills (just as they do with other household costs). We have therefore worked hard with such customers to minimise bad debt costs using all the tools we have available, recognising that disconnection for non-payment is not permitted. We therefore find it surprising that all three scenarios in your emerging findings where the benefits exceed the costs of competition assume significant reductions in bad debt costs without changes in the legislative framework to permit either disconnection for non-payment or the use of pre-payment meters. The plausible reductions in bad debt costs based on performance in the

energy sector or in the collection of Council Tax will only be possible with a different legislative framework. Reductions in disconnections for non-payment in gas and electricity have predominantly been achieved by more extensive use of pre-payment meters, an option not available in the water sector. Ofgem have noted that there are large numbers of pre-payment meters in use by gas and electricity companies and the majority of new pre-payment meters are installed to manage debt. Citizens' Advice have reported that some 15% of all pre-payment meter users "self-disconnect" from their energy supply at some point. The comparison with council tax debt was considered extensively in Anna Walker's 2009 Independent Review, which noted that local authorities have substantially greater enforcement powers than water companies, including an ultimate sanction of custodial sentences via Magistrates Courts.<sup>1</sup> The Review's recommendation that Government consider whether water companies should be able to pursue debt through the Magistrates' Courts in future is particularly pertinent to the assumptions being made in your emerging findings. Without such changes in legal powers it is difficult to envisage savings of the magnitude assumed in the assessment.

### **Switching, metering and water efficiency**

The scenarios outlined in your emerging findings all assume levels of active engagement in the market leading to switching rates of between 5% and 30% per annum. These compare to rates of around 12% per annum in the energy sector, where potential savings are much greater than in water, and to less than 2.5% the proportion of our residential customer base who switch to a meter each year on a 'risk free' basis (underpinned by a right to revert to unmeasured charges if savings are not achieved). The switching rates assumed therefore seem optimistic. Moreover, the scenarios all assume no increase in the retail margin for residential customers – on the grounds that this is a policy decision for Government and any increase could be offset by a lower wholesale average cost of capital – which constrains the investment retailers might be prepared to make to encourage switching. However, without consideration of the retail margin necessary for a flourishing competitive market, the balance of costs and benefits cannot be determined.

The scenarios also assume competition will reduce the cost of metering more than current regulatory arrangements, where companies only choose metering as part of a least cost option for managing supply demand balances, and where allowed costs are subject to comparative benchmarking.

Active metered customers in a competitive market are also assumed to reduce consumption by between 10% and 20%, a rate based on savings actually achieved historically (in a monopoly market). With the low margins assumed to be available to retailers, the scope for new, additional offers to help customers reduce consumption will be limited, and indeed may well be less than the incentives on existing water companies promoting metering as part of an integrated strategy for balancing supply and demand. At best, the impact of competition on water efficiency for residential customers is likely to be mixed.

### **Implementation costs**

Extrapolating the costs of setting up and operating a competitive residential market based on the current forecasts for the non-household market is sensible but subject to significant uncertainty. For example, the latest published forecasts of ongoing costs for the non-household market from MOSL are higher than has been assumed in the emerging thinking assessment, which should be updated before finalisation.<sup>2</sup> More significantly, the broad assumptions that

<sup>1</sup> Anna Walker, The Independent Review of Charging for Household Water and Sewerage Services (December 2009): [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/69459/walker-review-final-report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69459/walker-review-final-report.pdf)

<sup>2</sup> MOSL's latest budget for 2016-17 (March 2016): <https://www.mosl.co.uk/wp-content/uploads/2016/03/Revised-Budget-2016-17-Members-paper-AGM-020316.pdf>

some costs for the residential market will be similar to those for the non-household market, whilst other costs will simply be doubled, does not appear to be underpinned by evidence. Certainly operating costs for Xoserve and the BSCCo (part of Elexon) – who undertake similar functions to MOSL for the gas and electricity markets respectively – are significantly higher than has been assumed in the assessment.<sup>3</sup> Further reflection and evidence gathering needs to be undertaken in this area before the final report is finalised.

Pointing to areas where further evidence or revised judgements need to be considered before the final report is produced for Government reinforces the value of publishing an emerging findings assessment for comment at this stage. We have welcomed the opportunity to provide some observations from the perspective of a water only company committed to making an active contribution to the success of the non-household competitive market from April 2017. As always, we would be pleased to clarify or amplify on any of these observations if that would be helpful. Please contact Joanna Campbell, Economic Regulation Manager ([JoannaC@waterplc.com](mailto:JoannaC@waterplc.com), 01737 785 692) if you would like any further input.

Yours faithfully,



John Chadwick  
Finance and Regulation Director

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<sup>3</sup> Xoserve's Business Plan 2016-21: <http://www.xoserve.com/wp-content/uploads/Xoserve-Business-Plan-2016-21.pdf>

BSCCo Business Plan 2016-17: [https://www.elexon.co.uk/wp-content/uploads/2011/10/BSCCo-Business-Plan\\_201617.pdf](https://www.elexon.co.uk/wp-content/uploads/2011/10/BSCCo-Business-Plan_201617.pdf)