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| **From:** | Simon Sperryn |
| **To:** | Household Review |
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Dear review team, thank you for inviting me to Wednesday's workshop in Congress House. I'm sure that others, like me, appreciated the chance to make an input to your thinking at this critical stage in the review.

I was on Table 6 and I felt that our discussion was not adequately reported in the plenary session - understandably because Iain McGuffog, who led our table discussion, was facilitating the plenary and couldn't report for us. I hope it is therefore helpful to record the main points which we discussed. We were a mixture of CCG Chairs, water company professionals and the CMA, but there was a large measure of common ground. Please note I am not mandated in any way to speak for the table, only for myself. Also, the table discussion was necessarily hurried whereas in writing this I have been able to think through the ideas we exchanged.

In a nutshell we felt the Emerging Findings report is not balanced, putting a positive gloss on the benefits of competition without addressing the attendant risks. The scenarios are all optimistic, assuming different levels of benefit without quantifying with equal care the possible downside. The present scenario is not carried forward for comparison with the changed scenarios. This current scenario, fostered by enlightened regulation, is one of growing industry collaboration, falling costs and prices, rising investment, strengthening customer advocacy through the new CCGs and CCWater, and levels of trust and satisfaction among the customers which exceed that of all sectors into which competition has been introduced. That is what needs to be compared with the scenarios of retail competition, so that the risks as well as the opportunities are set out with neutrality.

Of particular concern to Ofwat is public trust and confidence in the water industry. Competition will attract suppliers from markets which customers rate as giving poor satisfaction and attract low levels of trust. I am not sure what value has been ascribed in the review to trust and confidence, or why the scenarios do not include the cost of losing it.

As a CCG Chair myself, my greatest concern is the way the report portrays likely customer response to competition. The report opens by claiming 56% support for choice, and Cathryn in her summing up said she had not heard anything in the discussion to challenge that. Table 6 challenged it. Why wouldn't customers opt for choice as a theoretical concept? And why would they not opt for unspecified and hypothetical additional services at no cost, which attracted 45%. These headline figures are presented as if they relate to the actual proposition for retail competition. By contrast, CCWater's research asked customers the relevant question which is: do they favour choice of the sort that retail competition is likely to bring. Customer response was clear: only if switching supplier brings the price down. Your finding is that the likely price reduction will be about £6 a year. CCWater's research shows that for a reduction of £10 a year or less, only 6% of customers would consider switching. That 6% should be the headline figure in the report, around which realistic scenarios should be built. An optimistic scenario might be 8% and a pessimistic one, 4%.

People on Table 6 questioned three of the benefits assumed in the four scenarios. First, three of the four scenarios assume improvement in bad debts and none recognizes the risk of deterioration. Unlike water companies, the new retailers will be able to choose their customers. It is unreasonable not to assume they will target profitable accounts and avoid vulnerable customers and people with poor credit records. These customers will be left with the incumbent who will no longer have the scope for cross subsidy, let alone the ability as now to mobilise the support of other local customers for funding social tariffs. The costs in the CBA should include the likelihood that government may have to accompany a move to competition by taking on itself the protection of vulnerable customers currently provided by their local water company and funded by the local community. It was said in the presentation in defence of the optimistic assumption about bad debts, that specialist service suppliers may enter the market with expertise in dealing with non-payers. They exist already and can offer their services to water companies independently of retail competition. One of the rapporteurs in the plenary session said that in the energy market there was a similar expectation that competition would reduce bad debts but, he said, the expectation proved wrong. In the energy market, a non payer can be cut off, whereas the water industry is unique in not having that option, and can therefore be expected to fare worse than the energy industry, not better. It would be reasonable to assume that bad debts may increase. A report with four scenarios which all ignore that possibility is skewed.

Secondly, three of the scenarios assume increases in water efficiency, and none assumes a decrease. The water companies have every incentive to manage demand and conserve stocks because they depend on their ability to abstract water for present and future customers to use. Competition will break that link between supplier and consumer and obscure the shared interest they both have in conserving local water and investing in resilience for the future. In areas where water is short, the water company is uniquely incentivised to conserve stocks and reduce demand. Retailers will have no such interest, their success depending on the opposite: increased sales. None of the scenarios recognizes the risk to water efficiency which retail competition may bring.

Thirdly the four scenarios assume price reductions at different levels, and none of them addresses the risk that prices will rise higher than they would without retail competition. The CBA shows cost increases for several years. Cost increases in the short term are more certain than hoped for savings in the longer term, and should be easier to estimate. It was pointed out on Table 6 that the assumption of implementation costs for the household market equating to implementation costs for the non household market should be corrected. He pointed out that the cost of systems and service is related to the number of accounts, not to the amount of water consumed, and he offered to provide an analysis of the present cost structure. His advice was that the implementation cost assumption for retail competition should be x13 the non household cost, not x1. As for the assumed savings for customers, much was made in the presentation yesterday of the likelihood of bundling, once again assuming benefit to the customer with no attempt to balance that by examining the risk. Has research been done to measure customer reactions to bundling? Bundling may well be a contributor to the poor customer rating of telecoms and energy services. In telecoms it is used to lock customers into contracts that can be changed unilaterally by the supplier, to hide the cost of individual components of the service, and to reduce competition by taking away from customers the ability to choose what gives them value and avoid what doesn’t. This anti-competitive marketing approach may be offered to water customers under the proposed retail reforms. Has research been done on how this will impact on customer service? For example, the relatively low margin on water sales may reasonably be expected to result in a low priority for service level by the retailer of bundles. Balanced scenarios would include the possible ill effects of bundling rather than assume benefits.

These risks all arise because the intervention of a retailer between customer and supplier breaks a relationship which is based on shared objectives and which both sides depend on because they have no choice. The customer is dependent on local water and the company is required to supply all local households and businesses, even if they don’t pay. That shared interest extends to the environment and to those in the local community who are in financial difficulty. None of that will apply to retailers. It will be difficult to avoid a breakdown in today's high level of customer satisfaction when the telephone is answered not by the people who are responsible for the service and who can solve the problem, but by a third party which has no lasting commitment is incentivised to sell more.

The objections raised on Table 6 were not against competition. They were in support of a report that is balanced, that accurately reflects the customer's indifference revealed in the CCWater research, that doesn't just assume benefits in its scenarios but balances them against an assessment of the risks which retail competition introduces. Downsides and assumed upsides should be quantified with equivalent care. Above all for me, as a CCG Chair, I am concerned that the view of customers is accurately shown as the research reveals: that despite support for hypothetical values such as choice or unspecified service improvements at no cost, customers have said they will switch only for price reductions that are very much more than your findings deem realistic, and that faced by the choice which customers will be offered by retail competition, only 6% are interested in taking part.

I hope this is helpful. Regards,

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