

Our ref: DH



27th July 2016

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Dear Sir/Madam,

Thank you for giving us the opportunity to respond to your recent publication, *the costs and benefits of introducing competition to residential customers in England*.

We are impressed by the amount of work that has been undertaken and the wide range of evidence used from third parties both inside and outside the industry.

The comments we would like to make on the document are in four areas, the tone of the findings, the evidence around the counterfactual and some suggestions on areas where Ofwat have encouraged further analysis or thinking and finally an assessment of the distributional effect of competition on specific groups of customers.

The tone

As Ofwat clearly state they are not required to make a recommendation to government but to just collect, analyse and produce a report on the benefits and costs of HH competition. However care has to be taken in the expression of these findings or else there is a risk of producing a bias that in itself might be construed as a recommendation. This is most notable in two areas firstly the scenarios selected in effect represent 3 scenarios driven by relatively aggressive market activity (mainly driven by scenarios 2&3 being so similar) and a fourth scenario at the less aggressive end of the range. Commentators have understandably used the number of positive scenarios versus the number of negative scenarios as a method of producing an indication of the likely overall benefits of HH competition and this can only be a valid conclusion if the spacing and the range of the scenarios is equitable. Therefore we would suggest revisiting the scenario construct to ensure they are evenly distributed within the plausible range and that therefore misleading conclusions are less likely to be drawn from the overall summary of scenarios.

The second issue on tone relates to the presentation of the customer survey results. In general these are promoted as positive towards competition even when the results are at or lower than the 50% level, it also does not obviously state that these findings are based on a stated preference. As an example the report shows 45% of customers would be likely to switch for additional services when in effect it is 45% of customers said they would be likely to switch, in research terms the difference between stated and observed is very important. The overall effect is this style risks a loss of credibility and it doesn't fit with the original brief to not create a recommendation. We would suggest the report is examined throughout for potential presentational bias.

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The counterfactual

The counterfactual is an extremely important element of the net cost/benefit assessment. Overall the assumptions of future industry performance and regulatory intervention seem very conservative in this area. The counterfactual relies too heavily on the Defra future pricing model which assumes relatively light regulatory intervention particularly at PR19.

A more plausible position would include some of the challenges already raised as potential future changes such as UQ challenge on retail costs, efficiencies from the WR split price control, efficiencies from greater focus on network plus and other proposals related to Water2020. In addition the report identifies areas where opportunities exist to reduce costs via markets such as customer debt but does not include any potential regulatory interventions that could be applied in the counterfactual to these areas to realise some of the benefit opportunities.

Further analysis

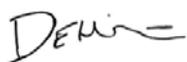
Ofwat used a wide evidence base to support the analysis and the areas that remain qualitative remain so for good reason. We would support that the ability to choose is a direct albeit difficult area to quantify we would also suggest that the benefits attributable to bundling of services and the reduction in customer effort is underplayed on the benefits side of the equation and would suggest examine the literature for valuations relating to reducing customer interaction times and effort.

We believe there is a strong link between choice and satisfaction and to assist we have included some data on our evaluation of the financial worth to customers of increases in satisfaction that might be of use in assessing some of the less easily quantifiable benefits. This data can be found in the appendix to this response, the section of interest is 7.4.

Distributional impacts

As raised at the recent workshop these is the need to assess the distributional impacts of the opening of the HH market. What is likely is that different customer groups will be impacted on to different degrees with the introduction of competition in particular the more sticky low income customers who are retained by the incumbent retailer or those whose circumstances change following a switch away from their incumbent may experience the greatest impact and this needs to be understood. This analysis is important as the legitimacy of the market and the likelihood of its success will depend on whether it creates good or bad news stories often generated by the "non-average" customer. This analysis should involve creating hypothetical typical customer groups and running them through a range of potential competitive pathways to understand their journeys to ascertain where and for whom the market might feel like it has failed or succeeded.

Yours Faithfully



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