

Household Retail Project
Ofwat
21 Bloomsbury Street
London, WC1B 3HF.

E-mailed to: household.review@ofwat.gsi.gov.uk

08 August 2016

Dear Sir,

Costs and benefits of introducing competition to residential customers in England – emerging findings

Further to the publication of your above consultation document on the 18 July 2016, and the subsequent workshop held on the 20 July, Yorkshire Water is grateful for being provided with the opportunity to consider Ofwat's emerging findings and to provide comment on the assumptions used in the analyses.

Firstly, we seek to make no judgement or inference in terms of the outcome of the analysis, but believe the approach and analysis undertaken by Ofwat to be balanced and well-considered. Given the challenging timescales, the magnitude of the possible options to be considered and the degree of uncertainty, Ofwat's team should be commended for the output to-date.

We believe the classic, wide, thin competition model which has been assumed for the purpose of the cost and benefit analysis, and the four composite scenarios chosen for the analysis to be generally within the realms of possibility.

With respect to the request for further evidence, we propose reference should be made to the research on bill stability undertaken by Yorkshire Water for PR14 (relevant extracts attached at Appendix A). This research indicated that customers in Yorkshire were not particularly sensitive to average bill variations of +/-£16 per annum, which is significantly greater than the two mid scenarios considered in Ofwat's analysis of £6 and £4. We would suggest this reinforces the observations of CCWater and Ofwat.

Furthermore, we have a number of observations we wish to make regarding the analyses to-date:

- We are concerned that there has been insufficient time or evidence to enable distributional analysis of the impacts to be undertaken, and consider the undertaking of this to be of fundamental importance in any decision.
- Although the four scenarios may well sit within the envelope of possible outcomes for the market, we do not consider the probability of each of the scenarios to be equal. We believe some form of confidence grade should be attached to the analysis and

some form of analysis undertaken to establish the relative likelihood of the market developing in line with each of the scenarios.

For example, we think scenario 1 is unlikely. This is partly because we believe that an average savings of £6.50 over the 30 year period of the analysis will not support the level of market activity that is assumed as part of this scenario storyline, namely 50% active and 30% switching. And we reference the conclusions of your supporting documents to add weight to our caution on this point – only 6% of customers said they would consider switching for a £1-10 saving when asked to name the price and only 6% say a saving of 5% or less is worthwhile switching for – equivalent to £19 on the average bill.

In our view this first extreme scenario will only be plausible if the new products/services benefits – as discussed in chapter 2 of the report - materialise and customers then value them enough to switch retailers.

- We have briefly reviewed the review on costs undertaken by Water UK and share the concerns regarding the assumptions around future MO costs and the extrapolation of costs from non-household to household.
- Given the challenges remaining to implement the non-household retail market in April 2017, we feel the aspiration to have a residential market in place by 2020 requires careful consideration and that sufficient time is allowed to gather important learning from non-household retail to be incorporated in a market design for residential.

We trust you find these comments to be helpful and supportive, however should any matter be unclear or you require further information, please do not hesitate to contact myself or my colleague Howard Smith at Market_Design_Team@yorkshirewater.co.uk.

Yours faithfully,



P.P.

Adrian Kennedy
Director of Regulation

Extracts from YWS Representations on Draft Determination – October 2014

1. Summary of Representations

The table below contains details of the matters upon which Yorkshire Water is making representation together with other required updates. It follows Ofwat's suggested format and identifies where the representations and supporting evidence are located within the document.

Area	Issue	Reference in Representation
Representations		
Appointee	Customer bills. Customer bills have been reduced by adjusting PAYG, RCV asset lives and RCV run off rates back to the December 2013 Business Plan version. This was done because we did not have evidence of customer support for the rates submitted as part of the updated plan in June 2014. It is critical to the continued legitimacy of the plan that customers views are properly reflected in establishing bills.	Section 3.1

2. Overview of Key Representations

We are making representations on customer bills and two drinking water Measures of Success. An overview of each is given below. These representations have been discussed, agreed and endorsed by the Board of Yorkshire Water on 24 September 2014.

Customer bills

We have conducted further customer engagement into how and when customers are willing to pay for the services they receive. The results confirm that customers prefer stability and predictability of the bill, but that customers, including those defined as hard to reach, would prefer to have a reduction in the short term. Based on customers' views we are proposing to reduce average household bills by a further 2.5% from £353 to £344 in 2015-16 with only inflationary increases occurring thereafter up to 2019-20. Bills are quoted at a 2012-13 price base.

3.1. Customer bills

3.1.1. Issue

In the Draft Determination (DD) adjustments were made to pay as you go (PAYG), RCV asset lives on additions and RCV run off rates, reverting back to values used in the December 2013 Business Plan submission and resulting in a reduction in average household bills of £17 by 2020. These steps were taken because we presented insufficient evidence of customer preferences for bill profiles following a reduction in the weighted average cost of capital (WACC). It is critical to the continuing legitimacy of the plan that customers' views are properly reflected in establishing bills.

3.1.2. Additional information and analysis

We have further engaged with customers on the most acceptable bill profile, presenting options ranging from passing on the costs in line with when they are incurred, through to the profile included in the DD. This research was conducted in two phases.

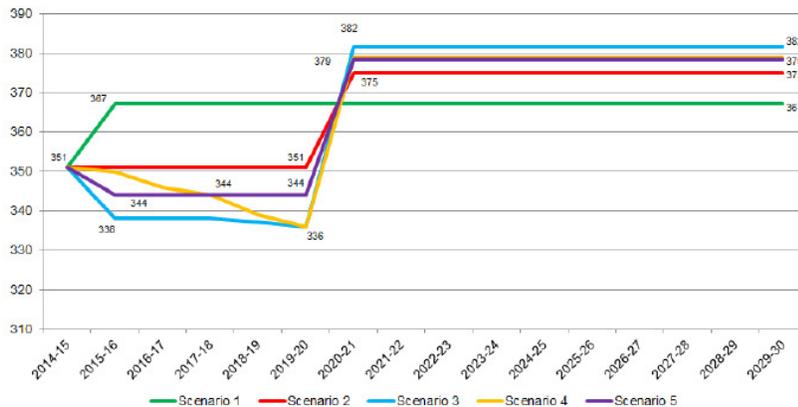
Phase 1 of the research included six household focus groups and 100 business customers. These cohorts were designed to be representative of the overall population. Figure 3.1A

shows the demographics of the domestic customers, while business customers were selected from groupings of small, medium and large users.

Location	Participant Profile	Date
Sheffield	ABC1, under 34	16th September
Leeds	C2DE, 35-69	18th September
Leeds	Hard to Reach	18th September
Hull	BC1C2DE, over 60	18th September
Scarborough	C2DE, under 34	22nd September
Skipton	ABC1, 35-59	23rd September

Figure 3.1A – Demographic split of domestic customers

In the first phase of research the following five options were presented to customers at the end of a 90 minute discussion on the principles, methods and merits of different ways of paying for goods and services. The scenarios set out in figure 3.1B were presented excluding the uncertainty of potential future efficiency sharing mechanisms, long term inflation rates and further European or national policy improvements. This ensured that customers were able to focus on the matter of how and when they wish to pay for the services to be delivered through to 2020. The profiles were extended out for 15 years to ensure customers were able to identify for themselves the impact of their decisions on future generations.



Note: the research used the YW June 2014 business plan average bill of £351 as the starting point.

Figure 3.1B – Potential bill profiles presented to customers

In general customers held the view that on an annual basis the price differential between the scenarios was not significant and that they experience much greater increases elsewhere in their household costs. In addition, they concurred with all the findings of our previous engagement, in that they expressed the preference for stable, predictable bills over the long term as can be seen in figure 3.1C below.

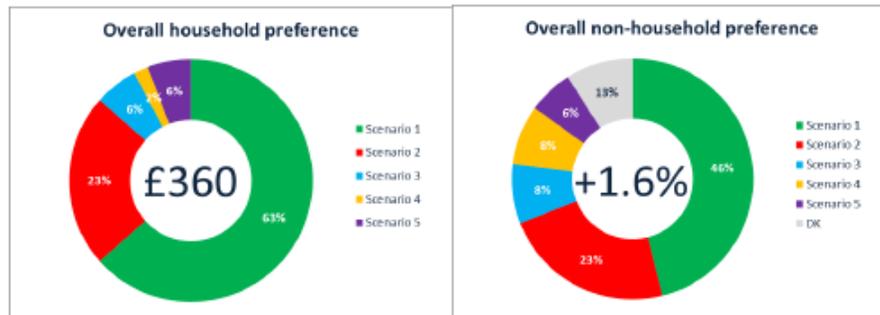


Figure 3.1C – Customer support for stable and predictable bills

Overall the survey suggested that customers had a preference for a one-off increase in bills, with bill value remaining stable thereafter. This would result in average household bills increasing to £360 annually, a rise of 2%. Non-households expressed a similar view indicating a preference for a one-off increase of 1.6%.

Clearly, in the current challenging economic conditions this would be unacceptable for some families, presenting them with difficulties in continuing to afford their water and sewerage charges. This was a view expressed by some of the household focus groups.

With this in mind we considered carefully the views of hard to reach customers. From this group we observed a much greater variability in preference. It was evident from the results that 63% of this grouping showed a preference for a bill reduction (scenarios 3, 4 and 5) in the short term, and would benefit from some of the reduced WACC being passed on to them. This can be seen in figure 3.1D which shows the spread of hard to reach customer preferences and their weighted average preferred bill value of £346 per annum between 2015-20.

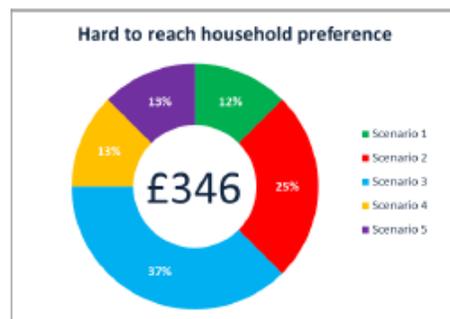


Figure 3.1D – Hard to reach customer support for bill profile options

Before concluding the research we reviewed the results against the customer acceptability engagement conducted in 2013 for the original Business Plan. This engagement, with over 4000 customers, resulted in 77% acceptability for average household bills at £351 per annum. The comparable acceptability level for hard to reach customers was 82%, which is

particularly relevant given that an estimated 24% of our household customers are considered as being in water poverty.

From this we concluded that:

- The research confirmed the need for stability and predictability of bills,
- It was not appropriate to consider options in excess of the £351 price point given the views of hard to reach customers, and,
- A significant proportion of hard to reach customers would benefit from a lower bill through to 2020.

Consequently we conducted a second phase of research to elicit customer preferences based upon bill scenarios 2 to 5, (scenario 1 was removed). We engaged with 200 customers through an online survey, ensuring the sample was representative of the regional population. The results were consistent with phase 1 in that they exhibited a preference for bill stability. However, the overall result concurred with the views of hard to reach customers in phase 1 in that the weighted average of customer preferences was £347 between 2015-20. The results are illustrated in figure 3.1E.

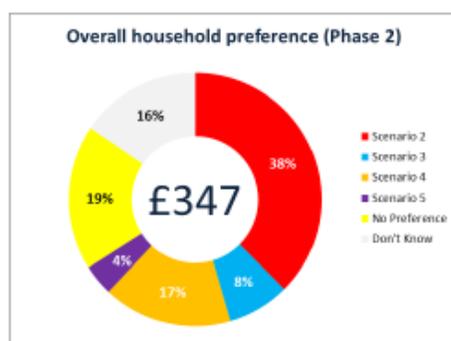


Figure 3.1E – Phase 2 customer engagement results

Appendices 1a and 1b contain the full details and the research agency's report from the research activity.

The results of this latest engagement with customers show that customers would like to see bills fall from the current level of £353 for the period 2015-20, with hard to reach customers being particularly supportive of a bill reduction (figure 3.1D).