

1 Cornwall Response: Monitoring the Business Retail Market from April 2017

Dear Sir/Madam,

Cornwall would like to thank Ofwat for the opportunity to respond to this consultation and share its views on plans to monitor the business retail market post-April 2017.

Cornwall is an independent consultancy with over 10 years' experience of providing market intelligence, training and project support in the energy sector. Over this time, we have witnessed the considerable change in the energy sector as new suppliers have entered the market and the low-carbon transition has hit its stride, with consequent impacts on both market structure and participants. We frequently work with new suppliers to help them achieve market entry, and run a monthly Energy Supplier Forum particularly aimed at small companies. This helps them keep track of industry developments and connect with other suppliers, compensating for their lack of resources compared to the Big Six. Cornwall is expanding to offer consultancy services to the water market and we are keen to share our experiences of the energy sector with the industry.

We applaud Ofwat for putting forward what is a very comprehensive document covering off the important topics in this fledgling market. We particularly recognise that it has been able to take advantage of developments in the energy sector—especially the recent investigation by the Competition and Markets Authority—in order to inform its approach. However, Cornwall would recommend several refinements to Ofwat's chosen parameters and encourage careful consideration of some other aspects.

Our central recommendations are that Ofwat must embrace the importance of third party intermediaries (TPIs), achieve a good understanding of market segmentation, and have a clear recognition of what it will use the information it gathers for. It must also establish how customers engage with the market and what they are paying, both now and in the future. In its document Ofwat has already addressed these areas, but not necessarily with the depth and clarity we believe necessary to create an effective framework for monitoring the effectiveness of competition and the success of market opening.

The opening of competition in the retail water sector represents an unrivalled opportunity for Ofwat to establish a framework that is fit for purpose for the sector's operation. We therefore call upon the regulator to ensure that it does not squander this chance through half measures. We would be pleased to discuss these matters further, either by phone or in person.

Kind regards,



Nigel Cornwall



2 Responses to Consultation Questions

2.1 Are there any other objectives that market monitoring could or should fulfil in addition to those mentioned?

Cornwall has no specific views on this topic. Based on our experience of energy and how the water market is expected to develop, we agree that market monitoring should:

- Identify and assess barriers to effective competition
- Track the evolution and nature of competition in the market
- Provide an evidence base with which to consider regulatory interventions that could improve the effectiveness of competition amongst other goals

2.2 Do you agree with the issues we propose to monitor? What issues do you think should be monitored particularly closely?

Cornwall supports Ofwat's selection of its proposed issues to monitor, including:

- Number, services and development of retailers and TPIs
- Behaviour of market participants (including fair treatment of customers)
- Quality of the switching experience
- Customer engagement
- Customer outcomes

Considering their significance to the energy market, we take the view that all of these broad areas are important and suitably cover the fields that Ofwat needs to capture data on. Cornwall would therefore not propose any additional umbrella issues to monitor. However, it is our view that particular salience needs to be given to customer outcomes.

We recommend that Ofwat needs to pay close attention to what customers are paying in the broadest sense, including how much they pay and for what type of service (water plus sewerage; water plus value-added service; multi-utility etc.), how this compares to what they were paying before market opening, and the retail/wholesale split in their bills. We observe that references to costs, charges and tariffs only appear a handful of times in the Ofwat document (p10, 11, 14, 31 and 35), and would contrast this with Ofgem's annual report on the energy sector, in which a significant proportion of the content is dedicated to breaking down what customers are paying, and what they are paying for¹. This is particularly important in that, like energy, water is a non-discretionary good and so the prices paid, both absolutely and in terms of proportion of consumers income, will be vital.

More broadly, Cornwall would emphasise that Ofwat must have a clear plan for how it shall use this data and what reason it has for gathering it. Particularly, we suggest that the regulator must ensure it knows what baseline it is working from, and what objective it is working towards, or otherwise it will be hard to evaluate the success of the market.

We examine this issue in greater depth in section 3.

¹ [Ofgem: Retail Energy Markets in 2016](#)



2.3 Do you agree with the type and format of the information we are planning to obtain from the market operator?

We answer this question in conjunction with Q4 below.

2.4 What information will retailers hold that will help us achieve our monitoring objectives?

It is our experience of the energy market that when major changes come about—such as immediately following privatisation and the rush of new companies that enter the market when wholesale prices fall—that problems can rapidly build up and escalate. Ofwat intends to gather and publish information on the market annually, but for the initial period Cornwall would strongly recommend that it has some form of sub-annual reporting on at least a six-monthly or perhaps quarterly basis. So as not to be too burdensome this could be concentrated on certain KPIs such as:

- The extent to which transfers are taking place
- The benefits customers are accruing (going beyond raw savings from switching)
- If wholesalers and retailers are turning around bills on time.

This will help Ofwat to identify emerging issues and hopefully head them off before they become severe. A prominent example of this has been mis-selling in energy, often in the form of door-to-door sales. Poor sales practices can be sustained for years without detection, such as in the case on E.ON's fine in 2014.² What is more, mis-selling has actually been a recurring issue in the market, particularly due to new companies entering the market and making the same mistakes as older ones, or companies attempting to exploit new sales channels and making new mistakes.

Similarly, it is very common in the energy market for suppliers to face considerable customer service problems after introducing new IT systems. Perhaps the worst example was npower³, which implemented a new billing system in 2011 and was subject to a £26mn fine after five years of persistent customer service failures as a result. This demonstrates how frequent review of supplier performance should help reveal issues before they become systemic and we recommend that Ofwat ensures it is working as closely with the Consumer Council for Water and Citizens Advice to capture complaints data frequently.

Ofwat plans to receive data from the Market Operator on a monthly basis, which is a wise choice, but with only annual reporting from retailers we note it will have to wait a full year before finding out several important details including:

- The number of retailers offering multi-utility deals
- The number of TPIs that retailers deal with
- The number of customers on multi-utility deals
- The number of microbusiness customers
- The number of customers who renegotiate their contracts

The regulator has correctly identified these data points as important; however, Cornwall would advise that, given their importance, it would help to obtain them earlier than planned. Additionally, it would be valuable to obtain a breakdown of how

² [Ofgem: E.ON Financial Penalty](#)

³ [Ofgem: npower Financial Penalty](#)



long a retailer's customers have been with them so as to determine how "sticky" customers are.

We are also wary that the document appears to suggest that Ofwat would consider revising the reporting requirement downwards, which would be to a frequency less than annual. It states that Ofwat knows the importance of regular assessment but was "mindful of keeping any reporting burden proportionate". Though this may not be the regulator's intention in this paragraph, we would stress that annual reporting should be the minimum frequency considered adequate, and sub-annually is preferable in the early stages of market development. It is also worth noting that, in the energy sector, the burden from formal reporting is relatively light, and what really puts strain on market participants are major ad hoc consultations and requests for information. Were Ofwat to move to reporting less frequently than yearly, it may have to carry out more ad hoc requests to fill in any blanks and thus actually increase the overall burden.

With regard to data points, Cornwall observes that Ofwat does not plan on seeking information on how many multi-site customers retailers have, customer usage per site, or savings per site. It has long been recognised that consolidated billing for multi-site customers is one of the biggest benefits the market will bring. We recommend that Ofwat keeps a close watch on this for two reasons:

- Firstly, this will demonstrate the extent to which the flagship benefit of marketing opening is occurring
- Secondly, it will be important to identify if multi-site customers are the only ones genuinely benefitting from market opening, to identify if a two-stream market is developing where smaller customers see greatly reduced benefits. The CMA's investigation has certainly highlighted that in the energy industry large business customers already enjoy significant advantages over SMEs

2.5 We would welcome views on our proposal for informal monitoring, any other tools we could use, and how we might make the best use of the information available

Ofwat's proposals for informal monitoring are interesting and wide-ranging. Such tools may indeed facilitate more informal engagement in order to head-off issues before they develop to the point where enforcement becomes necessary. While not directly analogous, this has similarities to Ofgem's recent move towards agreeing voluntary redress packages with market participants.

Over the past months, Ofgem has been launching fewer formal investigations and increasingly has worked with parties to agree appropriate changes to their practices and a redress scheme to compensate affected customers. This saves the regulator resources—and saves the party from such bad publicity—but it does somewhat limit transparency as the energy regulator does not publish as much detail of a participant's transgressions when redress has been agreed compared to when there has been a formal investigation. This in turn lowers the opportunities for other market participants to learn from the failings of others, so it would be advisable for Ofwat to avoid this pitfall and make sure it formally documents and transparently publishes these informal actions.

We would also echo the previous point that ad hoc information requirements are best avoided, and that informal monitoring should not become an additional route for the regulator to request information at short notice.



2.6 We would welcome views on how best we could involve third party intermediaries in our monitoring framework, which information would be best to collect and how we could obtain it.

Cornwall would advise Ofwat to work closely with TPIs as they have a prominent role in the energy market and expect to have the same in water. TPIs often move into markets early to form lasting relationships with large customers, and can have considerable influence with them. In energy, we estimate that at least 75% of industrial and commercial customers use TPIs. They will hold a lot of useful information, but Ofwat has no statutory powers to extract it.

We note that Ofwat states in the document that TPIs have “as much reason as any other market participant to make sure the market is successful, transparent and trusted.” As a broad statement this might be true, but there is a history of rogue TPIs in the energy market that has led many to seek a formal code of practice (CoP), and we are aware of calls by TPIs to be licensed in the water sector. It is disappointing that, despite sustained issues and pressure from brokers, Ofgem has shelved plans for a TPI CoP. We know that Ofwat had planned to collaborate with Ofgem on such a CoP and would encourage it to persevere with its own if possible. This would give confidence to consumers that TPIs—many of whom may be unfamiliar names entering from other sectors—can be used safely, and would presumably involve a reporting system that could be used as a basis for obtaining the information Ofwat requires. At the very least, the regulator should establish an informal TPI panel to keep in close contact with the sector. This would also help drive confidence in the switching process for consumers in the new market and so help ensure that the expected benefits of competition are realised.

2.7 We would welcome views on how best to collect useful information on market segments. In particular, we would welcome views on challenges to deriving the market segment information we envisage and ways of overcoming them.

We welcome plans to pay close attention to segmentation and would recommend Ofwat particularly examines certain areas. The regulator already plans to examine:

- Customers by type (large, SME and microbusiness), water use (very low, low, medium, high and very high) or value
- Market activity by wholesaler area (looking for local issues in incumbent supply areas)
- The success of new entrants versus incumbent retailers

We welcome the recognition that microbusinesses work more like household customers than businesses and need extra protection. We note that, in energy, traditionally about 25% of small businesses use TPIs, so most shop around directly, while conversely 75% or more of industrial and commercial customers use TPIs. Use of TPIs is on the rise among SMEs, but this is a recent trend. Thus, there is a considerable disparity in how sizes of business interact with the market. The CMA found that microbusinesses had been some of the worst-affected of all customer groups from the failings of the energy market. Particular problems stemmed from auto-rollover contracts and lack of price transparency, so Cornwall would recommend that Ofwat maintain a close eye on contract termination arrangements, and if retailers are charging comparable prices for the same services to different customers.



We also observe recent research by Citizens Advice Scotland⁴ that indicates that, although awareness of the market is very high amongst even small business consumers, switching rates are low, and interest in switching is even lower among customers with a low water spend. While the sample size was small, that this trend is still apparent eight years after Scottish market opening clearly highlights that new solutions are needed to encourage microbusinesses to engage.

Additionally, as in our response to Q4, we strongly recommend that Ofwat breaks down customer type not just by size but by number of sites; for example, a single large customer may benefit less from market opening than a chain of small users with equivalent combined usage due to consolidated billing.

2.8 How can we best make sure that relevant information is shared in a transparent and useful manner, whilst also being mindful of commercial and personal confidentiality and without prejudice to competition law?

As discussed in our response to Q4, information on the state of competition in the market should be published annually in the form of an anonymised report. At least during the initial few years following market opening, this could be supported by shorter bi-annual or quarterly reports based on KPIs.

This information should be broken down by customer group and supplier group as discussed in our response to Q7, and widely distributed to the market.

3 Other views:

Our most serious concern is that the document does not paint a clear vision of why Ofwat has chosen these metrics for and how useful they will be. There needs to be a clear idea of what success looks like, or otherwise Ofwat will find it hard to decide whether interventions are required.

Similarly—particularly for subjects such as water consumption and tariff data—a baseline is necessary. Finding out what customers are using and paying a year after market opening will tell the regulator little about the improvements that ensued if there is no clear picture of where customers started.

Cornwall would also recommend that Ofwat reports include a breakdown of switching over the course of each year (or relevant period, for sub-annual reporting). Considering that, reputedly, a large number of deals have already been negotiated for big customers, a situation may emerge where a significant proportion of the customer base switches at market opening and achieves significant savings, but then never switches again. To illustrate, data might show that 40% of the customer base has switched by one year after market opening, which would be a very positive result, but if 80% of those customers switched at market opening and may never switch again, the market will not be as healthy as it appears.

Ofwat only makes rather limited reference to the sort of interventions it might make. While standard enforcement actions are to be expected, there is no clear picture of what sort of market interventions Ofwat might make. If the regulator does find that few switches are occurring despite high customer awareness (so the obvious route of awareness campaigns is unhelpful), there is no clear route detailed in the document as to how it might respond, except perhaps to refer the market to the CMA. Ofwat

⁴ SMEs' Awareness and Experience of the Water Market in Scotland



plans the metrics proposed in this document to be its evidence base for interventions, but it must know what that evidence base may be leveraged to achieve. We are, for example, mindful that the Scottish retail market only really took off once WICS allowed the gross retail margin to expand.

Similarly, the metrics will help the regulator make sure it understands whether the market is working well, but it only provides an outline of what an idealised well-functioning market rather than a clear picture of what it might recognise as one working well. The CMA was particularly criticised for having based its calculation of excessive energy supplier profits on an unrealistic image of a well-functioning market that was not far removed from a state of perfect competition.⁵

Ultimately, while it may be hard for a regulator to lay out exactly what it would describe as “enough competition”, Ofwat must be able to pin down where the market is starting from and where it would like it to go in order to be able to judge progress and development in a meaningful way.

⁵ [Response by former GB energy regulators to CMA Provisional Decision on Remedies, p11](#)

