Retail Exit Code consultation

United Utilities response - October 2022

Key points

United Utilities Water (UUW) welcomes the opportunity to respond to this consultation.

The purpose of the REC is to protect customers where an active competitive market falls short in providing that protection. It is clear that for SMEs competition alone does not, at present, provide sufficient protection and we support the continuation of a price cap for those customers. However, the price cap should provide a backstop rather than a replacement for a competitive market and the associated competitive pressures. Speaking to retailers operating with the United Utilities region a significant concern has been raised that an REC price cap set with insufficient margin between costs and the price cap will inhibit the success of a competitive market. As a wholesaler we have a strong interest in ensuring that the market is a success. We have two primary concerns with the proposals set out within this consultation:

- If price caps fail to reflect regional specific costs then NHH retail competition for SMEs in the North West will falter and the benefits of that competition will fail to be realised.
- That if the price cap is set at a rate nationally that fails to provide retailers with sufficient margin this will be to the detriment of service provided to the market, including levels of meter reading, engagement on water efficiency and support to address market frictions.

Without successful competition achieving the benefits to customers of innovation and improved customer services are unlikely to materialise. Successful competition, including sufficient margin, allows retailers to undertake activity that ensures that all customers are registered in the market correctly and served effectively – this is critical to the delivery of broader customer outcomes such as water efficiency, leakage detection activity and reporting (both supply and customer side), vacancy management and fair charging for all customers and the management of events and incidents. We therefore urge caution when setting the price cap within the REC that it does not discourage retailers from engaging the lower value, less readily engaged customers. We believe this is a segment that Ofwat should give particular consideration to when making its final decision in this matter.

<u>Deprivation and bad debt</u>

As currently proposed the REC price cap appears to fail to reflect some of the variation in cost associated with the operation of a retailer. Within the HH Retail market, deprivation and the associated bad debt has a substantial cost for activities including bad debt and debt management activities, including the management of vacant premises. It would seem logical to assume that deprivation in the local economy has some impact on costs within the provision of retail services for the NHH market. The North West is subject to higher levels of deprivation, as shown within the ONS Indices of Multiple Deprivation over many years. We are therefore concerned that in setting a national price cap, the North West would be a more expensive region within which to operate due to the costs of bad debt stemming from insolvencies. This could inhibit the development of a successful NHH market in the North West and result in poorer outcomes for businesses in the region that already face significant challenges.

For both HH and NHH customers there is a correlation between deprivation and the levels of vacancy. There are costs associated with the active management of vacant premises including bad debt, taking meter reads, monitoring vacancy status and on boarding new customers promptly. As a wholesaler we are very keen for retailers to actively manage vacant premises and bring customers into charge. This activity helps identify leakage and reduce costs for customers.

Outcomes for NHH customers

We would advocate that the REC price cap must provide sufficient margin for retailers in the North West to deliver water efficiency and innovation for NHH customers, in an area of relatively high deprivation and where operational conditions are more difficult because of lower value economic activity. At present many of these activities are being championed by wholesalers rather than retailer driven through a competitive market. In the long term we hope that retailers will increasingly lead on efforts to deliver water efficiency for NHH customers as was envisaged when establishing the NHH retail market. Insufficient margin would likely mean that retailers would not invest more in water efficiency going forward, contrary to key expectations of market benefits.

The efforts to resolve many of the market frictions require input and resources from both wholesaler and retailer. Without sufficient margin retailers may not be in a position to undertake activity required to resolve these challenges including, for example, effectively managing changes to customer accounts resulting from data improvement activity. We do note that the current costs associated with addressing these frictions have been reflected within the calculations. We also note that it is hoped, and we share this hope, that significant progress will be made over coming years to address these issues. However retailers will need sufficient margin to support wholesalers in their efforts to deliver this. If the efforts to address the identified frictions increase so will the need for retailer input and resource demands.

We have addressed each of the questions within the response below.

Question 1 – Setting aside our February 2022 decision to temporarily increase gross margins for customer Group Two by 0.49% in respect of customer bad debt costs which is outside the scope of this consultation, do you agree with our proposals to retain gross margins for Group Two customers at 8% (water) and 10% (wastewater)?

We do not wish to comment on the level of the gross margin, but do note that this group of customers do appear to be more actively engaged in the market suggesting that current arrangements are allowing competitive forces to take effect.

Question 2 – Do you agree with our proposal for a single, England-wide, retail allowance to apply to Group One customers?

We do not agree with the proposal to set a single, England-wide retail allowance for all group one customers. In our experience of working for both household customers, and non-household customers prior to 2017, demographics have a significant bearing on the cost to serve. Deprivation leading to increased cost to serve, increased bad debt and higher levels of vacancy is not uniform across the country. In 2011 52% of the most deprived 1% of Local Super Output Areas were within the North West (English Indices of Deprivation 2010, Department for Communities and Local Government, 24 March 2011). In 2021 the ONS figures for proportion of the population experiencing deprivation relating to low income continues to identify the North West as the most deprived region.

As currently proposed the REC appears to fail to reflect some of the costs associated with the operation of a retailer. Within the HH Retail market, deprivation and the associated bad debt has a substantial cost for activities including bad debt and debt management activities, including the management of vacant premises. It would seem logical to assume that deprivation has some impact on costs within the provision of retail services for the NHH market. The North West is subject to higher levels of deprivation, as shown within the ONS Indices of Multiple Deprivation over many years. We are therefore concerned that in setting a national price cap, the North West would be a more expensive region within which to operate due to the costs relating to deprivation. This could inhibit the development of a successful NHH market in the North

West and result in poorer outcomes for businesses in the region that already face significant challenges. We therefore urge caution when setting the price cap within the REC that it does not discourage retailers from engaging the lower value, less readily engaged customers. We believe this is a segment that Ofwat should give particular consideration to when making its final decision in this matter.

For both HH and NHH customers there is a correlation between deprivation and the levels of vacancy. There are costs associated with the active management of vacant premises; taking meter reads, monitoring vacancy status and on boarding new customers. As a wholesaler we are very keen for retailers to actively manage vacant premises to identify leakage and ensuring incorrectly identified vacants are brought into charge.

Question 3 – Do you agree with our proposal that REC price caps for Group One customers should apply to each unique service supplied?

We do not wish to respond to this question.

Question 4 – Do you agree with our proposal that an additional meter read cost allowance should apply only where a customer takes a measured water service?

We do not agree that the only meter reading costs that retailers are subject to relate to the measured water service. There is an obligation for taking meter reads from vacant premises. There is also a requirement to undertake property management activity (for the management of occupancy / change of tenancy) at premises that are only in receipt of sewerage services. Trade effluent meters also need to be read and the cost of reading these meters can be higher than for a water meter.

Question 5 – Do you agree with our proposal to continue with the current REC specification of customers and premises, including as set out in Annex A1 'Allowed charges for Customer Group One'?

We do not wish to respond to this question.

Question 6 – Do you agree with our approach to assessing efficient costs to serve for Group One customers? Do you have any comments regarding our approach?

We do not agree with the approach taken to assess efficient costs. It would appear that costs relating to servicing vacant premises have not been fully accounted for within the assessment. In addition we believe that there are additional costs associated with providing services to areas of greater deprivation and bad debt that may not have been incorporated fully within the assessment.

Question 7 – Do you agree with our approach to allowing indexation?

We agree with the approach to utilise CPIH to index the price cap.

Question 8 - Do you agree that we should revise the allowed net margin in respect of Group One customers to 2.0%? Do you have any comments on our approach to determining the level of allowed net margin?

We do not wish to respond to this question.

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Question 9 – Do you agree with our proposed revisions to REC price caps for customer Group One?

We do not agree with the proposals, in particular the level of the price cap and the application of single national assessment of costs.

The purpose of the REC is to protect customers where an active competitive market falls short in providing that protection. If the REC is set in a manner that inhibits the potential for competition by creating insufficient margin between costs and price cap successful competition is unlikely to develop. What is needed at this time are steps to invigorate the market for smaller customers.

Without successful competition achieving the benefits to customers of innovation and improved customer services are unlikely to materialise. Successful competition, including sufficient margin, allows retailers to actively engage group one customers which is critical to the delivery of broader customer outcomes such as water efficiency, leakage detection activity and reporting (both supply and customer side), vacancy management and fair charging for all customers and the management of events and incidents. We therefore urge caution in setting a price cap within the REC that there is sufficient margin to allow competition to flourish, for these customers to be engaged and served effectively and deliver the best outcomes for customers. There is also potential for the price cap to discourage retailers from engaging the lower value, less readily engaged customers. We believe this is a segment that Ofwat should give particular consideration to when making its final decision in this matter.

As currently proposed the REC appears to fail to reflect some of the costs associated with operation of a retailer. Within the HH Retail market, deprivation and bad debt have a substantial cost for activities including support schemes, debt recovery activities and the additional activity needed to achieve payments. It would seem logical to assume that deprivation has some impact on costs within the provision of retail services within the NHH market.

The North West is subject to higher levels of deprivation, as shown within the ONS Indices of Multiple Deprivation over many years. We are therefore concerned that in setting a national price cap, the North West would be a more expensive region within which to operate due to the costs of bad debt stemming from insolvencies. This could inhibit the development of a successful NHH market in the North West and result in poorer outcomes for businesses in the region that already face significant challenges.

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We would advocate that the REC price cap must provide sufficient margin for retailers in the North West to deliver water efficiency and innovation for NHH customers, in an area of relatively high deprivation and where operational conditions are more difficult because of lower value economic activity. At present many of these activities are being championed by wholesalers rather than retailer driven through a competitive market. In the long term we hope that retailers will increasingly lead on efforts to deliver water efficiency for NHH customers, as was envisaged when establishing the NHH retail market. Insufficient margin would likely mean that retailers would not invest more in water efficiency going forward, contrary to key expectations of market benefits.

The efforts to resolve many of the market frictions require input and resources from both wholesaler and retailer. Without sufficient margin retailers may not be in a position to undertake activity required to resolve these challenges including, for example, effectively managing changes to customer accounts resulting from data improvement activity. We do note that the current costs associated with addressing these frictions have been reflected within the calculations. We also note that it is hoped, and we share this hope, that significant progress will be made over coming years to address these issues. However retailers will need sufficient margin to support wholesalers in their efforts to deliver this. If the efforts to address the identified frictions increase so will the need for retailer input and resource demands.

Question 10 – Do you agree that we should protect Group One customers from material changes in the retail element of bills by using a 'glide path'? Do you have views on the timing and form of such a glide path?

We agree that the application of a glidepath is a sensible approach to try and limit the impact of the proposed changes have on customers.

Question 11 – Taking account of the proposals set out in this document for revisions to REC price caps for Customer Groups One and Two, do you agree with our proposed amendments to the Retail Exit Code?

As set out above we do not support the proposed approach.

Question 12 – Do you agree that Ofwat should require that Retailers submit by June each year, assurance that they are complying with the REC price protections, and that such assurance is compiled by a suitably qualified third party?

This approach seems appropriate.

