

# United Utilities response to the Ofwat consultation: Costs and benefits of introducing competition to residential customers in England – emerging findings



## Key Messages

We welcome Ofwat's transparent approach to the process of undertaking its cost benefit analysis.

In our response we set out a number of important social and policy implications which Government should carefully consider before making a decision on household retail competition and which do not currently feature significantly in Ofwat's analysis. In particular Government should;

- Work with companies to identify the range and scale of current industry cross-subsidies for different groups of customers, undertake an assessment of distributional effects of retail competition and set out mechanisms that could enable retention of those cross-subsidies deemed to be socially valuable at a national level;
- Profile the bill impacts of a change in household retail water market policy using Defra's 'Water bills projection model' (project number WT1557);
- Identify support and assistance schemes to be retained, and set out clear mechanisms that will enable them to be retained within a competitive market; and
- Develop a clear and compelling proposition for domestic customers in advance of taking the decision to pursue market reform.

We agree with the strong evidence that the majority of customers place a value on choice. We make the following observations which related to Ofwat's emerging findings:

- We believe that market implementation and ongoing costs represent a key uncertainty in the current impact assessment. Ofwat should work with companies to develop a more detailed view of market design and specification to enable companies to develop a set of informed cost estimates.
- For bad debt costs to reach levels seen in the energy sector (as set out under Ofwat's 'scenario 1') we believe considerable policy changes would be needed to provide the water sector with equivalent interventions and sanctions to incentivise payment. Given that such policy changes aren't being considered we believe that the more optimistic assumptions are unlikely to be attainable.

Given the relatively finely balanced CBA case – and the fact that costs are frontloaded and benefits back end loaded - we believe it is important to consider what additional evidence may emerge soon in order to refine these estimates and provide more certainty of the outcome. In particular we believe that the assessment would benefit from evidence arising from;

- 2017 non-household retail water market opening costs; and
- The impact of energy reforms emerging from the latest CMA investigations.

We believe that these will provide important evidence which should be taken into account prior to the government making its final decision in relation to retail competition for residential customers.

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## Introduction

We welcome the opportunity to contribute to Ofwat's consultation on the costs and benefits of introducing competition for retail household markets in the water and wastewater sector. We also welcome the open and transparent way that Ofwat have approached this process to date, and believe that this will benefit the overall outcome of the exercise.

As an incumbent water and wastewater service company with approximately 3 million household customers, serving a population of over 7 million people, we believe UUW is well placed to make a relevant contribution to the consultation. There are many factors, some of which are unique to the water industry and UU, which we believe will need to be considered as part of this review.

It is recognised that the North West region is home to many of the most extreme examples of household poverty and deprivation in England. This provides us with particular insights into the issues that can mean customers find themselves in vulnerable circumstances.

We fully agree with the strong evidence demonstrating that the majority of customers place a value on choice. Providing consumers with choice is, all things being equal, likely to drive long term benefits for customers and wider stakeholders. However to ensure that household retail competition works in the best interest of all customers - and in particular helps those least able or likely to take part in an active market - we encourage Ofwat and Government to take a number of further steps to inform final policy decisions before they are made.

We have set out our response to Ofwat's consultation below. Our primary focus has been on the importance of understanding the distributional effects that the introduction of competition might bring to customers, with particular reference to the magnitude and nature of protections vulnerable customers may need. In particular, we want to ensure that the risks to financially vulnerable customer groups are well understood and that any proposed market design carefully considers and where necessary mitigates the potential for such customers to be disadvantaged.

We note in the draft impact assessment Ofwat has asked for comments in a number of areas including requesting feedback on the scope of the impact assessment, and additional evidence on costs and benefits. In structuring our response we have set out three broad areas of comment:

- Firstly we have provided a number of comments on **additional investigative activity and research** which we believe are necessary in advance of a final policy decision being taken by government, either as part of this impact assessment, or as further pieces of work.
- Secondly we consider the **additional evidence** we are able to contribute (within the time available) towards assessing benefits and specific cost areas identified in Ofwat's impact assessment. We have identified a few instances where we believe there is a good case for reconsidering the assumptions underpinning Ofwat's analysis. In particular we believe that some Ofwat assumptions on bad debt are only plausible if combined with material national policy changes.
- Finally we have commented on how the emerging evidence base may impact views on the optimal **timescales for implementing competition** and present some further evidence on the key policy and process issues that should be resolved before a policy decision is made in order to retain customers' trust and confidence in the industry.

We would be happy to discuss any of these comments in our response and associated documents, or indeed on other areas of household retail competition that Ofwat would like to discuss further.

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## 1. Additional investigative activity and research

Ofwat has sought to complete an impact assessment on the costs and benefits of extending retail competition to household water customers, as set out in the UK Government’s “A Better Deal” paper in support of a future Government policy decision in this area.

Whilst a cost benefit assessment is an important enabling analysis exercise ahead of government policy decisions it is unlikely, on its own, to provide a full picture of the likely consequences of a new policy. The proposal to open household retail activities to competition is a particularly complex area, with many varied interactions and issues which merit consideration. We have provided a number of comments on additional investigative activity and research which we believe would be beneficial in advance of a final policy decision by Government, either as part of this impact assessment, or as further pieces of work. These include:-

Distributional and time based impacts	<ul style="list-style-type: none"><li>• <b>Identify the range and scale of cross-subsidies.</b> Undertake further impact assessment work on the distributional effects of retail competition and set out mechanisms that could enable retention of those cross-subsidies deemed to be socially valuable.</li><li>• <b>Profile bill impacts</b> of a change in household retail water market policy using Defra’s ‘Water bills projection model (project number WT1557).</li></ul>
Support mechanisms	<ul style="list-style-type: none"><li>• <b>Identify support and assistance schemes to be retained</b> and set out mechanisms that could enable them to be retained within a competitive market if so desired.</li></ul>
Implementation	<ul style="list-style-type: none"><li>• <b>Review wholesale/retail interactions</b>, consider their nature and scale, and set out mechanisms required to provide for effective interactions within a competitive framework.</li><li>• <b>Develop a clear and compelling proposition for domestic customers</b> in advance of taking the decision to pursue market reform.</li></ul>

### Distributional and Time Based Impacts – Identify range and scale of cross-subsidies

The recent CMA review into energy markets<sup>1</sup> and the Public Accounts Committee report on the economic regulation of the water sector<sup>2</sup> both serve as a reminder that the impact of regulation on vulnerable customers is a matter of significant public concern. We recognise the wide range of factors considered in the household retail competition impact assessment, and agree the assessment addresses the primary factors which may influence the cost and benefits of market reform for the average customer. However, to date, the assessment has not assessed or reported on the anticipated impacts for those groups of customers that sit outside the average, for example, customers that many would consider ‘vulnerable’.

<sup>1</sup>CMA ‘Energy market investigation - Final report’ 24 June 2016

<https://www.gov.uk/cma-cases/energy-market-investigation#final-report>

<sup>2</sup> House of Commons Committee of Public Accounts ‘Report into Economic regulation of the water sector - Fifteenth Report of Session 2015–16’ 16 December 2015

<http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/505/505.pdf>

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The North West has the highest concentration of the most income deprived areas in England<sup>3</sup> and reforms that have substantial impacts on potentially vulnerable customers will disproportionately impact the North West.

Our own experience in the North West suggests that vulnerable customers are some of the most likely groups to fall into payment arrears. In Appendix 1 of this response document we have provided substantial analysis of how water sector and UU bad debt and debt management costs are closely correlated to levels of financial vulnerability and measures of deprivation. This analysis shows that vulnerable customers are more likely to make use of many of the discount and support schemes available as part of the current industry structure.

**As well as considering the benefits and costs of market reform for the average customer, an assessment should be undertaken for a sub set of customers that might be defined as vulnerable.** This is because the outcomes for these customers are likely to be significantly different than for the average customer and we believe it is important that the interests of these customers are protected. We would be happy to work with Ofwat and/or Government to help develop a clearer picture of the characteristics of this group of customers, and how their interactions with water service retailers may differ from the average.

We agree with Ofwat that competition in the domestic market would need to have mechanisms in place to enable socially desirable cross-subsidies to continue. Otherwise, such cross-subsidies are likely to unwind over time on an unplanned basis, to the detriment of financially vulnerable customers and potentially other parts of the customer base. **Ahead of any policy decision on household retail competition we believe that it will be important for Government to consider evidence about the range and scale of existing cross-subsidies, and to have a clear vision of the mechanisms that could enable socially valuable cross-subsidies to be retained within a competitive market.**

At present there are many social cross-subsidies in place for household customers which allow companies to charge customers the same within a region despite differences in cost to serve. The largest of these is the bad debt cross-subsidy. A significant part of the cost of bad debt is spread across all customers, meaning customers with a high risk of non-payment are usually charged the same as customers with negligible risk of non-payment.

The scale of these cross-subsidies is much larger than the average benefits of competition identified in Ofwat's impact assessment. A joint industry report by ICS<sup>4</sup> identifies existing cross-subsidies of up to £145/yr. More typically:

- Households in the bottom 30% of incomes receive retail cross-subsidies equal to about £43 per household whereas households in the top 30% of incomes contribute around £17 per household;
- Households who pay by direct debit contribute on average a subsidy of £14. Households who do not pay by direct debit receive on average a subsidy of £19.

**The implications of such cross-subsidies require much greater consideration than is presently available in Ofwat's summary of the cost/benefit case. It is important that the distributional effects of market reforms are highlighted to Government prior to policy decisions being made.** The ICS report provides a good starting point for this analysis, but undoubtedly more work could be done to supplement this.

The issue of bad debt is complicated, as it is in part a side-effect of the wider problem of financial vulnerability. There is plenty of evidence (see Appendix 1) to suggest that more financially vulnerable

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<sup>3</sup> The northwest has 6 of the top 10 most income deprived LSOAs. From ONS 'English indices of deprivation 2015' 30 September 2015

<https://www.gov.uk/government/statistics/english-indices-of-deprivation-2015>

<sup>4</sup> ICS report to WaterUK 'Distributional impact of introducing household retail competition in the water sector' April 2016

<https://dl.dropboxusercontent.com/u/299993612/Future%20of%20the%20water%20sector/Distributional%20Impacts%20of%20Retail%20Competition%20Final%20Report.pdf>

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customers, located in more deprived areas, are more likely to fall into arrears. Our experience of operating in the North West also suggests that customers in more deprived areas are, on average, more costly for retailers to serve than customers in more affluent neighbourhoods for a variety of operational reasons in addition to the bad debt charge itself.

Observations from other utility sectors and other countries suggest that the most appropriate and effective means of allowing socially desirable support mechanisms and cross-subsidies is to follow the Universal Service Obligation (USO) funding approach. Under this approach all providers share in the provision of a universal service to customers on a national basis, even where they might not do so in a purely competitive market.

At present water companies provide an implied form of USO. In part because of this household retail competition creates a real risk that customers that do not effectively engage in the market could see increases in charges. This is a particular risk for customers in vulnerable circumstances whom may find it difficult to engage in the market for a variety of reasons. Such customers are currently more likely to benefit from existing cross-subsidies that spread the cost of managing bad debt and assistance schemes. In a competitive environment all retailers will find that their ability to spread such costs is reduced, resulting in a reduction in the value of such cross-subsidies, or perhaps their ultimate removal. Customers who can't or don't access the market will experience an unwinding of current social cross-subsidies.

Because of the implied USO – which includes the obligation to supply service to domestic customers even where no payment is received – there are limited sanctions available to water retailers to address non-payment. This means that levels of bad debt – particularly amongst customer groups facing affordability challenges – are likely to persist in a way that is different from other sectors. We do not believe that these issues can be mitigatable by company action alone (see the discussion of bad debt efficiency in Section 2).

We welcome Ofwat's acknowledgement that any design of a household retail market would need to ensure that such customers are protected. We consider it is important to go beyond recognising the issue and to consider how mitigation of it could be implemented before proceeding to a policy decision on market reform. A significant part of preventing socially undesirable outcomes could be achieved by operating a form of Universal Service Fund.

#### Suggestions for further investigation

**In summary, before a policy decision on household retail competition is taken we consider it is important for Government to have:**

- **clear evidence which identifies the range and scale of existing cross-subsidies;**
- **further impact assessment work on the distributional effects of retail competition; and**
- **a clear view of the mechanisms that could be utilised to facilitate the retention of cross-subsidies where these are socially desirable, including the provision of a universal service fund.**

**Were Ofwat to consider this work outside of its current scope, then we believe it is important to flag that such work should be undertaken to inform Government on these matters before a policy decision is made.**

#### Distributional and Time Based Impacts – Profile bill impacts

Market opening requires substantial upfront investment by companies and regulators. Ofwat estimates market opening upfront costs to companies are likely to be in the region of £200m to £400m, noting that costs may be higher or lower than assumed in the draft impact assessment (see the discussion of market opening costs in Section 2).

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Under Ofwat's more favourable scenarios it will take 10 to 20 years for benefits of competition to outweigh these upfront costs, so positive NPVs are back end loaded. In its impact assessment Ofwat expects that companies would not necessarily pass on all costs to customers in the short term.

It is not clear at this stage how market opening costs will be paid for or who will pay for them, but experience from the non-household market opening suggest that there will be two primary sources of funding for market opening: water wholesalers and water retailers. We do not know at this stage how costs would be split between the two groups. However, efficiently incurred market opening costs are ultimately likely to be reflected in upward pressure on customer bills.

We agree with Ofwat's assertion that retailers may well seek to insulate customers from short term bill fluctuations. However we think that it is unlikely that retailers in a competitive market could wait 10 years or more to realise positive returns. It therefore seems likely that they will need to pass on some upfront market opening costs onto customers in the form of near term bill rises.

Wholesalers have more capacity to smooth the bill impacts of large upfront capital investments, particularly through use of the RCV mechanism. However wholesalers are not able push returns on past investment into perpetuity. The RCV will naturally "depreciate" in line with the anticipated asset life of new investments, and therefore result in an increase in customer bills spread over the life of the new investment.

In the case of a domestic retail market opening it seems likely that the majority of upfront capital investments will be in new IT capabilities and systems. These assets typically carry an asset life of 5 to 7 years. This is substantially less than the 10 to 20 years Ofwat estimate it will take for customers to realise NPV positive benefits from market reform.

We therefore conclude that regardless of how market enablement costs are distributed between wholesalers and retailers it is extremely likely that such costs will need to be recovered from customers in the initial 1 to 7 years of market opening and consequentially it seems likely that the average customer will experience net bill increases at some point during this period.

Recent work by Defra<sup>5</sup> to develop a water bills projection model would seem well suited to the task of considering how market opening would impact household bills on an annual basis. The model is capable of considering a wide range of different market reform scenarios, including modelling different market opening costs, and the impact of allocation such costs between wholesalers and retailers to differing degrees.

#### Suggestions for further investigation

**Ahead of a policy decision on household retail competition we believe that using the Defra 'Water bills projection model' (project number WT1557) to consider the annual bill impacts from household retail competition would form an important piece of evidence.**

#### Protecting support and assistance schemes

In response to the affordability challenges faced by customers and the growing expectations from a range of stakeholders many support and assistance schemes have been established by the water industry.

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<sup>5</sup> Defra 'Water bills projection model - WT1557' July 2015

<http://randd.defra.gov.uk/Default.aspx?Menu=Menu&Module=More&Location=None&ProjectID=19321&FromSearch=Y&Publisher=1&SearchText=water%20bills%20projection&SortString=ProjectCode&SortOrder=Asc&Paging=10%23Description>

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Currently household retail activities in the water sector differ substantially from other utilities. In particular there is substantial support available for vulnerable customers embedded within current industry services and charges, including:-

- The national ban on disconnection and pre-payment meters for households;
- Discretionary support for vulnerable customer groups;
- A range of discretionary allowances and discounts for customers who unknowingly incur large charges for wholesale services, e.g. leakage allowances;
- Regional social tariffs;
- Trust funds;
- Restart schemes and win-win tariffs.

Like other companies UUW offers a range of mechanisms to help vulnerable customers facing financial difficulties (see Appendix 2 for further details), and a 'Priority Services' scheme, providing additional guidance and support to customers in vulnerable circumstances



Polish version of UU's Priority Service promotional leaflet. UU's Priority Services is one of the industries' many support schemes for vulnerable customers

For the year 2015/16 it is anticipated that we will provide direct support worth some £12.4m to some of the North West's most vulnerable households. UU will bear around 72% of the cost of this support, with the rest being paid for through general water and wastewater bills.

The current regional approach to introducing social tariffs and the regional cross-subsidies put in place for the Water Sure scheme presents some challenges under scenarios for retail market reform. Current energy market provisions in this area offers a good example of how national schemes could operate in practise.

#### Suggestions for further investigation

Ahead of a policy decision on household retail competition it will be important for Government to take into account:

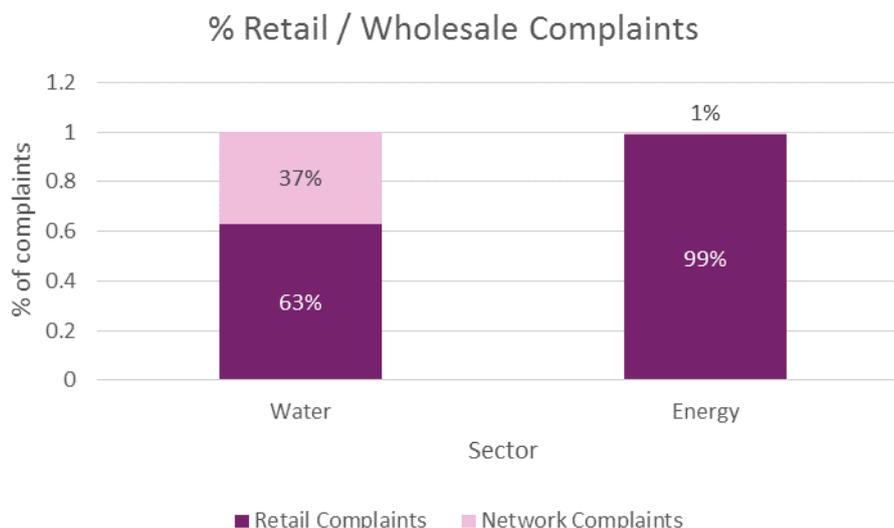
- the range and effectiveness of industry national and regional support and assistance schemes; and
- the market mechanisms that could enable them to be retained within a competitive market.

#### Implementation

The nature of interaction between wholesale and retail elements of the value chain is more complex in water than energy. Functional separation of these elements of the existing integrated value chain will need to be very carefully planned in advance.

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**Fig 1: Network and retail complaints for the energy and water sectors<sup>6</sup>**



The above graph demonstrates the greater interaction that exists between wholesale and retail elements of the value chain in water versus the energy sector. As a result there are substantial benefits to the integrated value chain that we should seek to preserve, including influencing customers to think about what they put down drains, and engaging customer support in detecting and reporting leaks.

When introducing market reforms, it would be important to try and preserve incentives to promote these useful behaviours. The approach to delivering this should be clearly articulated before taking a decision to fragment the value chain. Without direct upfront consideration of wholesale and retail interactions the valuable interactions between these elements of the value chain are at risk, potentially resulting in avoidable service deterioration for household customers.

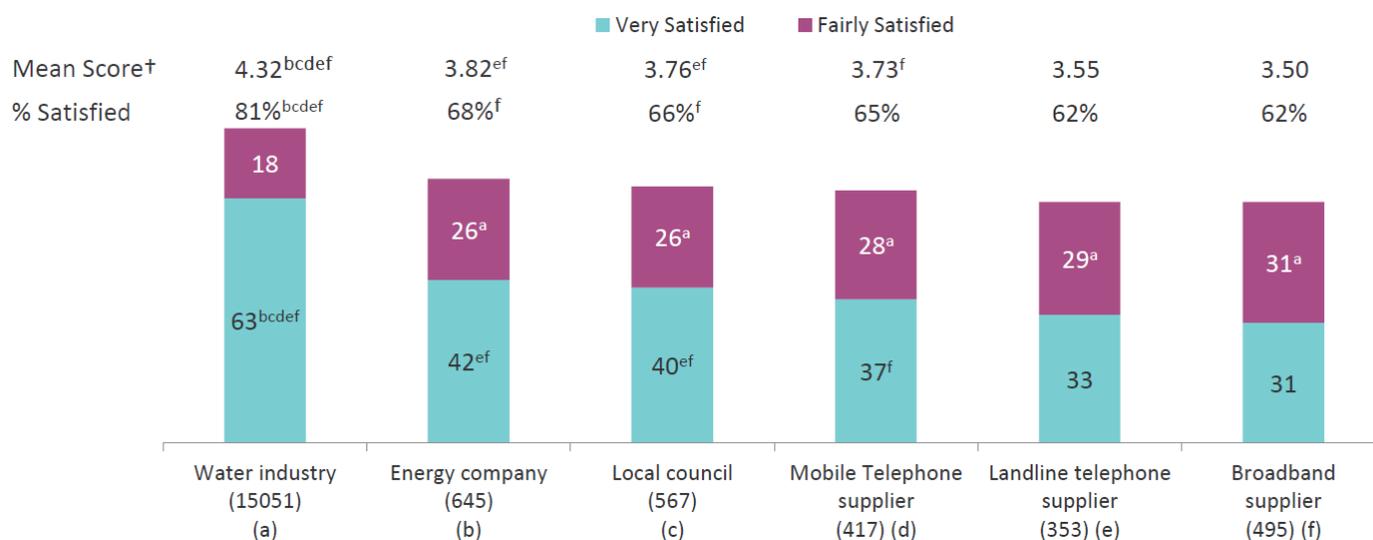
In addition it is important to note that industry satisfaction levels are high relative to similar and improving. Ofwat's SIM customer satisfaction surveys indicate that water industry satisfaction levels are higher in water than in any other comparable utility service. Since the introduction of SIM and other Ofwat incentives there have been big improvements in water customer service and satisfaction levels.

<sup>6</sup> Comparison of total retail and network complaints. Water analysis considers all written complaints, energy analysis compares total reported complaints to retailers, DNOs, and GDNs:

Ofgem – Supplier Performance on Consumer Complaints, <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-consumer-complaints>

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**Fig 2: Industry comparison: % of customers reporting satisfied or very satisfied<sup>7</sup>**



Customers and their representatives may expect clarity on why a competitive retail water market could reasonably be expected to deliver better service than currently seen in comparable competitive markets, such as the domestic energy market. Building this confidence will be a significant exercise, but upfront action must be taken to avoid customers being disappointed or concerned that the same mistakes made in energy might impact their experience in water. The relatively high satisfaction levels in water mean that this may prove a high hurdle. In order to maintain and further strengthen trust and confidence in the industry, a clear and widely supported statement of the expected benefits needs to be communicated to customers.

### Suggestions for further investigation

**Ahead of a policy decision on household retail competition it is important;**

- to review wholesale/retail interactions, their nature and scale, and set out mechanisms to ensure effective interaction within a competitive market; and
- that Ofwat and Government work with industry to develop the clear and compelling proposition for domestic customers, ensuring customers can be confident that service levels will not be detrimented by the introduction of competition.

<sup>7</sup> McCallum Layton “Ofwat SIM Survey – 2015/16 Annual Report”

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## 2. Additional evidence

In this section we present the additional evidence we are able to contribute towards assessing the potential benefits of household retail market reform. We have presented additional evidence broken down into the specific cost areas identified in Ofwat's impact assessment and have restricted our comments to those areas where we believe we have relevant additional views or evidence. We have not therefore commented on all areas of cost and benefit considered in Ofwat's impact assessment.

In a few instances we have identified areas where Ofwat's most optimistic scenarios include assumptions that are not compatible with existing national policies. In particular we believe that some Ofwat assumptions on bad debt are only plausible if combined with material national policy changes.

### Costs of introducing retail competition

The household retail market is much larger than the non-household retail market, with c. 3x the annual revenue and c. 18x the number of potential customers. This would suggest that system and process costs would be substantially larger than the non-household example. However, as noted by Ofwat in its impact assessment there is good reason to expect in some areas that not all system costs will increase linearly with scale, and that some non-household systems might potentially be extended to cover the domestic market, meaning costs would not need to be incurred twice.

The non-household market can act as an initial guide to the possible costs of enabling a domestic retail market. However it remains difficult to estimate how the different objectives, scale and scope of the two markets will impact enabling costs. Ofwat in its impact assessment has assumed that a household retail market implementation and ongoing costs would be between 1 and 4 times as large as those seen in non-household. At this stage there remains significant uncertainties in this area. Ofwat acknowledge that estimates of household market opening and operating costs are at this stage based on limited qualitative evidence.

Crucially Ofwat's impact assessment is sensitive to market opening costs. If market implementation and ongoing costs were circa 6x the non-household experience Ofwat's central scenarios would deliver net zero benefits. This is only 50% more than Ofwat's current upper view of potential costs. Based on an internal review of possible costs of market implementation we believe that under some options for market design and system specification a more than 6x increase on non-household costs would be plausible.

**We therefore propose that further work is undertaken by Ofwat and companies to more closely specify the likely domestic market design and, therefore, the system specifications. This will facilitate the generation of a range of properly informed cost estimates for market implementation and ongoing costs which is sufficiently robust to give confidence in the cost benefit case.**

In addition we ask that Ofwat consider latest MOSL estimates of market operator ongoing costs. These indicate that annual ongoing costs are likely to be £8.4m a year, versus the current assumption in Ofwat's analysis of £5.6m.

### Bad Debt

Ofwat's emerging findings on the costs and benefits of residential retail competition considers high and low scenarios for potential bad debt reduction above the base assumptions for retail efficiency. In the most positive scenario Ofwat has assumed that water bad debt levels could be reduced to the levels seen in the energy industry. In setting out this assumption Ofwat acknowledges it has limited evidence on potential bad debt reductions, but notes that it believes companies would face increased incentives to reduce bad debt in a competitive environment. Ofwat goes further and states that differences between energy and water sectors around supply disconnection are not a material factor and that collection rates for council tax provide further evidence that the water sector can do better.

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However in the water sector in England and Wales, there are constraints on the availability of effective sanctions to address bad debt:

- Unlike other utilities, water and wastewater services are supplied without a contract - even when we don't know the occupier. It is therefore not surprising that the water service is viewed as more universal (and more of a public service) than other utilities;
- Disconnecting (or threatening to disconnect) households is prohibited – this is unique compared to other retailers;
- Often it is not the action of disconnection so much as the threat of disconnection that can drive customer behaviour. As a result of this lack of sanction, debt advisors will advise customers seeking support to prioritise payments to other utilities (e.g. gas and electricity) over paying outstanding debt to their water company;
- Customers in other sectors that are struggling to pay have more opportunity to avoid payment by (temporarily) removing access to the service. Prepayment meters in energy represent a form of “self-disconnection” on a temporary basis.

This creates a unique challenge specific to the water sector. Whilst this is not the only cause of bad debt, it creates a substantial difference between water companies and other utilities.

### *The impact of pre-payment meters*

Ofwat's comparison with the energy sector does not recognise these key difference between how the energy and water sectors are able to manage household customer debt. Energy companies are able to make use of - and extensively do make use of - pre-payment meters. These require customers to pay in advance in order to receive electricity or gas supplies. This is an option which is not available to water companies as a result of the statutory ban on disconnection under the Water Industry Act 1999.

There are a large number of pre-payment meters (PPM) in use by gas and electricity companies, most of which are installed to manage debt, at considerable up front expense. In 2014 there were around 4.5 million electricity PPMs, about 17% of all accounts. There were a further 3.4 million gas PPMs accounts in 2014, representing 15% of all gas customers.<sup>8</sup>

In 2014 60% of newly-installed PPMs were installed to manage debt<sup>9</sup>. They appear to be an effective debt management tool as only 7% of electricity prepayment customers and 10% of gas prepayment gas customers are currently in debt<sup>10</sup>.

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<sup>8</sup>Ofgem, “Domestic Suppliers’ Social Obligations: 2014 annual report”, 8 September 2015, p.31.

<https://www.ofgem.gov.uk/publications-and-updates/domestic-suppliers-social-obligations-2014-annual-report>

<sup>9</sup>Ofgem, “Domestic Suppliers’ Social Obligations: 2014 annual report”, 8 September 2015, p.33.

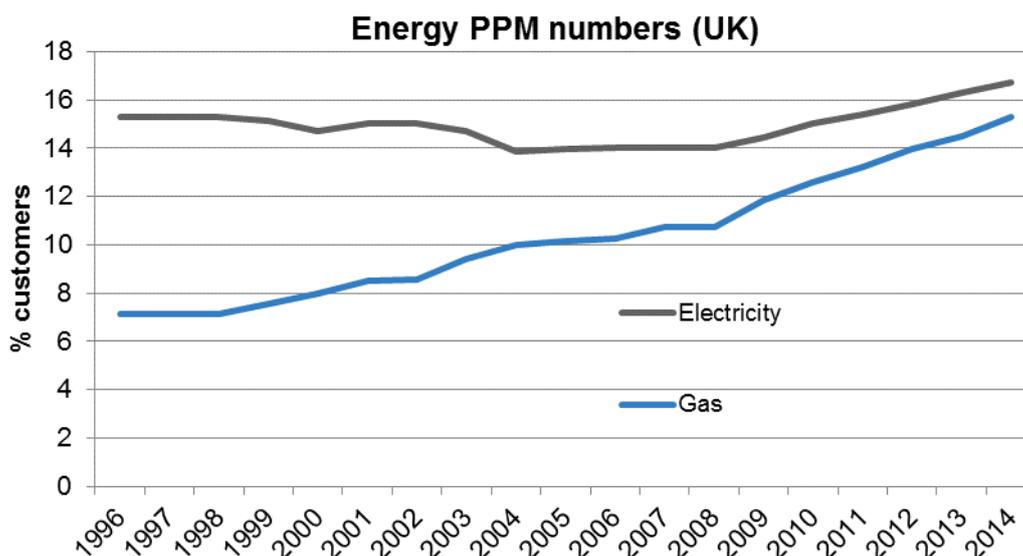
<https://www.ofgem.gov.uk/publications-and-updates/domestic-suppliers-social-obligations-2014-annual-report>

<sup>10</sup>Ofgem, “Prepayment review: understanding supplier charging practices and barriers to switching”, 9 September 2015, p.5.

<https://www.ofgem.gov.uk/publications-and-updates/prepayment-review-understanding-supplier-charging-practices-and-barriers-switching>

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Fig 3: Energy PPM growth since 1996 (source DECC)



The 2009 Independent Review of Charging for Household Water and Sewerage Service led by Anna Walker<sup>11</sup> identified the need to take account of the impact of pre-payment meters when comparing customer debt levels in water and energy.

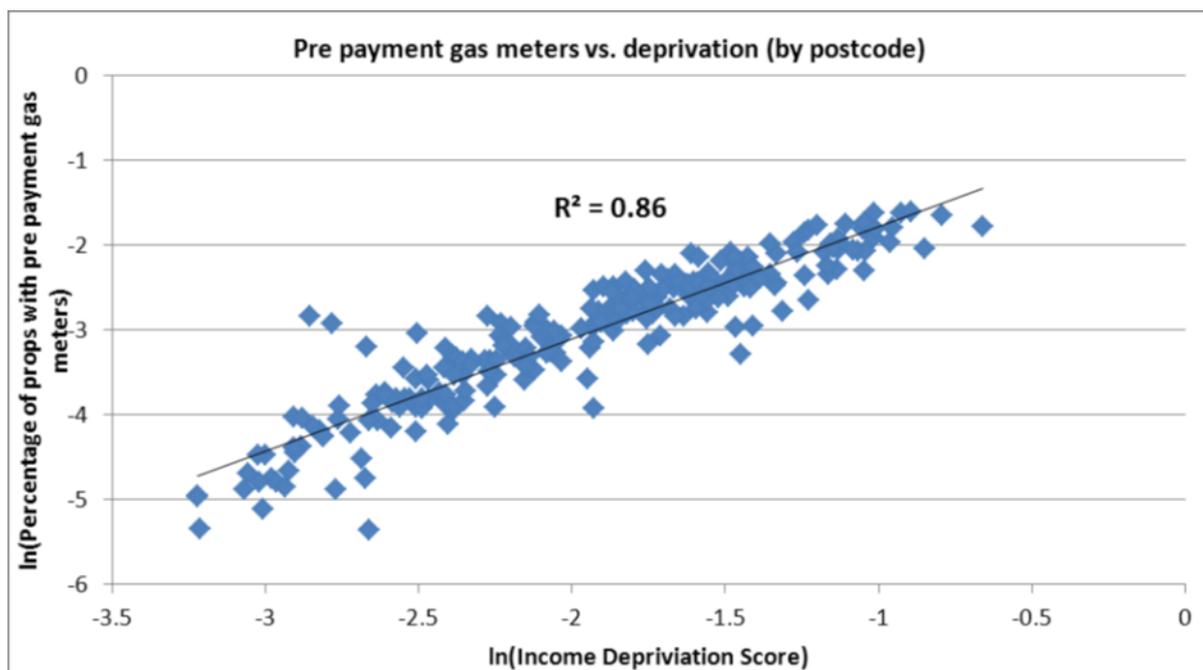
The review noted that PPMs and the ability to disconnect in the energy sector were a key driver of the difference between bad debt in the water and energy sectors. One further consequence of the absence of a risk of disconnection in water is that it is assigned as a lower priority debt by the money advice sector. If a customer is trying to reduce their debt levels, they are often advised that payment of the water bill should be the lowest priority.

The chart below shows that the incidence of prepayment meters by a gas retailer is highly correlated to deprivation scores. That is, the more deprived an area, the more likely you are to find prepayment meters installed.

<sup>11</sup>Anna Walker, "The Independent Review of Charging for Household Water and Sewerage Services", 2009  
<https://www.gov.uk/government/publications/the-independent-review-of-charging-for-household-water-and-sewerage-services-walker-review>

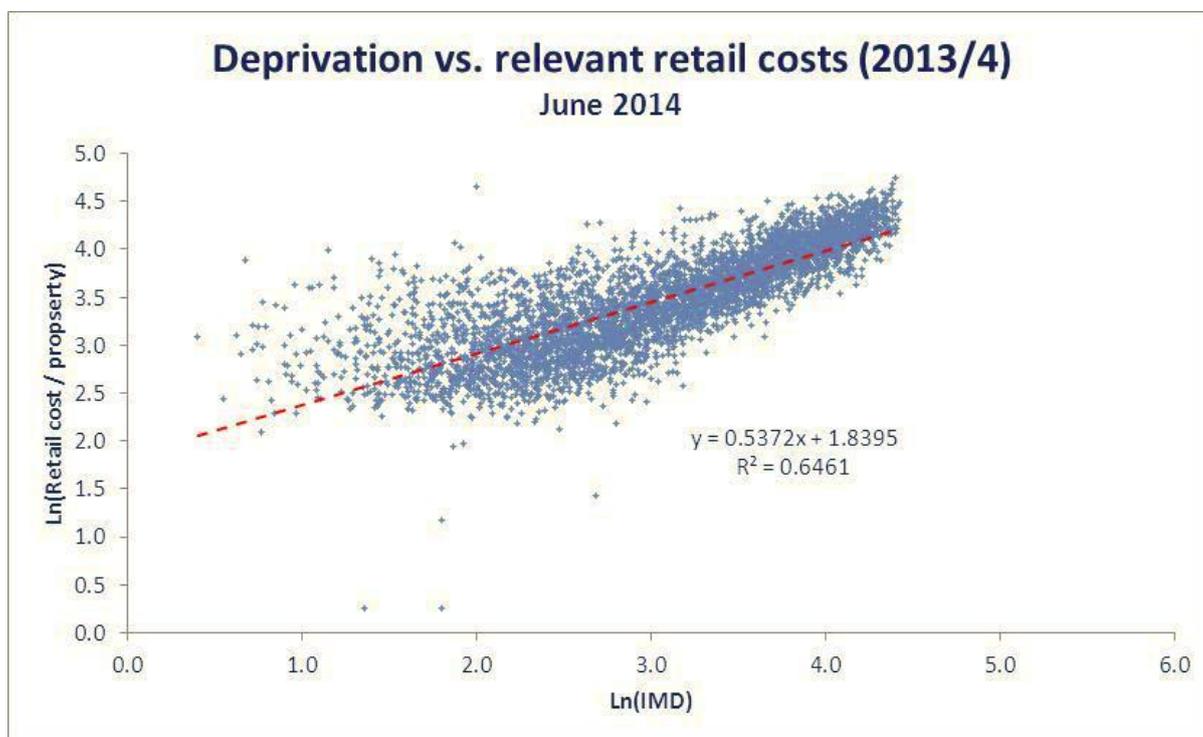
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**Fig 4: Pre-payment meter installations correlates strongly with income deprivation<sup>12</sup>**



The chart below shows that retail costs for Uuw – the largest of which is bad debt – also correlates to the level of deprivation in a given area.

**Fig 5: Deprivation correlates strongly with UU retail costs<sup>13</sup>**



Based on the above analysis we do not agree with Ofwat’s view that the ability to disconnect (or install prepayment meters) is not a material issue in explaining the relative bad debt levels that exist between the energy and water sectors. Pre-payment meters appear to be prevalent in deprived areas, which are the

<sup>12</sup> UU Business Plan Submission “Retail Household Supplementary Information ‘Proposed adjustment to the average cost to serve reflecting impact of deprivation on retail costs’ - Document Reference: R-SI302” Page 35, December 2013

<sup>13</sup> UU Revised Business Plan Submission “RD305 Proposed deprivation adjustment to ACTS (Test 6.1)” June 2014

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same areas where we observe significant bad debt costs. The areas where we have bad debt are those areas where the energy sectors does not have bad debt, but does have prepayment meters. Whilst it is correct to state that very few customers are physically disconnected by energy companies for non-payment –i.e.: the wire or pipe to the home is not cut - the analysis above shows how they are able to address levels of bad debt by installing prepayment meters instead. Prepayment meters are, of course, a form of disconnection in that they withhold service to customers until such time as they pay for it in advance.

### *The impact of council tax benefits*

Ofwat also suggests that council tax arrears levels are substantially better than those seen in the water sector. However this observation neglects to adjust for the substantial financial subsidies provided to councils from central government for Council Tax Benefits (CTB).

Until 2013, central government provided LAs with a financial subsidy to offset the cost of CTB. For England and Wales in 2012/13, the CTB subsidy was £4.5bn (14.7% of gross council tax). After 2013, council tax support became a LA responsibility, with LAs choosing to provide support broadly equivalent to the CTB arrangements. Latest figures on CTB showed that £4.9bn was paid to local authorities, providing the equivalent of full council tax subsidy to 14.7% of the population<sup>14</sup>.

Therefore, we do not believe that bad debt costs for council tax collections are a strong comparator to the water sector. A large proportion of customers who would face affordability issues in paying their council tax are either heavily subsidised, or entirely exempt from the tax in the first place. This fact combined with the additional threat of a custodial sentence for non-payment mean that comparisons on debt collection performance between councils and the water industry are not instructive.

### *No evidence that bad debt is a special case*

This evidence would suggest that Ofwat's assumption that levels of bad debt in water could be reduced to levels seen in the energy sector are only achievable with changes to national policies on disconnection and PPMs for household retail customers. Given that there are no proposals to change the current national policy on water disconnections for households it would be reasonable to assume that bad debt levels in water will not reach levels seen in the energy sector, regardless of whether or not the sector is opened to competition.

This leaves open the question of what level of bad debt reduction could be achieved in a competitive market. The industry regulatory regime has historically allowed water companies to pass a proportion of operating costs, including bad debt to customers. However bad debt costs are not unique in this regard, all company retail costs have been subject to the same pain/gain share mechanisms. Companies have historically been incentivised to manage bad debt in the same way as all other retail opex and capex costs. In the absence of evidence to the contrary there appears no particular reason to believe that bad debt efficiency levels are substantially worse than other areas of retail cost. Company efforts in reducing bad debt are likely to be no more or less effective than general cost reduction efforts across the rest of the household retail cost base.

In summary we conclude there is no reason to believe, or evidence to suggest that bad debt efficiency opportunities in a competitive market would be any different to the opportunities for cost reduction across the rest of household retail activities. We believe the assumptions around general retail one-off and ongoing efficiency benefits from the introduction for competition are an adequate representation of viable efficiency benefits for the full spectrum of household retail costs, including bad debt costs.

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<sup>14</sup>Council Tax Benefit Expenditure by Local Authority Source: DWP Statistical and Accounting Data  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/487615/expenditure-by-la-2014-15.xlsx](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/487615/expenditure-by-la-2014-15.xlsx)

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**The available evidence base indicates that an additional bad debt reduction rate above that already embedded in wider retail cost efficiency benefits from competition should be set to zero.**

### **Financing costs**

In its impact assessment Ofwat has suggested that there is likely to be no net financing impacts from the introduction of competition.

On balance we believe that there is likely to be a net increase in non-diversifiable risk as a result of exposing retail elements of the value chain to market risks, particularly related to volume risks. Currently regulatory mechanisms insulate water companies from demand side volume risks. However under Ofwat's proposed market design it would appear probable that domestic water retailers would be exposed to demand side volume risks. Since these volume risks would be correlated with the wider economic growth it would be expected that the overall net industry risk profile would increase.

We recognise assessing the magnitude of such impacts at this stage is difficult and subject to substantial uncertainties, but on balance we believe there is merit in recognising changes in net financing costs as an unquantified cost in Ofwat's final impact assessment.

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#### 3. Timescales for implementing competition

The timescales for market introduction can substantially alter views on the benefits and risks of reforms. We believe there are good positive reasons to believe that the optimal time to engage in household retail market reform is likely to be later than the currently proposed 2020 date. In particular we see three reasons why, in this specific case, better policy decisions on household retail competition could be made after this date.

<b>Short term bill rises are likely</b>	<ul style="list-style-type: none"><li>• As identified in Section 1 we think that retailers will need to pass on some upfront market opening costs onto customers in the form of near term bill rises.</li><li>• It is therefore desirable to consider when such a bill rise is likely to be most tolerable for customers. Defra’s water bills projection model suggests 2025 and 2030 may mark periods where industry investment expenditure may fall to levels which could provide some headroom.</li></ul>
<b>Better evidence is coming soon</b>	<ul style="list-style-type: none"><li>• Ofwat’s scenarios present a wide range of potential costs and benefits, reflecting the significant uncertainty of household competition.</li><li>• However over the next few years evidence from the energy market and the non-household retail market will provide substantial new evidence on the costs and benefits of competition. The evidence base, and therefore the certainty of costs and benefits could improve substantially.</li></ul>
<b>Complexity of reforms</b>	<ul style="list-style-type: none"><li>• Government, regulators and industry are all engaged in a range of wider reform programmes which lead us to believe that time and resources available to support household retail competition may be suboptimal in the near term.</li></ul>

We discuss each of these points in more detail below.

#### **Short term bill rises are likely**

Market opening requires substantial upfront investment by companies and regulators. Ofwat estimates upfront market opening costs for companies are likely to be in the region of £200m to £400m, with ongoing costs of £20m to £40m per year thereafter. As noted in Section 1 we consider it likely that customer bills will increase in the short term under all Ofwat scenarios. This is as a consequence of the substantial upfront costs of market opening, and the back end loaded nature of forecast benefits.

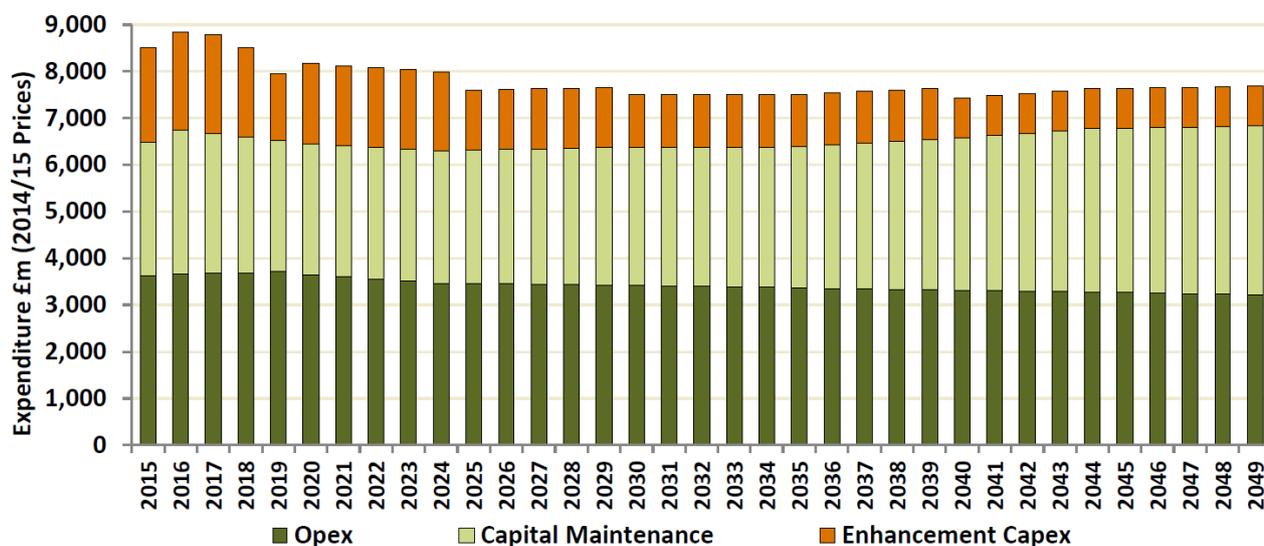
Our experience of operating with customers facing significant affordability challenges is that bill increases are likely to be unwelcome. Whilst we agree that many customers place a value on choice there are many others for whom keeping bills down in the near term is an overriding concern.

Since Ofwat’s impact assessment appears to indicate that short term bill rises for household customers are likely under all scenarios it seems reasonable to consider when such bill rises would be most tolerable to customers. Recent work by Defra to develop a water bills projection model<sup>15</sup> would seem well suited to the task of considering how different market opening dates would impact household bills. This work projected baseline total expenditure for the industry over the next 30 years. As shown in the graph below 2025 and 2030 are key future points where total industry expenditure is likely to reduce due to the resolution of wider investment drivers.

<sup>15</sup> Defra “Water bills projection model - WT1557” July 2015

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Fig 6: Industry projected baseline total expenditure by cost component<sup>16</sup>



### Suggestions for further investigation

Ahead of a policy decision on household retail competition we encourage Ofwat and/or Government to consider the consequences of different market opening dates on customers' average bills through use of the Defra water bills projection model.

### Scenarios show scale of uncertainty, but better evidence is coming soon

Given the uncertain, marginal, and back end focussed benefits of household market reform it makes sense to wait for further evidence to emerge, and so enable a more informed choice as to whether or not to proceed with household retail competition.

Ofwat's scenarios present a very wide range of potential costs and benefits, reflecting the significant uncertainty as to the real potential of household competition. Whilst all potential market reforms carry a degree of uncertainty Ofwat's assessment has identified that household retail reform is particularly complex and the outcomes particularly uncertain. A great deal of both costs and benefits are dependent on as yet unknown consumer behaviours and substantial industry innovation. In addition even under the most positive scenario the quantifiable benefits are likely to be viewed as marginal at a household level.

The combination of uncertainty of future benefits, relatively marginal potential bill reductions, and upfront costs with back end loaded rewards all lead to the conclusion that caution should be exercised in committing to market reform. It would be reasonable to spend time developing further evidence to increase the confidence behind the risk and reward assessments. Fortunately, in the case of household market reform there are a number of major pieces of evidence emerging in coming years which could help address these uncertainties.

Over the next few years evidence from the energy market (smart meter roll out, recent CMA review/interventions) and the non-household retail market in water will provide substantial new evidence on the costs and benefits of competition and preferred market designs. In addition, existing new technologies and innovations emerging across utility retailers, including innovations in tariff design, smart

<sup>16</sup> Defra "Water bills projection model - WT1557" July 2015

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metering, and new customer switching technologies will have had a chance to demonstrate their true potential, removing uncertainty as to their likely benefits in a domestic retail water market.

This gives good reason to believe the uncertainty around costs and benefits pertaining to the evidence base could reduce substantially in the next few years. Further observation of the success or otherwise of major reforms taking place across utility markets should lead to a better understanding of the best approach to household retail market reform.

We note that Defra's Impact Assessment on introducing retail competition into the non-household sector (available at <http://www.parliament.uk/documents/impact-assessments/IA13-19B.pdf> and published in June 2013) indicates that a review of the policy and associated impact assessment should take place in April 2017. We consider that such a review is likely to provide significant new data that should be pertinent to any policy decision – or cost benefit analysis – for household retail competition.

#### Suggestions for further investigation

**Ahead of a policy decision on household retail competition we believe it would be appropriate for;**

- **Defra to complete a refresh of the Water Non-Household competition impact assessment in April 2017, as set out in Defra's 2013 updated impact assessment for non-household competition; and**
- **Government to take account of the success or otherwise of major reforms taking place across other utility markets, including the CMA's recent recommendations in the energy sector.**

#### Complexity of reforms requires time and focus

As set out Section 1 there are many policy and process challenges raised by the potential introduction of household retail competition. Experience of non-household market opening is that introducing household competition will be complex and require significant management attention. There could be significant consequences for poor implementation, particularly for vulnerable customer groups.

Currently the industry is already committed to a wide range of other reforms, including opening water resources and bio-resources to competition, and seeing through the successful implementation of non-household retail competition. These reforms have the potential to deliver better outcomes for customers and the environment, but they are also complex and require considerable focus and effort from Government, regulators and company management alike in order to succeed. The backdrop of the UK's decision to exit the European Union may further complicate the policy background.

If household retail competition was to be introduced to timescales indicated in the "A Better Deal" document it is apparent that substantial parallel demands would be placed on the time and resources of regulators, government and companies. One of the collective lessons learnt for the last price review process was that it is vital to ensure there is sufficient time and resource available to adequately work through all the implications of any new reforms. Given the already challenging reform programme set out in the Water 2020 proposals it is not apparent that the additional demands of introducing household retail competition could be met by all stakeholders at the same time; at the very least, there will be uncertainty that it could be dealt with in a way which would maximise the benefits to customers of such a policy.

Collectively these points lead us to believe that time and resources available to support household retail competition would be limited in the near term, increasing market implementation risk, and making it more difficult to maintain the trust and confidence of customers during the reform process.

However upstream market reform and implementing the UK's exit from the European Union are finite projects. Once completed there is likely to be more capacity within government, regulators and companies to support the necessary policy and process decisions needed to enable market opening.

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This leads us to conclude that if the decision to pursue household retail competition is taken then it is more likely to be a successful implementation if the process is begun after Water 2020 and other major reforms are completed.

### **Suggestions for further investigation**

**Ahead of a policy decision on household retail competition we encourage Ofwat and Government to consider additional policy, market design and process requirements needed to support household retail market opening and how the consequential time and resource demands on government and regulators to develop these would be accommodated within current work plans and budgets.**

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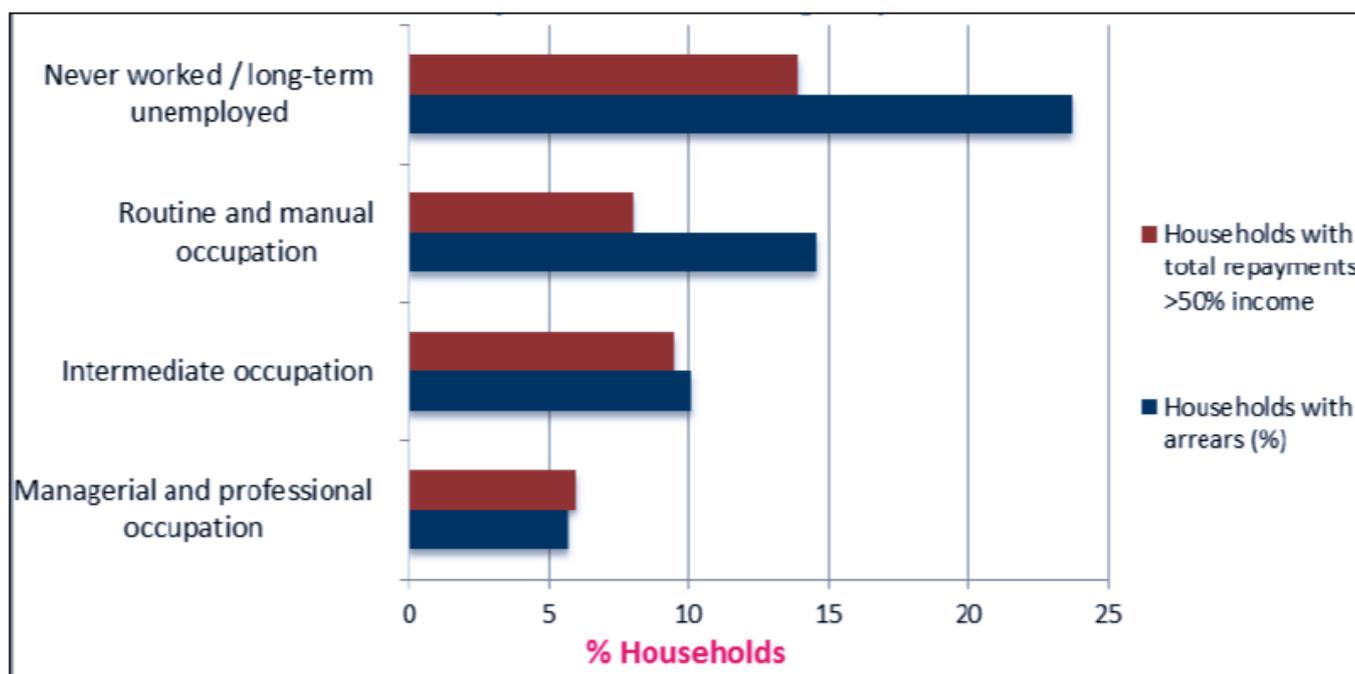
### Costs and benefits of introducing competition to residential customers in England – emerging findings

#### Appendix 1 - Debt, financial vulnerability, and measures of deprivation are closely related

Many studies have demonstrated the relationship between aspects of socio-economic deprivation, employment status, and arrears risk, and hence debt. For example, the Institute for Social and Economic Research (ISER), used data from two well-established socio-economic research programmes to consider the nature and causes of household debt<sup>17</sup>.

Its multivariate analysis found that the incidence of bad debt and arrears were positively associated with having dependent children; being separated or divorced; being unemployed or sick or disabled; and being a tenant. Many of these factors are the same as those commonly referenced when discussing financially vulnerable customers.

ISER found that all customer groups had debt, but that people in higher status occupations had lower levels of over-indebtedness than those in lower status occupations or who had become detached from the labour market. ISER's results on work status are shown in the chart below.



*Arrears by socio-economic group (source: BIS)*

The Department for Work and Pensions (DWP) report 'Households Below Average Income' (HBAI)<sup>18</sup> also found that household income is a significant factor in relation to the incidence of non-payment of household bills of all kinds. The table below shows that the bottom two quintiles (by household income) contain smaller proportions of households with no bills in arrears and more than three quarters of those having one or more bills in arrears.

<sup>17</sup> ISER 'Over-indebtedness in Great Britain: an analysis using the Wealth and Assets survey and Household Annual Debtors survey' 2010

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf)

<sup>18</sup> DWP 'Households below average income (HBAI) statistics' 14 June 2013

<https://www.gov.uk/government/collections/households-below-average-income-hbai--2>

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	Bottom quintile	Second quintile	Third quintile	Fourth quintile	Top quintile	Total	Working age adults (m)
Zero bills in arrears	18%	16%	19%	23%	25%	100%	31.6
One or more bills in arrears	51%	25%	15%	6%	4%	100%	3.1

*Distribution of households with bills in arrears by household income quintile (Source: HBAI 2010/11) income quintiles*

This relationship is not linear, with the very poorest substantially more likely to be in arrears, but there is little apparent difference between those in the top two income quintiles. This is suggestive of an exponential relationship and indicates that the propensity for being in bad debt increases substantially at the poorest end of the socio-economic spectrum.

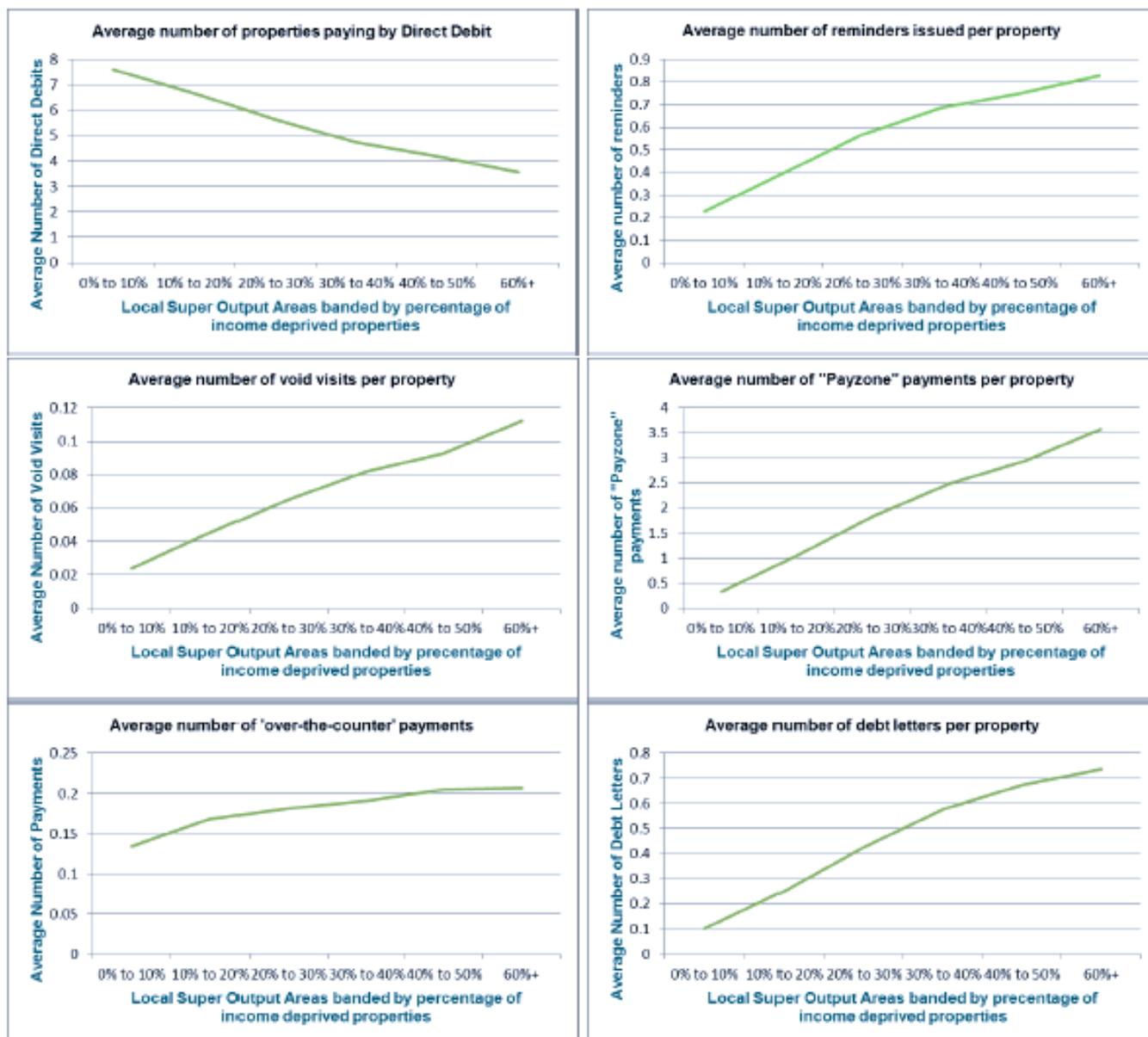
Whilst the overall trend is not surprising, with the poorest most likely to be in arrears, it is the scale of variation between the extreme ends of the socio-economic groups that is especially striking. This means that the most important indicator for the external drivers of bad debt is the proportion of customers at the extreme end of the socio-economic spectrum.

#### *Customers in deprived areas are also more costly to serve*

We have analysed our retail costs for the 2013/14 to a fine level of detail, in order to better understand differences in costs between different areas of our region. We have mapped tens of millions of individual customer interactions to the 4,500 Lower Super Output Area (LSOA) locations within our region to examine the relationship between income deprivation and retail activities. This revealed that it is not only bad debt that is higher in more deprived areas, but we also found that the intensity (and hence total cost) of many retail activities (e.g. number of bill reminders) increases in line with the levels of income deprivation. Also the prevalence of more costly payment methods (e.g. Payzone) increases, whereas the use of lower cost payment methods (e.g. Direct Debit) decreases at higher levels of deprivation. These effects are illustrated in the charts below.

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A sample of UUW retail activities in different areas of socio-economic deprivation<sup>19</sup>



As such, it is not just bad debt that is affected by higher levels of deprivation, but retail activity (and hence cost) as a whole across a range of retail activities. This also serves to demonstrate that the higher levels of customer debt that UUW experiences in areas of high deprivation occurs despite having more intense retail activity in those areas, not as a result of relative neglect of those customers.

Taken together the above evidence strongly suggests financially vulnerable customers, are more likely to experience higher levels of deprivation, and are also more likely to fall into arrears, and to drive higher levels of retail costs. When Ofwat considers the benefits and risks of retail competition it should therefore consider whether retailers will actively target more affluent, and therefore easier to serve customer groups, to the detriment of financially vulnerable customers.

<sup>19</sup> UU Business Plan Submission "Retail Household Supplementary Information 'Proposed adjustment to the average cost to serve reflecting impact of deprivation on retail costs' - Document Reference: R-SI302" Page 35, December 2013

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### *Why is this a water industry specific problem?*

In the water sector in England and Wales, there are constraints on the availability of effective sanctions to address bad debt:

- water and wastewater services are supplied without a contract;
- disconnecting (or threatening to disconnect) households is prohibited;
- the threat of disconnection that can drive customer behaviour;
- prepayment meters in energy represent a form of “self-disconnection” on a temporary basis.

This creates a unique challenge specific to the water sector. Whilst this is not the only cause of bad debt, it creates a substantial difference between water companies and other utilities.

In 2014/15 doubtful debt accounted for 37% of industry household retail operating costs, rising to 45% of costs when the cost of debt management activities are also included. This represents a very high proportion of household retail costs. Our internal evidence, supported by both the IRES and DWP studies referenced above, indicates that this bad debt is concentrated in the most deprived areas of the country. It also highlights why entrant retailers might be unwilling to take on customers from more deprived areas, given the high bad debt risk, and potentially few options to successfully mitigate it.

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### Appendix 2 – UU’s Payment Support Schemes

This appendix provides a more detailed description of the design and impacts of our various support schemes and customer assistance initiatives. These various programmes represent a substantial commitment by us to helping a wide range of vulnerable customers. Much of the cost of these schemes is borne by United Utilities alone, although where legislative and regulatory guidance requires some of the cost of some of the discounted tariffs is passed through to all customers’ bills.

When considering the impact of reforming the retail household market it is important to consider the impact of such reforms on support tariffs and other customer support schemes offered by us and other water companies. Some of the current measures would require reform if they are to continue to operate effectively in a competitive market; whilst others may not be able to continue at all.

We have not tried at this stage to reflect the impacts of a competitive market on the schemes, as any impact is likely to be dependent on the exact nature of market reforms. For example it seems likely that the current approach to region specific social tariffs would be very difficult, if not impossible to maintain if full competition was introduced; however a national support tariff arrangement, specified and supported through legislative reform may be possible on a national basis.

We offer a range of different support schemes for customers, including:-

- The UU Trust Fund
- Support Tariffs
- The “Help to pay” Social Tariff
- Arrears Allowance arrangements
- WaterSure (Vulnerable Customer) Tariff

We also provide support and advice in a range of areas that can help customers reduce their bills and identify the most appropriate payment plan for them. We maintain important links with a wide range of money advice providers, such as the National Debt Helpline and Citizen Advice Bureau. We have also created strategic partnerships with organisations such StepChange and Payplan, where we work together to ensure UUW customers obtain wider holistic help tailored to their individual financial situation.

Since 2009/10 we have seen an upward trend in the number of customers being helped by all of our payment support schemes and now help a total of 45,000 customers on these schemes.

Assistance scheme	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Volume of customers who received a UU Trust Grant	4,671	4,231	4,437	4,598	5,579	5,293	4,559
Volume of customers on a Support Tariff	630	1,621	2,412	3,096	3,889	5,147	5,446
Volume of customers on a Help to Pay (Social) Tariff	-	-	-	-	-	-	7,539
Volume of customers paying via Arrears Allowance Scheme	-	7,679	6,218	8,806	14,146	18,095	18,829
Volume of customers on WaterSure Tariff (Vulnerable customer)	3,960	4,805	5,451	6,448	8,120	8,534	8,702

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Whilst the numbers of customers accessing these support schemes is relatively low, the value of the support they receive is substantial. For the year 2015/16 we provided direct support worth some £12.4m to some of the Northwest’s most vulnerable households. U UW will bear around 72% of the cost of this support, with the rest being paid for through general water and wastewater bills.

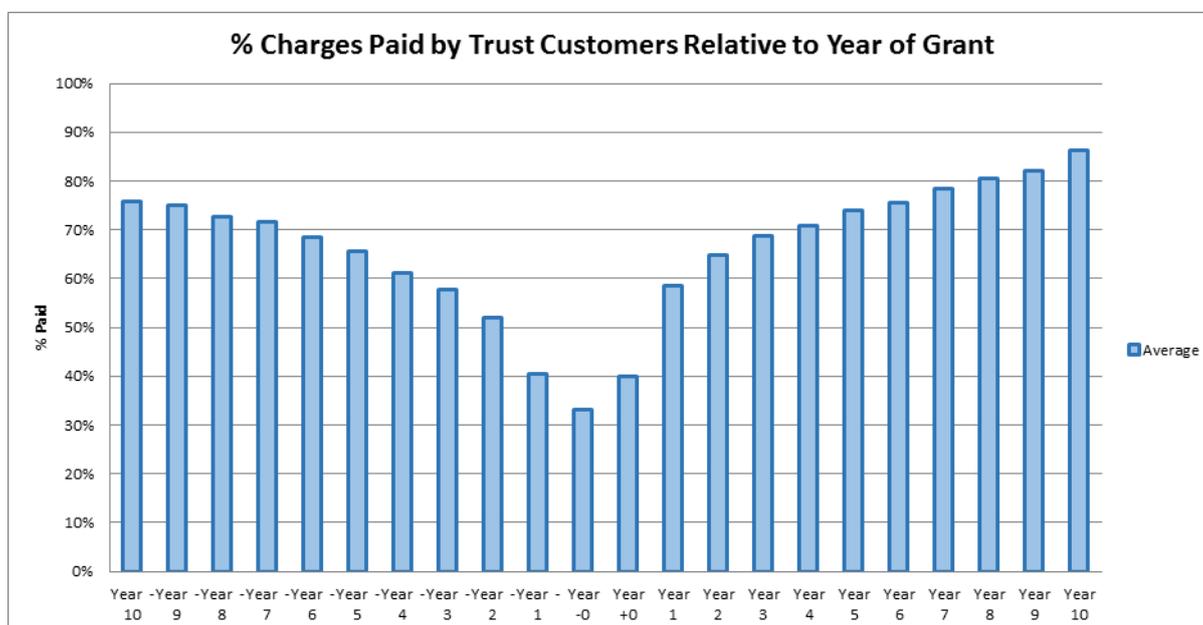
	Total discount (£m)	Portion funded by U UW	Potion funded by customers
UU Trust Fund grant	6.200	100%	0%
Support Tariffs	2.134	100%	0%
Help to Pay	1.001	55%	45%
WaterSure (Vulnerable Customers)	3.049	0%	100%
<b>Total Social Tariffs</b>	<b>12.384</b>	<b>72%</b>	<b>28%</b>

In the following sections we discuss the nature and operation of the various support schemes promoted to customers.

### UU Trust Fund

We introduced the UU Trust Fund (UUTF) in 2005/06 into which we made initial annual donations of £3m p.a. Over the last 6 years we have increased the donations made, which in 2014/15 was £6.8m. This independent registered charity has helped approximately 46,000 customers as at 31 March 15, and is having a positive impact on rehabilitating future payment levels from those customers helped.

Typically, a customer who is helped by the UUTF pays approximately 35% of their charges in the year in which they get a grant. After receiving help their payment rate increases to between 75% and 85%, and our records show that this is maintained even when a customer applied to the UUTF 10 years ago.



### Support tariff

We have continued to promote our “win-win” tariff (the “Support tariff”) and there are now over 5,000 customers on the tariff. Once again, the scheme is having a positive impact on customers’ rehabilitation rates, with approximately 75% of customers paying their ongoing charges on the support tariff.

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The tariff is available to both unmeasured and measured customers and provides a capped bill based on a customer's household income level. The 6 bands of the tariff range from £117 to £449.

UU funds the tariff and no customer contribution is sought. Crucial to the viability of this scheme is the long term benefits to cash received as compared to reduction in sales from imposing a capped tariff, and reductions in the cost to serve these hard to engage customer groups.

The cash collection from the tariff in Year 0 and beyond shows increasing cash payment. The fall from relatively high charges improves affordability for vulnerable customers, allowing them to not only pay current year charges, but also to begin addressing any arrears they may have built up.

In addition to increased cash contributions there are additional benefits to costs of billing and debt collection activities. There is an observed fall in the average cost for billing and debt activities of £9 per customer on the support tariff, despite a minor increase for payment activity, as would be the case for improved cash collection frequency.

#### **Help to Pay - Social Tariff**

We launched our social tariff – the “Help to Pay” (HTP) scheme – on 1st April 2015. This followed two rounds of customer research to obtain the required level of support from customers for its introduction. The research concluded that our customers were prepared to pay 47p of cross-subsidy provided it was used specifically to support poor pensioners. This was on the proviso that UUW would also match the level of cross-subsidy from customers and fund the administration of the scheme. Following this mandate from customers, we have undertaken a “Soft-Launch” of the tariff since April 2015 in order to test operational processes and understand the most effective channels of promotional activity. This soft launch successfully converted 7,539 customers to the tariff in 2015/16.

The HTP tariff provides a capped bill for customers of £250 per year and is available to both unmeasured and measured customers.

The main criteria for eligibility under the “Help to Pay” scheme is for the customer to be in receipt of Pension Credit. ONS statistics show there are over 300,000 customers on this benefit in our region. We expect to sign up a further 8,000 customers during 2016/17.

#### **Arrears allowance**

The arrears allowance scheme was introduced to provide customers who had built up substantial arrears to be given an opportunity to rehabilitate their payments with UU. For every £ a customer pays, UU matches this for the first 6 months of payments. Thereafter UU double matches each £ paid by a customer on the scheme. This scheme is funded entirely by UU. Encouragingly rehabilitation rates for this scheme are very positive and we now have over 50% of customers on this scheme receiving the double matching write-off, meaning that they have maintained payments for at least 6 months.

As well as double matching payments made by customers after 6 months we are also sending customers pre-emptive text messages prior to a payment being due, and are sending more regular communications showing them how their balance is reducing to help drive strong sustainability of this scheme. Since April 2013 we have promoted the scheme extensively to customers and we currently have circa 19,000 customers making regular payments. This is an increase of over 13,000 since April 2013 and we believe this to be one of the largest re-start schemes in the industry.

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#### WaterSure

We continue to promote WaterSure at various customer interactions throughout our organisation and have 8,702 customers on the tariff. Agents are trained to recognise appropriate customers and promote the scheme to them. We have streamlined several processes, particularly around the renewal process to improve the customer experience. Customers on the WaterSure tariff are directed to a dedicated team who have received additional training on customer vulnerability so we can support these customers appropriately.

In addition to the above direct support arrangements we also offer a range of advice and services that can help customers reduce their ongoing bills and access the full range of support available to them.

#### Efficiency Advice

Water efficiency plays an important role in helping metered customers who face affordability problems, and is also relevant to wholesale business duties to balance water supply and demand. At U UW we achieved total savings for AMP5 of 16.87 Ml/d.

Our water efficiency campaign includes numerous activities, we have set out below those that also contribute to addressing affordability issues:

- Our “guide to using water wisely” contains a section on saving water in the home. In 2015/16, we distributed over 48,762 audit kits;
- We provide an online water usage calculator, which allows customers to assess where they use the most water, and offers advice on how they can reduce their overall consumption. 67,281 people used the tool in 2015/16;
- Carried out 1,700 water efficiency audits in customers’ homes leading to the installation of over 6,000 water efficient products;
- Include bill inserts promoting water saving products available via the U UW website;
- Linking water efficiency and affordability through partnership work with a collection of councils and housing associations across the U U region;
- Providing “A simple guide to your water meter” (including water saving information) with household customers after a meter is installed;
- Commissioned a behaviour change research study to get a better understanding of customers attitudes to using less water and how best to encourage them to use less and save money.

#### Flexible Payment Plans

Many customers who face affordability challenges benefit from our payment options which offer flexibility and ease of use.

Payment Cards can be used to make payments to U UW at a range of outlets, free of charge at any Payzone outlet and Post Office. Customers can make payments at a time, location, and frequency that is convenient to them. Over 99% of the UK population live within 3 miles of a Post Office outlet. Payzone outlets have in excess of 3,000 outlets across our region. Whilst the Payment Card option is more expensive for U UW to process than other payment options we continue to provide it free of charge to our customers. Customer feedback on this option is very positive. For customers that are not eligible for the discount schemes identified above we use the payment card to help them make payments as and when they are able.

Another payment option that many customers choose to use is for payments to be taken directly from their benefits. Working in conjunction with the DWP we are able to put in place payment arrangements

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which enable customers to pay their charges to UU from their benefits before they receive them. In excess of 36,000 customers currently choose to pay via this route.

#### Supporting our customers

All agents in our customer services operation are trained to ask appropriate questions of customers to understand their situation. Where necessary we complete an income and expenditure assessment for customers who state that they are facing financial hardship and affordability problems. This aligns to the common financial statement utilised in the money advice sector. Agents are trained to promote the wide range of payments assistance schemes and advise to find which one best suits customers' individual circumstances. Central to this is setting an affordable but sustainable payment plan arrangement. This arrangement is made in the context of the customer's wider circumstances; including taking into account all of their outgoings.

For customers who face both debt and affordability issues we look to "bundle" schemes together so that we can address their historic debt problem, and also provide the customer with a lower bill that helps to address affordability issues, thereby mitigating the risk of them falling into arrears in the future again.

Our agents are trained to signpost customers who are in arrears to a range of external money advice providers such as National Debt Helpline and Citizen Advice Bureau. We have created strategic partnerships with both StepChange and Payplan, where we work together to ensure UUW customers obtain wider holistic help for their financial situation. We have established relationships with local advice agencies, charities and voluntary organisations in the UUW region. We have a dedicated role (Outreach Manager) who engages with the advice sector in the UUW region and promotes the assistance packages available to customers.