

ECONOMIC LOSSES ATTRIBUTABLE TO HOMESERVE'S WATER SERVICE LINE REPAIR CONTRACTS SOLD TO CUSTOMERS OF DELCO WATER COMPANY¹

Kevin Gainer²

Introduction and Summary

HomeServe USA is a subsidiary of the UK-based company HomeServe PLC. In the United States, HomeServe sells “repair service plans” for residential water and sewer service lines, electrical wiring, gas piping, and heating, cooling and water heating equipment. Whether here or abroad, HomeServe has been the focus of a substantial number of consumer complaints. In 2014, the U.K. Financial Conduct Authority (FCA) levied a record \$38 million fine against HomeServe PLC for a litany of abusive practices committed by the firm during the period January 2005 to October 2011³. In the United States, from 2010 to 2015, HomeServe signed agreements with Attorneys General or state officials in Ohio, Kentucky, New York, Maryland, Massachusetts and Georgia, the purpose of which was to settle consumer complaints about HomeServe’s promotion of “repair service plans”.⁴

In 2015, HomeServe agreed to pay a \$3 million settlement in a class-action lawsuit in New Jersey where the allegation was that consumers were sold HomeServe service plans that were of no value because those consumers lived in apartments or condominiums. In commentary published on the Internet, HomeServe’s promotion of residential repair service plans has been repeatedly referred to as a scam, principally because HomeServe ***does not disclose*** that in many instances the “risk” that the consumer is attempting to protect himself or herself against, by buying a “protection

¹ Prior to publication, ***two*** draft versions of this document were provided to Mr. Myles Meehan, SVP Public Relations, HomeServe as well as to Mr. Glenn Marzluf, General Manager/CEO, DelCo Water Company. Neither individual acknowledged receipt of either draft and neither individual provided any response, corrections, comments, amplifications, or controverting evidence. Consequently, all of the data, claims, and calculations in this document have gone completely unopposed.

² Reader inquiries may be sent to Kevin Gainer; E-mail: kgainer@columbus.rr.com.

³ See <https://www.fca.org.uk/news/press-releases/homeserve-fined-%C2%A330-million-widespread-failings>

⁴ Shaver, Katherine. (September 10, 2016). “Maryland water utility partners with company accused of misleading customers”. *The Washington Post*.

plan”, in fact has a negligible ***rate of occurrence***. That consistent failure to disclose the most material fact of all in this “insurance” type of consumer transaction, coupled with the decidedly lop sided economics of the repair service plans, that is the disproportionate share of the “premiums” that are retained by HomeServe, versus the tiny share paid out for actual repairs on behalf of consumers, means the possibility that HomeServe is scamming consumers has to be given serious consideration.

DelCo’s Involvement with HomeServe

In 2016, DelCo Water Company⁵ entered into a partnership with HomeServe that allows HomeServe to solicit DelCo’s residential customers *en masse* for the sale of an exterior water line service contract⁶. An initial solicitation, published by DelCo on behalf of HomeServe, was prominently printed on DelCo Water Company bills mailed to residential customers in or around February 2017. In March 2017, an additional direct mail solicitation promoting the sale of HomeServe water line service contracts was mailed to DelCo’s residential customer base of about 43,000 accounts⁷. None of the advertising material or solicitations sent to DelCo customers disclosed that ***the estimated rate of failure of residential service water lines in the DelCo Water Company service area is only 1 per 500 lines per year***⁸.

Estimate of the Losses to the Local Economy

With DelCo’s estimate of the water service line failure rate in hand⁹, the advertised price of purchasing a HomeServe water line service contract,

⁵ DelCo Water Company is headquartered at 6658 Olentangy River Road, Delaware OH 43015-9211; Tel: 740-548-7746; website: <http://www.delcowater.com>.

⁶ I requested the specifications of the partnership in early March 2017 as well as other data. Both DelCo and HomeServe have refused to answer questions and provide details of the partnership, presumably because public awareness of the details of the program will reduce sales of the “repair plan” that HomeServe is vending to DelCo customers. Both DelCo and HomeServe have ignored virtually all ***questions*** sent to them seeking further details about this plan and frankly both are in “cover-up” mode at this point.

⁷ Copy of the March solicitation is available as a .pdf on request.

⁸ Glenn Marzluf, the General Manager and CEO of the DelCo Water Company disclosed the failure rate to me during a telephone conversation that I had with him on March 1st.

⁹ The failure rate of 1 in 500 represents Mr. Glenn Marzluf’s initial testimony during a telephone interview I conducted on March 1, 2017. The figure is corroborated by a subsequent confidential interview that I conducted on March 25th of a water plant employee at another Columbus area water system. The failure rate of 1 in 500 is further corroborated by published data from a Michigan water

and assumptions regarding the number of sales of these contracts (i.e., the “adoption rate”) and repair costs¹⁰, we can gain an understanding of just how one sided, and thus irrational, the economics of this DelCo “program” are. Table 1, on the next page, provides 3 scenarios, based on varying rates of DelCo customer adoption, of the aggregate economic losses to the community that this DelCo sponsored program creates.

Based on the data in Table 1, nearly the entirety of the monies collected by HomeServe, that is 97%, are forecast to be retained by HomeServe with the remaining 3% paid out to repair water service lines for DelCo customers who bought the service plan. The fact that HomeServe is projected to retain an estimated 97% of customers’ “premiums” means that the local economy will suffer a ***substantial*** net loss. Hypothetically, if we knew which scenario (or interpolation between scenarios) will prevail, you could simply read the amount of the loss to the local economy right off the last column of Table 1.

utility. Mr. Marzluf’s initial testimony that the failure rate is 1 in 500 presumably represents his view of what the failure rate is when the negotiations with HomeServe were previously conducted in 2016. Subsequent to the March 1st interview, that is as questions began to be asked about the economic reasonableness of these exterior water line service contracts, on or about March 3rd Mr. Marzluf called me and changed his story as to his “understanding” of the failure rate. Mr. Marzluf’s new view on March 3rd was that the failure rate “might” be 1% per year but when asked for actual documentary evidence to substantiate his new estimate, he said he had none and would have to create it. At this writing, a failure rate of 1% is not credible as: 1) it contradicts Mr. Marzluf’s initial freely offered testimony; and 2) such a rate is inconsistent with the other failure rate data collected thus far from other sources. Going forward, if and when DelCo supplies documentary evidence that the failure rate is different from the 0.2% rate ***that appears to have been relied upon during the negotiations with HomeServe***, I will modify this analysis as appropriate. Indeed, in early March I requested any and all data on this key point from both DelCo and HomeServe and I did not receive even so much as an acknowledgement of that inquiry.

¹⁰ According to an article in *The Washington Post*, published September 10, 2016, HomeServe reports the average cost of repairing an exterior water line as \$450. Complete replacement of the line, which is rare, is estimated to cost \$2,500 on average. See *Washington Post* story: https://www.washingtonpost.com/local/maryland-water-utility-partners-with-company-accused-of-misleading-customers/2016/09/10/2ef4777c-705e-11e6-8365-b19e428a975e_story.html?utm_term=.7ee4b7a01d61

Table 1
**Aggregate Economic Losses Borne by the Communities Served
 by DelCo Arising from Sales of Water Service Line Contracts**

Adoption Rate - Number of DelCo Customers	Total 3-Year Gross Revenues to HomeServe	Total 3-Year Payout by HomeServe to Cover Customer Claims	<u><i>Share</i></u> of Gross Revenues <u><i>Retained by</i></u> <u><i>HomeServe</i></u>	<u><i>Share</i></u> of Gross Revenues <u><i>Used For</i></u> <u><i>Service</i></u> <u><i>Line</i></u> <u><i>Repairs</i></u>	Net Loss to Local Economy Over Three Years
4,300	\$462,852	\$12,900	97.0	3.0	\$449,952
10,750	\$1,157,130	\$32,250	97.0	3.0	\$1,124,630
17,200	\$1,851,408	\$51,600	97.0	3.0	\$1,799,808

NOTES:

- 1) Adoption rate represents 10, 25 or 40% of DelCo's 43,000 residential customer accounts.
- 2) Gross revenues are based on HomeServe's annual per customer revenues of \$35.88 times the number of customer accounts in the program times the program duration of 3 years.
- 3) Payout is based on a claims incidence of 1 in 500 water service lines per year times an estimated \$500 per claim to cover claim plus administrative costs. The payout is aggregated over three years.
- 4) The shares shown in the two columns of the table represent the ***distribution of the economic benefits of the program***. Based on the totality of the assumptions built into the table data, ***approximately 97% of the economic benefit of the program flows directly to a single party, namely HomeServe***, while merely 3% of the benefit remains for consumers within the local economy and community. In other words, the program represents a sizable and disproportionate net drain on the local economy, amounting to nearly \$2 million over three years in a scenario where 40% of DelCo customers sign on. In essence, the aggregated net economic loss is a measure of the amount of money "siphoned off" from the local economy to the out-of-state corporation.

Conclusion

Inasmuch as the water line failure rate represents the “risk” that the customer desires to protect against, no DelCo Water Company customer can make a rational determination of the necessity or value of a water service line repair contract without having that rate clearly and conspicuously **disclosed** in HomeServe’s offer.

Here, in this specific instance, we have a failure rate, as revealed by the General Manager of DelCo Water Company, of 1 in 500 lines per year, or 0.2% of lines per year. The failure rate is so close to zero, that such is **a material fact** that, if disclosed, **will** affect consumers’ decisions to purchase exterior water service line coverage. The failure rate should not be intentionally omitted from the promotion of these “repair service contracts” because such omission has the effect of gaming the system, and in the exceptionally lopsided manner documented in Table 1, principally financially benefits HomeServe **at the expense of DelCo service area residents in a seven county region.**

DelCo management have unfortunately created a circumstance where one party, namely HomeServe, has been allowed to game the system **primarily** for HomeServe’s financial benefit. The gaming, in this instance, occurs as HomeServe solicits monthly payments from consumers for a water service line contract where the actual risk of loss to HomeServe is close to zero. As a consequence of this gaming, DelCo has created a circumstance where a substantial net loss to the local economy **will** occur. Although the economic losses will occur regardless of the manner in which the program is vended, a portion of the losses involved in this episode are aptly characterized as “the economic costs to the community that arise from deception”. In particular, that category of loss is directly borne by those consumers who would have most decidedly not purchased a water line service contract were it clearly, conspicuously, and truthfully disclosed that the historical annual incidence of water service line failure in the DelCo service area is merely 0.2%, that is close to zero.