

**APPROVAL OF COMPANIES'  
CHARGES SCHEMES  
IN 2001-2002**

**OFWAT'S CONCLUSIONS  
ON THE CONSULTATION**

**SEPTEMBER 2000**

# CONCLUSION ON THE CONSULTATION

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## **1. INTRODUCTION**

This paper summarises responses to the Ofwat consultation paper, *Approval of Companies' Charges Schemes 2001-02*, published in June 2000.

It sets out the Ofwat's conclusions on each of the tariff policy issues considered:

1. The measured/unmeasured tariff differential.
2. Social tariffs for vulnerable customers.
3. Low user (or zero standing charge) optional tariffs.
4. Reduced charges for customers with unadopted sewers.

Annex A lists all those who responded to the consultation. Copies of these responses, except where they have been submitted in confidence, have been placed in the Ofwat library.

## **2. THE MEASURED/UNMEASURED TARIFF DIFFERENTIAL**

The measured/unmeasured tariff differential (the differential) is the mechanism used by Ofwat to ensure ongoing fairness in the balance between measured and unmeasured household customers' charges.

The *maximum* differential represents the Director's estimate of the additional costs that measured customers impose on water and sewerage companies, which should be met by measured customers rather than customers generally. The *actual* differential is calculated for every company each year to check that it is no more than the maximum specified by the Director.

The consultation paper reviewed the way in which the maximum differential should be set and how the actual differential should be calculated.

### **2.1 Maximum Differential**

Ofwat proposed that the maximum differential should be set at £30 for 2001-02, in 2001-02 prices. Views were sought on the following questions:

- whether it remains appropriate to continue to exclude the cost of creating the metering space; and
- whether £30 per year, rounded to the nearest pound, is a reasonable estimate of the additional costs of metering (comprising £17.50 for the customer-related costs of metering and £12.10 for the cost of benefits received by metered customers, but not by unmeasured customers).

### **Respondents' Views**

A number of the companies argued that differences in company conditions/policies could never be adequately reflected through the strict application of a single industry figure for the maximum differential. Some suggested that the differential is best set, and applied, as a company specific calculation taking into account company-specific factors. Others suggested that if a company were able to demonstrate that their costs were significantly different from the industry maximum, then some consideration should be given to allowing them to exceed the maximum differential set by Ofwat.

In particular, companies argued that the inclusion (or otherwise) of the meter space will depend on the historic metering policies of individual companies. In addition, the average monetary value of the customer benefits would vary between companies according to: customers' preferred payment methods, the age profile of meters already installed, the level of household volumetric tariffs, and the condition of customers' supply pipes.

Additionally, two companies suggested that the measured customer benefits should be valued using an equivalent measured bill (based on average unmeasured volumes), rather than the average measured bill (based on the average measured volumes). It was argued that this would then ensure that the method of setting the

maximum differential was comparable to the method of calculating the actual differential.

#### Continuing to exclude the cost of the meter space

Of the fifteen companies that responded to the question of including the cost of the meter space in the differential, seven agreed that it should be excluded from the differential. Additionally, nine CSCs and Age Concern supported the proposal to continue to exclude the cost of creating the meter space from the maximum differential, for the reasons outlined in the consultation paper. However, because of their own historic metering policies, eight companies felt that some allowance towards the cost of creating the meter space should be included.

#### The level of customer related costs of metering

The majority of the companies were broadly comfortable with the figure estimated for the customer related costs of metering. However, three companies suggested that the allowance for meter reading and billing and account management costs was an under-estimate. Seven CSCs said that the £17.50 allocated to customer-related costs of metering appeared to be a reasonable amount. One felt that the figure was too high, and two felt that it was too low, having regard to the disproportionate number of complaints companies receive from measured customers, and the costs to companies of dealing with those complaints.

#### The level of metered customer benefits

Of the fourteen that commented, seven companies were broadly comfortable with the amount of £12.10 allowed for measured customer benefits. None thought that it was too high. However, seven companies said that the cash flow benefit was an under-estimate, as it seemed to be based on the lowest possible differences in the timing of bill payments as between measured and unmeasured customers. Their experiences, based on customers' preferred payment methods, gave figures higher than the £2.40 assumed in the consultation paper. Three companies also suggested that supply pipe leakage allowances for externally metered customers were not, as assumed by Ofwat, minimal.

### **Ofwat's conclusions**

Ofwat recognises that there are arguments for using company specific cost assessments to identify an appropriate company balance between measured and unmeasured household customer charges. However, for simplicity and transparency Ofwat wishes to maintain the current policy of applying an industry wide figure for the maximum differential. The level has been set at the higher end of a range, especially for customer related benefits, and for many companies the appropriate level could be lower.

The maximum differential should be set at £32 rounded to the nearest pound, for 2001-02 (in 2001-02 prices). The current breakdown, the proposed change and the final assessment of the main cost components of the maximum differential are set out in Annex B.

### Continuing to exclude the cost of meter space

The argument that customers as a whole benefit from the expansion of metering continues to be significant, and the majority of respondents favoured the exclusion of the cost of the meter space from the differential. Evidence provided to Ofwat since 30 June by the companies suggests that in 2000-01 the rate of optional meter installation will be substantially lower (in almost all cases) than expected in November 1999. If this trend is sustained it will still be true that by 2004-05 more than 50% of meter spaces will have been paid for, in whole or in part, by customers. On balance, Ofwat continues to favour the exclusion of the cost of the meter space from the maximum differential. This conclusion can be re-assessed at the time of the 2004 Periodic Review.

### The level of customer related costs of metering

Most companies broadly agreed with the allowance for customer related costs of metering within the maximum differential. Some suggested that costs of meter reading and billing should be higher. Ofwat's view is that as companies' metered bases grow over time, account management and billing unit costs should fall for those companies where these are currently higher than average.

### The level of customer related benefits

In the light of comments received, Ofwat accepts that the consultation paper may have over-estimated the extent to which the difference in timing of payments as between measured and unmeasured customers is narrowing. The evidence provided by several companies for a wider gap is persuasive and suggests that a three month equivalent measured bill should be used to assess the benefit.

In the light of information provided by some companies, a small allowance has been made for the costs of supply pipe leakage allowances in respect of externally metered customers.

## **2.2 Actual Differential**

Annex B of the consultation paper restated Ofwat's approach to calculating the actual differential for each company each year. However, it suggested that it would be more appropriate (when calculating the actual sewerage differential) to base the water delivered figure on the water delivered to the average unmeasured *sewerage* customer, rather than the average unmeasured *water* customer, as is currently the case.

## **Respondent's Views**

The majority of companies had no comments on Ofwat's approach or the suggested change to it, although some noted that it would make little difference.

Two companies (Wessex Water and Anglian Water) argued that Ofwat's approach has become fundamentally flawed. They consider that in calculating the actual differential it is more appropriate to use average household volumes (rather than average unmeasured household volumes). This, they argued, reflects the greater extent of the measured customer base.

Three companies agreed that to base the actual sewerage differential on the average unmeasured sewerage customer (ie to take into account customers of the water only companies) was sensible, but noted that as forecasts are commercially sensitive (and likely to become more so with the advent of competition) this would only be workable if based on audited June return information. They therefore concluded that the current method should continue to be followed.

### **Ofwat's Conclusions**

Ofwat confirms the approach set out in Annex B of the consultation to the actual calculation of the differential.

It does not agree with the logic of the suggestion by Wessex Water and Anglian Water that the actual differential should be calculated on the basis of average household consumption. The purpose of the differential is to secure fairness between unmeasured and measured household customers and Ofwat is ready to restate the logic of its approach to those concerned.

Ofwat recognises the point made by a number of companies that it will make little difference whether the differential is based on the average water delivered to unmeasured sewerage customers or to the average unmeasured water customer. Ofwat will, therefore, leave the decision to the sewerage company as to which method is used. Where it is based on the average unmeasured sewerage customer, it must be based on the relevant water only companies' forecasts of water delivered. Ofwat expects water only companies to make those forecasts available if requested.

### **3. SOCIAL TARIFFS**

In his guidance to the Director, the Secretary of State said that where companies devised well considered and workable proposals for social tariffs, which do not have an unacceptable impact on other customers bills and do not represent “undue discrimination”, the presumption should be that such tariffs should be allowed in charges schemes. The consultation paper proposed criteria for assessing companies’ proposals for social tariffs and invited views on these. It also invited views as to possible targets for social tariffs and what, at an overall level, might be an acceptable impact on other customers bills.

#### **Respondents’ Views**

The majority of respondents were opposed to the introduction for social tariffs over and above those already provided for in the Vulnerable Groups Regulations. The majority of companies said that they do not see it as their role to develop social tariffs and some commented that they would not have the information to do so, even if it was their responsibility. Most companies argued that if social tariffs are to be extended, this should be under the statutory regulations which would ensure consistent provision across England. Leaving it to companies to decide would result in anomalies with customers in some regions being given assistance but customers in similar circumstances in other regions not being given assistance.

All CSC’s expressed a concern that the water charging system was not the appropriate mechanism for the delivery of social policy objectives. Financial assistance to vulnerable customers beyond that provided for under the statutory regulations, should be provided through the State Benefit system.

PUAF considered that ‘affordability’ should play an important part in deciding tariffs, but said that social tariffs are only one way of implementing ‘affordability’. It argued that social tariffs will only apply to measured customers and affordability is a problem for many unmeasured customers. It proposed that Ofwat should initiate a joint review of the development of social tariffs with companies and consumer organisations. Age Concern also supported the introduction of further social tariffs, particularly for customers of companies with high bills. It was concerned, however, that eligibility should not be confined to those in receipt of social security benefits.

Generally, all respondents agreed with the criteria set out in the consultation paper for assessing individual company proposals. In particular, they emphasised the importance of ensuring that any new tariffs benefit vulnerable customers rather than a wider group of customers who do not need assistance, and of minimising the impact on bills for other customers. Respondents were, however, reluctant to suggest what might be an overall acceptable impact on other customers’ bills.

There were very few suggestions about possible target groups for new social tariffs.

## **Ofwat's Conclusions**

The market research commissioned by Ofwat, *Protection for Vulnerable Customers*, indicates that customers are sympathetic to the provision of assistance to vulnerable customers and that there is general support for the measures that are now in place. That support, however, would diminish if the impact on customers' bills was much larger than it is at present. There is little enthusiasm for further social tariffs amongst the respondents to the consultation, although this largely stems from concerns that these are matters that should be decided by government rather than by companies. Allied to this is a concern that social tariffs should apply nationally to avoid inconsistencies between companies that cannot be explained by local factors.

Although the present Regulations have been in force in England for only six months, there is some evidence that there may be customers with medical conditions not covered by the Regulations, but which nevertheless require significant extra use of water. Ofwat considers that companies should be prepared to offer such customers similar protection to that provided by the Regulations without waiting for the outcome of the DETR review of the Regulations which is planned for 2001. The impact on other customers' bills will be minimal.

In the light of the Secretary of State's guidance, the market research and the consultation, Ofwat is prepared to allow new social tariffs for metered customers, provided companies can show that they are properly targeted (which may only be achievable by restricting eligibility to customers in receipt of benefit) and will have only a small impact on other customers' bills.

It is important that any new social tariffs are also examined as part of the DETR's planned review of the Vulnerable Groups Regulations with a view to incorporating appropriate changes in the interests of customers in revised Regulations.

Only two companies indicated an interest in additional protection for groups of unmeasured customers. The main protection for such customers is that most are still on the rateable value system which, however crudely, shows a clear correlation between low rateable value and low income. Ofwat does not consider that unmeasured tariffs should be complicated by additional and separate cross-subsidies between unmeasured customers. Ofwat will, however, look critically at company proposals to increase charges for customers on low rateable values through changes to RV modifiers.

#### **4. OPTIONAL LOW USER TARIFFS**

The Secretary of State, in his guidance to the Director, stated that he would expect all companies to offer the option of a low user tariff (that is a tariff without standing charges) for all customers in their main homes. The consultation paper set out the issues that would need to be considered and invited views, with particular reference to the following policy options:

*Option 1* – to allow no additional low user tariffs in view of difficulty of targeting and the likely impact on other customers bills, even though this would not be consistent with the Secretary of State's guidance.

*Option 2* – to allow additional low user tariffs in customers main homes, but only with lower break-even thresholds than at present (say 60m<sup>3</sup> per year) and where the tariff is made available to specific groups only (eg pensioners).

*Option 3* – to allow companies to introduce additional low user tariffs for similar thresholds as at present and without specific targeting.

#### **Respondents' Views**

There is only limited support for a low user tariff option across all groups of respondents.

Five companies supported such a tariff option. Three of these argued that the principal benefit is customer choice. Two suggested that there may be environmental benefits, but Anglian Water, which already offers a low user tariff, has advised Ofwat that there is little evidence of this. Most of the companies supporting a low user tariff option, however, were opposed to limiting the option to customers in their main homes. They saw no need to do so if the purpose is to provide customer choice and considered that such a limitation could be intrusive and difficult to administer.

Of the CSC's only the CSC for Wales positively supported the introduction of a low user tariff, pointing out, however, that the Secretary of State's guidance does not apply to Wales. Some CSC's, although opposed to a low user tariff option, favoured the introduction of a rising block tariff, which they consider would better target customers in their main homes and mean that the impact on other customers' bills would be less.

Many of those opposed to low user tariffs argue that these are not cost-reflective, since the standing charge is intended to cover customer-related costs for water and for sewerage services. In their view such tariffs must be seen as social tariffs, since these would involve cross-subsidies. Apart from general objections to social tariffs (see above), and the effect on other customers' bills, many point out that a low user tariff option would benefit many who do not need help and that, even if second homes were excluded, users with two homes could be low users in both. PUAFA argued that low user tariffs, which on balance it favours, should be targeted to customers on low incomes, such as pensioners.

One company, with a small metered customer base, said that currently most of its metered customers are low users, with the result that introducing a low user option would have severe consequences for the bills of those with average or high consumption. A number of companies argued that, if they are to be required to introduce a low tariff option, Ofwat should allow them freedom to design the option in the light of their particular circumstances.

Companies generally expressed concern about the practicality of limiting low user tariffs to customers in their main homes. There would, for example, be problems of deciding what is a second home, especially where this is in a different water company. CSC's considered it important, however, that, if such tariffs are to be introduced, they should be available only to customers living in their main homes.

Some companies and CSC's expressed concern at the impact of such a tariff on the ability of incumbents to compete on a level playing field with new entrants. Requiring incumbents to subsidise low users at the cost of other customers may increase the scope for entrants to win customers by exploiting cross-subsidies, rather than by offering genuine efficiency savings.

### **Ofwat's Conclusions**

The consultation has shown that there is only limited support for low user tariffs. Respondents have raised concerns about the purpose and targeting of such tariffs, difficulties of administration, impact on other customers' bills and possible difficulties for subsequent competition. In the light of these concerns, Ofwat does not consider it would be sensible at this stage to require companies to offer such tariffs next year.

The issues raised by the consultation need to be examined further against a better understanding of the potential bill impacts for other customers, the feasibility of excluding second homes, whether an alternative tariff might better secure the Secretary of State's objectives, and the implications for competition. Ofwat will be discussing these issues further with DETR and the companies with a view to reaching further conclusions for companies' charges schemes for 2002-03.

Ofwat will not, therefore, approve new optional low user tariffs for 2001-02. It will, however, look to further reductions in standing charges for those companies where these are still comparatively large. Ofwat has written to the companies concerned on this matter.

## **5. REDUCED CHARGES FOR CUSTOMERS WITH UNADOPTED SEWERS**

Some customers are connected to their sewerage company's network via private sewers for which they are responsible, but nevertheless pay the same charges as other customers. The consultation paper sought preliminary views on the issue of whether, and how, such customers should pay reduced charges in recognition of the fact that they are also responsible for the costs of maintaining private sewers.

### **Respondents' Views**

Overall there was limited support for introducing a system of reduced charges for customers served by an element of private sewers. The companies, in particular, opposed the proposal on the following grounds:

- In a system of regionally averaged charges there is no difference in principle between a customer connected to the public system by a private sewer and a customer located close to the treatment works and who is served by only a short length of public sewer.
- In most cases it is unlikely that there would be much difference in costs. The reduction in charges would, therefore, be too small to warrant the costs of administering a system of reduced charges.
- The cost differential could be difficult to quantify and does not necessarily relate to the length of private sewer.
- This is not a significant issue in terms of customer complaints.
- Customers served by private sewers may already have benefited financially by paying a lower price for their homes, and should not benefit twice by having reduced sewerage charges.
- Customers can always seek to have private sewers adopted, although this will require them to ensure that the sewers are brought up to an adoptable standard.

Many CSC's also opposed the idea making similar points to those made by the companies. A number felt that the issue was better addressed by making it easier for private sewers to be adopted. Some CSC's, however, considered that the principle of a reduction is correct and that the idea should be pursued further.

The majority of responses from individuals to the Consultation Paper were concerned solely with this issue, being customers with private sewers. They supported the idea of the reduction in charges, but considered that the ideal solution is for private sewers to be adopted.

Two companies (Severn Trent Water and North West Water) said they already offer a rebate for customers who drain directly to the treatment works via private sewers only. Dwr Cymru (Welsh Water) which accepts that there is a case in principle, nevertheless believes that there are considerable practical differences in operating a system of reduced charges.

Most of the companies said they have little or no information about the extent of private sewers and the number of customers involved. Anglian Water, which has carried out a desk study, said that approximately 1.5% of its customers are connected to public sewers via private sewers and that the length of private sewers represents approximately 0.5% of the total length of its public sewers.

### **Ofwat's Conclusions**

The consultation paper recognised that there would be difficult issues that could not be resolved quickly. Respondents' views confirm this. Ofwat does not, however, consider that the issue can be dismissed solely on the ground that regional averaging of prices means that there are many other instances where customers' charges exceed the costs they impose. Customers served by private sewers will, at some stage, have to meet the costs of maintaining those sewers – costs that other customers do not face. The amount of a justified reduction in charges must, however, be significant to warrant the costs and difficulties of introducing a system of rebates. In most cases, private sewers are very short, cause no problem to the owners, and only a trivial reduction in charges would be justified. With this in mind, Ofwat will examine, in consultation with the companies, whether there are situations, easily defined, where the nature and extent of the private sewer network would justify a material reduction in charges. The aim will be to identify workable proposals that companies could be expected to implement for 2002-03.

Ofwat welcomes the efforts which some sewerage undertakers have made to adopt existing sewers. The long-term remedy is to ensure that all new sewers are built and adopted in accordance with the standards promulgated jointly by the House Builders Federation and the sewerage undertakers (as published in "*Sewers for Adoption*", 4<sup>th</sup> Edition, May 1995). Ofwat supports proposals to this effect in the DETR Consultation Paper "*New drains and sewers*" issued earlier this year. If these proposals are implemented, it may be simpler to require companies to adopt all private sewers than introduce a system of reduced charges for customers with unadopted sewers. Such reductions are unlikely anyway to be of much assistance to the small minority of customers who face substantial maintenance costs.

## ANNEX A: RESPONDENTS TO APPROVAL OF CHARGES SCHEMES CONSULTATION 2001-02

### **Water Companies**

Anglian Water  
Bournemouth & West Hampshire Water  
Bristol Water  
Dwr Cymru/Welsh Water  
Folkestone & Dover Water  
Mid Kent Water  
North West Water \*  
Northumbrian Water  
Portsmouth Water  
Severn Trent Water  
South East Water  
Southern Water  
Sutton & East Surrey Water  
Tendring Hundred Water  
Thames Water  
Three Valleys Water  
Wessex Water  
Yorkshire Water

### **Ofwat Customer Service Committees**

Central CSC  
Eastern CSC  
Northumbrian CSC  
North West CSC  
Southern CSC  
South West CSC  
Thames CSC  
CSC for Wales  
Wessex CSC  
Yorkshire CSC

### **Organisations**

National Old Age Pensioners Association of Wales  
Woodlands Residents Association  
National Consumer Council  
Federal of Small Businesses  
The Residents Association – Johnston, Pembrokeshire  
Policy & Enterprise Services  
Age Concern  
PUAF  
Water UK

### **Individuals**

Mr M J Downer/Mr I Gore  
Mr G Enston  
Andy King MP  
Ms J Randerson AM

- Submission (in part or in whole) to Ofwat made “in confidence”.

**ANNEX B: The components of the maximum tariff differential (£)**

	2000-01 actual	2001-02 proposed approach	2001-02 final assessment
<b>Meter Space</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
Meter installation and replacement	7.38	9.50	9.50
Meter reading, billing and account management	7.38	8.00	8.00
<b>Total customer related costs of metering</b>	<b>14.76</b>	<b>17.50</b>	<b>17.50</b>
Payment in arrears (cash flow benefits)	6.26	2.40	3.70 (2)
Meter under-registration	5.47	5.60	5.60
Leakage allowances	3.70	4.10	4.70 (3)
<b>Total measured customer benefits</b>	<b>15.43</b>	<b>12.10</b>	<b>14.00</b>
<b>Total level of differential</b>	<b>30.19</b>	<b>29.60</b>	<b>31.50</b>

Notes:

1 the 2001-02 differential calculation is based on 2001-2002 prices assuming an annual inflation rate of 3% at November 2000.

2 allows for a three month equivalent measured bill

3 allows additionally for £0.60 per year for the value of externally measured customer rebates.