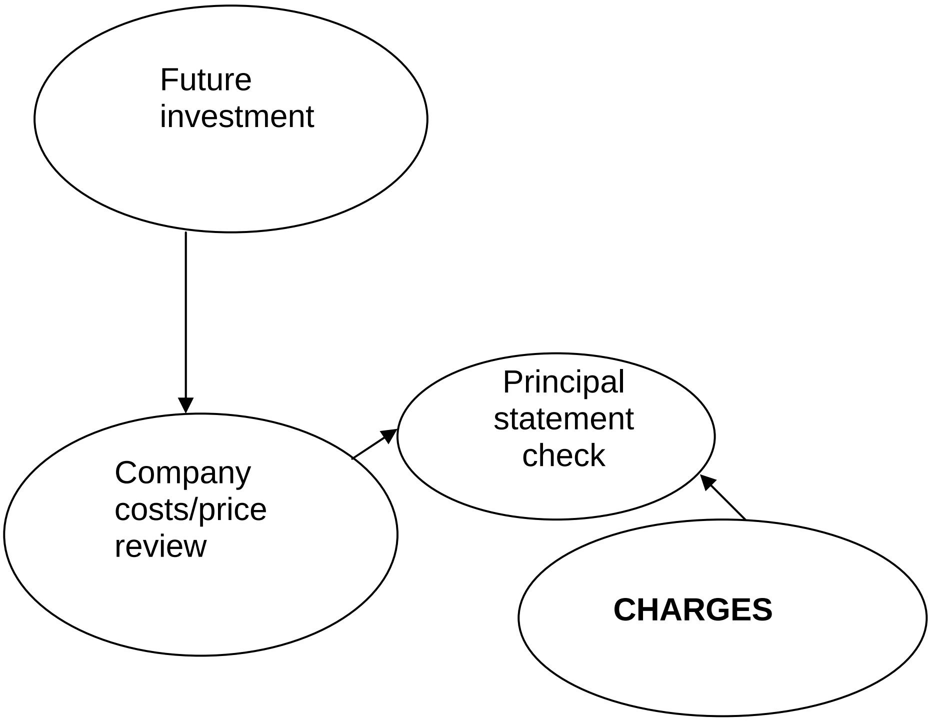
Supporting information

1. Customer charges – the wider context

We think it is important to make sure that our future charging strategy recognises the links between charges and other issues in the wider context.

Traditionally, the primary objective of setting charges for water and sewerage was to enable each company to collect revenues from customers consistent with the outcome of our five-yearly price control process. We have an annual charges approval process, which includes checking to ensure that each company's charges for customers using less than 50 million litres (megalitre – Ml) of water, (or 250 Ml in Wales), do not exceed the permitted average change in charges. We require each company to produce an annual audited statement (the principal statement) to enable this check. This process can be illustrated by the links below.



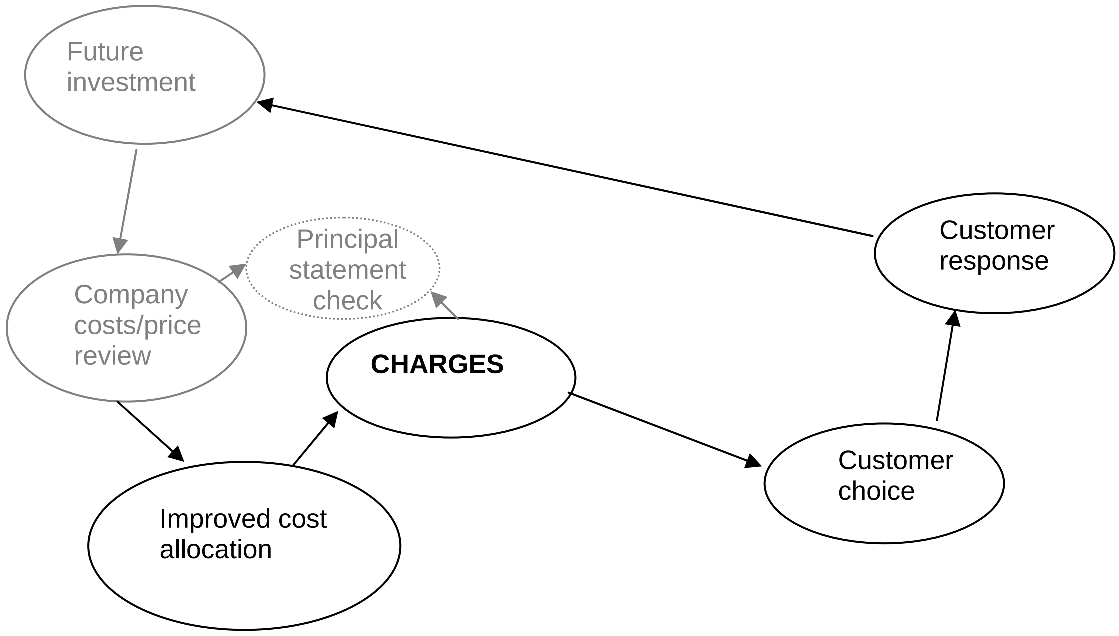
We believe that the structure and the level of future charges can help to deliver much more than has traditionally been the case.

Previous tariffs development has led to refinements in the structure of charges to make them more reflective of the underlying costs for particular groups of customer. Primarily, the focus has been to improve cost-reflectivity with the spin-off that charging structures can influence the behaviour of some customers.

Customers who have opted for metering have usually done so to avoid higher water bills based on the RV of their property. The fact that they could choose to make further savings by cutting back on how much water they use offers customers a secondary opportunity to benefit.

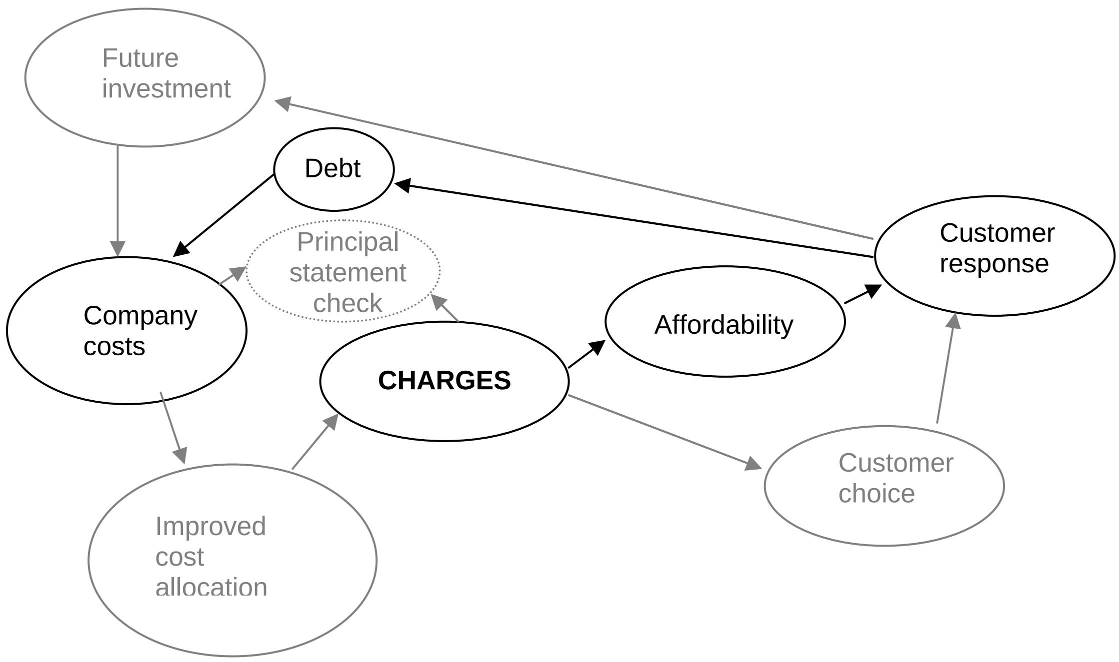
Continued refinements to cost allocation that lead to charges more closely reflecting the underlying cost drivers can be used to intensify the price signals that customers face. These stronger signals will influence some customers to change their behaviour.

This effect can be represented by expanding the previous chart as follows.



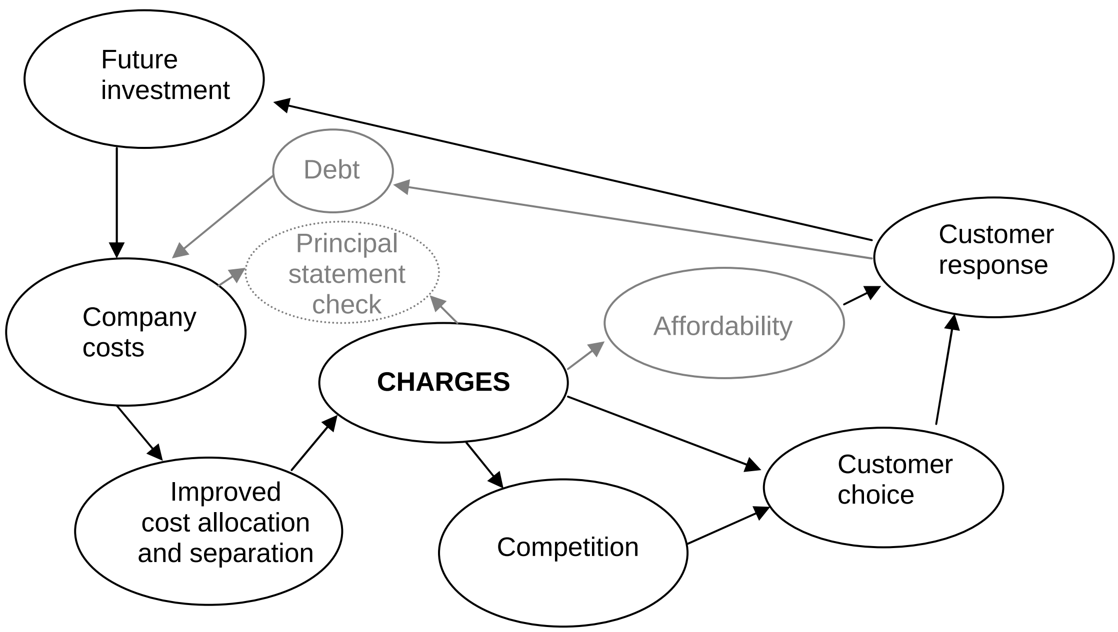
Whether customers find their water and sewerage charges affordable will depend on their individual financial circumstances, but will also be affected by the level of charges individual customers face and how they are translated into the final water bill. The level of affordability impacts on the level of customer debt which in turn affects the company's costs.

These linkages have been added to the chart below.

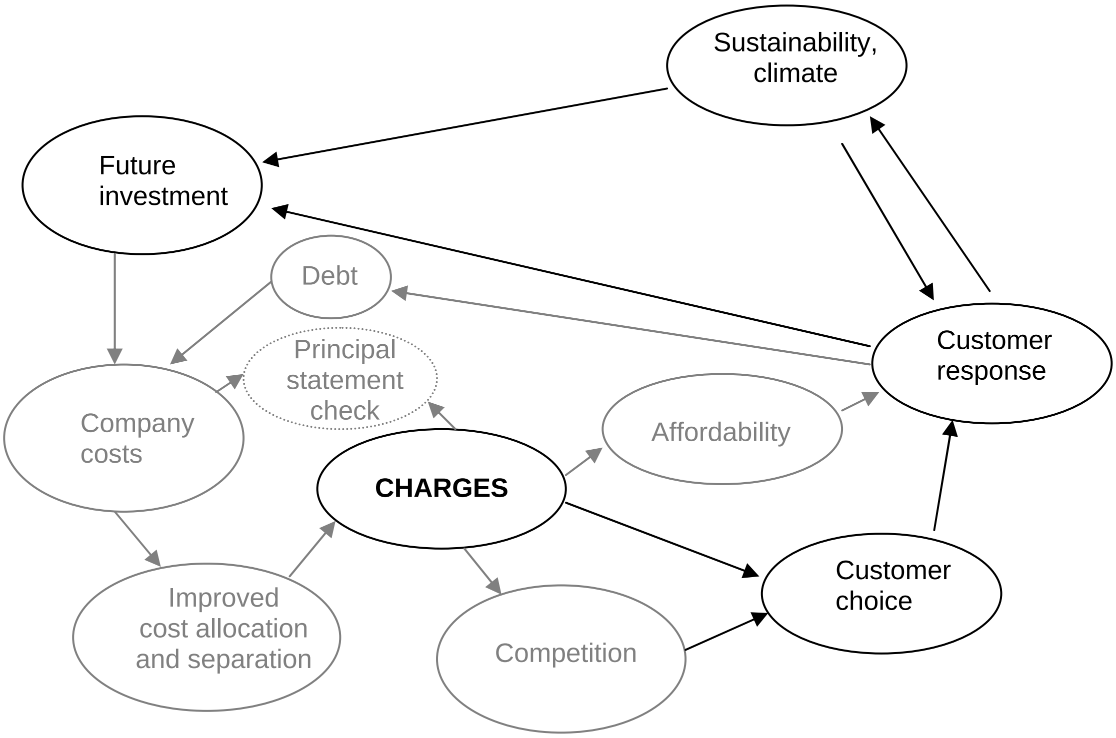


We think that there can be benefits from encouraging opportunities for greater competition in parts of the supply chain for water and sewerage services. It is necessary to ensure that company's costs and charges can be unbundled to enable these opportunities to be identified and potentially exploited for the benefit of customers. Cost separation can be a key step in seeking to enable both lower costs and greater customer choice.

These linkages have been added to the charge below.



There are also links between the way customers choose to respond to particular charging structures and the wider issues of sustainability and climate change (greenhouse gas emissions). Customers may reduce their environmental impact because they respond to price signals inherent in a particular charging structure and/or because they wish to respond directly to environmental concerns. These considerations make become increasingly important and have been add to the chart below.



We think that it is necessary to be aware or the above linkages when considering individual aspects of charging strategy.

2. Impact assessment

We have included here an interim assessment of the potential areas of cost and benefit of our proposed policies.

We welcome views on the completeness of this analysis. We will use this to develop an impact assessment in line with our published framework.

We also welcome any comments on the magnitude and quantification of these individual elements.

Potential costs and benefits associated with individual charging policies

Policies in charging strategy	Costs – set up	Costs – ongoing	Benefits – hard	Benefits – soft/qualitative
3.1 Unmetered charges –no change to unmetered charges being based on RV	Avoids water companies' set-up costs of alternative to RV based charging.	Existing approach already established. Household RVs are not updated.	Bills do not require retrospective adjustment to reflect changes in customer behaviour.	Established charging method supported by legislation
3.2 Metering - Increase in meter penetration compared to PR04 plans	Capital and opex cost of additional meters and associated carbon impacts of production, supply chain and installation and any disruption. Potential impact on company financeability	Meter reading, meter maintenance and billing costs and associated carbon impacts.	Any resultant reduction in water use will reduce companies volume related production distribution and storage costs and associated carbon impacts. Customers can receive lower water and sewerage bills than if they were unmetered. There can be associated energy savings if less hot water is used by customers and lower associated carbon impacts. Lower unit costs for meter installation through planned	Improved fairness and transparency for customers as more customers bills will more closely reflect the costs they each impose. Reduced abstraction can benefit surrounding habitat. Extend the potential for more customers to benefit from competition. Avoided cost of replacing or modifying RV based charging.

			approach in particular areas	
3.3 Metered standing charge		No change from current routine update process.	Customers will continue to be made aware of the marginal volumetric costs of the services they receive and can choose how to react. Any resultant reduction in water use will reduce companies' volume related production distribution and storage costs and associated carbon impacts.	
3.4.1 Seasonal tariffs	Companies will incur costs for developing and applying changes to tariff structure and billing systems.	Companies will have to obtain additional meter reading to support winter /summer period. Companies may incur the costs of dealing with additional or more complex customer queries. Some customers will see higher bills than under existing tariffs.	Any resultant reduction in water use will reduce companies volume related production distribution and storage costs and associated carbon impacts. This may also enable deferment of future investment and associated carbon impacts. Some customers will see lower bills than under existing tariffs.	Customers will have more cost reflective charges than under existing tariffs. Reduced abstraction can benefit surrounding habitat.

3.4.2 Rising block tariffs	Companies will incur costs for developing and applying changes to tariff structure and billing system They could incur additional costs for obtaining additional customer/household specific information.	Companies may incur the costs of dealing with additional or more complex customer queries. They could incur additional costs for obtaining additional customer/household specific information. Some customers will see higher bills than under existing tariffs	Any resultant reduction in water use will reduce companies volume related production distribution and storage costs and associated carbon impacts. Some customers will see lower bills than under existing tariffs	Depending on the particular structure of the tariff cross-subsidies may be increased for lower-income household but at the expense of other customers. Reduced abstraction can benefit surrounding habitat.
3.5 Tariff trials	Companies will incur costs for developing and applying changes to tariff structures and billing systems. They could incur additional costs for additional metering functionality and obtaining additional customer/household specific information.	Ongoing costs could include additional meter reading, collection of stakeholder feedback. Some customers may see higher bills than under existing tariffs	The potential benefits will depend on the objectives specific tariff trials. Some customers may see lower bills than under existing tariffs	Information obtained from well designed trials can inform future tariff design for the wider Industry.

3.6 Innovative tariffs	Companies will incur costs for developing and applying changes to tariff structures and billing systems. They could incur additional costs for additional metering functionality and obtaining additional customer/household specific information. These costs may overlap with those in 3.5 but will include additional costs for roll-out.	Dependent on the details of the individual tariff and associated physical and system requirements.	Dependent on the features of the tariff and customer response and whether there are associated savings.	Likely to increase fairness for customers as more customers bills will more closely reflect the costs they each impose.
3.7 Affordability and social tariffs	Companies will incur costs for developing and applying changes to tariff structure and billing system They could incur additional costs for obtaining additional customer/household specific information.	Companies may incur the costs of dealing with additional or more complex customer queries. They could incur additional costs for obtaining additional customer/household specific information. Customers in general should be no worse off	Some customers will see lower bills than under existing tariffs. Companies should see reduced debt collection costs and/or lower debt levels.	Depending on the particular structure of the tariff cross-subsidies may be increased for targeted low income households.

		than.		
3.8 Assessed charges	Companies will incur costs for developing and applying changes to tariff structure and billing systems.	They could incur additional costs for obtaining additional customer/household specific information	Companies may receive less customer queries.	Likely to increase fairness for customers as more customers bills will more closely reflect the costs they each impose.
3.9 Sewerage charges: surface water drainage	Companies will incur costs for developing and applying changes to tariff structure and billing systems.	They will incur additional costs for obtaining additional customer/household specific information. Some customers will see higher bills than under existing tariffs	Some customers will reduce their surface water drainage requirements. Any resultant reduction in drained volumes will reduce companies volume related costs and associated carbon impacts. May defer the need for capital investment by companies in specific locations. Some customers will see lower bills than under existing tariffs	May reduce the likelihood of flooding in some locations under some conditions.
3.10 Customer choice	Companies will incur costs for unbundling tariffs and increasing cost separation. Regulators costs will increase.	Companies will face additional costs for more detailed reporting.	Companies and the Regulator should be better able to identify areas of inefficiency. Customers should benefit in the medium term from improved company efficiency and/or a more services being offered by competitors.	Customers will be better able to select and pay an unbundled price for the particular services they want.

3.11 Non-potable charging	Companies will incur costs for developing and applying changes to tariff structure and billing systems.	Some customers will see higher bills than under existing tariffs	Some customers will see lower bills than under existing tariffs	Likely to increase fairness for customers as more customers bills will more closely reflect the costs they each impose.
3.12 Technological innovation in support of initiatives like rainwater harvesting and grey water recycling	Companies will incur costs for developing and applying changes to tariff structure and billing systems. Customers will incur costs for new equipment .		Some customers should see lower bills than under existing tariffs. Companies would benefit from the resultant reduction in water use which will reduce companies volume related production distribution and storage costs and associated carbon impacts.	Reduced abstraction can benefit surrounding habitat.

3. Glossary of terms used in the consultation paper

Charges scheme: Appointed water companies are normally required to publish this document under condition D of their instrument of appointment. It sets out the company's charges for water and sewerage services and the terms and conditions of those charges. We review companies' charges schemes in draft and approve them when we are satisfied that the charges comply with price limits.

Licence condition E – discrimination in charging: This prohibits undue preference to, or undue discrimination against, any class of customer or potential customer for standard charges. For non-standard charges, the condition relates to discrimination and preference between individual customers (or potential customers).

Meter penetration: The proportion of metered properties.

Non-potable: Water that is not intended for domestic or food production purposes.

Non-return to sewer allowance: An allowance made by companies to account for water supplied that is not returned to the sewer (for example, water consumed or used for gardening).

Potable: Water for drinking, domestic and food production purposes that is required to be wholesome at the time of supply. This is defined in section 68 of the Water Industry Act 1991 and section 4 of the Water Supply (Water Quality) Regulations.

Price review (PR): The process of re-setting appointed water companies' price limits. The first review took place in 1994, and the price limits took effect from 1 April 1995. A second review was carried out in 1999, and set revised price limits from 1 April 2000. The third review took place in 2004 and set prices for the period 2005-10. The next price review will take place in 2009 for the period 2010-15. Price limits are currently set every five years. Also known as a 'periodic review'.

Principal statement: Each appointed water company sends this annual return to us in January. It sets out the company's standard charges for the forthcoming charging year (1 April to 31 March), as well as other information that enables the calculation of the increase in that company's overall average charges for the forthcoming charging year. The increase in the overall average charge must not exceed the company's price limit for that charging year.

Rateable value (RV): This is the official value given to premises (household or commercial) as shown in the official valuation list (published under part V of the General Rate Act 1967) on 31 March 1990. Hence, any premises built before 1990 should have a rateable value. Appointed water companies use this to determine how much unmetered customers should pay.

Revenue corrected price cap: Proposed new price cap, through which, any revenue outperformance or underperformance is symmetrically corrected over the next review period. An adjustment is made for over or under performance on billing new properties.

Rising block tariff: A tariff for metered customers that charges according to consumption within bands or 'blocks', which increase in price. The first block of water may be free or at a low unit cost. Further blocks will rise in price according to consumption.

Seasonal tariff: A tariff for metered customers that charges a volumetric rate that is higher in the summer months than in winter months.

Security of supply index (SoSI): Assesses each appointed water company's ability to supply customers in dry years without imposing demand restrictions such as hosepipe bans. Companies with higher index score bands have better security of supply.

Special agreement: An agreement between a company and a customer for the charging of a non-standard charge to reflect a customer's individual circumstance. Special agreements are outside the tariff basket, but are subject to condition E (if agreed or renewed since 1989) and the Competition Act 1998.

Standing charge: The set part of the tariff for customers with metered supplies that reflect fixed costs. (See also **'volumetric charge'**.)

Surface water drainage: The removal of rainwater from exterior areas of a property (such as roofs and driveways) to a surface water sewer or combined sewer.

Volumetric charge: The part of the tariff for customers with metered supplies, which varies according to how much water is used.

Water Act 2003: This Act came into force in February 2003 to:

- reform the abstraction licensing regime and regulatory arrangements;
- introduce a framework for self-lay; and
- extend opportunities for competition to large non-household customers.

Water Industry Charges (Vulnerable Groups) Regulations 1999: These regulations apply to charges schemes coming into force on and since 1 April 2000. They state the nature of the assistance to be provided to a prescribed class of persons (vulnerable groups) who are eligible to apply for financial assistance with water and sewerage charges in the form of a capped bill. The regulations apply only to companies in England.